Submission to the AER on its Preliminary Determination

System Capex Financial Performance 2014-15 Year

Contents

1. Introduction

On 30 April 2015, the Australian Energy Regulator (AER) released its Preliminary Determination on Ergon Energy's Regulatory Proposal for the regulatory control period commencing on 1 July 2015 and ending on 30 June 2020.

Expenditure reported for the current regulatory period was provided based on audited information for all historical expenditure and an estimate of expected expenditure for the 2014-15 year. This estimate for the 2014-15 year has been updated since the initial Regulatory Proposal lodged with the AER on 30 October 2014. This document provides an update of this estimated system capital expenditure relating specifically to the 2014-15 financial year and offers an explanation for changes.

This document is structured in the following manner:

- Section 2 – Reason for proposed changes to forecast system capital expenditure (2014-15)
- Section 3 – Revised financial information and commentary for Corporation Initiated Augmentation forecast expenditure (2014-15)
- Section 4 – Revised financial information and commentary for Customer Initiated Capital works forecast expenditure (2014-15)
- Section 5 - Revised financial information and commentary for Asset Renewal forecast expenditure (2014-15)
- Section 6 – Revised financial information and commentary for Reliability and Quality of Supply forecast expenditure (2014-15)
- Section 7 – Revised financial information and commentary for Other System and Enabling Technology forecast expenditure (2014-15)

2. Reason for proposed changes to forecast system capital expenditure (2014-15 estimates)

In populating the Reset Regulatory Information Notice (Reset RIN) current period expenditure information Ergon Energy provided an audited series of historical expenditure and an estimate of expenditure for the 2014-15 year. This was done for each variable in accordance with Reset RIN instructions, definitions and requirements.

The estimate of capital expenditure for the 2014-15 year provided in October 2014 was based on the latest information available. Since then Ergon Energy has actual costs available for most of the 2014-15 year which was used to update the estimate of expenditure for 2014-15 financial year and offers an explanation for the differences in this document.

Ergon Energy will provide this update by expenditure category in terms of:

1. providing an update of the expenditure estimate for the 2014-15 year based on current actual expenditure trend;
2. where necessary explain the reasons for the changes; and
3. update the estimate in the relevant Ergon Energy System Capital Expenditure Forecast Expenditure Summary documents that support Ergon Energy's revised regulatory proposal.

3. Corporation Initiated Augmentation (2014-15 estimate)

Ergon Energy provides the following update of the expenditure estimate provided for Corporation Initiated Augmentation expenditure for the 2014-15 year in the following table.

Table 1 - Corporation Initiated Augmentation (CIA) - previous regulatory period forecast vs. actual expenditure for 2014-15 year

Corporation Initiated Augmentation	Direct Cost ($2014-15, 000's)		Total Cost ($2014-15, 000's)	
2014-15 Year	Original Proposal (October 2014)	Revised Proposal (July 2015)	Original Proposal (October 2014)	Revised Proposal (July 2015)
AER 2010-15 Determination	327.000[1]	327.000	447.000	447.000
Ergon forecast expenditure summary	116.000[2]	101.984	168.000	146.671
Non-CPI escalation amount	3.218[3]	NA	-0.503	NA
Ergon expenditure forecast - fully escalated	119.218[4]	101.984	167.497	146.671
Variance ($000)	-207.782[5]	-225.016	-279.503	-300.329
Variance (%)	-64%[6]	-69%	-63%	-67%

1. *AER's determination (allowance) for Ergon Energy CIA expenditure for 2014-15 (in the 2010-15 regulatory period)*
2. *Ergon Energy's CIA expenditure forecast escalated to CPI only (Direct Cost)*
3. *The difference between Ergon CPI only escalation and final real price escalation*
4. *The sum of forecast expenditure reported in summary documents including real price escalations for 2014-15*
5. *The difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*
6. *The % decrease representing the difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*

Reasons for underspend

Augmentation investment in 2014-15 has been lower than expected owing to a number of investments undergoing planning and scope reviews under the new security criteria (combined with updates on the demand forecast) which have resulted in identification of lower cost solutions to forecasted constraints.

Additionally a significant planned investment in the township of Moranbah that was in design phase was de-scoped based on an agreement being reached with the transmission supplier to maintain the existing connection point arrangements.

Documentation Updates:

These changes are reflected in *07.00.02 Forecast Expenditure Summary for Corporation Initiated Augmentation 2015 to 2020* in the following sections for the Revised Regulatory Proposal:

Section 2. Expenditure profile

- Table 1: Corporation Initiated Augmentation (CIA) capital expenditure (Direct costs, $m real 2014-15)
- Table 2: Corporation Initiated Augmentation (CIA) capital expenditure (Total costs, $m real 2014-15)

Section 4. Current period outcomes at a category level

- Table 7: Ergon Energy's actual, and the AER's forecast, Corporation Initiated Augmentation (CIA) forecast (Direct costs, $m real 2014-15)

4. Customer Initiated Capital Works (2014-15 estimate)

Ergon Energy provides the following update of the expenditure estimate provided for Customer Initiated Capital Works expenditure for the 2014-15 year in the following table.

Table 2 - Customer Initiated Capital Works (CICW) - previous regulatory period forecast vs. actual expenditure for 2014-15 year

CICW	Direct Cost ($2014-15, 000's)		Total Cost ($2014-15, 000's)	
2014-15 Year	Original Proposal (October 2014)	Revised Proposal (July 2015)	Original Proposal (October 2014)	Revised Proposal (July 2015)
AER 2010-15 Determination	234.000[1]	234.000	320.000	320.000
Ergon forecast expenditure summary	135.000[2]	98.422	195.054	141.549
Non-CPI escalation amount	3.832[3]	NA	-	NA
Ergon expenditure forecast - fully escalated	138.832[4]	98.422	195.054	141.549
Variance ($000)	-95.168[5]	-135.578	-124.946	-178.451
Variance (%)	-41%[6]	-58%	-39%	-56%

1. *AER's determination (allowance) for Ergon Energy CICW expenditure for 2014-15 (in the 2010-15 regulatory period)*
2. *Ergon Energy's CICW expenditure forecast escalated to CPI only (Direct Cost)*
3. *The difference between Ergon CPI only escalation and final real price escalation*
4. *The sum of forecast expenditure reported in summary documents including real price escalations for 2014-15*
5. *The difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*
6. *The % decrease representing the difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*

Reasons for underspend

Customer initiated investment in 2014-15 has been lower than expected owing to lower demand from customers proceeding with connection enquiries and applications. Generically performance against expenditure forecast for 'Domestic and Rural', 'Commercial and Industrial' customers and subdivision works has been approximately 15-23% lower than expected. However significant reductions in gifted Subdivisions assets and Large Customer Connections have been experienced of up to 50% and 83% respectively. These reductions are most pronounced in Large Customer Connections and Subdivision works owing to the higher unit cost for these connection types and the volatility these customer types experience.

An additional factor that impacts the revised forecast expenditure for CICW 2014-15 year is the updated real cost escalators and overheads.

These expenditure revisions are consistent with declines in Queensland non-residential investment indicators that have significantly weakened following the completion of the Curtis Island Liquefied Natural Gas (LNG) construction projects.

A significant investment planned for the Cairns Northern Beaches area has been deferred from the original proposed timeline because of matters associated with relevant development and gaming licenses approvals and the overall subdued tourist activity in the Cairns area. The delay to this large customer connection project has also reduced the level of expected residential and commercial development in the suburbs surrounding the Cairns Northern Beaches associated with this development.

Economic indicators of construction expenses state-wide show a bearishness for 2014-15 and BIS Shrapnel, as shown on page 6-65 of the AER Preliminary decision, show a recovery in following years. Again, this is part accounted for in the drop in Commercial and Industry connection activity.

Documentation Updates

These changes are reflected in *07.00.03 Forecast Expenditure Summary for Customer Initiated Capital Works 2015 to 2020* in the following sections for the Revised Regulatory Proposal:

Section 2. Expenditure profile

- Table 1: CICW capital expenditure – Standard Control Services (Direct costs, $m real 2014-15)
- Table 3: CICW capital expenditure – Standard Control Services (Total costs, $m real 2014-15)

Section 4. Current period outcomes at a category level

Table 7: Ergon Energy's actual, and the AER's forecast, CICW forecast (Direct costs, $ million real 2014-15)

5. Asset Renewal (2014-15 estimate)

Ergon Energy provides the following update of the expenditure estimate provided for Asset Renewal expenditure for the 2014-15 year in the following table.

Table 3 - Asset Renewal - past regulatory period forecast vs. actual expenditure for 2014-15 year

Asset Renewal	Direct Cost ($2014-15, 000's)		Total Cost ($2014-15, 000's)	
2014-15 Year	Original Proposal (October 2014)	Revised Proposal (July 2015)	Original Proposal (October 2014)	Revised Proposal (July 2015)
AER 2010-15 Determination	227.000[1]	227.000	311.000	311.000
Ergon forecast expenditure summary	166.000[2]	195.419	240.719	281.047
Non-CPI escalation amount	5.334[3]	NA	-	NA
Ergon expenditure forecast - fully escalated	171.334[4]	195.419	240.719	281.047
Variance ($000)	-55.666[5]	-31.581	-70.281	-29.953
Variance (%)	-25%[6]	-14%	-23%	-10%

1. *AER's determination (allowance) for Ergon Energy Asset Renewal expenditure for 2014-15 (in the 2010-15 regulatory period)*
2. *Ergon Energy's Asset Renewal expenditure forecast escalated to CPI only (Direct Cost)*
3. *The difference between Ergon CPI only escalation and final real price escalation*
4. *The sum of forecast expenditure reported in summary documents including real price escalations for 2014-15*
5. *The difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*
6. *The % decrease representing the difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*

Reasons for growth

Asset Renewal investment was higher than expected owing to planned and unplanned risk management investments.

Unplanned expenditure included the recovery following cyclone Marcia, a category 5 cyclone that impacted central Queensland including the township of Yeppoon and Rockhampton. Additionally, Ergon Energy commenced work on a number of key safety investments that are critical to maintaining our safety commitments to our customers and employees. Such investments include:

- Preparatory work in relation to Low voltage 7/0.064 conductor replacement owing to the increasing risk of failure and conductors falling to the ground while energised. Specifically in 2014-15 planning for streetlight 7/0.064 conductor was targeted to ensure rapid replacement when funding became available. For example almost 350 circuit kilometres is scheduled to be replaced in the near future. Additionally Ergon Energy commenced the planning and scheduling work associated with LV Mains 7/0.064 conductor replacement.
- Conducted trials and commencement the planning and scheduling work associated with low conductor clearance rectification being a new program added to the expenditure portfolio

based on implementation of vegetation management ROAMES information. Ergon Energy has released 2,000 defects for remediation with 200 due for completion by 30 June 2015.

- Major streetlight inspection and repair programs arising from Safety Investigations into several disparate shock events received from streetlights.
- Replacement of low voltage Silva Link fuses which were identified to have friable asbestos.

Documentation Updates

These changes are reflected in *07.00.01 Forecast Expenditure Summary for Asset Renewal 2015 to 2020* in the following sections for the Revised Regulatory Proposal:

Section 2. Expenditure profile

- Table 1: Asset Renewal capital expenditure – Standard Control Services (Direct costs, $m real 2014-15)
- Table 3: Asset Renewal capital expenditure – Standard Control Services (Total costs, $m real 2014-15)

Section 4. Current regulatory control period performance

- Table 7: Current period asset renewal capital expenditure compared to the AER's allowance (Direct costs, $m 2014-15)

6. Reliability and Quality of Supply (2014-15 estimate)

Ergon Energy provides the following update of the expenditure estimate provided for Reliability and Quality of Supply expenditure for the 2014-15 year in the following table.

Table 4 - Reliability and Quality of Supply (RQoS) - past regulatory period forecast vs. actual expenditure for 2014-15 year

Reliability and Quality of Supply	Direct Cost ($2014-15, 000's)		Total Cost ($2014-15, 000's)	
2014-15 Year	Original Proposal (October 2014)	Revised Proposal (July 2015)	Original Proposal (October 2014)	Revised Proposal (July 2015)
AER 2010-15 Determination	18.000[1]	18.000	24.000	24.000
Ergon forecast expenditure summary	36.000[2]	37.231	52.000	53.545
Non-CPI escalation amount	0.646[3]	NA	-0.513	NA
Ergon expenditure forecast - fully escalated	36.646[4]	37.231	51.487	53.545
Variance ($000)	18.646[5]	19.231	27.487	29.545
Variance (%)	104%[6]	107%	115%	123%

1. *AER's determination (allowance) for Ergon Energy RQoS expenditure for 2014-15 (in the 2010-15 regulatory period)*
2. *Ergon Energy's RQoS expenditure forecast escalated to CPI only (Direct Cost)*
3. *The difference between Ergon CPI only escalation and final real price escalation*
4. *The sum of forecast expenditure reported in summary documents including real price escalations for 2014-15*
5. *The difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*
6. *The % increase representing the difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*

Reasons for growth

Reliability investment was higher than expected owing to stronger program coordination and delivery of the ACR and Gas Switch reliability improvement program. The time estimated to install the planned volume of switches was over estimated previously for Ergon Energy's original Regulatory Proposal. The increased service delivery efficiency has resulted in the decision being taken to install a higher volume of switches in the 2010-15 regulatory control period than originally planned.

Documentation Updates

These changes are reflected in *07.00.05 Forecast Expenditure Summary for Reliability and Quality of Supply 2015 to 2020* in the following sections for the Revised Regulatory Proposal:

Section 2. Expenditure profile

- Table 1: Reliability and quality of supply capital expenditure (Direct costs, $m real 2014-15)
- Table 2: Reliability and quality of supply capital expenditure (Total costs, $m real 2014-15)

Section 4. Current period outcomes

- Table 3: Current period Reliability and Quality of Supply capital expenditure (Direct costs, $ million real 2014-15)
- Table 4: Current period Reliability and Quality of Supply capital expenditure (Total costs, $ million real 2014-15)

7. Other System and Enabling Technologies (2014-15 estimate)

Ergon Energy provides the following update of the expenditure estimate provided for Other System and Enabling Technologies expenditure for the 2014-15 year in the following table.

Table 5 - Other System and Enabling Technologies - past regulatory period forecast vs. actual expenditure for 2014-15 year

Other System Capital	Direct Cost ($2014-15, 000's)		Total Cost ($2014-15, 000's)	
2014-15 Year	Original Proposal (October 2014)	Revised Proposal (July 2015)	Original Proposal (October 2014)	Revised Proposal (July 2015)
AER 2010-15 Determination	44.000[1]	44.000	61.000	61.000
Ergon forecast expenditure summary	44.000[2]	31.537	44.054	45.356
Non-CPI escalation amount	-12.644[3]	NA	-	NA
Ergon expenditure forecast - fully escalated	31.356[4]	31.537	44.054	45.356
Variance ($000)	-12.644[5]	-12.463	-16.946	-15.644
Variance (%)	-29%[6]	-28%	-28%	-26%

1. *AER's determination (allowance) for Ergon Energy Other system capital expenditure for 2014-15 (in the 2010-15 regulatory period)*
2. *Ergon Energy's Other System Capital expenditure forecast escalated to CPI only (Direct Cost)*
3. *The difference between Ergon CPI only escalation and final real price escalation*
4. *The sum of forecast expenditure reported in summary documents including real price escalations for 2014-15*
5. *The difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*
6. *The % increase representing the difference between the AER's allowance for 2014-15 and Ergon's fully escalated estimate for 2014-15*

No revision required:

Estimated actuals for the 2014-15 year are in line with the budget forecast as reported in Ergon Energy's Regulatory Proposal (October 2014). That is, no significant variance is expected.

Documentation Updates:

Minor amendments are reflected in *07.00.04 Forecast Expenditure Summary Other System and Enabling Technologies 2015 to 2020* in the following sections for the Revised Regulatory Proposal:

Section 2. Expenditure profile

- Table 1: Other System capital expenditure – Standard Control Services (Direct costs, $m real 2014-15)
- Table 3: Other System capital expenditure – Standard Control Services (Total costs, $m real 2014-15)

Section 4. Current period outcomes

- Table 5: Current period Other System capital expenditure (Direct costs, $ million real 2014-15)

8. Supporting documents

The following changes discussed in this document have been updated in the following documents.

Name
07.00.01 Forecast Expenditure Summary Asset Renewal 2015 to 2020
07.00.02 Forecast Expenditure Summary Corporation Initiated Augmentation 2015 to 2020
07.00.03 Forecast Expenditure Summary Customer Initiated Capital Works 2015 to 2020
07.00.05 Forecast Expenditure Summary Reliability and Quality of Supply 2015 to 2020
07.00.04 Forecast Expenditure Summary Other System and Enabling Technologies 2015 to 2020

Definitions, acronyms, and abbreviations

ACS	Alternative Control Services
AER	Australian Energy Regulator
Augex	Augmentation expenditure
CAM	Cost Allocation Method
Capex	Capital expenditure
CIA	Corporation Initiated Augmentation
CICW	Customer Initiated Capital Works
CPI	Consumer Price Index
Ergon Energy	Ergon Energy Corporation Limited
LNG	Liquefied Natural Gas
RIN	Regulatory Information Notice
RQoS	Reliability and Quality of Supply
SCS	Standard Control Services
WR	Work Request