

# TransGrid & EnergyAustralia Supplementary Draft Decisions 24 March 2005



## Submission Outline

- ElectraNet does not wish to comment on the appropriateness or otherwise of the proposed revenue caps
- Rather this submission makes comment on more general issues arising from the ACCC's application to these decisions of the new regulatory regime for capital investment
  - balance of ex-ante capex allowance and excluded projects
  - excluded projects implementation and assessment process
  - Cost estimation
  - Implementation issues remain to be resolved



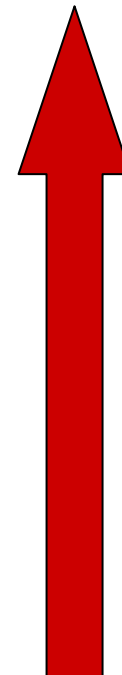
## Implementing the SRP

- SRP introduces a number of new approaches...
  - ex-ante capex allowance
  - excluded projects
  - Revenue cap re-openers
- Implementation issues associated with these changes remain to be resolved



## Capex Framework

Increasing regulatory certainty, stronger efficiency incentives, more light handed regulation etc.



Ex-ante allowance  
(large majority of expected capex)



Excluded projects  
(the rare exception)



Revenue cap re-opener  
(only to be relied on for unforeseen events)



## 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 dealing with the inevitable uncertainties faced 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 need to be 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

- Multiple 5-year mini revenue caps for excluded projects are undesirable and unnecessary
- Excluded projects can be managed as a variation to the existing revenue control – administratively much simpler
- This would provide incentives for excluded projects that are consistent with the incentives of the ex-ante capex allowance





## 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 may be 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... the following statements in relation to excluded projects indicate high levels of intrusion by the regulator that are inconsistent with the objective of light handed regulation
- 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)
- What is the relationship between the ACCC's proposed assessment process and the regulatory test?



## Excluded Projects Assessment

- Is the ACCC going to make its assessment by oversight of 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
- This approach would lead to higher compliance costs



## 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 increases in input prices are a material problem...



## Copper Spot Price



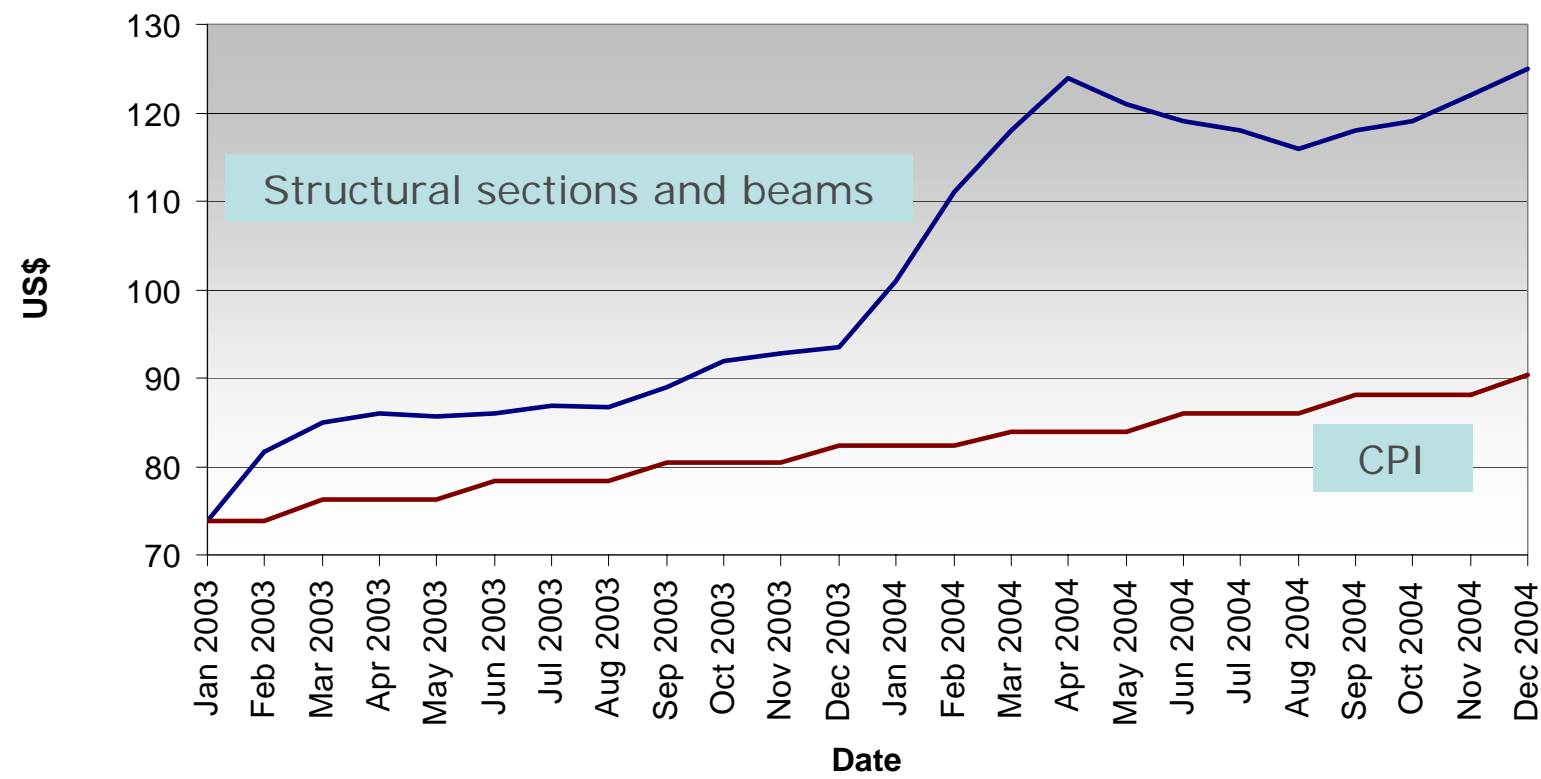
Source: London Metal Exchange ([www.lme.co.uk](http://www.lme.co.uk))



# 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...
  - Steel prices... lattice steel went up 30%
  - Line costs for steel tower lines... standard rate per 100 km increased by 13%
  - Transformer prices increased 9%
  - Substation costs have increased by approximately 8%
  - 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 take account of real price increases where these are forecast



## Conclusions

- A number of capex incentive framework and excluded projects implementation issues remain to be resolved
- More time is needed for consultation
- Immediate need to finalise TransGrid and EA revenue cap decisions should not compromise appropriate resolution of these issues
- Flexibility in relation to implementation is needed that recognises variations in existing revenue cap decisions and associated transitional issues

