



## Minister for Energy and Resources

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Our Ref:

Dear Mr Pattas,

### **RE: SUBMISSION ON THE VICTORIAN ELECTRICITY DISTRIBUTION NETWORK SERVICE PROVIDERS' REGULATORY PROPOSALS FOR 2011-15**

The Victorian Government welcomes the opportunity to provide a submission on the Victorian electricity distribution network service providers' regulatory proposals for 2011-15.

The revenue determination for the Victorian electricity distributors by the Australian Energy Regulator (AER) marks an important milestone in the transition of responsibilities from the Essential Services Commission (ESC) to the AER.

The AER must ensure that this determination protects the interests of Victoria's 2.5 million customers, as required by the National Electricity Objective. Because electricity distribution is provided by the private sector, Victorians rely on efficient and effective regulation to ensure they are paying the right amount for the appropriate level of service. This review is of critical importance given that nearly 50 per cent of customers' electricity bills are for distribution services.

This revenue determination is being made during a challenging period with a changing energy supply mix, ageing infrastructure, increasing frequency in extreme events, increasing take up of energy efficiency initiatives and uncertainty in global financial markets. Within this challenging environment, the AER must ensure that it strikes the right balance between the viability of the privatised electricity distributors and the interests of Victorian electricity customers.

#### **Process**

In making its decision, the AER must have regard to submissions received. However, the AER must be mindful that the ability for interested stakeholders, particularly those representing customers' interests, to make informed submissions is limited by the size of the regulatory proposals.



I am concerned that there has been a lack of effective consultation with stakeholders representing customer interests to date, and ask the AER to redress this issue as soon as possible.

### **Demand, Capital Expenditure and Operating Expenditure forecasts**

Historically the electricity distributors have earned materially higher revenues than forecast in the price determination. It is important that the AER is mindful of this when making its determination.

In the last price determination, the ESC noted the challenge of reconciling the "seemingly inconsistent combination of historical expenditure requirements and projected expenditure". Despite the ESC adopting a capital expenditure allowance for 2006-10 that was less than the distributors' proposals and less than that recommended by its expenditure consultant, the electricity distributors have continued to underspend relative to the forecasts.

The size of the capital works programs being proposed by the electricity distributors, in light of historical trends, is a major concern for the government and the value of all capital allowed by the AER must be subject to rigorous assessment to test if it is delivering value to *Victorian consumers*.

As with the capital expenditure proposals, the AER will need to rigorously assess the operating expenditure proposals and also consider the ability of the smart meter rollout to realise efficiencies in their operations.

### **Smart Meters**

The smart meter rollout is well underway in Victoria and is progressing well. This world-leading project will transform the way our electricity distributors provide services to Victorian families.

The Chair of the AER, Mr Steve Edwell, has previously indicated that, in relation to smart meters, "the AER will be vigilant in ensuring that the savings are passed back to customers via lower future electricity tariffs". The Victorian Government believes this is fundamental in ensuring the rollout is a success for Victorian customers.

The AER must be able to collect, analyse and meaningfully report reliable, consistent and robust financial and non-financial information on the performance of the electricity distributors.

In particular the AER must measure and monitor all costs, avoided costs and benefits, both operating and capital that come from the smart meter rollout.

The AER must ensure that smart meter benefits are passed back to customers to enable Victorian families to get value for money from the rollout.

The smart meter rollout will enable the widespread use of time of use (TOU) pricing for the first time. The AER must ensure that:

- Proper processes are in place to enable a smooth transition to TOU tariffs.



- There is not an increase in revenue due to the introduction of TOU pricing. Victorian families have a right to expect that electricity distributors will not be able to increase revenue simply by introducing TOU network tariffs. Revenue neutrality must be a cornerstone of the AER's approach.

TOU tariffs are designed to reduce demand at peak periods. With the rollout due to finish by the end of 2013, the Government expects that the electricity distributors' peak demand forecasts and resultant capital expenditure requirements will be significantly reduced in the latter years of the regulatory period.

I will also be writing to the AER separately regarding more immediate TOU network tariff issues.

### **Service standards and the service incentive mechanism**

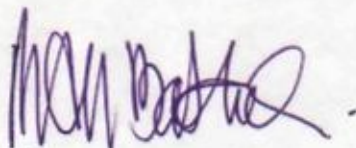
In making this determination the AER must develop appropriate service standards and incentives that ensure the service Victorian consumers receive from their distributors is commensurate with the charges they pay.

### **Conclusion**

Given the importance of preserving and improving the value to Victorian electricity customers of the previous price determinations, I have asked the Department of Primary Industries to advise me regularly of progress with this determination, and in particular any assistance the Victorian Government is able to provide that would assist AER. I trust the AER will develop a determination which ensures Victorian electricity customers continue to benefit from efficient, reliable, safe and secure distribution services.

Attached is a more detailed submission exploring the issues raised in this letter. Should you have any queries in relation to this submission, please do not hesitate to contact Peter Naughton, Acting Executive Director, Energy Sector Development in the Department of Primary Industries on telephone (03) 9658 4924 or by email on [peter.naughton@dpi.vic.gov.au](mailto:peter.naughton@dpi.vic.gov.au)

Yours sincerely



**Peter Batchelor MP**

10/2/2010



## Submission on the Victorian electricity distribution network service providers' regulatory proposals for 2011-15

Attachment to letter dated 10 February 2010 from Peter Batchelor MP, Minister for Energy and Resources, Victoria

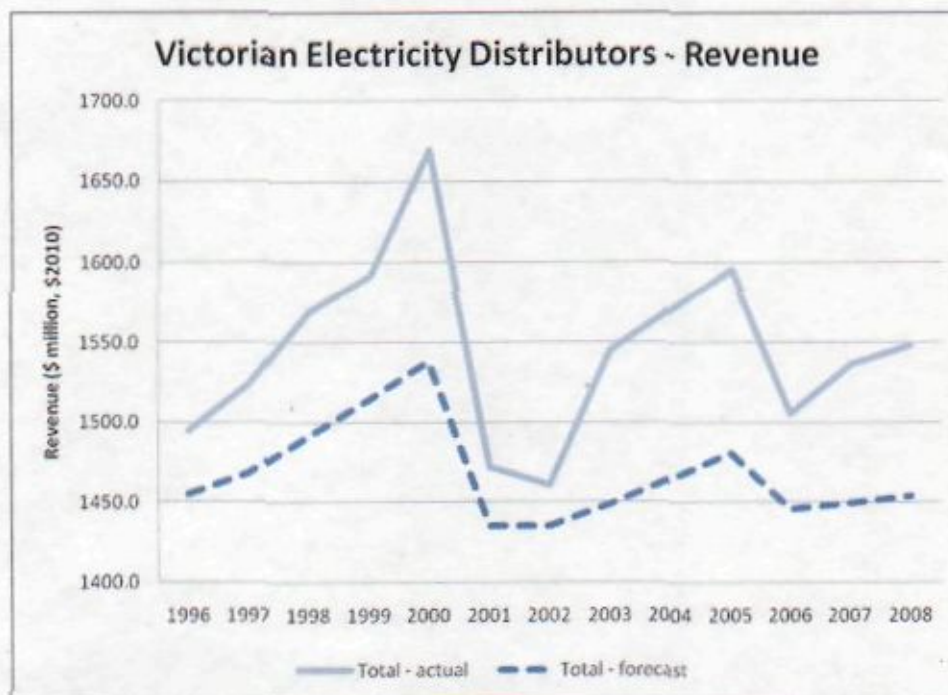
### Process

National Electricity Rule 6.9.3(b) provides for an Issues Paper to be published as part of the revenue determination process. An Issues Paper could have summarised the vast information provided by the electricity distributors and identified key issues for the AER in making its determination. The publication of an Issues Paper would have allowed for more informed submissions on these key issues from interested stakeholders.

In making the Draft Determination, the AER should have regard to the lack of effective consultation with stakeholders representing customer interests to date, and seek to reassess the appropriate balance between the interests of customers and the electricity distributors in the Final Determination, based on submissions to the Draft Determination and further analysis by the AER.

### Demand forecasts

Historically the electricity distributors have earned higher revenues than forecast in the price determination due to higher than anticipated growth in customer numbers and electricity consumption, as indicated in the figure below.

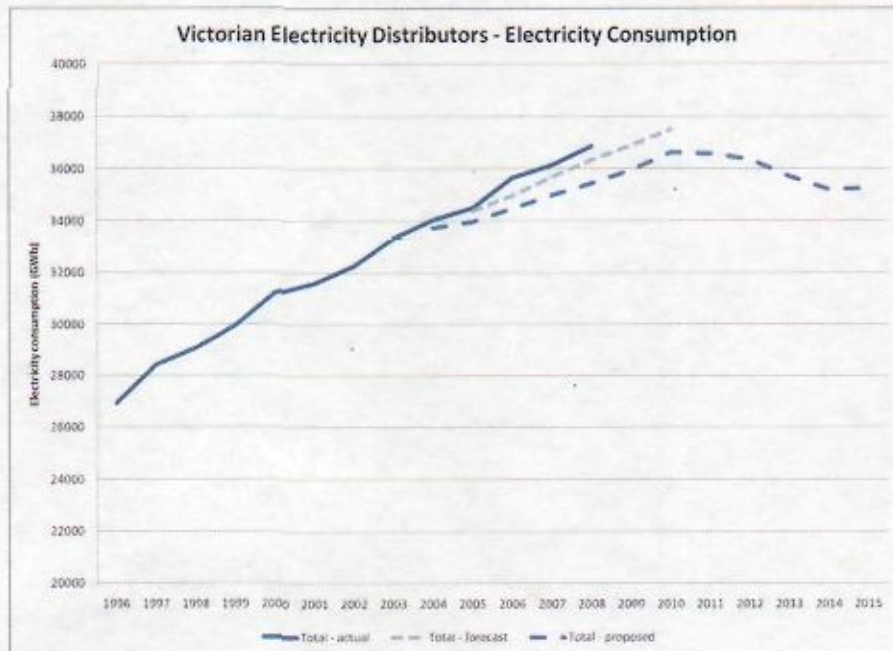


The electricity distributors have an incentive to propose low customer numbers and electricity consumption to continue to be able to earn higher revenues.



The electricity distributors have forecast a significant reduction in electricity consumption during the 2011-15 period, refer figure below. This is consistent with previous proposals which were lower than forecast by the ESC and the actual.

The AER must ensure that the electricity consumption and peak demand forecasts for the 2011-15 period are reasonable, particularly with the rollout of smart meters and the introduction of new time of use (TOU) network tariffs. The AER must rigorously test the assumptions used by the electricity distributors in their proposals for electricity consumption, as part of this determination as well as in the setting of new TOU network tariffs, to ensure that the interests of customers are protected during this transitional period.

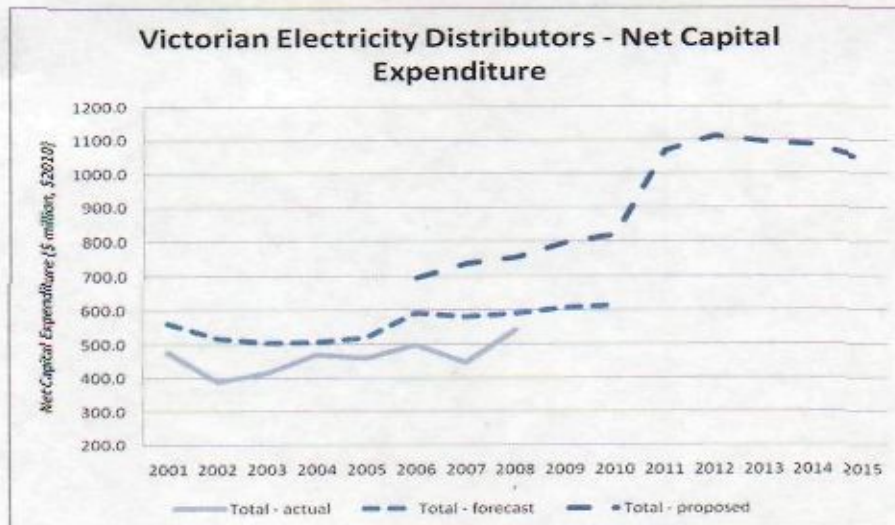


### Capital expenditure

In the last price determination, the ESC noted the challenge of reconciling the “seemingly inconsistent combination of historical expenditure requirements and projected expenditure”. “At one end of the spectrum, the distributors’ proposals might be characterised as ‘ambitious claims’ in what they take to be a process of negotiation.” “At the other end of the spectrum, the distributors may well have identified opportunities where capital expenditure scheduled for the last period was efficiently deferred, but now needs to be undertaken in the coming regulatory period”.

The AER is faced with a similar challenge, as illustrated in the figure below.





Despite the ESC adopting a capital expenditure allowance for 2006-10 that was less than the distributors' proposals and less than that recommended by its expenditure consultant, the electricity distributors have continued to underspend relative to the forecasts. Customer contributions, in particular, have continued to be significantly higher than forecast.

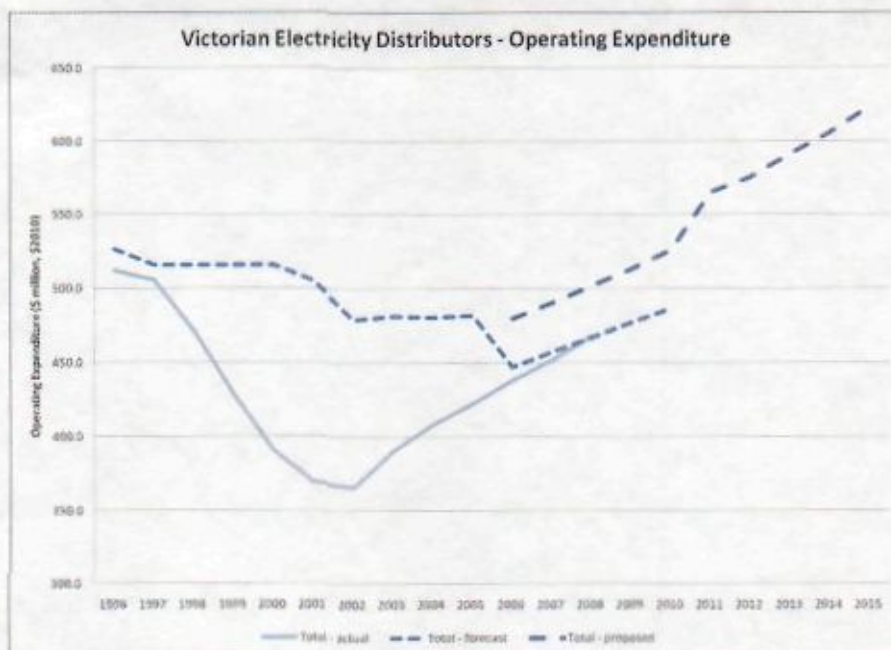
In making its determination, the AER will need to rigorously assess the assumptions made by the distributors, including the practicability of delivering a larger capital works program (particularly access to skilled resources), and whether additional regulatory obligations are required to ensure that the program is delivered. The AER will also need to ensure that appropriate consideration is given to the actual and expected capital expenditure incurred in the current regulatory period and efficient non-network solutions, in accordance with *National Electricity Rules 6.5.7(e)(5) and (10)*, respectively.

It is important that the AER is able to rely on reliable, consistent and robust financial information in the making of this determination. The AER's review of the historical financial data provided by the electricity distributors will inform the extent to which financial information reported by the electricity distributors can be relied on.

### **Operating and maintenance expenditure**

The electricity distributors have also proposed a significant increase in operating and maintenance expenditure relative to the historical levels of expenditure, as indicated in the figure below.





As with the capital expenditure proposals, the AER will need to rigorously assess the operating expenditure proposals and consider the ability of the smart meter rollout to realise efficiencies in their operations. The AER must also have regard to the actual and expected operating and maintenance expenditure in the current regulatory period, in accordance with National Electricity Rule 6.5.7(e)(5).

### Service standards

Service standards are an important element of economic regulation for which the AER has responsibility in Victoria. In making this determination the AER must consider the appropriate service standards and incentives.

As part of this determination, the AER will need to review a range of parameters that were determined as part of the last price review, including:

- The targeted levels of reliability experienced by the worst served 15 per cent of customers
- The thresholds for reporting low reliability feeders (with respect to SAIDI and MAIFI)
- Whether the quality of supply data that has been provided since the last price determination enables additional targets to be set for quality of supply
- Whether the GSL payment thresholds should be amended to ensure that GSL payments continue to be made to the worst served 1 per cent of customers
- Whether the level of GSL reliability payments should be amended to reflect the latest values of customer reliability.

### Service incentive mechanism

The AER has proposed a number of amendments to the service incentive mechanism and the electricity distributors have proposed complex transitional arrangements to account for these amendments.



In making its determination on the final form of the service incentive mechanism, the AER should review:

- The incentive rates based on the latest Value of Customer Reliability
- The risk that, if targets for 2011 are not the actual performance in 2010, Victorian customers may effectively pay for improvements in reliability that they have already effectively paid for, or that electricity distributors are penalised for a deterioration in reliability that they have already been penalised for.

#### **Pass through event - smart grids**

To ensure that the Victorian electricity distributors are able to access funding available from the Australian Government for the demonstration of smart grids, the AER should provide for a pass through event in the price determination to allow for the recovery of reasonable and efficient expenditure, in addition to that allowed for standard distribution and metering services, incurred by an electricity distributor in delivering a smart grid demonstration program.

#### **Comparative Performance Reports**

In the absence of an Issues Paper, public data, including that available in Comparative Performance Reports, was relied on to produce the figures in this submission.

In the process of collating this data, it has been identified that the form and content of the Comparative Performance Report should be reviewed following the Final Determination to ensure the report is relevant to the needs of stakeholders.

As an example, the loading on zone substations relative to capacity is useful in assessing the level of capital expenditure that may be required. However, even though peak demand at the zone substation level was forecast as part of the last price determination, this type of information has not been incorporated into the Comparative Performance Report (or the regulatory proposals).