Submission on the Victorian electricity distribution network service providers' revised regulatory proposals for 2016-20

Submission by the Victorian Government

State Government Victoria

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The Victorian Government welcomes the opportunity to provide a submission on the revised regulatory proposals submitted by the five Victorian electricity distribution network service providers (DNSPs) for the 2016-20 regulatory control period.

As indicated in a previous submission, the Victorian Government generally supports the preliminary distribution determinations that were made by the Australian Energy Regulator (AER).

The Victorian Government is extremely disappointed with the opportunism demonstrated by the DNSPs significantly increasing forecast revenue in their revised regulatory proposals, particularly through a significant increase in the proposed rate of return.

This submission provides further comments on the proposed rate of return and the following aspects of the DNSPs' revised regulatory proposals:

- Powerline Bushfire Safety initiatives
- operating expenditure.

Rate of return

The AER identified in its preliminary distribution determinations that:

Financial conditions have changed since our last decision … which covered the 2011-15 regulatory control period. … Interest rates are lower and financial market conditions are more stable. This means that the cost of debt and returns to attract equity are lower. These factors should be reflected in the rate of return.[1]

Consistent with this observation, the DNSPs initially proposed a return on debt for the 2016-20 regulatory control period that was significantly less than the return on debt that applied during the 2011-15 regulatory control period. The variance between the DNSPs' return on debt and the AER's Preliminary Determination varied between only 0.09 and 0.34 percentage points.

The DNSPs have now proposed that there be no transition to the trailing average approach for determining the return on debt. As a result, the revised returns on debt proposed by the DNSPs has increased by around 2.6 percentage points relative to the AER's preliminary determination and around 2.4 percentage points relative to the DNSPs' original regulatory proposals.

There has been no fundamental change in the market conditions since the DNSPs' original regulatory proposals to support such an increase in the return on debt. Accordingly, the Victorian Government does not support the DNSPs' revised proposed return on debt.

Despite the change in the financial conditions since the 2011-15 distribution determinations were made, the return on equity proposed by the DNSPs for the 2016-20 regulatory control period was similar to the return on equity determined for the 2011-15 regulatory control period. The DNSPs proposed various amendments to the AER's Rate of Return Guideline in forecasting their original returns on equity.

The Victorian Government supports the AER's preliminary determination on the return on equity, which is consistent with the AER's Rate of Return Guidelines and results in a return on equity that is around 2.6 percentage points lower than the DNSPs' original proposals.

The revised return on equity proposed by each of the DNSPs has been derived using a different methodology to that used to derive the returns on equity previously proposed, but results in similar returns on equity to those previously proposed. The methodology adopted seeks to vary the equity beta and market risk premium as specified in the AER's Rate of Return Guidelines.

[1] For example, Australian Energy Regulator, *Preliminary Decision, AusNet distribution determination 2016 to 2020, Overview*, October 2015, page 18

Powerline Bushfire Safety initiatives

AusNet Services and Powercor have submitted estimated costs to comply with the Victorian Government's proposed Bushfire Mitigation Regulations Amendment[2] through the installation of Rapid Earth Fault Current Limiters (REFCLs), and the replacement of powerlines in declared areas with underground or insulated cable at the end of their lives.

The costs submitted by AusNet Services for the installation of REFCLs and replacement of powerlines, and the costs submitted by Powercor for the replacement of powerlines, are higher than those either submitted by the DNSPs or estimated for the purposes of the Regulatory Impact Statement. There is no clear justification for including these higher costs.The costs proposed by Powercor for the installation of REFCLs are of a similar magnitude to those submitted by them for the purposes of the Regulatory Impact Statement.

Installation of REFCLs

The Regulatory Impact Statement recognises that the cost to install a REFCL and the ancillary works will vary significantly from zone substation to zone substation depending on the particular circumstances of the zone substation.[3] The Regulatory Impact Statement indicated that the average cost, as submitted by the electricity distributors, was in the order of $9 million each.[4] If it is assumed that not all surge arresters are replaced, the average cost is around $6.6 million.

The average cost proposed by Jemena and United Energy for the installation of REFCLs is significantly less than $9 million, and by Powercor is around $9 million.

By contrast, the average cost proposed by AusNet Services is around $13.4 million. This is significantly higher than submitted by AusNet Services for the purposes of the Regulatory Impact Statement. These prior estimates and differing cost claims from other distributors should put the burden of evidence upon AusNet Services to justify the higher claimed costs.

Replacement of powerlines

AusNet Services has proposed that 146 km of polyphase powerlines in declared areas be replaced at an incremental cost of $531,000 per km. Powercor has proposed that 66.73 km of polyphase powerlines and 23.35 km of Single Wire Earth Return (SWER) powerlines in declared areas be replaced at an incremental cost of $204,969 per km for SWER powerlines and $786,605 per km for polyphase powerlines.

The Victorian Government considers that the length of powerline proposed by the DNSPs appears reasonable, subject to a more detailed assessment by the AER, but the incremental costs of replacing the powerline appear high.

Powercor advised that the costs for replacing powerlines with bare wire conductors was sourced from its 2014 category analysis regulatory information notice and the costs for undergrounding powerlines was sourced from the Regulatory Impact Statement, as revealed by the Powerline Replacement Fund.[5] The Victorian Government notes that:

— The cost for replacing powerlines with bare wire conductors as sourced by Powercor is significantly less than estimated for the purposes of the Regulatory Impact Statement. The cost in the Regulatory Impact Statement for replacing bare wire conductors was estimated on the same basis as the estimates for undergrounding and insulating conductors.[6] If the cost in the Regulatory Impact Statement for bare wire

[2] Available at http://www.energyandresources.vic.gov.au/energy/safety-and-emergencies/powerline-bushfire-safety-program/proposed-electricity-safety-bushfire-mitigation-further-amendment-regulations
[3] ACIL Allen Consulting, *Report to Department of Economic Development, Jobs, Transport and Resources, Regulatory Impact Statement, Bushfire Mitigation Regulations Amendment*, 17 November 2015, page 68
[4] Ibid, page 70
[5] Powercor, *Revised Regulatory Proposal 2016-2020*, page 437
[6] ACIL Allen Consulting, *Report to Department of Economic Development, Jobs, Transport and Resources, Regulatory Impact Statement, Bushfire Mitigation Regulations Amendment*, 17 November 2015, page 95

conductors has been overestimated, then it implies that the cost estimates for undergrounding and insulating powerlines are also overstated.

— Powercor has considered only the cost for undergrounding powerlines, and not for installing insulated conductors. As the benefits of undergrounding powerlines are not materially greater than the benefits of insulated conductors, but the costs for undergrounding powerlines are generally higher than the costs of insulated conductor, the Victorian Government expects that powerlines will only be put underground where the circumstances preclude installing insulated conductors.

— Powercor has sourced the cost for undergrounding polyphase powerlines from the costs revealed through the Powerline Replacement Fund. The high cost revealed was heavily influenced by one 5.61 km of powerline that was in an expensive part of the state to underground powerlines. The Regulatory Impact Statement estimated a low cost for replacing polyphase powerlines of $300,000 per km (prior to 2020) and a high cost of $400,000 per km.[7] This range is significantly lower than the cost proposed by Powercor for replacing polyphase powerlines.

— The cost sourced by Powercor for undergrounding SWER powerlines is similar to the costs estimated in the Regulatory Impact Statement.

AusNet Services has provided little information to support its estimate of the cost for replacing polyphase powerlines. In the absence of any detailed information, the Victorian Government is unable to make any specific comments on the costs proposed by AusNet Services, other than to note that they appear high relative to the costs estimated in the Regulatory Impact Statement. Accordingly, the Victorian Government considers that the AER should examine the estimate carefully, particularly if AusNet Services' powerline replacement program is not treated as a contingent project.

Service Target Performance Incentive Scheme

AusNet Services has proposed that interruptions caused by the operation of REFCL devices be excluded from the Service Target Performance Incentive Scheme (STPIS) as it considers that the use of REFCLs is mandatory. This approach is similar to a current exclusion for calculating the number of momentary interruptions relating to interruptions caused by the operation of automatic reclose devices.[8]

AusNet Services is seeking an exclusion under the category of:

Load interruptions caused by the exercise of any obligation, right or discretion imposed upon or provided for under jurisdictional electricity legislation or national electricity legislation applying to a DNSP.[9]

The Victorian Government does not support the exclusion of the operation of REFCL devices from the Service Target Performance Incentive Scheme or the exclusion in calculating the number of momentary interruptions relating to interruptions caused by the operation of automatic reclose devices.

The use of automatic circuit reclosers and REFCLs should now be standard practice for all DNSPs to reduce the likelihood of powerlines starting bushfires. Other DNSPs are installing automatic circuit reclosers and REFCLs in the absence of the exercise of any obligation, right or discretion imposed upon or provided for under jurisdictional electricity legislation or national electricity legislation.

Under section 98 of the *Electricity Safety Act 1998*, the DNSPs have a general obligation to:

Design, construct, operate, maintain and decommission its supply network to minimise as far as practicable—

(a) the hazards and risks to the safety of any person arising from the supply network; and

(b) the hazards and risks of damage to the property of any person arising from the supply network; and

(c) the bushfire danger arising from the supply network.

[7] Ibid, page 94

[8] AusNet Electricity Services Pty Ltd, *Electricity Distribution Price Review 2016-20, Revised Regulatory Proposal*, 6 January 2016, page 5-6 – 5-7

[9] AER, *Electricity distribution network service providers, Service target performance incentive scheme*, November 2009, clause 6.4(a)(7)

Taken to its logical conclusion, this obligation implies that any interruptions caused by the operation of any network equipment should be excluded from the STPIS. This completely undermines the operation of the STPIS.

The DNSPs should be held to account for the reliability and safety of their networks. Accordingly, there should be no exclusions from the STPIS for interruptions caused by REFCLs or automatic circuit reclosers.

Operating expenditure

In the preliminary distribution determinations, the AER did not accept step changes in operating expenditure that were not considered to be material. The Victorian Government expects the AER to adopt the same approach in assessing the operating expenditure forecasts in the DNSPs' revised regulatory proposals.

The DNSPs have included additional expenditure associated with the introduction of cost reflective network tariffs.

In December 2015, the Victorian Government announced that customers must opt in to, rather than opt out from, cost reflective network tariffs. Accordingly, the AER will need to assess whether the expenditure proposed by the DNSPs is consistent with an opt in or an opt out approach. For example, CitiPower has forecast the costs associated with customer enquiries on cost reflective network tariffs based on the customer enquiry volumes for the rollout of smart meters.[10] It is expected that the customer enquiry volume will be significantly lower than this under an opt in approach.

The DNSPs have also included additional expenditure associated with changes that have been made to the Victorian Guaranteed Service Level (GSL) payments. However, the Victorian Government notes that the DNSPs have, either explicitly or implicitly, based their forecasts on the Essential Services Commission's draft decision rather than the final decision. There are two important changes between the draft decision and final decision that will reduce the costs that may be incurred by the DNSPs over the 2016-20 regulatory control period:

- New measure for long duration interruptions – while the Draft Decision proposed a payment to be made for all long duration interruptions[11], the Final Decision only requires a payment to be made if a payment is not made for the annual duration of interruptions.[12]
- Measuring quality of supply data – while the Draft Decision proposed that DNSPs measure and record quality of supply data for those customers with a smart meter installed[13], the Final Decision acknowledges a range of issues that will need to be resolved and that further consultation will be required before any obligation is introduced.[14]

The Victorian Government expects the AER to consider these changes in assessing the DNSPs' revised regulatory proposals.

[10] CitiPower, *Revised Regulatory Proposal 2016-2020*, page 181
[11] Essential Services Commission, *Review of the Victorian Electricity Distributors' Guaranteed Service Level Payment Scheme, Draft Decision*, November 2015, page 28
[12] Essential Services Commission, *Review of the Victorian Electricity Distributors' Guaranteed Service Level Payment Scheme, Final Decision*, December 2015, page 31
[13] Essential Services Commission, *Review of the Victorian Electricity Distributors' Guaranteed Service Level Payment Scheme, Draft Decision*, November 2015, page 31
[14] Essential Services Commission, *Review of the Victorian Electricity Distributors' Guaranteed Service Level Payment Scheme, Final Decision*, December 2015, page 34

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