Electranet Pre-determination Conference

12 December 2012

Adelaide

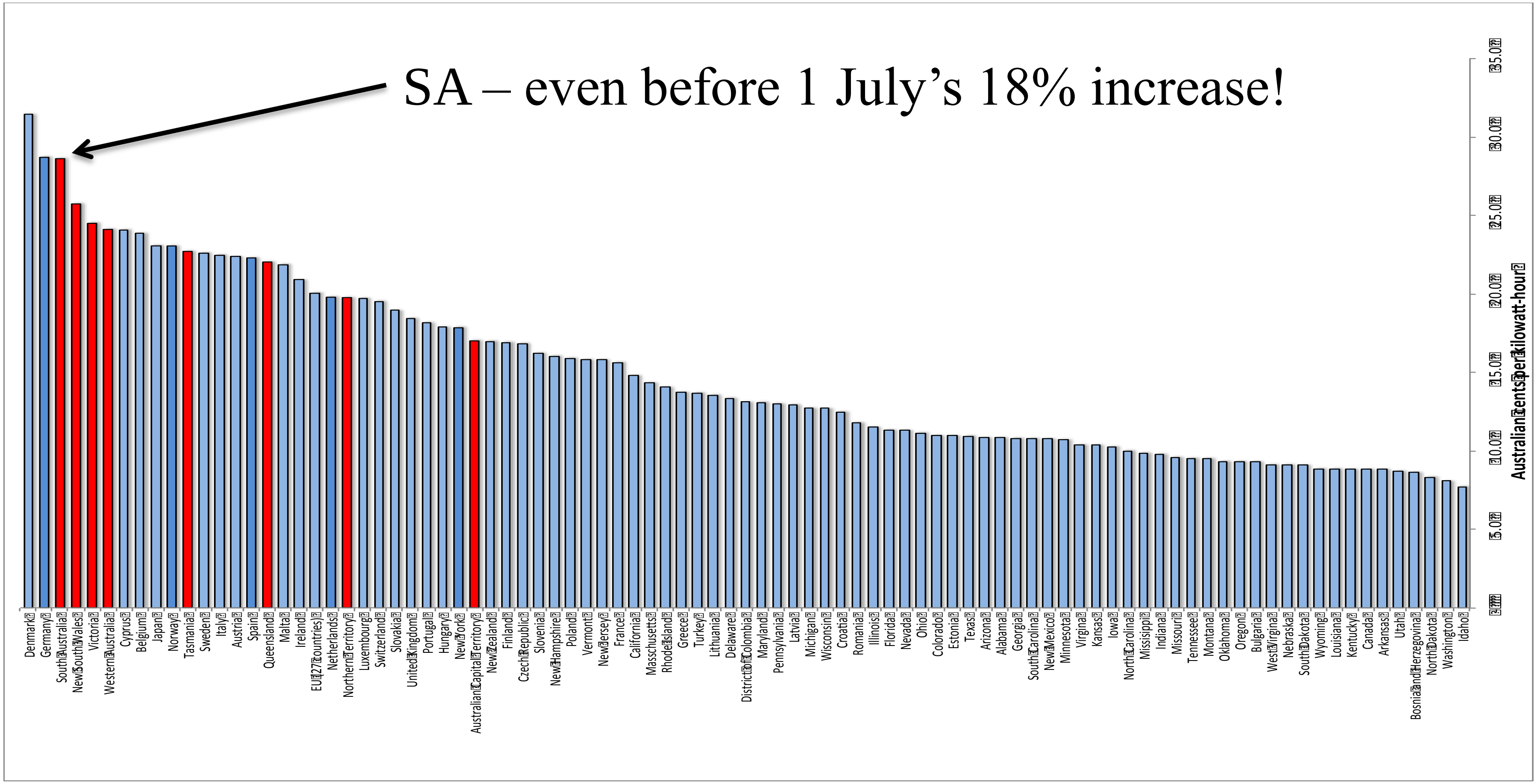
Outline

- Preliminary comments and background
- WACC
- Demand forecasts
- Opex
- Capex
- Service standards

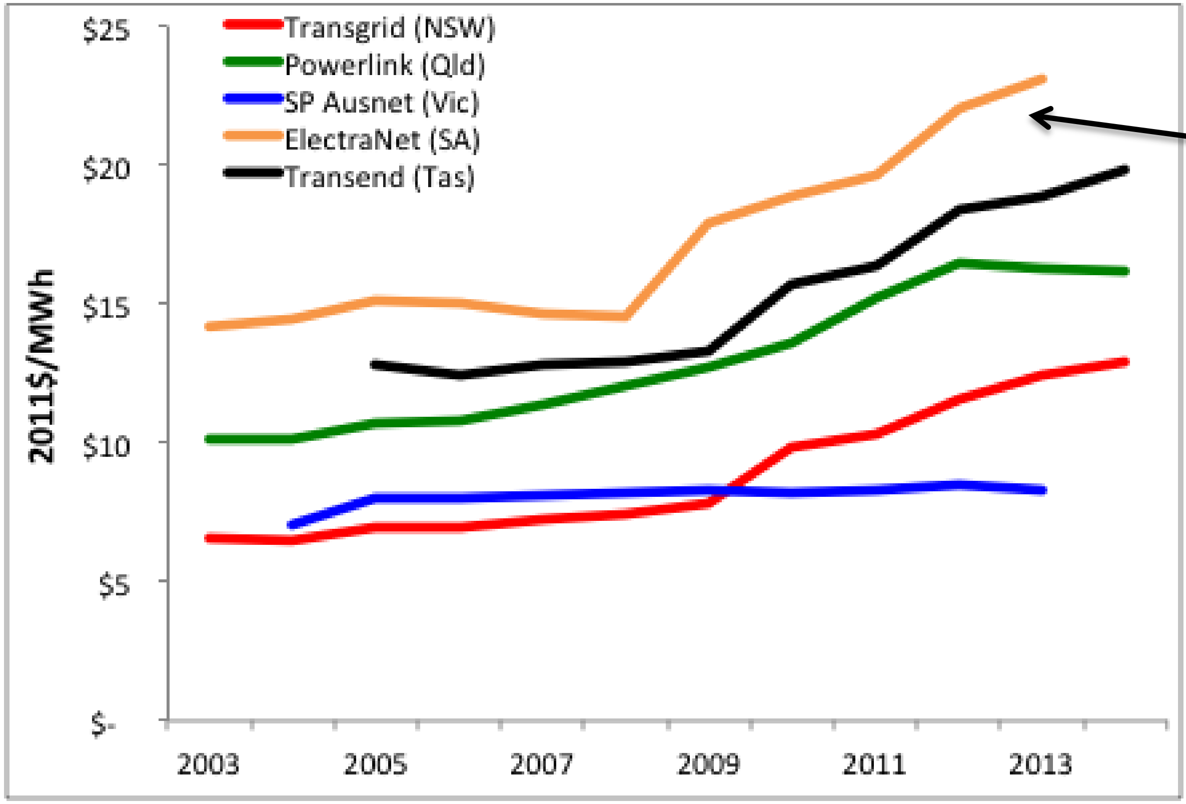
Preliminaries and context

- Several EUAA members have significant operations in South Australia and they care about this decision.
- EUAA members’ interests align with the interests of all electricity users in South Australia
- Credit to the AER for a clear and engaging Draft Decision. Evidence of clear thinking and careful analysis. Much to agree with, but tougher decisions needed in several areas.
- Despite its protestation to the contrary, Electranet’s proposal is an ambit claim. The AER’s “cuts” against Electranet’s proposal need to be seen in that context.
- This presentation: not more than a place-maker, does not pretend to be complete review of AER DD.

South Australia has the dubious distinction of the highest household electricity prices in Australia, and amongst the highest in the world

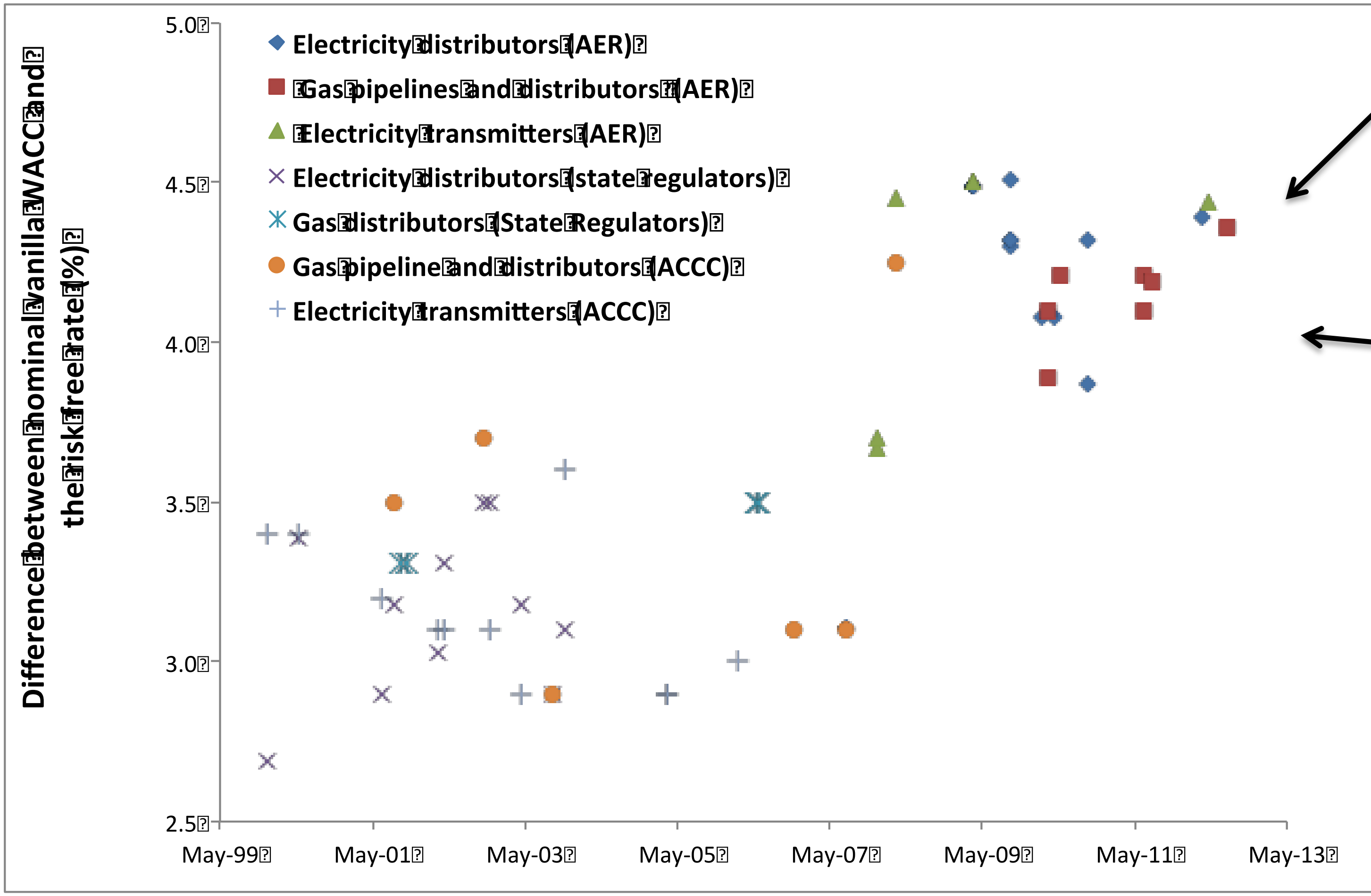


Electranet's charges – while not the biggest component of bills, has played its part in the poor outcomes in SA



Electranet is the most expensive TNSPs in the NEM, charging around **four times more** per unit delivered as in Victoria. The gap has grown much wider. The AER's decision will not narrow the gap.

WACC: AER DD still too generous

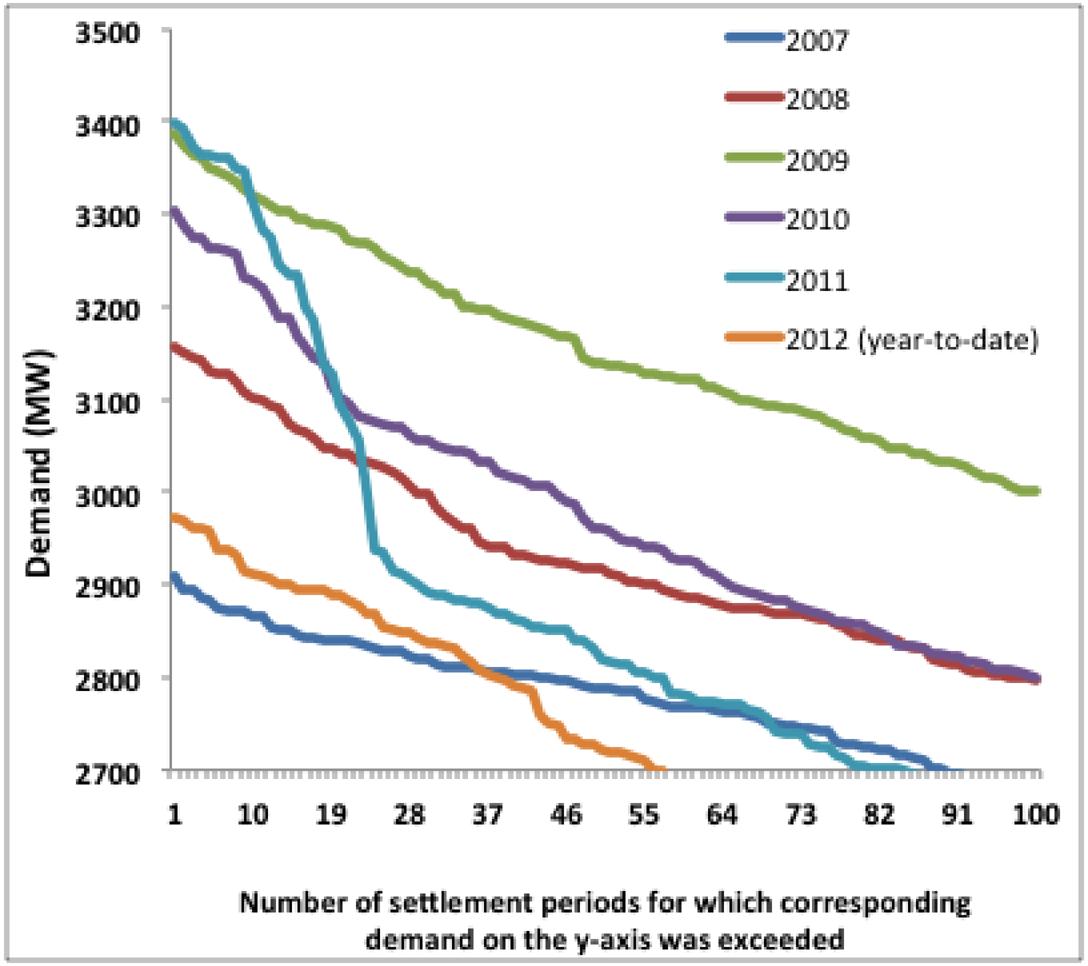


Electranet proposal

AER DD

AER DD at lower end of range of previous AER decisions, but above top end of the range of ACCC / jurisdictional regulator decisions

Demand – AER erring too much on the side of caution (and hence too much demand-related investment)



- Agree with AER that Electranet's demand forecast is not credible.
- AER forecast for 2013/14 still about 20% higher than 2011/12 demand, and about 10% higher than 2011 peak. Reason to believe 2011 peak was an outlier.
- Issue is not just peak demand, but duration of peak demand – short term line ratings allow for much higher demands to be met

WACC

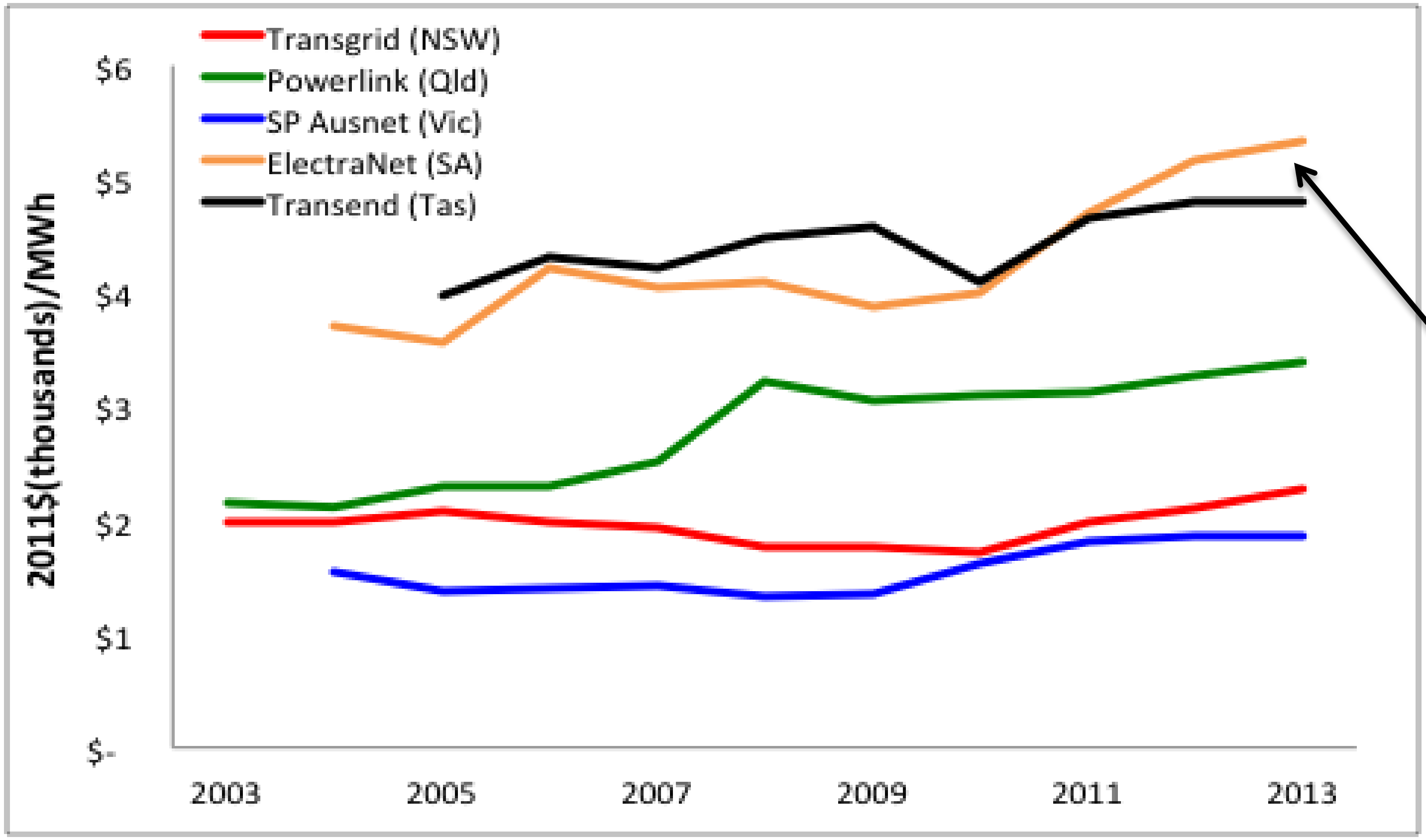
- Main (only) reason for lower WACC is lower RFR. AER has not made progress on any of the other overly generous factors including DRP, Gamma, MRP, Beta. AER is not bound by SRP or by ACT decisions, AER has discretion. We call on the AER to use this discretion in pursuit of the long term interest of users.

- We call on AER to have regard to the recent Grattan Institute report, in considering value of Beta. AER is free to do this in this decision. It is not bound by SRP.

- AER says that the DRP it has set is too high because extrapolation of Bloomberg FV is flawed. We agree! What is stopping the AER from placing higher regard on evidence of yield to maturity in recent debt issues – not just APA!

- State Grid of China's acquisition of Electranet (announced after the DD) at more than 9 times EBIT proves strong investor appetite for Electranet. AER should have regard to this in setting WACC.

Opex: Electranet has not done well. The AER's DD will not improve the situation

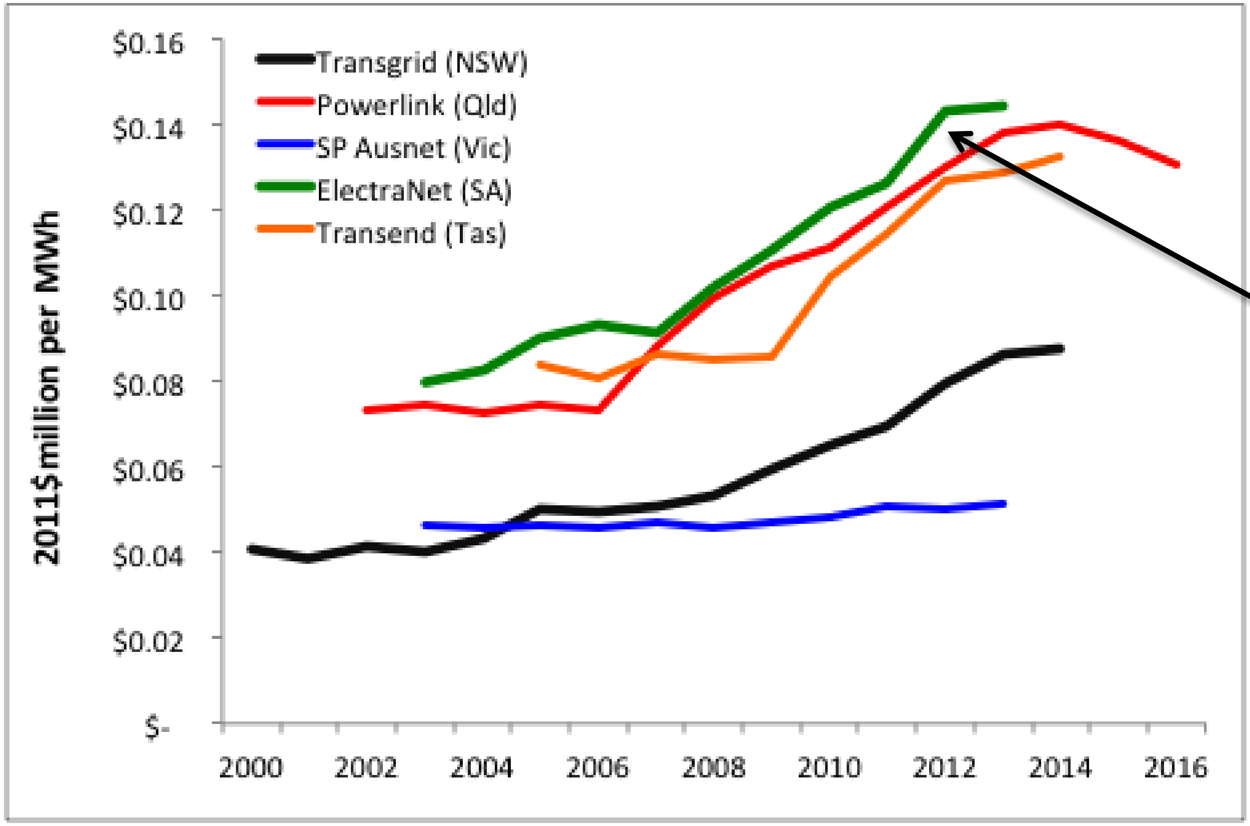


Electranet now charging about four times as much per MWh distributed as SP Ausnet

Opex

- AER DD – about 20% higher than Electrane'st forecast of 2008-13actuals (but even this forecast is likely to be inflated). So, a big increase.
- **Automatic escalation of opex for increase in RAB:** why? If any escalation is to be contemplated why not use metrics for asset life (less opex for newer assets), length of network and transformer capacity.
- **Base year:** Why 2010/11? AER rightly points to opex/capex trade-offs – no reason to believe that opex in 2010/11 is any more or less efficient than previous years. So why not use average for all years in reg period for which audited data is available.
- **Efficiency factor:** we presume (its not clear) that the efficiency factor is a compound number (not single adjustment). If not, it should be.
- **Field maintenance ambit claim:** Agree with AER that Electranet's claim is not credible. But perhaps other ways to think about adjustment for this. Why is a $50m deferral in capex the right adjustment? Rational company boards, concerned to achieve investment hurdles, will require IRRs to be met. We suggest AER should make adjustment reflecting this. In addition, if the expenditure is not justifiable, why has it been included at all in opex?
- **Benchmarking:** why has the AER not benchmarked Electranet against its peers?

Capex: again, Electranet has not done well



Electranet has the highest RAB per MWh delivered and it has grown faster than other TNSPs

Capex

- Strongly support AER rejection of easements ambit claim. Advance purchase of unneeded land that sits on Electranet's balance sheet and gathers an undepreciated (and escalated!) return is absolutely not in users interests. But why still allowed $13.4m? We ask the AER to reconsider in light of 2012 NTNDP.

- In view of earlier comments on demand growth, we ask the AER to revisit its decision on augmentation and replacement capex.

- In view of most recent NTNDP which shows significant reduction in transmission expenditure, we ask the AER to revisit its decision.

- Why no review (and possible adjustments) for projects under construction?

- Clause 11.6.11 ?? Many questions. Are all users expected to pay for the replacement of all connection assets as long as it is like-for-like replacement. There is $128m here. Is this clause really satisfied – what does like for like mean? Is the AER planning a rule change here? Why has the $128m not been adjusted considering EMCa's recommendation?

- Why no benchmarking?

Service performance incentive scheme

- We support much of the AER’s STPIS decisions.

- We disagree with the market impact parameter (number of mispriced dispatch intervals). The number of mispriced intervals does not matter: it’s the level of redispatch that matters. This is a function of the level of mispricing and the volume of redispatch. Neither of these are taken into account.

- Existing scheme provides significant profit upside to Electranet for no appreciable benefit to users. Suggest either scrap the market impact component or reduce weighting of MAR from 2% to 0.2%.