AusNet Services Deep Dive No.1
Opex Overview

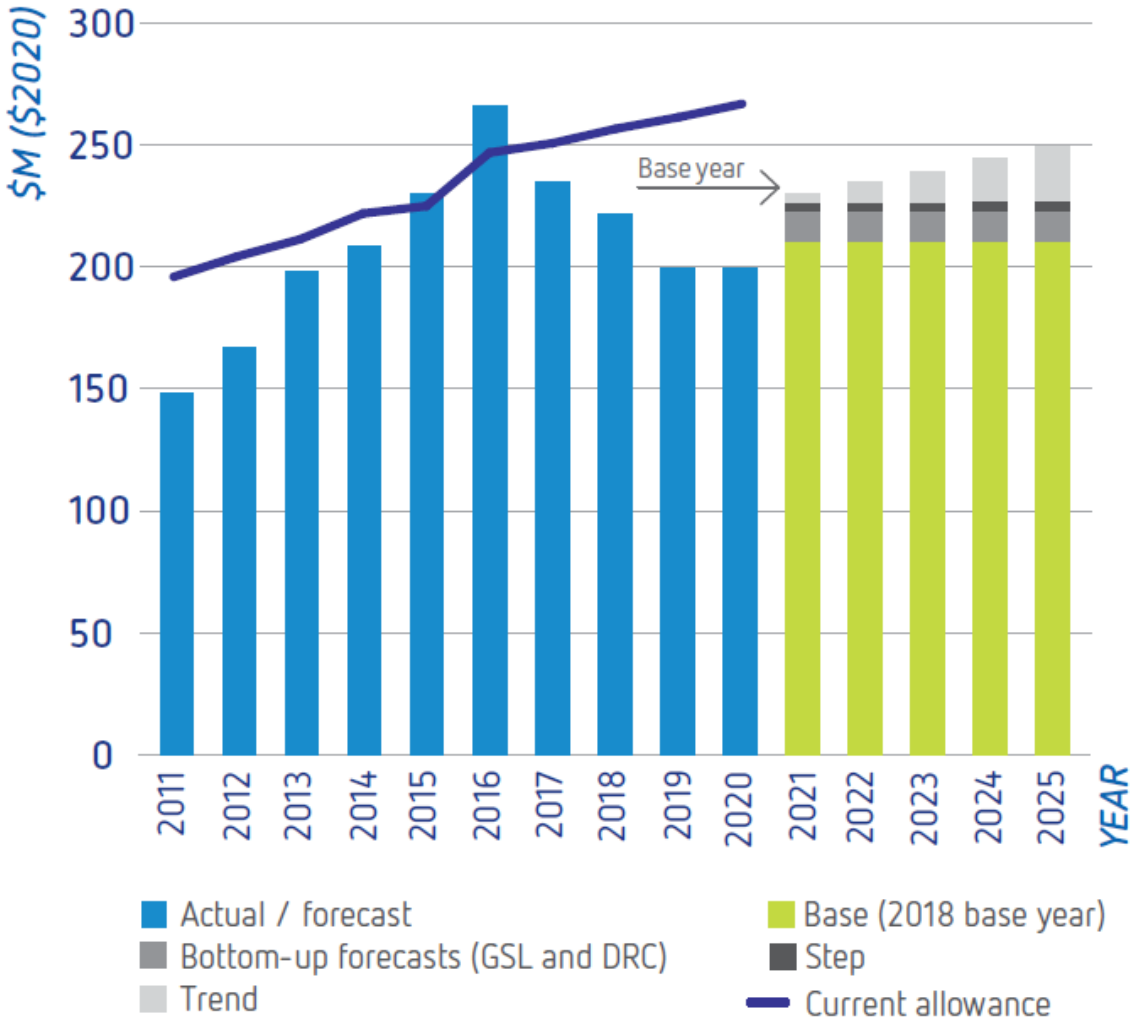
Pre-reading pack

11 February 2019

Opex – Draft Proposal - Overview

Our draft proposal is for $1,229 million ($real 2020), which is a 5% reduction from our approved allowance in 2016-2020.

AusNet Services is re-allocating some ICT opex (and capex) from the alternative control smart metering to standard control services. This reflects the increasing usage of these systems by the standard control services. This will be covered in detail in the ICT capex deep dive.



Note: The base opex amount shown excludes the $32 million ($2020) of shared smart metering opex.

Opex – Draft Proposal - Overview

A summary of the key components of the proposal are set-out below.

2020$ MILLION	2021	2022	2023	2024	2025
Base opex	209.6	209.6	209.6	209.6	209.6
Step changes (see table below)	3.7	4.0	4.0	4.2	4.3
Trend (output, labour and productivity)	4.1	8.4	13.1	18.3	22.8
Bottom-up forecasts (Metering reallocation, Guaranteed Service Levels, debt raising costs and innovation expenditure)	18.6	18.7	18.8	19.1	19.2
Total opex allowance	**235.9**	**240.7**	**245.5**	**251.1**	**255.9**

Our opex proposal provides a level of service that is valued by our customers.

AusNet Services will continue delivering the services most valued by customers, including providing a safe and reliable supply, for a lower cost than in 2016-20.

This has been achieved by the ongoing efficiency gains that AusNet Services has, and will continue to, achieve in 2016-20

For every $100 operating costs on the electricity network ...

Opex – Step Changes

Step Change	Driver	Cost	Detail

REFCL	New Regulatory Obligation	$8.5m	• This program delivers great safety benefits to all of AusNet Services customers through reduced bushfire risk. The step change covers the opex necessary to:
			  ◦ progress the third tranche; and
			  ◦ or ongoing testing and maintenance of the REFCLs at 22 zone sub stations.
			• The Customer Forum agreed in principle to this step change.

Security	New Regulatory Obligation	$1.2m	• The Security of Critical Infrastructure Act 2018 is expected to drive increased capex and opex. The opex increase is forecast at $1.2 million, however this is likely to be refined prior to submission of the regulatory proposal. • The Customer Forum has not yet been consulted on this step change.
5 Minute data	New Regulatory Obligation	$2.6m	• The operation of upgraded systems to manage 5 minute metering data requires additional ongoing activities. This program is being implemented to meet our obligations under a electricity market rule change, which is designed to assist the functioning of the wholesale market. This rule change is designed to deliver benefits to customers through reduced retail prices by improving price signals for more efficient generation and use of electricity. • The Customer Forum agreed in principle to this step change.

Opex – Step Changes

Step Change	Driver	Cost	Detail
IT Cloud	Capex/Opex trade-off	$7.8m	• Required ICT functionality is increasingly moving to cloud based software as a service. Cloud based systems are opex solutions rather than the traditional capex on-premises approach (where we own the IT equipment and maintain software). • The Customer Forum has provided in principle support to $2.54 million of the $7.8 million step change
New Issue - Environment Protection Amendment Act 2018 (Vic)	New Regulatory Obligation	$?	• The Environment Protection Amendment Act 2018 (Vic) was passed by Parliament in August 2018 and comes into effect on 1 July 2020. • Costs could be significant. We are working to understand the likely costs and consider this should be tested with the Customer Forum in the next round of negotiations.
New Issue - Insurance Costs	Material Cost Pressure	$?	• Following the recent California bushfires we expect insurance costs to face upwards pressure next time our policies are renewed. We will monitor the materiality of any cost increases and consider whether a step change is warranted. • We note that the AER would not generally approve this type of step change and we would only explore this further if it was material in the overall context of our opex proposal. • The Customer Forum has not yet been consulted on this step change. There is a low probability we will formally raise this with the Customer Forum.

Opex – Trend Parameters

Trend Parameter	2021	2022	2023	2024	2025
Output growth	1.61%	1.48%	1.49%	1.58%	1.25%
% change in labour price in real terms	0.57%	0.85%	1.17%	1.18%	1.18%
% change in material prices in real terms	0%	0%	0%	0%	0%
Productivity adjustment	0%	0%	0%	0%	0%

Trend Parameter	Approach
% change in labour price in real terms	• We will propose to use the average of two consultants reports. This is consistent with the AER's approach in the NSW draft decisions and we have used these decisions as a placeholder for the draft proposal. • The Customer Forum agreed in principle to this approach.
% change in material prices in real terms	• No real increases. This is consistent with the AER's latest decisions. • The Customer Forum agreed in principle to this approach.
Output Growth	• We have applied the AER's SFA model to forecast of growth in customer numbers, ratcheted maximum demand and circuit length. However, in the AER's most recent decision on the NSW DNSPs, the AER changed their approach and is now using the average of 4 econometric models. • The Customer Forum agreed in principle to the previous approach, but has not yet considered the AER's recent change in approach. We are considering adopting the AER's revised approach for the regulatory proposal and will discuss this with the Customer Forum.

Opex – Trend Parameters

Trend Parameter	Approach
Productivity	• We have not included a productivity adjustment in our draft proposal. However, we have committed to applying the outcomes of the AER's productivity review. Depending on the outcome of the AER's review (and particularly if the AER decides to apply a company specific adjustment) some further consideration may be necessary. • We note that we provided a submission to the AER's opex productivity review which set out that we do not see a reasonable expectation of a shift in the productive frontier at this time. We note that this is different from firm specific efficiency improvements and that we are looking to achieve productivity improvements throughout the remainder of this regulatory period. • We accept that an adjustment for the changing proportion in undergrounding is appropriate. However, we raised a number of questions about the robustness of the AER's proposed adjustment. • The Customer Forum considers that a productivity adjustment of 1.5% should be applied to our opex allowance. We have not adopted this position.

Opex – Other issues

Issue	Approach
Capitalised leases	From 1 April 2019, operating leases will be capitalised, rather than treated as opex. This is consistent with AASB 16 and is required for our statutory accounts. The AER appears to have accepted either approach for regulatory accounting. This reduces our operating expenditure by $31m over the 2021-25 regulatory period with an equivalent increase in capex.
Cost allocation of shared data and communication systems	AusNet Services has adjusted the allocation of costs for key data and communication systems to better reflect their integrated role in the delivery of core distribution services and metering services. This provides a higher allocation to the distribution service opex which increases standard control opex by $34m over the 2021-25 regulatory period (this has a corresponding reduction in the metering opex).
Innovation	The proposed innovation program is predominately capex. However, there is a $2.1m opex component and we are seeking to recover this as a step change as the regulatory regime does not properly incentivise innovation opex.
GSL expenditure	The AER has historically forecast GSL expenditure using a 5 year average of. We have adopted this approach and back cast data to account for revisions to the scheme in 2016.
Debt Raising Costs	We have applied the AER's benchmark approach to calculating debt raising costs

Questions regarding our draft proposal

- **Your feedback is sought on the draft opex proposal**

Do you think that capitalising leases in accordance with AASB 16 is the correct approach?	Do you consider that allocation of metering systems to better reflect usage is the correct approach?	Do you think our decision to apply the AER's final decision on productivity parameter is the correct approach?