



19 August 2010

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Dear Chris

**VICTORIAN BUSHFIRE ROYAL COMMISSION - IMPLICATIONS OF  
FINAL REPORT FOR THE EDPR**

As you will be aware, on 31 July 2010, the 2009 Victorian Bushfire Royal Commission (**VBRC**) delivered its final report to the Governor of Victoria (**Final Report**), who then presented the Final Report to the Premier who, in turn, tabled it in the Victorian Parliament. On 2 August 2010, the Premier released the Victorian Government's interim response to the Final Report (**Interim Response**).

The Final Report contains a number of findings and recommendations that are directly relevant to all distributors, but particularly rural distributors such as Powercor Australia. These findings and recommendations are pertinent to the 2011-15 Electricity Distribution Price Review (**EDPR**).

CitiPower and Powercor Australia's submission to the Australian Energy Regulator (**AER**) in respect of the VBRC's Final Report and the Interim Response is attached to this letter (**Submission**). The purpose of CitiPower and Powercor Australia's Submission is to highlight to the AER:

- the VBRC's findings and recommendations relevant to CitiPower and Powercor Australia's revised regulatory proposals dated 21 July 2010 (**Revised Regulatory Proposals**),
- implications for the making of the AER's forthcoming final determination (**Final Determination**); and
- provide the AER the relevant sections of the Final Report as they relate to CitiPower and Powercor Australia.

The key points made in the attached Submission include:

- The VBRC concluded, in its Final Report, that the implementation of those of its recommendations relating to electricity-caused bushfires and having direct applicability to Victorian distributors would involve significant cost to distributors.

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- It also concluded that a distributor was unlikely to pursue a safety related expenditure program where the relevant expenditure was not explicitly included in its total expenditure allowance approved by the AER.
- It further concluded that it was, therefore, essential to ensure that the costs of implementing its recommendations be explicitly included in distributors' revenue allowances under the economic regulatory regime.
- To this end, the VBRC recommended a 'trigger event' be established to ensure the explicit inclusion of those costs in distributors' revenue allowances in circumstances where there was uncertainty as to whether this would otherwise occur.
- The Victorian Government's Interim Response supports in principle all but one of the VBRC's recommendations having direct applicability to Victorian distributors and does not rule out the implementation of any of those recommendations.
- Some, at least, of the legal obligations or requirements introduced in response to those VBRC recommendations will not fall within the existing 'regulatory change event' in the Rules and it is uncertain whether the existing 'service standard event' would encompass those obligations and requirements.
- In view of the above, the VBRC's Final Report supports the inclusion, in the AER's Final Determination, of a nominated pass through event for the introduction of regulatory obligations or requirements in response to the VBRC's recommendations.
- The VBRC's Final Report also underlines the need for a nominated pass through for the introduction of new or changed obligations or requirements through the approval of schemes or plans required under the *Electricity Safety Act 1998* (Vic) or the instruments made or issued there under, including in particular a distributor's electricity safety management scheme. This is because the VBRC:
  - contemplated that many of its recommendations would be implemented by the ESV through the exercise of its administrative functions and powers including in particular the approval of these schemes or plans; and
  - in so doing, demonstrated the real likelihood that new or changed obligations or requirements unrelated to the VBRC's Final Report would be imposed on distributors in this manner during the regulatory control period.
- The VBRC's findings in relation to electricity-caused bushfires support the inclusion of expenditure related to Powercor Australia's proposed conductor replacement program in its total expenditure allowance approved by the AER.
- The AER's approach to forecasting replacement capital expenditure using its Repex Model and by reference to historical expenditure is unreasonable having regard to the VBRC's finding that there is an urgent need for the planning and implementation of a replacement program by Victorian distributors with ageing networks (which would include CitiPower and Powercor Australia).

- The VBRC's Final Report also supports the inclusion in Powercor Australia's total approved expenditure allowance of the proposed expenditure for the 'at risk townships' program. In particular:
  - The VBRC concluded that the AER should give explicit consideration to any benefits to the community from the reduction of bushfire risk in assessing expenditure programs proposed by distributors to reduce bushfire risk that were not necessitated by any legal obligation or requirement.
  - Powercor Australia maintains that the prudence limb of the operating expenditure criteria permits, and indeed was intended to ensure, AER consideration of benefits of this kind and, as the AER would be aware, Powercor Australia has advanced evidence of material benefits to the community from the 'at risk townships' program in this process.

CitiPower and Powercor Australia provide under cover of this letter and their Submission:

- the VBRC's media release in respect of its Final Report, the VBRC's recommendations and extracts from the VBRC's Final Report of relevance to the EDPR;
- relevant evidentiary material relied on by the VBRC in support of those of its findings and recommendations that are of relevance to the EDPR; and
- the Victorian Government's Interim Response.

This letter, the Submission and the accompanying attachments are provided to the AER by CitiPower and Powercor Australia pursuant to its current consultation process on its draft determination dated 4 June 2010 (**Draft Determination**) and the revised regulatory proposals of the Victorian distributors lodged in response to that Draft Determination.

Please call me or Brent Cleeve, Manager Price Reviews, should you wish to discuss any aspect of either Revised Regulatory Proposal.

Yours sincerely

**Richard Gross**  
**GENERAL MANAGER REGULATION & BDI**

## Submission on VBRC's Final Report and Victorian Government's Interim Response

### *Overview of VBRC Final Report and Victorian Government's Interim Response*

The Final Report made 7 recommendations that are directly applicable to Victorian distributors (recommendations 27-30 and 32-34) and a small number of other recommendations that have the potential to affect Victorian distributors. The recommendations having direct applicability to Victorian distributors include:

- the progressive replacement of all single-wire earth return (**SWER**) power lines in Victoria and all 22-kilovolt distribution feeders with aerial bundled cable, underground cabling or other technology that delivers greatly reduced bushfire risk (recommendation 27);
- a suite of interim measures aimed at reducing electricity-caused bushfire in the period before such a replacement program is completed (recommendations 28-30, 32 and 33); and
- the amendment of the regulatory framework for electricity safety to strengthen Energy Safe Victoria's (**ESV**) mandate in relation to the prevention and mitigation of electricity-caused bushfires and to require it to fulfil that mandate (recommendation 34),

together referred to as the **Distribution Related Recommendations**.

The interim measures recommended by the VBRC include:

- distributors to be required by the State, *through ESV*, to change their asset inspection standards and procedures to require all SWER lines and all 22-kilovolt feeders in areas of high bushfire risk are inspected at least every three years (recommendation 28);
- distributors to be required by the State, *through ESV*, to review and modify their current practices, standards and procedures for training and auditing of asset inspectors to ensure that registered training organisations provide adequate theoretical and practical training for asset inspectors (recommendation 29);
- the amendment of the regulatory framework for electricity safety to require that distributors adopt, *as part of their management plans*, measures to reduce the risks posed by hazard trees - that is, trees that are outside the clearance zone but that could come into contact with an electric power line having regard to foreseeable local conditions (recommendation 30);
- distributors to be required by the State, *through ESV*, to disable the reclose function on the automatic circuit reclosers on all SWER lines for the six weeks of greatest risk in every fire season and to adjust the reclose function on the automatic circuit reclosers on all 22-kilovolt feeders on all total fire ban days to permit only one reclose attempt before lockout (recommendation 32); and
- distributors to be required by the State, *through ESV*, to fit spreaders to any lines with a history of clashing or the potential to do so and to fit or retrofit all spans that are more than 300 metres long with vibration dampers as soon as is reasonably practicable (recommendation 33).

The Interim Response supports in principle all of the Distribution Related Recommendations made by the VBRC in the Final Report, with the exception only of the progressive replacement program (recommendation 27). The Interim Response contemplates further consultation on this Distribution Related Recommendation and the recommended interim measure regarding reclosers.

The VBRC explicitly considered the cost implications of its Distribution Related Recommendations in its Final Report and concluded that the costs of implementing those Distribution Related Recommendations would be significant. In particular:

- in respect of its recommendations in respect of electricity-caused bushfires (all but one of which, recommendation 31, is a Distribution Related Recommendation), the VBRC:
  - concluded (at 149) that these recommendations were *'framed against the view that there is a serious risk that must be dealt with'* and would *'entail considerable cost'*; and
  - stated (at 158) that *'[c]onsiderable expenditure will be required in order to implement the Commission's recommendations in relation to the electricity industry'*; and
- in respect of its recommended replacement of all SWER lines and all 22-kilovolt distribution feeders, the VBRC:
  - noted (at 154) *'the high cost of replacement'* but stressed *'the potential for tragic consequences if the Victorian Government and distribution businesses do not take decisive action and explore the full range of alternatives'*; and
  - observed (at 158) that *'distribution businesses and the State of Victoria submitted there is a large financial cost associated with any recommendation to replace Victoria's ageing electricity distribution network with technology that delivers a reduced bushfire risk'* but stated that *'[i]n the Commission's view, the cost of not renewing the network could be far greater'*.

The VBRC also gave explicit consideration (in Chapter 4 of Volume II, including but not limited to section 4.5) to the mechanisms available to distributors for the recovery of the costs they incurred in pursuing activities aimed at reducing bushfire risk including those measures recommended by the VBRC. The VBRC considered that if the economic regulatory regime denied funding for distributors for such measures, this may frustrate their implementation.

The VBRC gave explicit consideration (at 156) to the evidence of Chris Pattas, General Manager of Network Regulation South Branch of the AER, to the effect that:

- in a distribution determination the AER approves the total regulated allowances of a distributor and not individual investments or a set of specific investments that may form part of the distributor's proposal;<sup>1</sup> and
- accordingly, the distributor has discretion to spend its allowance as it considers appropriate and, thus, decisions on the expenditure projects pursued

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<sup>1</sup> 2009 Victorian Bushfire Royal Commission, Witness Statement of Chris Pattas, 8 December 2009 (WIT.6004.001.0001) (**Statement of Pattas**) at [17], [30]-[32]; 2009 Victorian Bushfire Royal Commission, Transcript of Proceedings (**Transcript**), Pattas T13413:19-T13414:27.

by the distributor are a matter for the distributor having regard to any existing legal obligations or requirements.<sup>2</sup>

The VBRC summarised this evidence as follows (at 156).

*'If a distribution business wants to make a major investment or replace or modify its infrastructure, it must present to the economic regulator a persuasive case for that investment. The regulator's rejection of an application for funds for any particular proposal does not prevent a distribution business from making the investment: the business has discretion to allocate funds as it sees fit, and safety concerns might lead it to use its discretion to invest in projects not approved by the regulator. [FN: Exhibit 621 - Statement of Pattas (WIT.6004.001.0001) [17]; Pattas T13430:25-T13431:3; Gardner T12252:13-T12252:18, T6834:9-T6834:30]'*

However, the VBRC did not accept this evidence without qualification. It immediately proceeded to conclude (at 156):

*'If, however, the regulator does not approve a particular investment proposal, the distribution business is unlikely to implement it because it can do so only at the expense of the proposals it was able to persuade the regulator were necessary. **For that reason, the fact that distribution businesses do not control their own prices inevitably constrains the extent to which they invest in activities aimed at reducing bushfire risk.**' [Emphasis added]*

As a result, the VBRC concluded that it was essential that the costs of implementing its Distribution Related Recommendations be recoverable by distributors under the economic regulatory regime. In particular, the VBRC concluded (at 158):

*'Considerable expenditure will be required in order to implement the Commission's recommendations in relation to the electricity industry. The necessary revenue is unlikely to be available without an adjustment to the price determination that is now under way. The National Electricity Rules allow for adjustments to a price determination if specific 'trigger events' occur, enabling distribution businesses to seek additional revenue approval from the regulator.*

*Mr Pattas told the Commission that a serious fire causing death and massive destruction would not be a 'trigger event'; nor would a recommendation from the Commission that distribution businesses substantially increase their expenditure.*

*The Commonwealth submitted, however, that a 'trigger event' would be constituted by 'material changes, which either reduce or increase the likely costs to be incurred by the [distribution businesses]' - for example, administrative or regulatory change creating new obligations necessitating additional expenditure. The Commission considers the State should take steps to create a trigger event'.*

The VBRC also made explicit reference to the creation of a 'trigger event' in discussing a number of the specific interim measures it was recommending.

In recommending the creation of a 'trigger event' to ensure the costs of implementing the VBRC's Distribution Related Recommendations would be explicitly allowed in Victorian distributors' revenue allowances, the VBRC would appear to have been

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<sup>2</sup> Statement of Pattas, [30]-[31]; Transcript, Pattas T13420:26-T13421:11, T13429:25-T13430:5.

unaware that the AER has power to create such a 'trigger event' in its Final Determination.

The VBRC also considered that, in assessing whether expenditure programs proposed by distributors to reduce bushfire risk but which are not necessitated by any legal obligation or requirement would be undertaken by a prudent and efficient distributor to meet the opex or capex objectives (as the case may be), the AER should give explicit consideration to any benefits to the community (in terms of avoided loss of life and property) from the reduction of bushfire risk.

The VBRC gave explicit consideration to the evidence of Chris Pattas to the effect that:

- the AER would not take into account community benefits in assessing whether an expenditure program was supported by the relevant cost-benefit analysis;
- the community benefits were policy questions for the State of Victoria;
- any measures to reduce bushfire risk were a matter for the State to require through the distributor's legal obligations or requirements; and
- in the absence of a legal obligation or requirement necessitating safety related expenditure, the AER would not include expenditure related to safety in a distributor's total opex allowance.<sup>3</sup>

The VBRC summarised this evidence as follows (at 157):

*'The Australian Energy Regulator told the Commission it does not approve individual investment proposals, but in determining a distribution business's total allowance for capital expenditure it does consider a cross-section of the more substantial projects proposed against the criteria set out in the National Electricity Rules, which in substance provide that 'A capital expenditure proposal must achieve the capital expenditure objectives of meeting expected demand and a host of regulatory, technical and safety requirements in an "efficient and prudent manner".'* [FN: Exhibit 621 - Statement of Pattas (WIT.6004.001.0001) [29]]

*Mr Pattas told the Commission the AER does not take into account costs that are external to the distribution businesses - such as the costs borne by the community when a bushfire is caused by failed electricity assets. In the Australian Energy Regulator's view, whether such 'external' costs should be taken into account is a question for policy makers. [FN: Pattas T13444:27-T13445:9]'*

The VBRC, however, criticised this approach (at 158) as follows:

*'The AER's failure to factor in the costs to human life and property arising from bushfire as part of its cost-benefit equation means that real and substantial costs to the community imposed by bushfire are left out of the price determination process.*

*The AER, and the Regulations under which it operates, should acknowledge that Victoria is one of the most bushfire prone places in the work and that major bushfires on the worst days are often caused by the failure of electricity assets. Protection of human life must become the priority when evaluating*

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<sup>3</sup> Statement of Pattas at [51]-[53]; Transcript, Pattas T13429:7-T13430:11, T13434:16-T13436:10, T13443:27-T13444:9.

*businesses' expenditure proposals. The economic regulatory regime must include mechanisms for ensuring that safety-related matters are properly reviewed so as to minimise the risk of bushfire being caused by the failure of electrical assets'.*

In addition, the implementation of VBRC recommendations other than the Distribution Related Recommendations have the potential to affect Victorian distributors and the costs they incur in complying with their regulatory obligations. These other recommendations include, for example, recommendations 37, 41 and 43. While these recommendations are not directly applicable to Victorian distributors and do not relate directly to their regulatory obligations, the implementation of those recommendations may result in consequential changes to Victorian distributors' regulatory obligations or the activities required for compliance with those obligations.

CitiPower and Powercor Australia consider below the implications of the VBRC's Distribution Related Recommendations and associated findings, and the Government's interim response, for the AER's Final Determination.

### ***Implications of VBRC's findings and recommendations for AER's Final Determination on pass throughs***

As discussed above, the VBRC has concluded that recovery of the costs incurred by distributors in complying with any legal obligations or requirements introduced in response to the VBRC's Distribution Related Recommendations is essential to ensure that distributors are not constrained in giving effect to those legal obligations or requirements. In view of the VBRC's findings, no reasonable administrative decision-maker standing in the shoes of the AER would make a distribution determination for Victorian distributors that did anything less than unequivocally ensure that those distributors will recover the costs of complying with any such legal obligations or requirements.

The VBRC recommended the creation of a 'trigger event' to ensure the recovery by distributors of the costs of implementing the VBRC's Distribution Related Recommendations. The VBRC made this recommendation because it considered there was uncertainty, on the evidence before it, that the existing 'trigger events', or defined pass through events, established by the Rules would suffice to capture the implementation of those Recommendations.

Powercor Australia is one of the Victorian distributors that will incur significant costs if (as is currently proposed in the Government's Interim Response) some or all of the VBRC's Distribution Related Recommendations are implemented. Neither the costs associated with implementation of the VBRC's recommended replacement program nor the costs associated with its recommended interim measures were provided for in Powercor Australia's Revised Regulatory Proposal.

Powercor Australia maintains that there is uncertainty as to whether all legal obligations and requirements introduced in response to the VBRC's Distribution Related Recommendations would fall within the existing defined pass through events the AER concluded in its Draft Determination (at 708-9) were potentially applicable, namely the 'regulatory change event' and 'service standard event' defined in the existing Rules.

The existing 'regulatory change event' is defined in Chapter 10 of the Rules to mean '[a] change in a regulatory obligation or requirement' that '*substantially affects the manner in which the ... Distribution Network Service Provider provides direct control services*' and '*materially increases or materially decreases the costs of providing those*



*services*'. The term 'regulatory obligation or requirement' is defined in s2D of the NEL, with the effect that the term does not have its ordinary and natural meaning but instead is confined to an obligation or requirement under an Act of a participating jurisdiction or an instrument made or issued under or for the purposes of that Act. That is, the term 'regulatory obligation or requirement' would not necessarily capture all of a distributor's legal obligations or requirements, just those that are imposed by an Act or an instrument made or issued under such an Act.

In his evidence before the VBRC, Chris Pattas identified the 'regulatory change event' as the existing 'trigger event', or pass through event, of potential applicability to the introduction of legal obligations or requirements in response to the VBRC's recommendations.<sup>4</sup> In particular, the following exchange occurred between Mr Rush and Chris Pattas during the latter's oral examination before the VBRC:<sup>5</sup>

*[Mr Rush] For example, if there were government regulation or if there was a recommendation from the Royal Commission in relation to some aspect of electricity safety, undergrounding, aerial bundled cable, and that recommendation was taken up by government, what is the mechanism then by which that capital expenditure that is necessary is reviewed by the AER? --- [Mr Pattas] A change to an obligation of that kind would mean that the business - we are taking the scenario here that this is after a determination has been finalised and we are in a five year regulatory period. **That change to the obligation will typically trigger what is loosely called a regulatory change event in the determination trigger mechanisms.** We call these provisions pass through provisions. The business would then go to the regulator and say, "We now have a new obligation and we need to spend additional amount throughout this period or the remainder of this period. We therefore want an adjustment made to our total revenue allowance." So the AER would look at that as a pass through. If it is satisfied that that is the required expenditure to meet that new obligation, then the regulator would approve an adjustment to the revenue allowance of the business.' [Emphasis added]*

However, Powercor Australia maintains that at least some of the new legal obligations or requirements imposed on Victorian distributors in response to the VBRC's Distribution Related Recommendations will not be captured by the existing 'regulatory change event'. It does not accept that the imposition of such a legal obligation or requirement will 'typically' trigger a 'regulatory change event' as asserted by Chris Pattas before the VBRC.

It is unlikely that all of the legal obligations and requirements introduced in response to the VBRC's Distribution Related Recommendations would fall within the existing 'regulatory change event' for two reasons as follows:

- first, in the Draft Determination (at 708-9), the AER concluded that a 'regulatory change event' *'is restricted to changes in existing regulatory obligations'* and does not encompass the removal or imposition of a new regulatory obligation or requirement and, if (contrary to the submissions advanced by CitiPower in its Revised Regulatory Proposal (at 408-9) and Powercor Australia in its Revised Regulatory Proposal (at 405-7)) the AER maintains this view this will likely have the consequence that one or more of

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<sup>4</sup> Statement of Pattas at [24]-[26]; Transcript, Pattas T13427:4-T13429:6.

<sup>5</sup> Transcript, Pattas T13427:14-T13428:4.

the legal obligations or requirements introduced in response to the VBRC's Distribution Related Recommendations do not fall within the definition of a 'regulatory change event'; and

- secondly, the VBRC's Final Report contemplates that most of its Distribution Related Recommendations will be implemented by the ESV by means of the exercise of its functions or powers but a 'regulatory change event' is restricted to regulatory obligations or requirements under an Act or instrument made or issued under such an Act, and does not encompass legal obligations or requirements imposed by an administrative act or decision, such as the acts or decisions of ESV.

The VBRC contemplated, in its Final Report, that its interim measures would be effected by ESV through the exercise of its functions and powers (both existing and those conferred in response to the VBRC's recommendations), including those with respect to the assessment and approval of the various management plans contemplated by the Electricity Safety Act 1998 (Vic). This is evident from the wording of the VBRC's Distribution Related Recommendations relating to these interim measures and from the recommended strengthening of ESV's mandate.

Of the Distribution Related Recommendations (recommendations 27-30 and 32-34), the wording of all but one indicates that the implementation of the Recommendation should be by means of the exercise of Energy Safe Victoria's (ESV) functions and powers (including enhanced powers recommended by the VBRC), including through the exercise of its power to assess and approve management plans such as Electricity Safety Management Schemes (ESMS), Vegetation Management Plans (VMP) or Bushfire Mitigations Plans (BMP). Consider, in particular, the words '*[t]he State (through Energy Safe Victoria)*' that appear in recommendations 28, 29, 32 and 33, the reference to the imposition of requirements '*as part of management plans*' in recommendation 30 and the broadening of the ESV's mandate in relation to the prevention and mitigation of electricity-caused bushfires recommended in recommendation 34. In short, the VBRC contemplated that most of the additional legal obligations and requirements imposed in response to its Distribution Related Recommendations would be imposed by administrative acts or decisions rather than by an Act or an instrument made or issued thereunder and so would not fall within the Rules' definition of a 'regulatory change event'.

In its Draft Determination, after concluding that a 'regulatory change event' does not encompass the removal of, or the imposition of new, regulatory obligations or requirements, the AER observed (at 709) that '*the NER definition of 'service standard event' appears to capture the removal of existing, or imposition of new, regulatory obligations beyond those obligations that might ordinarily be considered a 'service standard'*'. However, as suggested by the AER's use of language (i.e. '*appears to capture*'), Powercor Australia considers there is uncertainty as to whether regulatory obligations or requirements beyond those that might ordinarily be considered a 'service standard' would fall within the Rules' definition of 'service standard event'.

'Service standard event' is defined in the Rules to mean a legislative or administrative act or decision that has the effect of:

- substantially varying, during the regulatory control period, the manner in which the distributor is required to provide a direct control service;
- imposing, removing or varying, during the regulatory control period, minimum service standards applicable to direct control services; or

- altering, during the regulatory control period, the nature or scope of direct control services provided by the distributor,

and materially increases or decreases the costs to the distributor of providing direct control services.

Powercor Australia is concerned that the term 'service standard event' may be construed as restricted to the removal of or imposition of new or changed regulatory obligations or requirements that are service standards. This is because:

- regard may properly be had to the dictionary meaning of the phrase 'service standard' in the defined term in construing the definition of that term;<sup>6</sup> and
- in construing the term 'service standard event' and its definition, the definition must be read as a whole and in its context, which may, in turn, necessitate a consideration of:
  - the second limb of that definition, which refers to imposing, removing or varying 'minimum service standards'; and
  - the NEL definition of the term 'distribution service standard', which term is used in defining the term 'regulatory obligation or requirement' in s2D of the NEL, forms part of the context in which the definition of 'service standard event' is read and construed. The term 'distribution service standard' is defined in s2 of the NEL to mean '*a standard relating to the standard of services provided by a regulated distribution system operator by means of, or in connection with, a distribution system...*'.

This suggests that the term 'service standard event' may be construed as being restricted to the removal of or imposition of new or changed regulatory obligations or requirements that are service standards.

Powercor Australia does not express a concluded view on the preferred construction of the existing 'service standard event' definition because this is not necessary for present purposes. In view of the VBRC's findings, the existence of uncertainty suffices to warrant the creation of a 'trigger event', namely a nominated pass through, for the introduction of any legal obligations or requirements in response to the VBRC's Distribution Related Recommendations.

Powercor Australia's Revised Regulatory Proposal sought nominated pass through events for both the introduction of regulatory obligations or requirements in response to the VBRC's recommendations and the imposition of regulatory obligations or requirements by ESV through Powercor Australia's approved ESMS. CitiPower's Revised Regulatory Proposal also sought a nominated pass through event in respect of its approved ESMS.

The VBRC's Distribution Related Recommendations and associated findings underline the need for both a VBRC nominated pass through event and an ESMS related nominated event.

The VBRC's Final Report supports the arguments contained in section 17.5.1.3 of Powercor Australia's Revised Regulatory Proposal in support of a nominated pass

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<sup>6</sup> There is authority that while the dictionary meaning of a defined term is notionally displaced by the act of defining the term, the dictionary meaning is likely to have an influence on the court's view of the term's meaning (*Manly Council v Malouf t/as Fusion Point* (2004) 61 NSWLR 394 at 396-7).

through event for the introduction of regulatory obligations or requirements in response to the VBRC's recommendations because:

- the VBRC concluded that the implementation of its Distribution Related Recommendations would involve significant cost to distributors;
- it also concluded that it was essential to ensure that those costs be explicitly included in distributors' revenue allowances under the economic regulatory regime;
- the VBRC recommended a 'trigger event' be established to ensure the explicit inclusion of those costs in distributors' revenue allowances in circumstances where there was uncertainty as to whether this would otherwise occur;
- the Victorian Government supports in principle all but one of the VBRC's Distribution Related Recommendations and has not ruled out the implementation of any of those Recommendations; and
- for the reasons discussed above, Powercor Australia maintains that the existing 'regulatory change event' will not encompass some, at least, of the regulatory obligations and requirements introduced in response to the VBRC's Distribution Related Recommendations and it is uncertain whether the existing 'service standard event' would encompass those obligations and requirements.

The definition of a VBRC nominated pass through event should be drafted to capture, with certainty, any costs resulting from regulatory obligations or requirements introduced in response to the VBRC's Distribution Related Recommendations, including those imposed through the exercise by the ESV of its administrative functions and powers. It is essential that the VBRC nominated pass through event be drafted to include obligations or requirements imposed by the ESV through the exercise of its administrative functions and powers, given that the VBRC contemplated that many of its Distribution Related Recommendations will be implemented in this manner and these obligations and requirements will not be captured by the existing 'regulatory change event'. Powercor Australia proposes that the following definition for the VBRC nominated pass through event be adopted in the AER's Final Determination:

**A VBRC response event** means a legislative or administrative act or decision occurring during the regulatory control period in response to the findings and/or recommendations of the 2009 Victorian Bushfires Royal Commission set out in its final report dated 31 July 2010 that has the effect of imposing a new or changed obligation or requirement on a Victorian distribution network service provider including without limitation by means of a change to legislation, regulations, guidelines, policies, procedures or approved management schemes or plans required under the Electricity Safety Act, or an instrument made or issued under that Act, as amended from time to time.

In light of the VBRC's findings and recommendations regarding cost recovery by distributors, Powercor Australia requests that, if the AER's proposed definition of the VBRC nominated pass through event departs from the above, the AER circulate for comment prior to its Final Determination its proposed drafting for the definition of any VBRC nominated pass through event.

The VBRC's findings in its Final Report also support the arguments contained in section 17.5.1.6 of Powercor Australia's Revised Regulatory Proposal and section 17.5.1.5 of CitiPower's Revised Regulatory Proposal in support of an ESMS related

nominated pass through event. As discussed above, the definition of the VBRC nominated pass through event should be drafted to capture any costs resulting from regulatory obligations or requirements introduced in response to the VBRC's Distribution Related Recommendations, including those imposed through the exercise by the ESV of its administrative functions and powers. Nonetheless, the emphasis placed by the VBRC on the implementation of those obligations and requirements through the exercise by the ESV of its administrative functions and powers, including through its approval of an ESMS, VMP and BMP, demonstrates that during the regulatory control period additional obligations and requirements (including those unrelated to the VBRC's Final Report) are likely to be imposed on Victorian distributors through the approval of their respective ESMS, VMP and/or BMP. As discussed above, the existing 'regulatory change event' will not encompass the imposition of obligations and requirements through such an exercise of administrative power and it is uncertain whether the existing 'service standard event' would encompass obligations and requirements imposed through the approval of an ESMS, VMP and/or BMP.

Accordingly, the VBRC's findings and resultant Distribution Related Recommendations underline the need for a discrete ESMS nominated pass through event. In so doing, however, they also underline the need for this pass through event to cover VMPs and BMPs.

CitiPower and Powercor Australia observe that the *Energy and Resources Legislation Amendment Bill 2010* (Vic) proposes to amend the *Electricity Safety Act 1998* (Vic) to require preparation and acceptance of bushfire mitigation plans (in addition to those already prepared in accordance with existing section 83A of the Act) for electricity companies' at risk supply networks, being a supply network or part thereof that is above the surface of land and in a hazardous bushfire risk area.<sup>7</sup> Accordingly, the relevant nominated pass through event should also cover any additional management plans or schemes required under the *Electricity Safety Act 1998* (Vic), or an instrument made or issued under that Act, as amended from time to time.

CitiPower and Powercor Australia have revisited the proposed definition of the ESMS nominated pass through event set out in their Revised Regulatory Proposals (at 413) in light of the VBRC's Final Report and now propose that the relevant pass through event should instead be defined as follows:

**A management scheme or plan event** means the imposition during the regulatory control period of any new or changed obligation or requirement in a management scheme or plan required under the Electricity Safety Act, or an instrument made or issued under that Act, as amended from time to time which imposition is necessary to obtain ESV acceptance or approval of that scheme or plan, including without limitation:

- (a) the imposition by ESV of conditions or limitations under s103 of the Electricity Safety Act in respect of the design, construction, operation, maintenance or decommissioning of the supply network on its provisional acceptance of an electricity safety management scheme under section 103 of the Electricity Safety Act;
- (b) the modification of a proposed electricity safety management scheme in accordance with section 104 of the Electricity Safety Act to include an

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<sup>7</sup> See proposed new sections 98AA and 113C of the *Electricity Safety Act 1998* (Vic).

obligation or requirement necessary to address a reason or reasons for the non-acceptance by the ESV of the scheme;

- (c) the imposition by ESV of an obligation or requirement on the ESV's determination of an electricity safety management scheme under section 105 of the Electricity Safety Act;
- (d) the revision of an electricity safety management scheme under section 109 to include an obligation or requirement necessary to address one or more of the matters ESV required the revision to address under section 109(2)(b) of the Electricity Safety Act;
- (e) the amendment of a proposed management plan relating to compliance with the *Electricity Safety (Electric Line Clearance) Regulations 2010* (Vic) to include an obligation or requirement necessary to address one or more of the reasons that ESV required the preparation of an amended plan in accordance with r9(7) of those Regulations; and
- (f) the imposition of an obligation or requirement in a bushfire mitigation plan which imposition is necessary to obtain ESV approval of that plan in accordance with section 83A of the Electricity Safety Act.

***Implications of VBRC's findings and recommendations for AER's Final Determination on capital expenditure programs***

Section 9.9.3.3 of Powercor Australia's Revised Regulatory Proposal (at 281-3) sets out its arguments for its conductor replacement program. This is further supported by an independent review by PB Associates of the risk associated with its overhead conductor assets and an assessment of the effective and efficient level of investment to mitigate this risk over an extended planning horizon (see Attachment 252 to the Powercor Australia Revised Regulatory Proposal).

In particular, as discussed in the Revised Regulatory Proposal (at 281), PB Associates identified an existing risk in terms of the likelihood and consequences of conductor failures and an increasing risk to Powercor Australia's network and the health and safety of communities due to an ageing conductor population.<sup>8</sup> As a result, PB Associates concluded that it is prudent and efficient to reduce the risk associated with conductor failures over the next 15 years and considered it prudent that Powercor Australia increase the level of conductor replacement.<sup>9</sup>

The VBRC's Final Report supports the need for a proactive conductor replacement program. The VBRC states (at 151)

*'Professor Hastings noted that the increasing proportion of assets in Powercor's network at or beyond regulatory life and told the Commission that in his opinion this would lead to a substantial increase in failure rates for electrical assets. Professor Hastings' opinion is supported by the SKM report, which pointed to a probable gradual trend from random failure to common failure as a consequence of aging assets. The Commission accepts Professor Hastings' evidence'.*

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<sup>8</sup> PB Associates, Overhead conductor replacement investment strategy, May 2010 (Attachment 252 to Powercor Australia's Revised Regulatory Proposal), at 1 & 48.

<sup>9</sup> PB Associates, Overhead conductor replacement investment strategy, May 2010 (Attachment 252 to Powercor Australia's Revised Regulatory Proposal), at 48-9.

CitiPower and Powercor Australia also note that the VBRC observed, in the Final Report (at 151), that the evidence before it was to the effect that the existing regime for the economic regulation of distributors:

- constrains their ability to respond to an ageing network; and
- *'favours the status quo' and 'makes it difficult to bring about step change reform'*.

However, the VBRC went on to conclude (at 151), in respect of the replacement of ageing assets, that *'now is the time for a major change and a start in planning for the replacement of ageing infrastructure'*.

As discussed at the outset, the VBRC also recognised (at 156) that, whilst the AER's failure to include funds for any particular proposal in a distributor's total expenditure allowance does not prevent a distributor from making that investment, if the AER does not include the expenditure required for a particular investment proposal in the total approved expenditure allowance, the distributor is unlikely to implement the proposal because it can only do so at the expense of the proposals it was able to persuade the AER were necessary and in respect of which the AER included expenditure in the total approved expenditure allowance.

These comments are particularly pertinent to replacement capital expenditure. As discussed in CitiPower and Powercor Australia's Revised Regulatory Proposals (at 9.9.3), the AER adopted an approach that adopts a 'black box' model that is calibrated to produce expenditure forecasts for the period 2011-15 identical as those for 2006-08, plus a modest allowance for ageing. This equates to the adoption of a 'revealed costs' approach to forecasting replacement expenditure which, having regard to the ageing of CitiPower and Powercor's network assets<sup>10</sup>, is not a reasonable basis on which to prepare forecasts for replacement capital expenditure for 2011-15 that meet the capital expenditure criteria. The approach preserves the 'status quo' and, in so doing, is inconsistent with the VBRC's conclusions regarding the imperative for step change reform in the replacement of ageing assets and associated capital expenditure.

#### ***Implications of VBRC's findings and recommendations for AER's Final Determination on Powercor Australia's 'at risk townships' step change***

As the AER is aware, in its initial regulatory proposal dated 30 November 2009, Powercor Australia proposed a \$22 million (\$2010) step change to undertake prudent measures to reduce the fire risk posed by its distribution assets in areas identified in the Victorian Government's 'at risk townships' protection plan initiative. The anticipated benefits of the program are to reduce, as far as practicable, the risk of fires caused by asset failure or vegetation impacting on power lines.

The AER rejected this step change in its Draft Determination (in Appendix L at 232) on the grounds that:

- The Government's 'at risk townships' protection plan initiative did not impose a legal obligation on Powercor Australia to undertake specific fire mitigation strategies;

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<sup>10</sup> SKM, Review of AER Draft Decision - Opex Scale Escalation for CitiPower and Powercor Australia, 8 July 2010 (Attachment 133 to CitiPower and Powercor Australia's Revised Regulatory Proposals); SKM, Impact of ageing assets on Powercor operating costs, 8 July 2010 (Attachment 138 to Powercor Australia's Revised Regulatory Proposal); SKM, Impact of ageing assets on CitiPower operating costs, 8 July 2010 (Attachment 138 to CitiPower's Revised Regulatory Proposal).

- Powercor Australia could choose to self-finance its 'at risk townships' program; and
- Powercor Australia's proposal pre-empted the VBRC's Final Report. In so doing, the AER contemplated:
  - only the funding of the VBRC's relevant recommendations and then only to the extent that the Victorian Government imposed a legal obligation or requirement on Victorian distributors in response to those recommendations; and
  - any funding being provided through the existing pass through events defined in the Rules.

The AER's position in the Draft Determination is not sustainable in light of the VBRC's Final Report. Addressing each of the AER's grounds for rejection of the 'at risk townships' step change in turn:

- As discussed at the outset, the VBRC expressly stated that the AER should give explicit consideration to any benefits to the community from the reduction of bushfire risk in assessing expenditure programs proposed by distributors to reduce bushfire risk that were not necessitated by any legal obligation or requirement. As discussed in Powercor Australia's Revised Regulatory Proposal (at 188), the absence of any legal obligation mandating the 'at risks township' program is not a basis for rejecting this expenditure program. The expenditure program can only be rejected after a proper consideration of the community benefits of that program (as identified in the Revised Regulatory Proposal (at 189-90) and supporting attachments).
- As also discussed at the outset, the VBRC concluded that the AER's failure to include expenditure for programs justified by such community benefits in a distributor's total opex allowance would compromise the pursuit of such programs.
- The VBRC's Final Report has now been released and, in it, the VBRC explicitly conveyed that the funding of bushfire mitigation activities should not be confined by reference to its recommendations, those of its recommendations implemented by the Government or activities mandated by a distributor's legal obligations more generally. As already discussed, the VBRC recommended that the AER take into account community benefits in assessing the costs and benefits of expenditure programs proposed by a distributor and observed that a failure to do so would mean *'that real and substantial costs to the community imposed by bushfire are left out of the price determination process'*.

Powercor Australia observes that the existing provisions of the Rules provide the AER with power to consider community benefits from the reduction of bushfire risk in assessing expenditure programs not necessitated by legal obligations. This is the intent of the express requirement in clause 6.5.6(c)(2) of the Rules for the AER to consider the costs that a *prudent* operator in the circumstances of the relevant distributor would incur in, amongst other operating expenditure objectives, maintaining the safety of the distribution system.

In view of the VBRC's findings, any reasonable decision-maker standing in the shoes of the AER would include funding for Powercor Australia's 'at risk townships' program in its total opex allowance.



An analogy can be validly drawn between Powercor Australia's proposed 'at risk townships' program and its undergrounding program proposed before the Essential Services Commission of Victoria (ESCV) in the 2006-10 price review, as well as between the AER's rejection of the 'at risk townships' program in its Draft Determination and the ESCV's rejection of that underground program.

The Final Report gives a resounding endorsement (at 156-7) of the 'compelling submissions' put before the ESCV by Powercor Australia at the last price review in support of undergrounding of lines. In particular, based on the VBRC's consideration of Powercor Australia's proposed undergrounding program and its consideration by the ESCV (at 156-7), the following analogies can be drawn:

- evidence to the effect that the economic benefits are material accompanied the proposal of the undergrounding program and now accompanies the proposal of the 'at risk townships' program (see, in particular, the Revised Regulatory Proposal at 188-90 and the supporting material there discussed);
- in both instances, however, the benefits are, by nature, difficult to quantify;
- in both instances, the programs are consistent with community expectations and concerns; and
- just as the AER suggested the self-financing of the 'at risk townships' program, which would appear to be a reference to the efficiency benefit sharing scheme, the ESCV rejected the underground program, in part, because it considered '[t]he regulatory framework's incentive-based nature would ensure undergrounding where the benefits outweigh the costs'.

The parallels in the submissions made before the ESCV in support of undergrounding and those made before the AER in support of the 'at risk townships' program are compelling, as the ESCV and the AER's reasons for rejecting the claimed expenditure (e.g. a failure to quantify the benefits and the incentive scheme ensuring that the expenditure occurred where the benefits outweighed the costs) are identical.

The VBRC's conclusions in respect of the ESCV's rejection of the undergrounding proposal are equally applicable to the AER's reasons for rejection of the 'at risk townships' step change (at 157):

*'The ESC's assertion that undergrounding costs should be paid by the customer ignores the fact that many of the benefits of undergrounding – in particular, the reduction in bushfire risk – accrue to the entire community. The ESC's approach also ignores the fact that those benefits, including the saving of lives, are less amenable to measurement in financial terms. Accordingly, the ESC's argument that distributors would use underground cabling where the overall benefits outweighed the costs is flawed.'*

### ***List of attached documents***

CitiPower and Powercor Australia have included as attachments to this Submission the following materials for the AER's consideration:

1. VBRC media release, *Final Report Released*, 31 July 2010 (available at [www.royalcommission.gov.au](http://www.royalcommission.gov.au));
2. VBRC, *Final Report Recommendations* (available at [www.royalcommission.gov.au](http://www.royalcommission.gov.au));

3. VBRC, Final Report, Summary;
4. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Introduction;
5. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Part One, The January- February 2009 Fires - Overview;
6. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Part One, Chapter 5 The Kilmore East Fire;
7. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Part One, Chapter 6 The Horsham Fire;
8. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Part One, Chapter 7 The Coleraine Fire;
9. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Part One, Chapter 8 The Pomborneit Weerite Fire;
10. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Part One, Chapter 11 The Redersdale Fire;
11. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Part One, Chapter 13 The Bendigo Fire;
12. VBRC, Final Report, Volume 1 The Fires and Fire Related Deaths, Part One, Chapter 15 Conclusions;
13. VBRC, Final Report, Volume 1, Appendix A, Estimated Costs of the Fires;
14. VBRC, Final Report, Volume 1, Appendix C, Fire in Victoria: A summary;
15. VBRC, Final Report, Volume 1, Appendix D, Elements of a Bushfire.
16. VBRC, Final Report, Volume 2 Fire Preparation, Response and Recovery, Chapter 4 Electricity-Caused Fire;
17. 2009 Victorian Bushfire Royal Commission, *Witness Statement of Chris Pattas*, 8 December 2009 (WIT.6004.001.0001);
18. Extract from 2009 Victorian Bushfire Royal Commission, Transcript of Proceedings for 15 December 2009 containing examination and cross-examination of Chris Pattas;
19. 2009 Victoria Bushfire Royal Commission, *Witness Statement of Shane Breheny*, 1 September 2009 (RMS 3000221);
20. 2009 Victoria Bushfire Royal Commission, *Witness Statement of Vince Power*, 1 September 2009 (RMS 3000221); and
21. Victorian Premier media release, *Premier releases interim response to Bushfires Royal Commission Report*, 2 August 2010.