



# **Response Capability - Minor Works**

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**2007/8-2013/14 Capital Works  
Revised Proposal**

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**Response Capability – Minor Works**


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**ISSUE/AMENDMENT STATUS**

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1	28/09/2007	Creation	G Towns	
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## 1 Executive Summary

PB/AER in its draft decision has excluded the total \$5.5 million provision for unforeseen works for the 2008-2014 rate reset period. SP AusNet incurred in excess of \$45 million of unforeseen works over the current reset period and have subsequently reviewed they types of work incurred and included this type of work into the risk modelling. A reasonable and prudent allowance was made through experience engineering judgement of the quantum of unforeseen works that could not be modelled and could reasonably be expected in the 2008-2014 rate reset period.

An independent study, undertaken by Evans & Peck, using risk modelling tools and methodologies was used to determine an appropriate quantum. This established an amount of \$14.5 million to be reasonable.

SP AusNet recommends inclusion of the \$5.5 million to ensure the efficiency and effectiveness of the planned works program, required for delivery of expected network service standards, is not compromised.

## 2 Overview of the Draft Decision

PB recommends removing the entire \$5.5 million proposed allowance for 'Response capability for undefined works' projects on the basis that SP AusNet already has sufficient discretion within its overall replacement capex program to ensure minor unforeseen risks can be addressed.

The AER states that it agrees with this assessment, and considers that SP AusNet has not demonstrated that a capex allowance of undefined scope reasonably reflects the expenditure of a prudent and efficient TNSP required to meet the capex objectives in clause 6A.6.7(a) of the NER.

The AER considers that SP AusNet's estimation processes are accurate down to a fine level of detail, and that its asset management practices are flexible enough to address risks in a systematic and efficient way. On this basis the AER has removed this allowance, resulting in a downward adjustment to SP AusNet's forecast capex allowance of \$5.5 million.

## 3 SP AusNet's response to the Draft Decision

SP AusNet has continued to the on-going development and maintenance of accurate estimating systems and processes as acknowledged by the AER. This aspect of SP AusNet's asset management expertise is complemented by a parallel process of asset condition monitoring and forecasting that enables long term modelling of asset replacement requirements and risk.

Over the current reset period this asset management process required in excess of \$45<sup>1</sup> million, as noted in the Draft Decision, of unforeseen capital works to be undertaken. SP AusNet has reviewed these works in order to identify the asset classes and failure modes to enable the inclusion of these works into the planned works program.

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<sup>1</sup> P.286 Draft Decision

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Inclusion of these works into the planned works program is enabled through the collation of sufficient data to provide reliable probability of failure and consequence outcomes that can be included in SP AusNet's risk modelling. This has enabled the prioritisation of a detailed list of works that SP AusNet has recommended be completed in order to reduce and manage risk at levels appropriate to deliver the required service delivery outcomes and provide long term asset security.

Whilst SP AusNet's risk modelling has delivered a transparent program of prioritised works, there remains a balance of work that SP AusNet is aware, through engineering experience, will be encountered though the next rate reset period that will have to be undertaken and will not be included in the risk modelling. The reasons for exclusion of these works is that they will have been unforeseen and/or there is currently insufficient data available to provide reliable and transparent risk modelling.

At this point in the development of SP AusNet's risk modelling, inclusion of contingency for unforeseen works would have resulted in reduced confidence by external stakeholders in the modelling and the potential for inefficient investment in the network.

Accordingly, SP AusNet has successfully reduced its provision for unforeseen works by **87%** for the 2008-2014 reset period to a reasonable and prudent amount of \$5.5 million.

Determination of \$5.5 million has been derived through the review of completed 'unforeseen' works by experienced engineering staff in order to determine the types of work to be included in the risk modelling and the types of work likely to be encountered as future unforeseen works.

SP AusNet has subsequently engaged the services of Evans & Peck<sup>2</sup> to undertake risk based modelling, using the \$45+ million of unforeseen works completed, to determine the appropriate quantum for future unforeseen works. The result of their risk and probability modelling has indicated an amount of \$14.5 million as appropriate. The requested \$5.5 million is a relatively conservative provision for unforeseen works but is an amount that SP AusNet is, based upon its engineering judgement, prepared to accept as reasonable and prudent.

The 2008-2014 rate reset period will provide SP AusNet the opportunity to further develop and enhance its risk modelling and will include a review of the most effective and efficient methodologies to accommodate unforeseen works.

Given that SP AusNet has provided a bottom up, detailed, costed and prioritised works program to deliver the appropriate service standards, exclusion or deferment of planned projects to accommodate unforeseen works will compromise the efficiency and effectiveness of the service delivery program.

To ensure efficient and effective delivery of an agreed planned works program, it is normal industry practice to make provision for unforeseen works that SP AusNet, PB and AER are aware and have acknowledged will be incurred. Exclusion of this provision can only result in the delivery of a sub-optimal program of planned works.

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<sup>2</sup> SP AusNet, Risk Review of Capital Replacement Program, Evans & Peck, October 2007

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SP AusNet considers that the information set out above demonstrates that SP AusNet's proposed allowance for the cost of minor works reasonably reflects:

- the efficient costs of achieving the capital expenditure objectives set out in clause 6A6.7(a) of the NER; and
- the costs that a prudent operator in the circumstances of SP AusNet would require to achieve the capital expenditure objectives.

On this basis, SP AusNet considers that the AER must, pursuant to clause 6A6.7(c) accept the inclusion of the allowance for minor works costs in the capital expenditure forecast, in lieu of the proposed 'response capability for undefined works' allowance which the Draft Decision rejects.

Table 1 below sets out the proposed minor works allowance.

**Table 1: Allowance for the cost of minor works (\$m, 2007-08)**

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	Total
SP AusNet's original proposal	0.92	0.92	0.92	0.92	0.92	0.92	5.50
AER Draft Decision allowance	0.00	0.00	0.00	0.00	0.00	0.00	0.00
SP AusNet's proposal	0.92	0.92	0.92	0.92	0.92	0.92	5.50

## 4 Recommendation

SP AusNet recommends the inclusion of the \$5.5 million provision for unforeseen works to ensure the effective and efficient delivery of the agreed program of planned works necessary for the required delivery of agreed service standards and long term network security.

## 5 References

- SP AusNet, Risk Review of Capital Replacement Program, Evans & Peck, October 2007