

AER Board presentation: 2016–2020

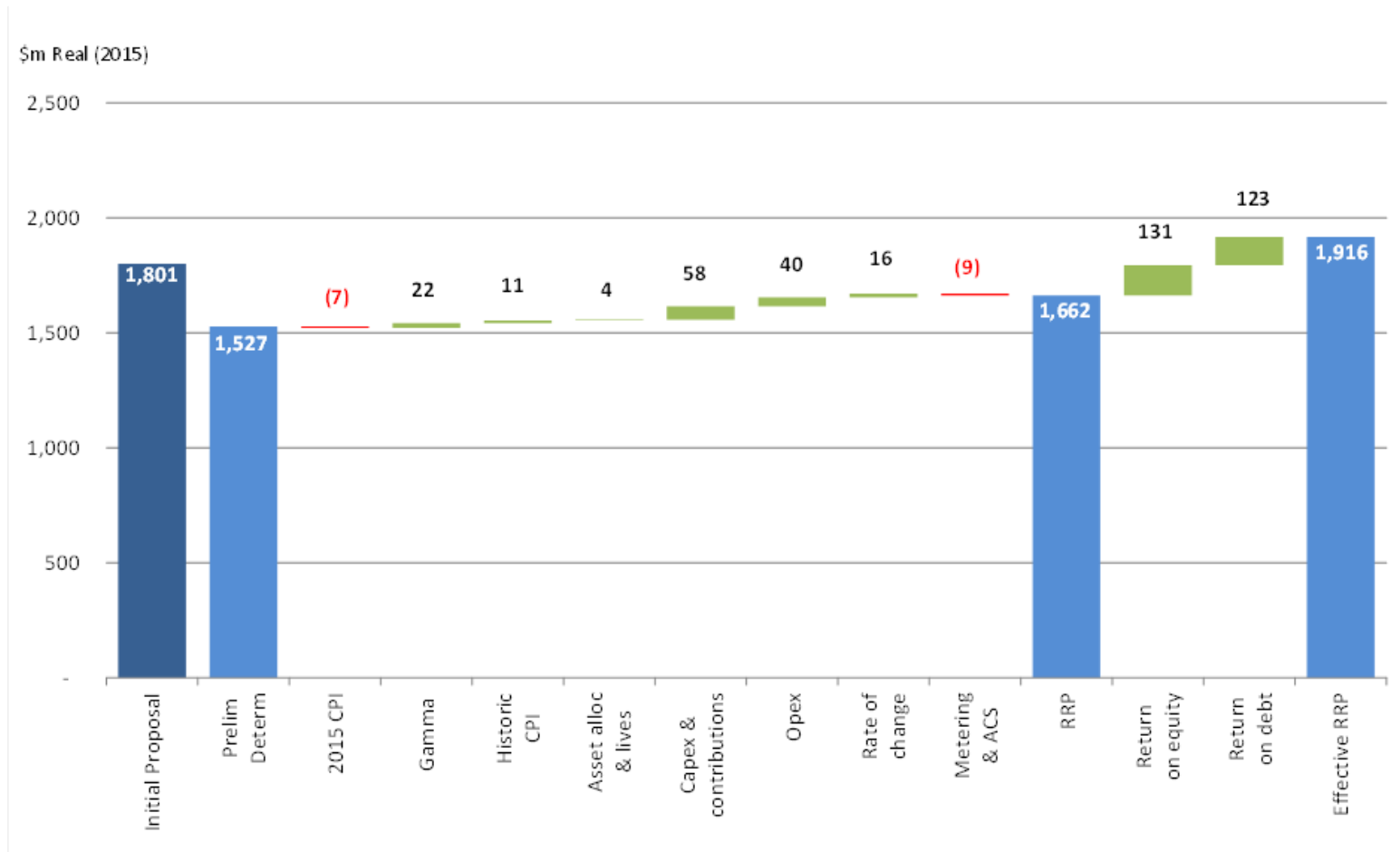
Revised regulatory proposal



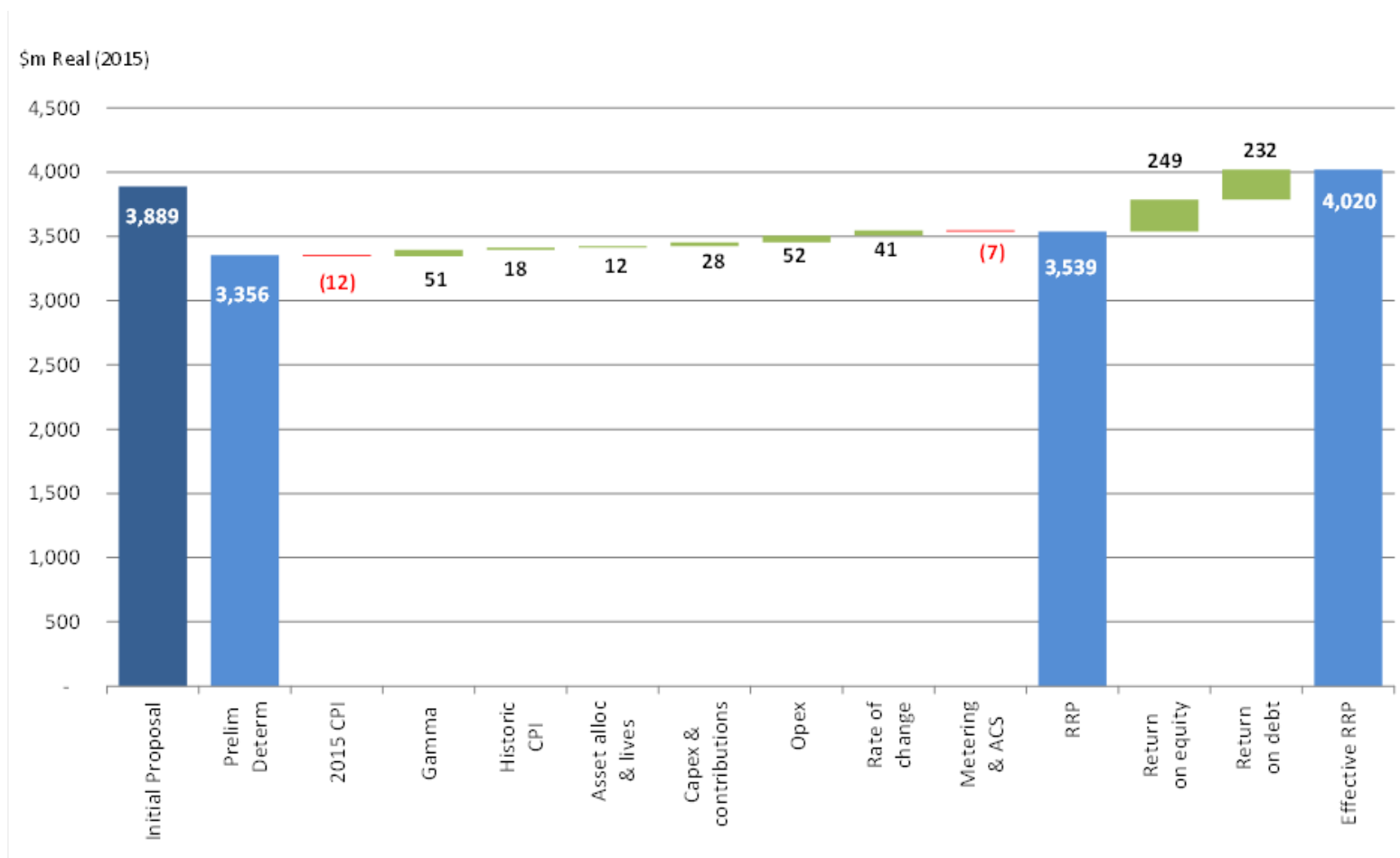
The philosophy

- We recognise the preliminary determination has accepted many elements of our regulatory proposals and has seen merit in the majority of our investment priorities
- We are also pleased the preliminary determination acknowledged the relative efficiency of our businesses
- There are however aspects of the preliminary determination we are uncomfortable with, on the basis we consider the investments involved will deliver strong benefits to our customers in the longer term or are essential for maintaining compliance
- Consequently in preparing our revised regulatory proposals we have sought to:
 - preserve the positive relationship we believe we have developed with AER
 - addressed what we consider to be errors of fact or calculation
 - manage our shareholder expectations with respect to the NSW/ACT/SA appeal outcomes
 - manage any risks posed by further regulatory change
 - manage risk associated with appeals by the Victorian Government or other stakeholders

Revenue difference between preliminary determination and revised proposal (CitiPower)



Revenue difference between preliminary determination and revised proposal (Powercor)



Labour

Our EBAs are efficient

- overall operating expenditure is efficient and this is inclusive of EBA-based labour growth rates
- incentive schemes provide continuous incentives to minimise our costs
- our negotiation process is rigorous but constrained by legislative restrictions and countervailing market power
- we must ensure retention of highly skilled, highly specialised employees
- we ensure efficient use of labour through flexible resource arrangements

Our EBAs cover a broad range of employees and contractors

- we cannot systematically discriminate between employees paid under EBA or not
- employees in roles covered by EBA may choose to opt in or out of the EBA

EBAs are a regulatory obligation

- Tribunal found that NSW distributors are bound by EBAs as a matter of law
- unions can compel negotiation of an EBA, and negotiation is subject to legislative restrictions
- we must abide by EBA outcomes

Allocation of costs from metering to standard control

- We propose reallocating operating costs associated with IT systems required to provide distribution services from metering to standard control services
 - IT systems that are either wholly or primarily used for the provision of standard control services
- These costs must be allocated correctly from 2016 to:
 - avoid metering customers cross-subsidising standard control customers
 - ensure that competition is not impacted by artificially encouraging churn
 - deliver a transparent stand-alone cost of providing meters
 - be consistent with comments of the Victorian Government, recognising that there is no requirement for a nationally consistent approach to allocation of metering costs
 - be consistent with the revenue and pricing principles to promote efficient investment
 - be consistent with the AER's cost allocation guidelines and our approved cost allocation method
- Resolving this through the 2017 ring fencing review is too late as any recommendations will be unable to be implemented prior to the 2021-2025 regulatory control period

Demand

- We support the development of AEMO's demand forecasting methodology
 - AEMO's revised 2015 forecasts are closer to our 2015 forecasts
 - in future AEMO's forecasts may provide a useful comparator to assess our forecasts
- At present, however, AEMO's connection point forecasts are not sufficiently robust to use as a substitute for our forecasts

AEMO's connection point forecasts

- ✗ do not take account of key demand drivers at the connection point level
- ✗ do not take account of local knowledge or engineering expertise
- ✗ simply apportion state-wide growth across distributors and connection points
- ✗ have recently been revised with major impacts for key Powercor locations
- ✗ must be adjusted for Powercor to include direct connect load

Our forecasts

- ✓ reflect current and forecast energy market conditions through historical modelling and post model adjustments, embedded generation & limiting industrial load growth
- ✓ utilise valuable bottom up spatial information, local knowledge and engineering expertise
- ✓ apply a conservative reconciliation process
- ✓ are independently developed by CIE and reviewed by ACIL Allen

Operating expenditure step changes

Updated information on one step change

- Lease renewals: Montague zone substation
 - rezoning is a planning change outside of our control
 - analysis demonstrates that renewing lease is most efficient option

Inclusion of three new step changes in our revised regulatory proposal

- Introduction of cost-reflective tariffs
 - now have a better understanding of required expenditure following development of TSS
 - need to actively promote the benefits of cost-reflective pricing under an opt-in policy
- RIN compliance
 - difference between AER RIN requirements (actual data) and business operation requirements (estimated/aggregated data)
 - operating expenditure component for greater data governance across business
- Introduction of chapter 5A from 1 July 2016
 - additional costs for new requirements regarding non-expedited basic connections

Capital expenditure – CitiPower

We have re-estimated and re-included a number of our capital expenditure projects and programs

- we have provided clarity and further information on our program to augment the network to allow us to decommission the 22kV sub-transmission network ex WMTS
- we have provided further evidence to support our “unmodelled” replacement expenditure, including costs associated with buildings and civil works in the CBD, and compliance with noise regulations
- we have re-estimated our augmentation program based on revised demand forecasts
- we have corrected the AER’s assumptions in relation to customer contributions and errors in relation to CitiPower’s recoverable works allowance
- revised the IT RIN capex project and added costs associated with introducing meter contestability now the Rule change has been passed
- excluded CRM/CIS and smarter networks from 10% discount applied to IT capex consistent with the AER approving these individual projects in full

Capital expenditure – Powercor

We have re-estimated and re-included a number of our capital expenditure projects and programs

- we have re-estimated our augmentation program based on revised demand forecasts, including demonstrating:
 - that establishment of the Torquay zone substation is still required
 - a clear need for a third transformer at the Truganina zone substation
- we have revised our proactive conductor replacement program given proposed Victorian Government bushfire regulations, and reallocated expenditure to unmodelled replacement
- we have clarified why our bi-directional regulator program is needed to promote further connection of embedded generation to our network
- we have corrected an error in the AER's repex model relating to switchgear
- revised the IT RIN capex project and added costs associated with introducing meter contestability now the Rule change has been passed
- excluded CRM/CIS and smarter networks from 10% discount applied to IT capex consistent with the AER approving these individual projects in full

Other matters

- We have sought a private ruling from the Australian Taxation Office (**ATO**) on customer contributions for the Powerline Replacement Fund
- Our smart meter rollout was undertaken efficiently, prudently and in the timeframes set out by the Victorian Government
 - savings achieved through these initiatives are already been passed onto our customers
 - the benefits are reflected in our proposed operating and capital expenditure forecasts
 - our STPIS targets do not need to be adjusted for smart meter benefits
- REFCLs will not be installed until late in the 2016-2020 regulatory control period
 - operation of the REFCLs may result in negative reliability benefits
 - our STPIS targets do not need to be adjusted for the installation of REFCLs