EXPENDITURE OBJECTIVES, CRITERIA AND FACTORS

PAL RIN 07 – PUBLIC
2026–31 REGULATORY PROPOSAL

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1. Background

The National Electricity Rules (Rules) require the Australian Energy Regulator (AER) to decide whether to accept, reject or substitute our forecast expenditure for standard control services. To enable the AER to make its decision, our regulatory proposal must include the total forecast expenditure for the 2026–31 regulatory period necessary to meet the expenditure objectives.

Our forecast expenditure must also comply with the requirements of the Final 2026–31 Reset RIN (RIN). On 17 October 2024, the AER issued a RIN for our 2026–31 regulatory reset where it sought information on:

- why the total forecast capital and operating expenditure is required for us to achieve each of the objectives in clauses 6.5.6(a) and 6.5.7(a) of the Rules and paragraphs 4.4.1(a) and 4.6.1(a)(i) of the RIN
- how our total forecast capital and operating expenditure reasonably reflects each of the criteria in clauses 6.5.6(c) and 6.5.7(c) of the Rules and paragraphs 4.4.1(b) and 4.6.1(a)(ii) of the RIN
- how our total forecast capital and operating expenditure accounts for the factors in clauses 6.5.6(e) and 6.5.7(e) of the Rules and paragraphs 4.4.1(c) and 4.6.1(a)(iii) of Schedule 1 of the RIN
- an explanation of how the plans, policies, procedures and regulatory obligations or requirements have been used to develop forecast capital expenditure as required under paragraph 4.4.1(d) of the RIN
- an explanation of how each response provided in the above bullet points is reflected in any increase or decrease in expenditures or volumes, particularly between the current and forthcoming regulatory control periods as required under paragraph 4.4.1(e) of the RIN.

The purpose of this appendix is to provide evidence on why we consider our forecast expenditure should be accepted by the AER with reference to the objectives, criteria and factors as set out in the Rules and the RIN. We have also sought to explain the following:

- the key drivers of capital expenditure as requested in paragraph 4.4.6(a) of the RIN
- how it can be distinguished between categories as required by paragraphs 4.4.6(b)(i) to 4.4.6(b)(iv) of the RIN.

This appendix consists of three sections:

- how we consider the total expenditure forecasts are required to achieve the expenditure objectives
- how we consider the total expenditure forecasts reasonably reflect each of the expenditure criteria have regard to the expenditure factors
- a description of the capital expenditure category key drivers and how the categories can be distinguished.

2. Meeting the expenditure objectives

2.1 Interpreting the expenditure objectives

We have interpreted the expenditure objectives of the Rules as follows:

- expenditure objectives should be considered as a whole, rather than in isolation. Support expenditure in information and communications technology (ICT), property and fleet are vital for ensuring we can meet our objectives
- where there are reliability, quality, security or safety standards in place, we must ensure that forecast expenditure is directed at meeting those standards for each year of the regulatory period
- where there are no standards in place for reliability, quality, security or safety, we must ensure that the forecast expenditure is to maintain performance
- safety is a broad concept and includes safety of the workforce, public and the environment.

2.2 Meeting the capital expenditure objectives

The purpose of this section is to demonstrate how our forecast capital expenditure achieves the capital expenditure objectives.

Our forecast capital expenditure is based on several capital expenditure categories. It should be noted that:

- a single capital category may meet multiple capital expenditure objectives. For example, augmentation expenditure meets regulatory obligations, maintaining reliability of the network, and maintaining safety
- all capital expenditure categories involve complying with regulatory obligations as a network or Corporations Act 2001, e.g. our policies, procedures and strategies deliver on the requirements set out in the Victorian Electricity Distribution Code of Practice (EDCoP)
- non-network investment supports provision of the necessary functions to achieve network objectives. For example, property capital expenditure is required to ensure that the offices and depots are fit for purpose for housing staff, fleet and materials. Non-network investments may also relate to complying with regulatory obligations, such as market settlement rules.

Table 1 summarises each type of capital expenditure and why it is required to meet the capital expenditure objectives.

TABLE 1 CAPITAL EXPENDITURE OBJECTIVES

Augmentation	Enables us to augment our network to ensure we have sufficient capacity to avoid: • asset utilisation rates exceeding the upper bounds of good engineering practice. This ensures the safety, reliability and security of supply is always maintained. It also ensures there remains sufficient capacity available to support a low carbon future including electrification • increases in the repair and maintenance of heavily loaded assets

	• becoming non-compliant with applicable legislation and regulatory obligations, particularly the requirements of Energy Safe Victoria. Augmentation investment supports 24-hour monitoring and control of our zone substation and sub-transmission substation assets and other distribution assets (including feeders). This strengthens network performance, improves data security, increase data visibility and provide more accurate and timely information to customers on fault rectification. (meets capital expenditure objectives 1, 2, 3 and 4)
Replacement	Enables us to maintain network performance within acceptable risk levels and replace network assets that have failed. In the absence of replacement expenditure, with time, network assets would age and deteriorate and, if they are not replaced, will fail or operate at a sub-standard level. This will result in a degraded level of service reliability and quality for customers. Investment in asset replacement enables us to remain compliant with applicable environmental, electrical safety, regulatory and other Victorian and Federal legislation. This includes requirements of Energy Safe Victoria, the Environmental Protection Authority and Parks Victoria. (meets capital expenditure objectives 2, 3 and 4)
Connections	Enables us to meet customer requests for new and enhanced connection services. Connection activity is exogenous to the network and will be determined by economic conditions, demographics, planning laws and prevailing energy policies including those related to the energy transition. (meets capital expenditure objectives 1, 2 and 3)
Resilience	Resilience expenditure is a new investment category for this regulatory period, identified to meet compliance requirements and community needs arising from the Victorian Government sponsored Electricity Distribution Network Resilience Review and Network Outage Reviews. Beyond these reviews, investment in resilience is a direct response to feedback we have consistently received from our customers and stakeholders throughout our stakeholder engagement program. It is noted the Victorian Government has lodged a Rule change request with AEMC to explicitly identify resilience and as new capital expenditure objective. As draft determination from the AEMC as to whether there should be an explicit resilience capital expenditure factor is due 13 February 2025. (meets capital expenditure objectives 2, 3 and 4)
Non-network	Non network investment supports our information technology and communication, motor vehicles, office furniture and property functions.

Whilst not directly related to the network, these functions are essential to ensure the maintenance of services to customers.

Over the next regulatory period, non-network investments will be essential to support the energy transition through investments to support the NEM market reform initiatives, provision of distribution system operator functionality and reducing the emissions of our fleet amongst other things.

(meets capital expenditure objectives 2, 3, 4 and 5)

2.3 Meeting the operating expenditure objectives

The purpose of this section is to demonstrate how the forecast operating expenditure achieves the operating expenditure objectives.

Our regulatory proposal includes a total forecast operating expenditure for the 2026–31 regulatory period that we consider necessary to achieve each of the operating expenditure objectives listed in clause 6.5.6(a) of the Rules. Our forecast operating expenditure is made up of several cost categories that represent the costs of undertaking a set of interrelated activities and to operate the various systems necessary to achieve each of the operating expenditure objectives.

We believe our operating expenditure forecast for the next regulatory period will deliver the operating expenditure objectives because:

- we are currently meeting these objectives and our forecast operating expenditure has been developed using a 'revealed cost' approach by applying justified rate of change and step changes to the 2024-25 operating expenditure base year. This means that the forecast is based on our currently efficient operating expenditure, with necessary adjustments being made for the forecast rate of change, and changes to the scope of existing work
- the nature of the activities that we will undertake through our operating expenditure program are targeted at specifically delivering the operating expenditure objectives. These activities are based on the practices that are currently being applied in the 2024-25 base year and will only change in the next regulatory period to accommodate the forecast rate of change and changes to the scope of work
- we have robust plans, policies, procedures and strategies to support the delivery of our operating expenditure program. These are based on those that are currently being applied in the 2024-25 base year and will only change in the next regulatory period to accommodate the forecast rate of change and changes to the scope of work
- we are physically able to deliver the work for the operating expenditure program by acquiring and deploying necessary labour and materials. The operating expenditure forecasts will be delivered in a similar manner to that which is currently being applied in the 2024-25 base year, with changes only being made in the next regulatory period to accommodate the forecast rate of change and changes to the scope of work.

3. The expenditure criteria and factors

3.1 Interpreting the expenditure criteria and factors

The AER is required to accept our expenditure forecasts if it is satisfied that the total of the forecast expenditure reasonably reflects each of the expenditure criteria. In making this decision on whether it is satisfied, it must have regard to the expenditure factors.

3.2 Expenditure criteria

We consider that our forecast expenditure is consistent with the capital and operating expenditure criteria outlined in clauses 6.5.6(c) and 6.5.7(c) of the Rules, as it reflects:

- the efficient costs of achieving the capital and operating expenditure objectives
- the costs that a prudent operator in our circumstances would require to achieve the capital and operating expenditure objectives
- a realistic expectation of the demand forecast, and cost inputs required to achieve the capital and operating expenditure objectives.

We believe our capital and operating expenditure reflects the expenditure criteria because we have developed our forecasts by applying a prudent approach to developing our expenditure forecasts. This approach includes:

- having regard to historic expenditure levels
- having regard to the benchmarked efficiency of our operating expenditure, as per the Annual Benchmarking Report 2024 - Electricity distribution network service providers November 2024
- application of our well-established high voltage network forecasting tool that has been used and refined within our planning and asset management practices for multiple regulatory periods. In addition to manage the increasing uncertainty presented by the energy transition, and more accurately assess its locational impacts, we have developed a new low voltage analysis and forecasting capability that significantly improves the sophistication and granularity of our forecasts. This is a fundamental evolution in our forecasting capability, leveraging the extent of our smart meter population, and sets us apart from other networks (who must rely on simplified archetype modelling). Further the demand forecasts are reconcilable with those of the Australian Energy Market Operator (AEMO)
- applying customer number forecasts consistent with those of AEMO
- consideration of applicable regulatory obligations, identified in Workbook 1 - Forecast, regulatory templates 7.1 and 7.3 of the RIN
- applying the internal plans, policies, procedures that are listed and explained in Part B of the regulatory proposal and Workbook 1 - Forecast, regulatory templates 7.1 and 7.3 of the RIN
- application of the AER's value of customer reliability (VCR), customer export curtailment value (CECV), value of emissions reduction (VER) and value of network resilience (VNR), and our own customer values analysis (CVA)
- drawing on relevant consultants' reports, which are listed in the attachments to this regulatory proposal. The application of each report is discussed in Part B of this regulatory proposal
- applying efficient cost escalators discussed in Part B this regulatory proposal
- undertaking regulatory investment tests, where relevant

- undertaking, where relevant, risk-monetisation assessments to quantify risks of not implementing capital solutions and determining the most efficient timing of investment. This includes for network and non-network capital expenditure
- undertaking multiple-options analysis, including in collaboration with key stakeholders, to assess the most efficient cost and highest customer benefit solutions for investment, including non-network solutions
- having regard, where relevant, to non-network alternatives.

When considering our expenditure forecasts, it is important to recognise the circumstances under which we operate. Our expenditure forecasts cater to our network's specific needs and reflect expected future challenges relevant to our environment. Caution should be exercised when contrasting our network with others in the NEM.

3.3 Expenditure factors

The capital and operating expenditure factors in clauses 6.5.6(e) and 6.5.7(e) of the Rules are the matters that the AER must have regard to in assessing whether forecast capital and operating expenditure forecasts reasonably reflect the capital and operating expenditure criteria in clauses 6.5.6(c) and 6.5.7(c) of the Rules. As discussed above, we consider that our capital and operating expenditure forecasts in this regulatory proposal fully reflect the capital and operating expenditure criteria.

Table 2 below describes how we believe we have meet each of the expenditure factors under clause 6.5.6(e) and 6.5.7(e).

TABLE 2 MEETING THE EXPENDITURE FACTORS

Clauses 6.5.6(e)(4) and 6.5.7(e)(4) The most recent annual benchmarking report that has been published under rule 6.27 and the benchmark capital expenditure that would be incurred by an efficient Distribution Network Service Provider over the relevant regulatory control period	Our network benchmarks favourably in the AER's most recent Annual Benchmarking Report - Electricity distribution network service providers November 2024 compared to other networks in the NEM. This is reflected in us having amongst the lowest network charges in the NEM despite operating a large rural network. The efficiency of our operating expenditure base year (2024-25) is discussed in Part B of our regulatory proposal.
Clauses 6.5.6(e)(5) and 6.5.7(e)(5) The actual and expected capital (operating) expenditure of the Distribution Network Service Provider during any preceding regulatory control period	We have provided detailed commentary on the differences between our actual and expected expenditure in Part B of our regulatory proposal and our Transparency appendix which respond to clause 4.4.4 of the RIN.
Clauses 6.5.6(e)(5A) and 6.5.7(e)(5A)	Part A of our regulatory proposal discusses in detail how we have addressed the feedback received from customers and stakeholders through our reset engagement program.

The extent to which the capital (operating) expenditure forecasts includes expenditure to address the concerns of electricity consumers as identified by the Distribution Network Service Provider in the course of its engagement with electricity consumers	Part B of the regulatory proposal provides further details on each specific initiative that has arisen in response to customer or stakeholder feedback.
Clauses 6.5.6(e)(6) and 6.5.7(e)(6) The relative prices of operating and capital inputs	We have prepared our operating expenditure forecasts applying the 'revealed costs' methodology using 2024-25 as our base year. The unit costs underlying our operating expenditure forecasts are therefore based on those achieved in 2024-25. This is discussed further in Part B of our regulatory proposal. The unit costs or projects estimates which underpin the capital expenditure forecasts have been developed based on the costs of undertaking similar capital works in the current regulatory period, and/or based on reported RIN data. Our forecast input price changes are discussed in Part B of the Regulatory Proposal. Expert consultants were engaged to forecast the real escalation for each subcategory. The escalators determined by the expert consultants were applied in the development of both capital and operating expenditure forecasts.
Clauses 6.5.6(e)(7) and 6.5.7(e)(7) The substitution possibilities between operating and capital expenditure	All of business cases have considered substitution possibilities in their consideration of solution options. Examples include: • tariff and non-network solutions as a substitute for capital solutions as part of our customer energy resources and electrification strategies • maintenance versus replacement of network assets through our asset management policies and practices supporting our replacement investments • evaluation of cloud-based solutions as an alternative to capital investment in IT system replacements or enhancements.
Clauses 6.5.6(e)(8) and 6.5.7(e)(8) Whether the capital expenditure forecast is consistent with any incentive scheme or schemes that apply to the Distribution Network	Our capital and operating expenditure forecasts are based on delivering network reliability and quality of supply, consistent with the consumer preferences identified through the VCR, VER, VNR and CECV. We also consider our investments consistent with the service target performance incentive scheme (STPIS) which is also based on the VCR.

Service Provider under clauses (6.5.8) 6.5.8A or 6.6.2 to 6.6.4	Our forecast expenditure is consistent with the capital efficiency sharing scheme (CESS) and the efficiency benefits sharing scheme (EBSS) as the proposed expenditure in this regulatory proposal is efficient and prudent, as required by the expenditure criteria. Any additional unforeseen productivity or efficiency gains that potentially arise during the regulatory period will be shared with customers in accordance with the properties of the incentive schemes. Under the demand management incentive scheme (DMIS) we are provided an allowance for investigating innovative technologies that have the potential to defer capital and/or operating expenditure. We have not identified any overlap between the DMIS allowance and our proposed expenditure. Under the CSIS we are provided an incentive for improving performance regarding call answering, speed of SMS communications during an outage and planned outage performance. We have not proposed expenditure to improve these parameters over the next regulatory period.
Clause 6.5.7(e)(9) The extent the capital expenditure forecast is referable to arrangements with a person other than the Distribution Network Service Provider that, in the opinion of the AER, do not reflect arm's length terms	Please refer to the Related Parties appendix which responds to 4.4.2 of the RIN.
Clause 6.5.7(e)(9A) Whether the capital expenditure forecast includes an amount relating to a project that should more appropriately be included as a contingent project under clause 6.6A.1(b)	Please refer to Part B of our regulatory proposal which discusses contingent projects.
Clause 6.5.7(e)(10) The extent the Distribution Network Service Provider has considered, and made provision for, efficient and prudent non-network alternatives	Our regulatory proposal has provision for customer up take of flexible export services and the further automation of our non-network platform (Piclo Flex) to make our network constraints are visible, and actionable, by third parties. These initiatives have allowed us to reduce augmentation investment in the 2026–31 regulatory period compared to what it may have otherwise been. We have published our Demand Side Engagement Strategy (Strategy) which sets out our framework and processes for assessing non-network solutions to address a current or future constraint in the network.

	Consistent with the Strategy, we will continue to examine the relative merits of network, and non-network, alternatives in making investment decisions. Non-network alternatives will be pursued where they provide the best solution in the circumstances to address the identified need.
Clause 6.5.7(e)(11) Any relevant final project assessment report (as defined in clause 5.10.2) published under clause 5.17.4(o), (p), or (s)	Where relevant we have included, in the attachments to the regulatory proposal, all final project assessment reports completed at the time of preparation of this regulatory proposal.
Clause 6.5.7(e)(12) Any other factor the AER considers relevant and which the AER has notified the Distribution Network Service Provider in writing, prior to the submission of its revised regulatory proposal under clause 6.10.3 is a capital expenditure factor	The AER has not advised us of any further expenditure factors at the time of preparing this regulatory proposal.

3.4 Capital expenditure categories

Paragraph 4.4.6(a) of Schedule 1 of the RIN requires a description of capital expenditure key drivers. Table 3 provides the key drivers.

TABLE 3 KEY DRIVERS OF EXPENDITURE

Augmentation	• enabling an efficient level of capacity to support integration of customer energy resources and decarbonisation of the Victorian economy • providing an efficient level of backbone network capacity to support economic growth • modernising the network to support the changing and evolving needs of our customers • delivering more equitable service outcomes for rural and regional communities • meeting the expectations of our customers and stakeholders with respect the energy transmission, reliability, quality of supply and network capacity
Replacement	• safe environment for our customers and workers (including mitigating bushfire risk) • providing a reliable and quality supply of electricity

	• meeting our compliance obligations • delivering a long-term sustainable program of works
Connections	• deliver more connections to power customers' everyday activities • facilitate infrastructure growth • support connection of large loads and generation
Resilience	• respond to the recommendations arising from the Victorian Government sponsored Network Outage Review and Electricity Distribution Network Resilience Review • address strong customer and stakeholder sentiment supporting network and community resilience improvements • tackle the increased severity and frequency of climate driven events on network performance whilst recognising the community's increasing dependence on electricity supply
Information and communications technology	• increase the visibility and experience for customers and market participants wanting access to network data • support the NEM market reform system changes • enhance the visibility of the low voltage network to support network planning, network operation and distribution system operator functionality • refresh core operational system including SAP and billing systems • support the safe, reliable and efficient delivery of network services • maintain delivery of services to customers and meet on-going regulatory obligations • protect our operations from emerging cyber threats
Non-network expenditure	• ensure we continue to have access to an appropriately trained and skilled workforce • maintain compliance with relevant industry practices and standards • enhance workforce diversity • decarbonise our depots and fleets

Paragraph 4.4.6(b) of the RIN requires us to provide an explanation as to how we distinguish between various classes of expenditure. Table 4 provides the relevant explanations.

TABLE 4 DISTINGUISHING BETWEEN EXPENDITURE CLASSES

Greenfield driven and reinforcement driven augmentation capital expenditure	Projects that have been classified as 'greenfield driven' are those where demand has increased due to changes in the use of the land in an area, with all other projects being treated as reinforcement.
Connections expenditure and augmentation capital expenditure	A connection project is one undertaken at the request of a customer. For each project, a customer contribution is calculated in accordance with our published Connection Policy attached to this regulatory proposal. An augmentation project is one initiated by us which would benefit a wider range of customers. Augmentation projects are standard control services hence funded by all customers.
Replacement capital expenditure driven by condition and assets replacements driven by other drivers (e.g. the need for greenfield or reinforcement driven augmentation capital expenditure)	Where an asset is being replaced due to its condition, and is replaced with a modern equivalent asset, this is classified as a replacement project. There are some zone substation projects being driven by asset condition that are classified as augmentation projects where, rather than replace the assets on a like for like basis, the highest benefit option is to decommission the asset(s) and extend high voltage feeders to an adjacent substation. This type of project is classified as a ‘non-demand driven’ augmentation as the assets have not been replaced with 'like for like' modern equivalents.
Any other capital expenditure category or operating expenditure category where there is a reasonable scope for ambiguity in categorisation	Resilience initiatives are those targeted at managing the risks or consequences associated with extreme weather events. This includes any initiatives related to, or in response to, the Victorian Government Network Outage Review or Electricity Distribution Network Resilience Review. Our resilience program excludes asset interventions that would otherwise have been replaced through our forecast replacement programs.

Part B of our regulatory proposal includes descriptions of the key drivers and distinguishing features of each of the capital expenditure categories. Part B of our regulatory proposal also sets out the methodology for forecasting expenditure for each of the capital expenditure categories, including an explanation as to why the methodology used is appropriate.

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