

**Minutes of the public forum on the Victorian DNSPs’
Draft distribution determinations
(1 January 2011 to 31 December 2015)**

Location: Rendezvous Hotel
328 Flinders Street, Melbourne
Date: 17 June 2010
Forum Chair: Andrew Reeves
Attendees: (see appendix 1)

Summary of Discussion

1. Introduction by Chris Pattas (AER)

Chris Pattas opened the forum and noted that:

- the AER’s draft decision for the Victorian distribution determination was published on 4 June 2010 and that the consultation period for the draft decision has commenced
- comments and questions raised in this public forum will be taken into account by the AER in making its final decision for the Victorian distribution determination
- the DNSPs’ revised proposals are due on 21 July 2010 and submissions are due on 19 August 2010.

2. Presentation by Andrew Reeves (AER)

Andrew Reeves gave an overview of the AER’s draft decision. The overview covered key points including the AER’s processes and methodologies, allowed capital and operating expenditures, growth forecasts, the cost of capital and incentive arrangements.

A copy of the AER’s presentation is available on the AER’s website at:

<http://www.aer.gov.au/content/index.phtml?itemId=736984>

Comments and questions on the presentation by Andrew Reeves

Bob Lim (representing EUCV) pointed out inconsistencies in some aspects of the AER’s methodologies in the draft decision and recommended that the AER take these into further consideration. In particular:

- for the WACC the calculation of the debt risk premium is based on short run data whereas the AER considers market risk premium calculations from a long run perspective (to smooth out volatility in the short run data);
- materials costs are taken into account by DNSPs from a long term perspective, however the AER bases its forecasts on short run materials cost data;
- opex allowances are based on 4th year actual expenditure, which is inconsistent with the approach used for capex.

Andrew Reeves stated that the AER recognises these issues. Regarding the opex base year, Mr Reeves pointed out that the AER uses a sample year and adjusts this for one-off events, and that the methodology is robust although there may be some application

issues. Mr Reeves stated that as the AER builds a greater data set, it will have more information with which to assess the base year.

It was asked whether the AER is allowing service providers to self insure for certain events and whether it is appropriate that the service providers self insure for catastrophic events.

Andrew Reeves confirmed that the AER has approved a self insurance allowance for certain events for some DNSPs. However catastrophic events would ordinarily be treated as a pass through event rather than self insurance.

Richard Gross (CitiPower/Powercor) asked the AER to justify the AER's view that the Victorian DNSPs' historical expenditure is efficient compared to DNSPs in other jurisdictions, yet the AER approved large expenditure increases for the latter DNSPs. Mr Gross commented that this rewards inefficiency.

Andrew Reeves noted that DNSPs in different jurisdictions have different network characteristics, regulatory obligations and rates of growth. **Chris Pattas** pointed out that historical expenditure provided a starting point for the AER's analysis, however the AER also considers the DNSPs' justifications for their proposals. The draft decision provides analysis as to where the AER considers that the Victorian DNSPs have not adequately justified their proposals.

Anton Murashev (Jemena) stated that Jemena's actual capex in several years of the current regulatory control period was greater than the allowance set by the ESCV. Mr Murashev asked how proposals are funded where they are not covered by allowances from the regulator.

Andrew Reeves noted that the regulatory regime is set such that DNSPs finance their overspends and can subsequently add overspends on capex to their regulatory asset base.

3. Presentation by Roman Domanski (EUAA)

Roman Domanski noted that the views to be represented were preliminary as the EUAA had limited time to assess the draft determination of the AER. The key themes of Mr Domanski's presentation were:

- In a EUAA survey of recent AER determinations (for gas and electricity, and distribution and transmission networks), the increases in prices are a concern for its members.
- The increases in prices in NSW and Queensland will have economic implications for those states.
- The AER had not performed sufficient benchmarking in reaching its draft determinations for the Victorian DNSPs or for its past determinations. The EUAA would like this area to be further developed and pointed to the approach used by Ofgem as an example of a robust and comprehensive use of benchmarking.
- The AER has applied the regulatory regime in Victoria correctly and that the outcomes of the Victorian draft determination are reasonable. However this cannot be said for past AER determinations. The EUAA recommended that the approach used for the Victorian distribution determination should be used in future determinations.

- The EUAA stated that the appeal process is a cause for concern given that past appeals have resulted in higher prices. Further the appeal process allows points in favour of the appellant to be raised without subjecting other aspects of the Determination to review.

The EUAA's presentation slides are available on the AER website at:

<http://www.aer.gov.au/content/index.phtml?itemId=736984>

4. Questions

David Prins (Etrog Consulting) noted that the ESCV had in the past set the performance standards for Victorian DNSPs and asked whether the AER now has a role in setting performance standards. Mr Prins also asked whether the AER is seeking comments on particular matters regarding service standards in the draft decision. Mr Prins then noted that **Roman Domanski** had just stated that the appeal process favours DNSPs and asked whether user groups can also front the Tribunal and whether any rule changes or other changes are required to enable this.

Andrew Reeves responded that he understood the role of setting service standards has not yet transitioned to the AER for the purposes of setting service standards for the next regulatory period. It was pointed out that the AER can in fact make recommendations for changes in service standards to the Essential Services Commission who retain control of the relevant distribution codes¹. Mr Reeves also stated that there are opportunities for customers to participate in appeals, noting that the process is very technical and resource intensive. This means that small customers can be disadvantaged as they may not have adequate time and resources to participate in the appeals process.

Richard Gross stated that under the NER, changes introduced by the Victorian Bushfires Royal Commission (VBRC) would not be incorporated into the distribution determination.

Andrew Reeves responded that if the Victorian Government amends legislation as a result of VBRC recommendations, these will be considered under pass through arrangements. Mr Reeves stated that the AER does not want to anticipate the outcome of the VBRC and the Victorian Government's response. **Scott Sandles (AER)** pointed out that new regulatory obligations are considered in the draft decision in the chapter dealing with pass through arrangements.

Richard Gross noted that the proposed 1% materiality threshold would mean VBRC costs may not be able to be passed through.

Andrew Reeves encouraged written submissions regarding this threshold.

Ariel Liebman (EUAA) asked how the debt raising costs calculated in the draft decision can be reconciled with debt raising costs observed in actual markets, where conditions are changing.

Chris Pattas responded that the AER used a benchmark to calculate the DRP in the draft decision and acknowledged that the benchmark can differ from actual market

¹ Editorial note: The AER set out in its framework and approach for the Victorian distribution price review in May 2009 that it would be applying the national service target performance incentive scheme (STPIS) which does not envisage a separate review of service standards as part of this price review.

rates. Mr Pattas pointed out that the methodology employed by the AER has been consistent over time and is set out in its WACC report.

Ariel Liebman pointed out that the AER only allows a benchmark of domestic risk free rates; however DNSPs can raise capital using international markets.

Chris Pattas stated that the AER aims for consistency over all parameters employed, and as a principle uses domestic rather than international benchmarks in this regard. Further, to the extent that a DNSP can raise capital at lower cost using international markets, this is an example of a DNSP outperforming a benchmark.

Roman Domanski stated that the AER is very specific regarding the parameters the AER can use. This can lead to windfall gains or losses to DNSPs. Mr Domanski stated that users would like a better understanding of how this process works and indicated that this point may be included as part of the EUAA's written submission.

David Stanford (CUAC) asked whether any other factors have affected the WACC parameters. **Chris Pattas** responded that the beta and MRP have changed.

Brian Green (Australian Paper) commented that the "CPI plus" approach is not a good measure of business best practice and that allowing input costs to increase above CPI is inefficient. Mr Green stated that the draft decision does not benchmark the Victorian DNSPs against international businesses. Mr Green asked why the "CPI plus" approach is adopted by the AER and why the Victorian DNSPs are not benchmarked on a global scale.

Andrew Reeves stated that the "CPI plus" approach is an outcome of the price path under the building block model and is based on requirements under the AER. Mr Reeves further commented that firms are entitled to commercial returns on depreciated assets. Regarding benchmarking on a global scale, Mr Reeves stated that conditions vary across the different jurisdictions in Australia, thus benchmarking among domestic firms is already a challenge. However international benchmarking may be considered by the AER for future determinations.

Pat Farrell (Energy Action) enquired whether the sources of the AER's benchmarking exercise were shared with the Victorian DNSPs and with DNSPs from other jurisdictions.

Andrew Reeves responded that the benchmarking data is shared through the draft decision.

Regarding AMI, **Richard Gross** commented that the AER rejected TOU tariffs on the basis of the moratorium placed by the Victorian Government. Noting that the moratorium finishes at the end of 2010, Mr Gross questioned why this was not reflected in the AER's models.

Chris Pattas noted the draft decision's view that there will be no significant impact on electricity sales as a result of TOU tariffs and that the issue of the moratorium is a matter for the Victorian Government. **Mr Gross** pointed to a Victorian Government study that indicated a positive response arising from the introduction of TOU tariffs.

Ruth Kershaw (EB Economics) asked why the draft decision uses a benchmark to calculate Labour cost escalation given that the current EBA will soon end and that a new EBA will be negotiated. Ms Kershaw commented that this may provide the Victorian DNSPs with a windfall gain.

Andrew Reeves stated that it is better to use a benchmark rather than actual outcomes as the latter is a “cost plus” regime rather than an incentive regime.

Ruth Kershaw asked whether updated input cost modelling will be performed at the final distribution determination.

Andrew Reeves responded that modelling is updated at every determination.

Regarding modelling errors, **Bruce Mountain (Carbon Market Economics)** pointed out that DNSPs have the incentive to notify the AER only of those errors which are beneficial to them. Mr Mountain asked how the AER deals with modelling errors.

Andrew Reeves responded that the AER has in place quality control systems and checks to deal with modelling errors.

Anton Murashev commented that the ESCV used constant X factors. Mr Murashev wanted to know the logic behind the AER’s X factors and why the final year X factor is materially different from other years’ X factors.

Andrew Reeves responded that to arrive at the correct NPV there is less latitude when using constant X factors. **Lawrence Irlam (AER)** pointed out that the ESCV was not subject to the same regulatory framework as the AER and that the AER’s approach in this decision is consistent with its previous decisions. Mr Irlam stated that the AER welcomes submissions regarding this issue.

Roman Domanski requested a clarification regarding the relationship between the VBRC and pass throughs. In particular, Mr Domanski asked whether the AER will pass through the complete recommendations made by the VBRC, or whether the AER has some discretion under the NER and the NEL.

Andrew Reeves pointed out that a more important consideration is the Victorian Government’s response to the VBRC recommendations. Further the AER must look at efficiency considerations under the regulatory framework when considering the outcome of the VBRC and the Victorian Government response. **Chris Pattas** also pointed out that the extent of the AER’s discretion will depend on the nature of the obligation imposed by the Victorian Government.

Matthew Serpell (CitiPower/Powercor) pointed to the draft decision which stated that DNSPs cannot recover transmission charges, inter-DNSP charges and avoided TUOS charges under the NER (pending AEMC processes). Mr Serpell asked how the outcome of this process would affect the AER’s previous determinations, where these charges were allowed to be recovered.

Chris Pattas responded that this would depend on the outcomes of the AEMC process. Mr Pattas also noted, in response to the query on the AER’s change in approach, that this apparent deficiency in the rules had not been raised previously.

Richard Gross pointed out that the AEMC process may not be concluded by the time the Victorian DNSPs’ pricing proposals are due for submission to the AER. Mr Gross asked how the Victorian DNSPs would recover those charges.

Chris Pattas responded that this is a legal issue and depends on the AEMC’s decision.

5. Next steps and conference close

Andrew Reeves and **Chris Pattas** expressed their appreciation to the presenters and attendees for their participation and closed the meeting at approximately 12.50pm.

Appendix 1: List of attendees

Organisation	Attendees
ACIL Tasman Pty Ltd	Marianne Lourey
ALDI Stores	Andrew Henderson
Alternative Technology Association	Craig Emery
Assured Guaranty Services (Aust) Pty Ltd	Jim Metasas
Aurora Energy	Kim Rosinski, Leigh Mayne
Australian Energy Regulator (AER)	Andrew Reeves, Chris Pattas, Darren Kearney, David Chan, Paul Dunn, Lawrence Irlam, Israel del Mundo, Caterina Popa, Michael Larkin, Andrew Ley, Robert Nolan, Sam Sutton, Ian McNicol, Mark McLeish, Scott Sandles, Jeffrey Anderson, David Chan, Nick Innes, Frans Jungerth, Eugene Henry, Maria Djopa
Australian Paper	Brian Green
Bob Lim & co Pty Ltd	Bob Lim
Cadency Consulting	Anthony Seipolt
Carbon Market Economics	Bruce Mountain
Central Victorian Greenhouse Alliance	John Harvey
Citelium Australia Pty Ltd	Adam Carey
Country Energy	Jason Cooke
Consumer Utilities Advocacy Centre	David Stanford
DUET	David Bartholomew
Energex Limited	Neil Andersen
Energy Action	Pat Farrell
Energy Advice	Ian Delahuntry
Energy Networks Association	Garth Crawford
Energy Safe Victoria	Robert Skene
Energy Users Association of Australia	Ariel Liebman, Roman Domanski

(EUAA)	
Essential Services Commission	Wendy Heath
Etrog Consulting Pty Ltd	David Prins
Foodworks	Kevin Weatherall
IBM Global	Peter O'Keefe
Jemena Asset Management	Peter Wong
Jemena Electricity Networks (Jemena)	Anton Murashev, Craig Savage
Market Intelligence Group Pty Ltd	Stephen Farrell
Marsden Jacob Assoc.	Jeff Washusen
Nuttall Consulting	Brian Nuttall
CitiPower/Powercor	Richard Gross, Matthew Serpell, Stephanie McDougall, Sandeep Kumar, Vivienne Pham
SKM Melbourne	Cheng Lee
SP AusNet	Tom Hallam, Alastair Parker
The Australian Industry Group	Vivienne Filling
TRUenergy	Mark Davis
United Energy Distribution & Multinet Gas	Lisa Drought, Jeremy Rothfield
Victorian Council of Social Services	Sarah Toohey
VicUrban	Sarah Iwaniw
Westfield	Rob Conroy