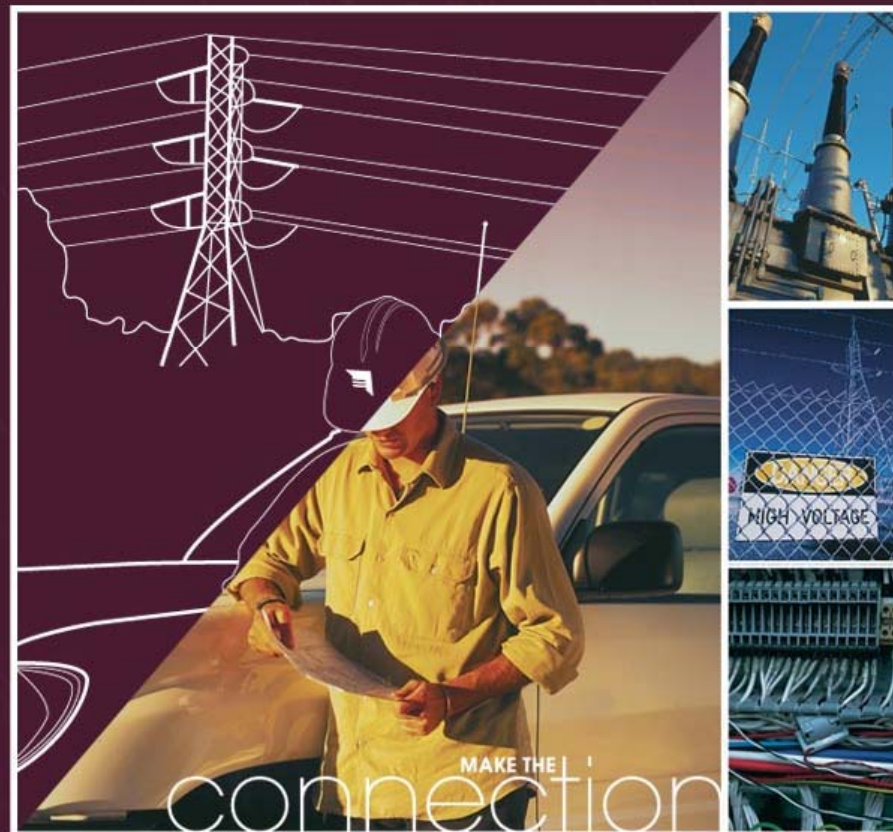


# TransGrid & EnergyAustralia Supplementary Draft Decisions

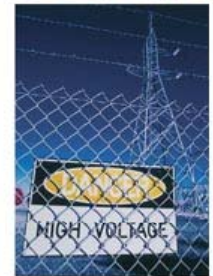
18 March 2005



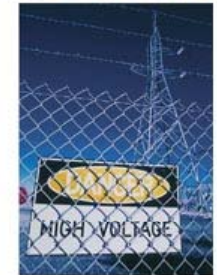
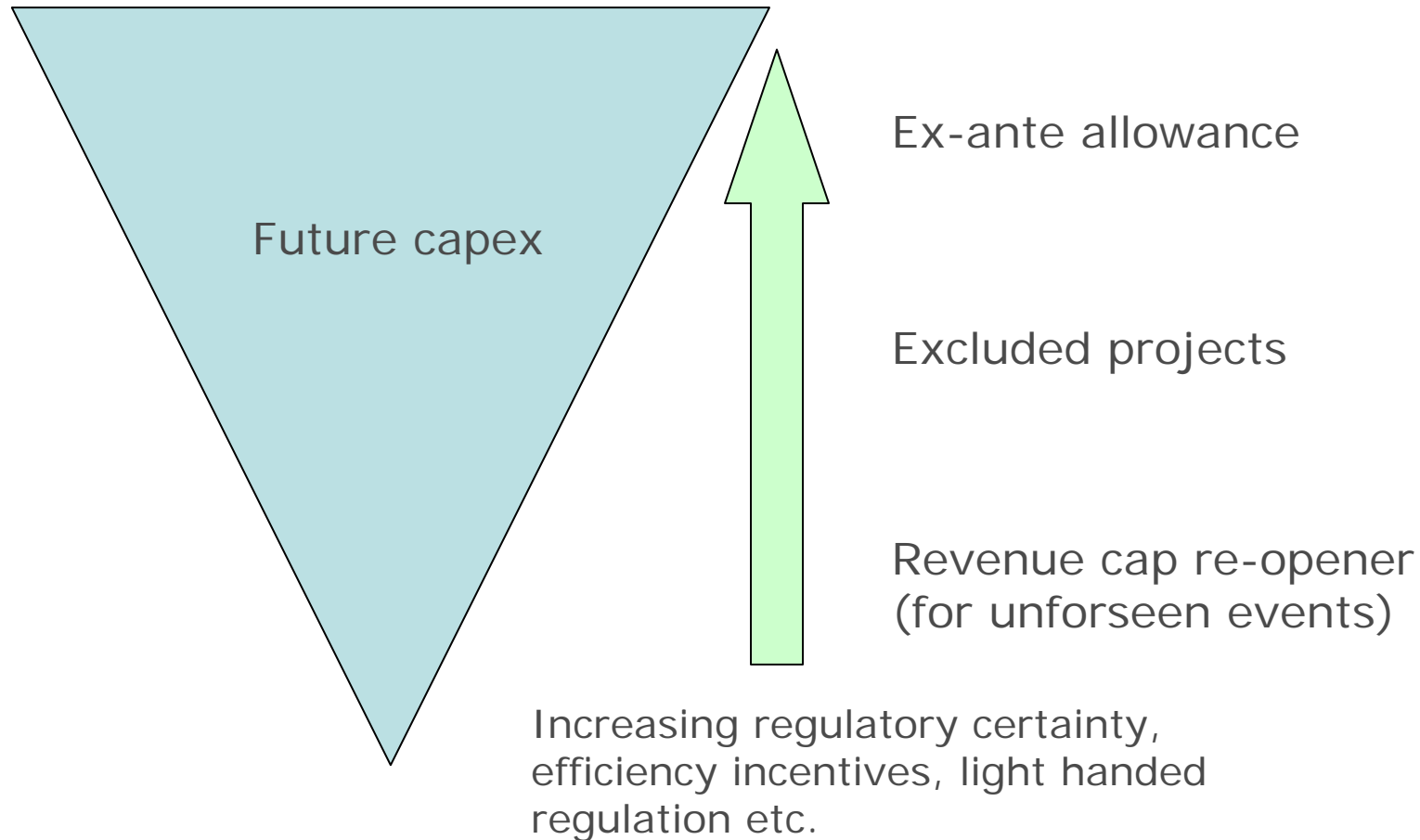
**ElectraNet SA**  
electricity transmission network

## Presentation Purpose

- ElectraNet does not wish to comment on the appropriateness or otherwise of the proposed revenue caps
- Rather this presentation makes comment on more general issues arising from the ACCC's application to these decisions of the new regulatory regime for capital investment

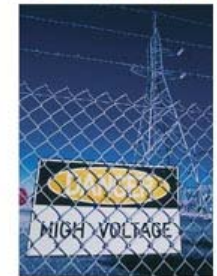


# Capex Framework



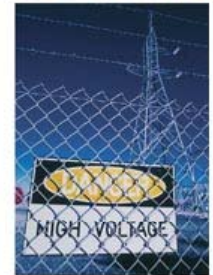
## Ex-Ante Capex Allowance

- ElectraNet agrees with the statement that only in exceptional circumstances should possible projects be explicitly excluded from the ex-ante cap (MA/PB p6)
- The ACCC says that the SRP sets out its expectation that TNSPs would apply a probabilistic analysis to deal with the inevitable uncertainties they will face in determining future capex requirements (TG p61)
- The ACCC also states that it "*...does not expect that TransGrid should have completed the equivalent of a regulatory test evaluation before the ACCC would consider inclusion of the project in the ex-ante cap*" (TG p61)



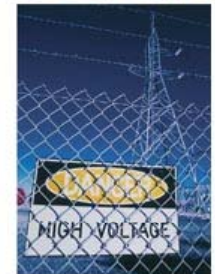
## Ex-Ante Capex Allowance

- BUT... requiring a full analysis of options, including full investigation and comparison of non-network solutions is essentially equivalent to requiring a regulatory test assessment for a new large network asset
- Analysing capital requirements to this level of detail for up to 10 years into the future is unreasonable and unrealistic
- Requiring high levels of certainty before projects are included in the ex-ante cap is inconsistent with adopting a probabilistic approach to assessing capex requirements – need to get the right balance



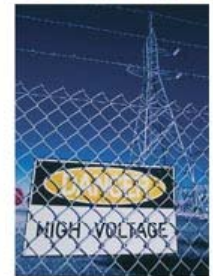
## Excluded Projects

- Main concern is that excluded projects are funded within regulatory period
- ElectraNet supports Code change to remove uncertainty about whether this will happen
- ElectraNet supports the concept that attempting to precisely define an excluded project at the time of the revenue cap decision is of little value
- Instead... focus should be on defining the circumstances (or triggers) that would give rise to the need for the excluded investment with the most appropriate option determined at the time the need is triggered (TG p54)
- Triggers need to be clearly defined



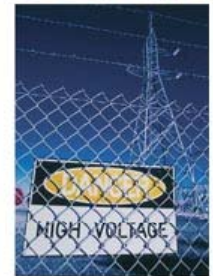
## Excluded Projects Incentive

- The ACCC will set a fixed capex allowance once a pre-defined trigger has occurred and the TNSP will have the incentive to beat the capex target in present value terms
- ElectraNet supports efficiency incentives with respect to excluded projects
- BUT observes that...
  - assessing an individual project on the basis of the present value of costs is more likely to pick up errors in planning forecasts than genuine efficiencies
  - it may be easier and more realistic to focus on total project costs rather than the present value of expenditure in assessing any efficiency gain



## Excluded Projects Assessment

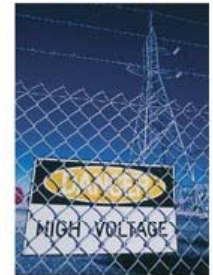
- It is acknowledged that the ex-ante approach to capex requires thorough up front analysis by the regulator
- BUT... are the following statements in relation to excluded projects consistent with light handed regulation or an indication of the regulator becoming too intrusive?
- ACCC intends to assess excluded projects when they arise at a further level of detail to that which TransGrid has used to analyse options in the past (TG p118)





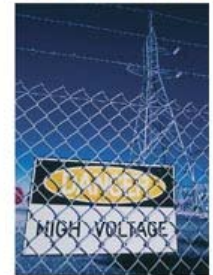
## Excluded Projects Assessment

- ACCC will undertake consultation with interested parties throughout the assessment of an excluded project – this may include more consultation than is required by the regulatory test (TG p119)
- The ACCC expects that it would require about four to six months to complete a review of an excluded project (TG p121)



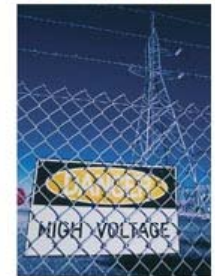
## Excluded Projects Assessment

- What is the relationship between the ACCC's proposed assessment process and the regulatory test?
- Is the ACCC going to make its assessment by becoming sufficiently involved in the regulatory test process or is it going to impose a completely separate and additional layer of process and assessment?
- ElectraNet is concerned that the latter approach may be contemplated and that this runs a much greater risk of the regulator getting in the way of meeting mandated reliability investment timeframes

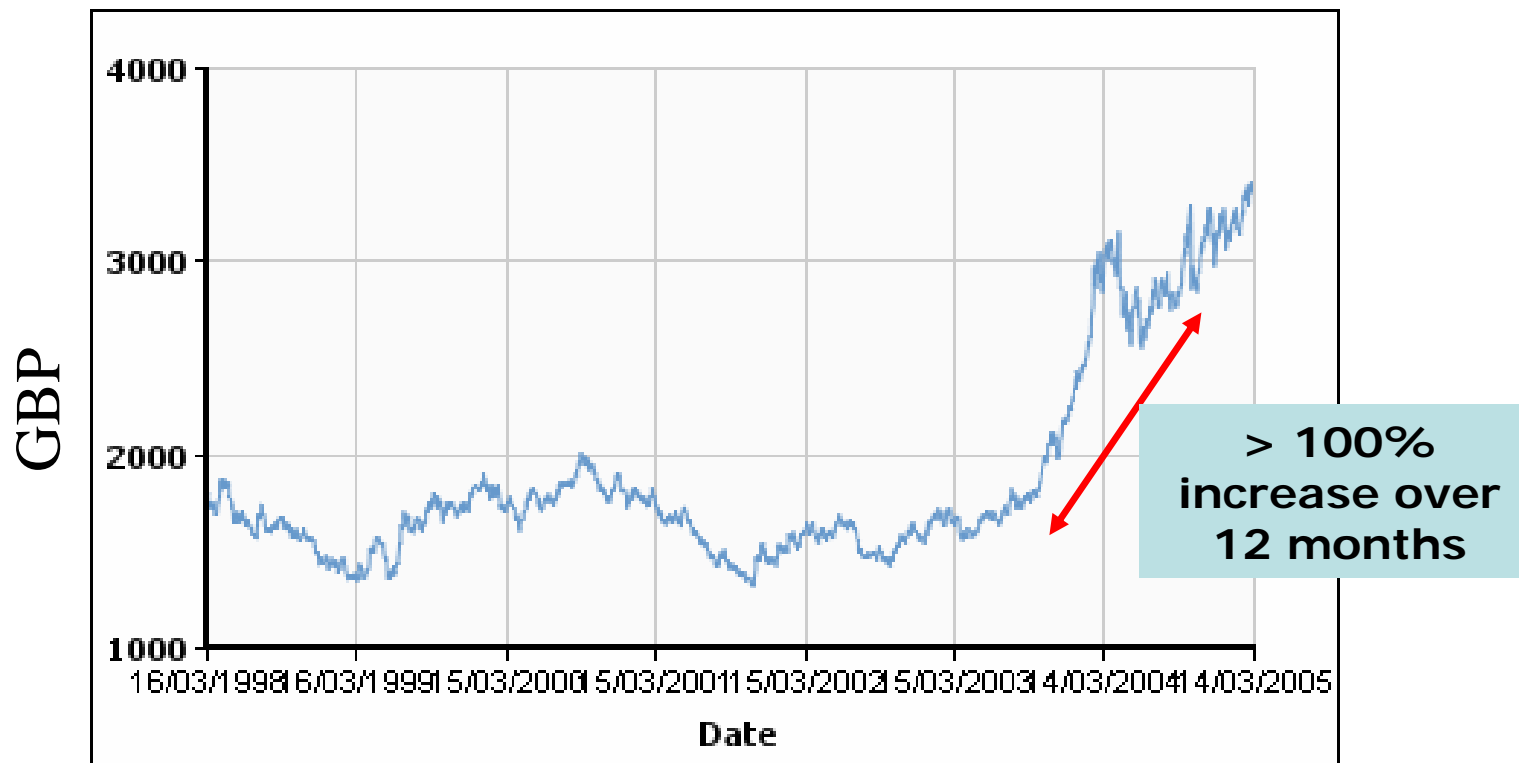


## Cost Estimation

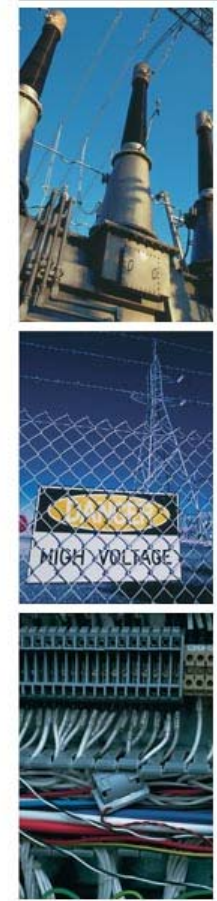
- TransGrid indicated a likely increase in real construction costs over the regulatory period and proposed that capex should be adjusted by construction price indices
- The ACCC was not convinced about the materiality of the problem (TG p86)
- Current experience indicates that real input price increases are a material problem...



## Copper Spot Price



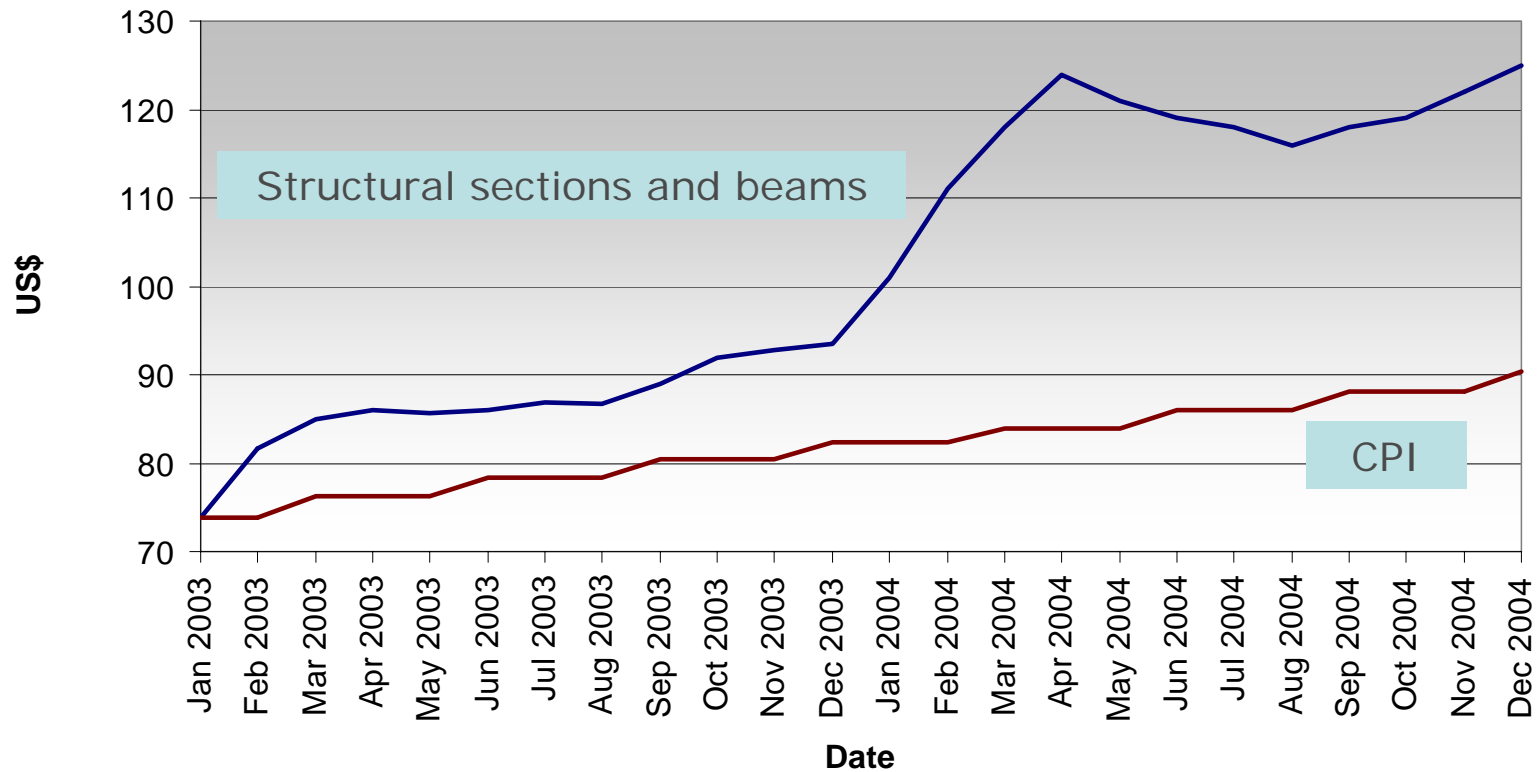
Source: London Metal Exchange ([www.lme.co.uk](http://www.lme.co.uk))



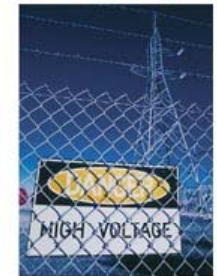
# Steel Spot Price

## MEPS - Asian Carbon Steel Product Price Index

(sources: [www.meps.co.uk](http://www.meps.co.uk) & [www.abs.gov.au](http://www.abs.gov.au))

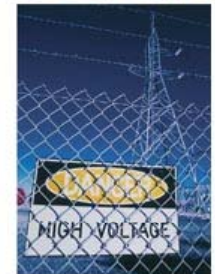


**Note:** Prices are derived from an arithmetic average of the low transaction values identified in Japan, Taiwan, South Korea and China - collected in national currencies and converted into US dollars at a specified date each month to provide a basis for comparisons. Index is based on January 1997 = 100.



## Real Input Price Increases

- ElectraNet has seen significant increases in market prices for recent construction projects
- Market data shows that in the past 12 months...
  - Line costs for steel tower lines increased by around 13%
  - Standard rate per 100 km increased by 13%
  - Substation costs have increased by approximately 8%
  - Steel prices – lattice steel went up 30%
  - Transformer prices increased 9%
  - General labour costs increased 10% above CPI



## Real Input Price Increases

- Real input price increases are a material problem
- Strong global demand for raw materials and increasing domestic demand for construction resources suggests this will continue to be a problem for the foreseeable future
- Estimates of future capital requirements must be allowed to take account of real price increases where these are forecast

