Coordination Group

Independent Report on Regulatory Proposal 2026 -2031

Report for AusNet Services

2 May 2025

Acknowledgement of Country

We acknowledge the Traditional Custodians of the lands on which AusNet owns and operates its electricity distribution networks and facilities, and where its customers, community and stakeholders work and reside. We honour the customs, history and traditions and special relationship of those Traditional Custodians with the land as well as the lands where this report is being prepared. We respect the Aboriginal communities who have cared for the lands for thousands of years and honour elders past and present. These include the lands of the Bidwell, Bun wurrung, Dauang wurrung, Gunai (Kurnai), Jaitmatang, Ngarigo, Nguraiilam wurrung, Taungurung and Yorta Yorta peoples.

Foreword

This report is written by the Coordination Group in response to AusNet's Regulatory Proposal for its 2026–31 electricity distribution price review (EDPR) lodged with the AER on 31 January 2025. This report follows our prior report on AusNet's Draft Proposal.

This report, our prior report on AusNet's Draft Proposal and AusNet's Regulatory Proposal were developed after significant time and effort from the Coordination Group, the other EDPR panel members and AusNet.

In its Regulatory Proposal and during our engagement with AusNet they noted a commitment to:

- be sincere and genuine in listening and responding to their customers' needs
- be held to account for any commitments they make
- submit a proposal to the Australian Energy Regulator in January 2025 that reflects customer preferences.

AusNet's Regulatory Proposal has evolved from the Draft Proposal based on feedback from our report and further consumer engagement however at an aggregate level it is not materially different from their Draft Proposal.

Their proposal includes a range of initiatives aimed at investing in the network and assisting in meeting customer expectations at a time when the energy industry is undergoing a period of unprecedented transformation and customer affordability is a key focus.

The Coordination Group and panel members remain fully committed to engaging constructively and collaboratively with the Australian Energy Regulator (AER), AusNet and other stakeholders as the proposal is reviewed and revised.

I note that the AER has published its Issues Paper in relation to the Victorian electricity networks' Regulatory Proposals. While our report does not directly respond to the specific questions in the Issues Paper, many of our themes and topics indirectly respond to the issues paper questions.

I sincerely hope that this report provides useful and practical insights and perspectives to inform the AER's issues paper, broader review and the next stage of AusNet's EDPR 2026-31 work program.

Peter Eben

Independent Chair, Coordination Group 2 May 2025

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1 Executive Summary

The Coordination Group again commends AusNet on their extensive effort and sincere engagement in preparing their Regulatory Proposal. This report is a formal submission from the Coordination Group in response to AusNet's Regulatory Proposal. It is also our summary of AusNet's engagement with its consumer panels for work undertaken between AusNet publishing the Draft Proposal and lodging the Regulatory Proposal with the AER on 31 January 2025.

AusNet has proposed a total (smoothed) revenue requirement in \$2025/26 real dollar terms of \$4,619m over the 2026 – 2031 period, which is not materially different (a \$14m reduction) from the Draft Proposal. However, it is a \$541m or a 13 per cent increase over the approved revenue in the current regulatory period (2021 – 2026).

The increased revenue compared to the current regulatory period is driven by changes in financing costs and significant increases in both operating expenditure (\$213m or 14%) and capital expenditure (\$1.4b or 71%) compared with forecast expenditure in the current period.

These expenditure increases are (largely to) fund a range of proposed initiatives designed to invest in and deliver stronger reliability and resilience (including for worst served customers), assist in unlocking renewable energy, support the energy transition to net zero and delivering improved customer experience.

From an affordability perspective AusNet has also worked with stakeholders and considered areas where some cost savings could be made. The Regulatory Proposal identifies a number of measures aimed at improving affordability, which AusNet are estimating that the affordability measures identified in the proposal means customers will reduce costs by \$13 per year for an average residential customer and \$65 per year for an average business customer.

From a customer cost perspective and in addition to the affordability measures identified AusNet is forecasting real average customer prices between 2026 to 2031 to be relatively flat (ranging from a 1 per cent real reduction for some residential segments to a 2 per cent real increase for some business segments).

The minimal average price impact is dependent on realising a material forecast increase in consumption, which spreads the increased revenue across a larger customer and consumption base.

1.1 Coordination Group key perspectives

The Coordination Group and panels' key perspectives on the Regulatory Proposal include:

- A strong and continued appreciation of AusNet's sincerity, transparency, and huge effort in preparing the Regulatory Proposal and also in undertaking its consumer engagement.
- Commending AusNet's continued goodwill and effort in providing the Coordination Group and the panels with opportunities to be involved in informing and influencing aspects of their Regulatory Proposal, which is consistent with the AER's Better Resets Handbook expectation of network businesses.
- Acknowledging that AusNet has done a good job overall of eliciting customer views for those Regulatory Proposal components where there was engagement (i.e. specific operating and capital expenditure items, incentive schemes and the innovation fund). Those areas of the proposal where AusNet engaged generally reflect the views and

feedback expressed by the Coordination Group and panels as consumer representatives and therefore reflect consumer preferences.

- Noting that we have identified areas of residual concern in relation to some operating expenditure step changes (e.g. hazard tree program operating vs capital expenditure trade-offs and mix) and some aspects of capital expenditure (e.g. getting regional reliability allowance governance right and the calculation of net benefits for large renewable enablement through the sub transmission system) that may warrant further consideration and also that we believe AusNet should be more ambitious in their operating expenditure productivity.
- Understanding that changing primary contractors was designed to provide opportunities for AusNet, however this change combined with the size of the increased capital expenditure, at a time of significant infrastructure development not just across Victoria but across eastern states, will also present risks for AusNet to deliver on their commitments.

From an affordability perspective our views include:

- Supporting and noting that AusNet explicitly considered affordability but that in aggregate these proposed expenditure savings (even if they would have been approved by the AER) are small relative to overall revenue (approximately 1 per cent).
- More importantly highlighting that AusNet's proposed average customer prices are heavily dependent on the achievement of the uncertain increased demand forecasts. Lower electricity demand, e.g. through a slower take-up of electrification of gas loads, could result in significantly higher prices.
- To better address affordability concerns and the uncertainties discussed we encourage the AER (and AusNet) to consider a number of potential matters including "backending" cost recoveries where practical, efficient and prudent to do so, continuing with advocacy and education in relation to tariff reform and further considering the required "reopeners" to address the key uncertainties identified.

Looking at the Regulatory Proposal in aggregate including the perspectives and limitations discussed above and in this report:

- **Services:** the proposal includes the continuation of current and the provision of additional services that are reflective of consumer preferences
- **Prices:** consumers generally supported an overall proposal that has a price path of a flat or slight rise in real terms to deliver the services they wanted
- **Uncertainties:** there are uncertainties impacting the delivery of these services at the forecast prices that need to be considered and managed not only in the finalisation and approval of this proposal but also throughout the 2026 2031 regulatory period.

2 Introduction

This report is written in response to AusNet's Regulatory Proposal it lodged with the AER on 30 January 2025. It is designed to:

- provide the Coordination Group (and panels') independent views on AusNet's Regulatory Proposal - the adequacy of engagement to date and whether the proposal appropriately reflects consumer preferences (based on evidence presented to us and that which the Coordination Group and panels independently obtained).
- identify gaps and areas for further consideration by the AER and / or AusNet in the review and approval of the proposal.

2.1 The Coordination Group

The Coordination Group is an independent group with an overarching governance and coordination role in AusNet's EDPR 2026-31 engagement program to work with a series of customer panels. The Coordination Group has an independent Chair and includes the lead from each of the six customer panels.

The members of the Coordination Group are:

- Peter Eben (Independent Chair)
- Helen Bartley (Research and Engagement panel lead)
- Kieran Donoghue (Availability panel lead)
- Gavin Dufty (Tariffs and Pricing panel lead)
- Mark Grenning (Benchmarking and Operating Expenditure panel lead)
- Dean Lombard (Future Networks panel lead)
- Emily Peel (Customer Experience panel lead)

2.2 Report structure

This report is structured with the following sections:

- Section 1 (Executive Summary): to provide an overview of the Coordination Group's perspectives on the Regulatory Proposal and key areas requiring further consideration.
- Section 2 (Introduction): to provide an overview of the report's purpose and structure and the Coordination Group.
- Section 3 (Context): to provide an overview of the key internal and external context of relevance to the Regulatory Proposal.
- Section 4 (Research and engagement): to provide an overview and assessment of AusNet's customer research and engagement activities.
- Section 5 (Capital Expenditure): to provide an overview and assessment of the capital expenditure components of the Regulatory Proposal.
- Section 6 (Operating Expenditure): to provide an overview and assessment of the operating expenditure components of the Regulatory Proposal.
- Section 7 (Incentive Schemes and Innovation): to provide an overview and assessment of the incentive schemes and innovation components of the Regulatory Proposal. Noting that there is an overlap between these components and operating / capital expenditure.
- Section 8 (Metering): to provide an overview and assessment of the metering components of the Regulatory Proposal.
- Section 10 (Overall Draft Proposal conclusions): to provide an overview of the overall conclusions on the Regulatory Proposal and price path.
- Appendices (A and B): to provide further detail on the capital and operating expenditure components of the revenue proposal respectively

3 Context

Context is everything. Every Regulatory Proposal is impacted in multiple ways by the key issues and dynamics of the time in which it is developed, what is expected during the regulatory period itself, while at the same time planning for beyond the regulatory periods in question and in the end to work towards achieving the National Electricity Objective. As community and customer engagement plays an increasingly larger role in shaping Regulatory Proposals, the issues impacting the community during the development period influences their concerns and priorities.

In this section, we give an overview of significant aspects of the broader context of AusNet's 2026–31 Regulatory Proposal, and how they impact the proposal.

3.1 The economic environment

The significant rise in inflation after the COVID-19 pandemic, peaking around the end of 2022 and currently still above pre-pandemic levels, has engendered a cost-of-living crisis. This has been important context within which consumers have engaged with AusNet's Electricity Distribution Price Review. A reduced customer appetite (and in many cases, capacity) for expenditure has necessitated that pricing proposals be developed with a strict and overt focus on affordability, ensuring that they are "not a penny more" than necessary.

This economic environment has also put upward pressure on many costs for the business due to the increased costs of many infrastructure components and services (such as insurance and capital costs). This cost pressure has been exacerbated by the need for new expenditure to accommodate changing needs of the transitioning energy system, and to address government and community concerns about energy system resilience (both discussed below).

Together, these factors have led to a tension between affordability and expenditure to meet emerging operational considerations and customer supported initiatives – presenting AusNet with a challenging context in which to be developing the 2026–31 Regulatory Proposal.

3.2 The energy transition

The rapid development of energy production, consumption, and management technologies and the urgent need to reduce emissions is driving ongoing change in the energy system. Essentially, this is a transition from a centralised system with large fossil-fuelled generators sending energy to passive users, to a decentralised system with mostly renewable generators of all sizes, battery storage, and dynamic control of distributed supply and load. In this transition, distribution networks' role is changing from a conveyance for one-way flows of electricity, to a platform managing multiple flows and exchanges.

This transition is happening of its own accord as new technologies are developed and improved, new markets arise, and consumer preferences change. But it is also being shaped by government policies designed to support, manage, or leverage the transition including policies aimed at migrating customers away from gas consumption. Distribution networks operate within parameters set by government policies and must respond to changing technologies and evolving consumer preferences.

There are many aspects of the energy transition. Those with the most critical impact on distribution networks are:

• Electrification – replacing fossil-fueled equipment with electric alternatives.

- **Energy efficiency** improving efficiency of electric appliances and thermal performance of buildings.
- Community / consumer energy resources (CER) rapid uptake of rooftop solar and batteries by homes and businesses.

Some of these put upward and some downward pressure on energy consumption and demand (though it's generally accepted that the net result will be increases, especially in the medium term), and some have other impacts on network operations. Together, they materially impact the types and levels of investment required to operate the network.

3.2.1 Electrification

Households and businesses are increasingly electrifying gas-powered loads. For many (especially households) there is an economic benefit thanks to the increasing efficiency and lower cost of heat pumps and the avoidance of a fixed charge for a second utility supply – but this is not widely known. But the short term cost of transition can be high, especially for businesses where productivity is also affected by replacement of large equipment.

The Victorian government has been developing a framework to encourage and enable electrification as part of its broader objectives to progress decarbonisation by reducing reliance on fossil fuels and transitioning to a primarily electricity-based energy system. A central plank of this framework is the <u>Gas Substitution Roadmap</u>, a medium to long term strategy to transition away from equipment connected to reticulated gas networks to electric alternatives. Policies and programs to implement this strategy range from assistance to upgrade infrastructure to prohibitions on installing gas-powered equipment and connecting to gas networks. The new <u>State Electricity Commission</u> (SEC) also has programs to help households electrify.

Another part of the electrification framework is the Zero Emissions Vehicle Roadmap, which aims to accelerate the transition from internal combustion engine vehicles to electric alternatives with a range of policies and programs to facilitate and encourage uptake among households and businesses.

Large-scale electrification will lead to increased electricity usage and demand, change the timing of high and low demand periods, and may increase the differential between high and low demand periods.

3.2.2 Energy efficiency

Technological improvement steadily increases consumers' energy efficiency and lowers the cost of appliances and equipment. The national <u>Equipment Energy Efficiency</u> (E3) program, which implements legislation from the *Greenhouse and Energy Minimum Standards Act 2012* (GEMS Act), sets (and periodically updates) minimum efficiency standards for many categories of equipment and appliances and mandates a public-facing star rating and disclosure scheme to inform consumers.

Thermal performance of new buildings is governed by the National Construction Code (NCC), last updated in 2022. Existing buildings must also comply to an extent if undergoing significant renovation. Increases in thermal performance as stipulated by the NCC lead to lower energy use, primarily from heating and cooling.

In Victoria, the <u>Victorian Energy Upgrades</u> (VEU) program, part of the Victorian Energy Efficiency Target (VEET) scheme, subsidises energy efficiency upgrades and appliance electrification in households and businesses to reduce energy consumption and greenhouse emissions in existing buildings. Recent and imminent changes to the

Residential Tenancies Act will also reduce energy use in rental dwellings – occupied by around 30 per cent of households.

Increasing energy efficiency of buildings and appliances, accelerated by these government programs, will reduce electricity usage and demand – countering the effect of electrification to an extent. However the net impact of electrification and improving energy efficiency is still expected to an increase in usage and demand.

3.2.3 CER growth

A third key aspect of the energy transition is the rapid uptake of CER. Households and businesses have continued to invest in distributed energy technologies such as solar photovoltaic (PV) systems and, increasingly, battery storage systems. By getting a significant share of their electricity needs from their own solar systems, consumers with CER draw much less energy from the grid during the day (and, with batteries, during evenings as well) has led to an increased diversity in energy generation and consumption patterns, creating a more complex customer environment for energy distribution businesses. Previously, customer energy usage was relatively homogeneous, with predictable demand curves that allowed for standardized network planning. But as more customers adopt CER, energy flow dynamics have become more variable, requiring more sophisticated demand forecasting models and network management strategies.

While growth in CER leads to reduced electricity usage (and to a lesser extent, where batteries are also installed, peak demand), it can also lead to technical issues in networks – especially when high solar exports are concurrent with low demand. Distribution businesses have needed to invest in dynamic management systems and other techniques to manage this volatility in the network. These measures are outlined in the business' CER enablement plans.

3.3 Tariff reform

One tool distribution businesses can use to help manage the more dynamic and variable energy demand of the future network is cost-reflective network tariffs. Designed strategically, tariffs can encourage customers with CER or flexible energy needs to adjust their usage in ways that offset volatility and also allocate the costs of managing volatility to those customers causing (and benefiting from) it. However, due to concerns about the risk of cost impacts on vulnerable consumers – despite analysis undertaken by the networks and shared with stakeholders that shows the risk is low and manageable – Victorian Government policy constrains distribution businesses' ability to impose default cost-reflective tariffs. This absence of mandated cost-reflective pricing has limited the ability of Victorian distribution networks to use targeted price signals to encourage efficient and future-focused energy usage patterns and allocate CER enablement costs more fairly.

Despite this constraint, AusNet and other Victorian electricity distribution businesses recognise the necessity of migrating as many customers as possible to more future-oriented pricing foundations. This effort requires proactive engagement with consumers and policymakers to ensure that pricing structures can support both affordability and network sustainability objectives.

3.4 Climate change impacts and resilience planning

In addition to economic and policy constraints, the physical impacts of climate change pose significant challenges for distribution networks. The increasing frequency and severity of weather events and their impacts on infrastructure – with severe storms and fires disrupting supply for whole communities – has highlighted the complexity of

assessing the trade-offs between investing proactively in network resilience (adding to the value of the regulated asset base (RAB), reflected in network charges over the life of the investment) versus post-event expenditure to repair the damage, restore supply and support affected communities (with the cost passed through to customers and recouped over a shorter period).

With growing reliance on electricity due to the shift from other fuels to electricity for vehicles, appliances and industrial processes, the resilience of the electricity supply system is becoming more crucial. Investments in network hardening, emergency response capabilities, and adaptation strategies have been required to mitigate the risks posed by climate change. The Australian Energy Regulator (AER) recently developed a new metric, the value of network resilience (VNR), to support a consistent approach to cost–benefit assessments of resilience investment. Victorian government directions to network businesses following its recent resilience review have also put additional obligations on the businesses to invest in resilience-related prevention and response measures.

3.5 Demand forecasts and investment challenges

Historically, demand forecasts to predict future network expenditure have been largely based on the continuation of historic trends of energy usage, population growth, industry development, and so on. But the dynamics outlined above have combined to create a challenging context for future demand forecasting. The increased diversity of energy sources, evolving consumer behaviours, climate change considerations, and regulatory constraints have made it difficult to predict future energy consumption patterns accurately. Still, network businesses must plan investment to support the long-term sustainability and reliability of the electricity grid.

Like other distributors, AusNet has developed more sophisticated forecasting tools using a range of data sources, network data from smart meters and bottom-up assessment to develop energy flow models to build various scenarios to inform its forecasts. But there is more uncertainty than ever before. AusNet's stakeholders have urged it to orient its proposals to this uncertainty, prioritising 'no-regrets' investments and designing projects to meet multiple needs and to be readily scalable and flexible. But with a revenue cap form of regulation, cost impacts on customers depend on energy throughput and if forecasts are materially incorrect, costs can materially change. This is an unavoidable risk with the current regulatory framework in the current context.

4 Research and Engagement

4.1 Approach and context

In commenting on AusNet's and assessing AusNet's research and engagement program we have considered the AER's expectations as outlined in the Better Resets Handbook.¹ We documented our assessment approach in relation to the Better Reset's Handbook in our report on AusNet's Draft Proposal (Section 4.1.1). We have continued to consider Better Resets Handbook Expectations in our assessment of AusNet's engagement in terms of how the business responded to feedback on its Draft Proposal, including:

- AusNet's engagement between publishing its Draft Proposal in September 2024 and in the lead up to lodging its Regulatory Proposal
- How AusNet responded to the feedback it received in its proposal

This section of our report briefly summarises our assessment of AusNet's engagement that informed its Draft Proposal and the issues we raised in our report. Readers who are interested in our detailed assessment are referred to Sections 4.1 and 4.2 in our October 2024 report on AusNet's Draft Proposal.

Our main commentary on AusNet's engagement in this report is on our assessment of AusNet's engagement with its broader customer base, its panels and the Coordination Group since AusNet published its Draft Proposal in September 2024. We have separately considered how AusNet responded to customer and stakeholder feedback in its Regulatory Proposal in the relevant building block chapters in this report.

4.1.1 Our assessment of AusNet's engagement to inform its Draft Proposal

In summary, in our October 2024 report, the Coordination group commended AusNet for:

- Preparing its 'living' engagement plan informed by a co-design workshop with customer representatives and stakeholders and periodically reviewing the plan to ensure it remained fit for purpose. This included responding to the original Stakeholder Reference Group (SRG) and chair's suggestions to reshape the SRG into a Coordination Group, establish a Research and Engagement (R&E) panel and appoint a new independent chair².
- Establishing the R&E panel dedicated to working with the business to contribute to its EDPR customer research and engagement, which is also tangible evidence of AusNet's commitment to ensuring its research and engagement activities are transparent and reflect customers' views.
- Regularly meeting with the R&E Panel to involve members and collaborate on engagement and research activities specific to informing the development of its Draft Proposal. For example, the R&E Panel contributed consultant briefs, consultant selection, consultant meetings to plan research and engagement activities and reviewed draft report. Key areas of R&E panel influence were:
 - A series of customer workshops undertaken at different stages throughout the development of AusNet's proposal
 - Research to Quantify Customer Values
 - Resilience Research

¹ AER, July 2024, Better Resets Handbook

² Noting the originally appointed chair stepped down from the role due to unrelated reasons

- Involving the R&E panel in AusNet's planning of its deeper engagement with other panels. For example, the AusNet tested its proposed approach to gathering wider panel member input at its offsite meetings with the R&E panel. AusNet then adopted various suggestions from the Panel at its off-site face-to-face meetings held in August 2023 at Kalorama, March 2024 at Epping and August 2024 in the Yarra Valley.
- Providing funding to allow members of all panels an opportunity to observe AusNet's customer workshops, thereby allowing individuals to form their own views of customer issues and preferences from what they observed and heard.
- Seeking and utilising R&E panel members' advice on broader customer communication and engagement related to the EDPR, such as AusNet's broader engagement to gain customer feedback on its Draft Proposal.
- Funding the Coordination Group to undertake work of our choice, provided it was related to and helped inform our advice to AusNet. This resulted in panel members being funded to independently gather evidence of customer needs and preferences (customer interviews) to help inform responses to the focus questions and to test customer support or otherwise for AusNet's proposals.

The Coordination Group also acknowledged that AusNet has invested considerably in its business-as-usual research program and appreciated AusNet sharing the findings with panel members to help inform their views.

4.1.2 Areas identified for further engagement

Our report on AusNet's Draft Proposal specifically noted some areas where AusNet had not engaged with either the Coordination Group, individual panels or the broader customer base, and we appreciate AusNet also noted these in its Draft Proposal. These areas largely focused on affordability, which was a central theme in our report. In particular, the Coordination Group encouraged AusNet to test customers' response to:

- The overall bill impact of the proposal when the individual components of AusNet's proposal are considered collectively; and
- Within this context test affordability and the associated trade-off between the cost to customers and the perceived value

We also note that at the time of publishing its Draft Proposal, AusNet was still developing its proposals on items such as its hazard tree program, its Regional Reliability Allowance (RRA), some customer experience initiatives, some step changes and benchmarking of capital expenditure.

4.1.3 Recent engagement with AusNet

Since publishing its Draft proposal, the R&E panel has engaged with AusNet in the following activities:

- Broader outbound communication of its Draft Proposal
- The design of the Round 4 Customer workshops
- A formal R&E panel meeting in November 2024 when AusNet presented the panel with an overview of the outcomes of its customer workshops
- The design of its refreshed customer satisfaction research

See below for further comments in relation to these the R&E panel's comments on its engagement with AusNet in relation to the customer workshops and its refreshed C-Sat.

4.1.3.1 Customer workshops (Round 4) Background In our report on AusNet's Draft Proposal the Coordination Group provided some feedback on the first three rounds of AusNet's customer workshops aimed at engaging with a breadth of customers from across AusNet's distribution network at different stages as AusNet developed their Draft Proposal. The R&E panel concluded its engagement with AusNet in shaping the customer workshops, regardless of the outcomes, was timely, sincere and transparent, although at times we felt under pressure to contribute quickly to not delay the progress. While the customer workshops were initiated and led by AusNet, the way the R&E panel worked with AusNet was largely *collaborative*.

While the R&E panel commended AusNet and the consultants on the conduct and delivery of the first three rounds of customer workshops, we noted several opportunities for improvement in the way the workshops were delivered:

- AusNet was ambitious in the feedback it was seeking which meant customers were
 presented with a large amount of content and the workshops (out of necessity) were
 highly structured
- We are not confident that all participants contributed to their fullest because of the size of the groups and the time taken to present content, including reflecting on the previous sessions
- The challenges and limitations in asking participants to engage on speculative topics, such as how they might behave *if* they owned an EV, particularly as we noted in one group only one person owned an EV.

Subsequently AusNet recognised the need to reduce the presentation time and allow more time to *listen to customers* during the fourth round of workshops.

The round four workshops focused on providing customers with an overview of AusNet's Draft Proposal and seeking customer feedback on key customer outcomes related to energy availability (reliability, safety and network resilience), the energy transition, customer experience and value for money and affordability. We were pleased to note that affordability and value for money were key topics for discussion at the workshops.

AusNet prepared an initial agenda which it shared with the R&E Panel. The R&E panel made several suggestions to improve the engagement in the workshops, such as a tiered incentive to reward participants who read the Draft Proposal and provided independent feedback to written questions ahead of their workshop attendance, to complement any collective feedback. We commend AusNet for incorporating the panel's suggestions into a revised agenda.

Panel members observed two of the Round 4 workshops³ and provided feedback to AusNet after each session. We noted the greater value derived from AusNet (rather than the consultant) presenting the highlights of Draft Proposal to customers. Panel observers commended AusNet on the quality of the information presented to customers, and they noted AusNet clearly explained the differences between value for money and affordability. They also commended AusNet for listening to customers and answering customers' questions. Panel observers also noted the ongoing engagement with participants over four rounds of workshops meant customers were well informed to provide some meaningful insights.

However, the observers noted some customers found it difficult to comment on the value for money and affordability of AusNet's proposal given network charges are not

³ Noting that technical issues prevented observation of the online sessions when participants were in breakout rooms.

specifically shown on customers' bills. In contrast, the consultant concluded in their report that:

"Generally, customers saw the proposal as value for money and affordable."⁴

The Coordination Group's view on the value for money and affordability of AusNet's proposal and other issues, which considers the customer workshop feedback and other evidence, is discussed in more detail elsewhere in this report.

4.1.4 Refreshed customer satisfaction research (C-Sat)

AusNet's C-Sat survey results are an important tool for the business to monitor the quality of its customer service and they are a key input into AusNet's Customer Service Incentive Scheme (SCIS). The existing outsourced survey has been in operation for around eight years. With the support of the wider panel membership in general, and the R&E panel specifically, AusNet is refreshing its customer satisfaction survey (C-Sat).

AusNet engaged with the Customer Experience Panel on the interactions and the Customer Experience Panel decided on the C-Sat interactions (see Section 7.2 of our report on AusNet's Draft Proposal) for the refreshed C-Sat survey. The agreed inclusions for the refreshed survey are satisfaction with AusNet's response to planned outages, unplanned outages, customer connections and first-call resolution of issues.

In scope for the R&E panel were the survey platform (*inform*), survey delivery and data collection method (*consult*), ensuring feedback channels are inclusive (*collaborate*), the questionnaire and drivers of satisfaction (*consult*).

Overall, the R&E panel supports AusNet's move to bring this research inhouse which will lead to improvements in the approach, including more timely (real time) data collection, improved sample size and representativeness, and allow AusNet to respond more rapidly to customer feedback.

On specific elements of the survey, AusNet acknowledged the panel's contribution which is documented in the published minutes on AusNet's engagement hub. Since that time, AusNet has worked with a Customer Consultative Committee member with direct experience as an AusNet customer to finalise the survey. More generally, survey oversight from a customer perspective may be something for the revamped Customer Consultative Committee to consider in the future.

4.1.5 Broader panel engagement

Following the Round 4 customer workshops to test consumer support for its Draft Proposal and inform its Regulatory Proposal, AusNet met with individual panels in November 2024 to brief them on the findings and resolve any outstanding issues, which also served to "close the loop" with respect to its engagement with individual panels.

AusNet has continued to engage with the Coordination Group, including:

- Meeting in December 2024 to receive feedback on the Round 4 customer workshops and consult on its proposed approach to addressing the Coordination group's concerns on affordability and other issues raised in our October 2024 report.
- Shared early drafts of the relevant sections of its Regulatory Proposal with the respective panel leads to ensure the language of the proposal was reflective of the panel's experience. The panel leads appreciate the opportunity to provide feedback and we made several suggestions which AusNet incorporated into its final version.

⁴ SenateSHJ, November 2024, Business and residential customer workshops: Round four report, p.32.

• Meeting with the Coordination Group in February 2025 to present its Regulatory Proposal, highlight changes since the Draft Proposal which also allowed the Coordination Group to clarify aspects of the proposal.

4.2 **Our perspectives**

Overall, from an engagement perspective, we appreciate AusNet's sincerity, transparency, and collegiate nature of the relationship between and with the business. We are confident AusNet has consistently welcomed our advice and challenge and has been responsive to our suggestions, information requests and challenge throughout the development of its proposal.

5 Capital expenditure

This chapter provides a summary of the capital expenditure elements of AusNet's Regulatory Proposal and our overall perspectives. Further detail of our perspectives on specific elements of their capital expenditure proposal is contained in Appendix A.

5.1 Introduction

Capital expenditure (capex) is expenditure on physical assets (and some types of software) that will endure for several years, or even decades. Accordingly, consumers pay for capex across the life of the investment and so it impacts consumers in this period and into the future. New capex programs (such as resilience capex in this proposal) are likely to continue into future periods and so can have a cumulative impact on bills.

In the regulatory framework, capex is a significant driver of networks' costs over the long term, because networks are compensated for capex investments via:

- *return of capital* (straight line depreciation over the asset life that varies from a few years e.g. 5 years for light vehicles or computers to 55 years for transmission lines)
- *return on capital* a return on the expenditure at a rate determined by the AER.

Around 65 per cent of AusNet's proposed revenue in 2026-31 comes from these two building blocks – 45 per cent from return on capital and 19 per cent from return of capital.

The majority of this revenue relates to past investments, and so the level of capex in the current period has a modest impact on allowed revenue in the period, but it also commits customers to pay for that capex for many years into the future, this has a compounding cost impact as new capital is added to the asset base.

Capex drivers fall into two broad categories:

- Some capex is carried out because in AusNet's view it is either the only or the most
 efficient way to meet legislated obligations or regulatory standards. In general, such
 capex is subject to a relatively low level of consultation closer to the inform end of
 the spectrum.
- Other capex is to deliver outcomes over and above these obligations and standards in line with customer preferences. AusNet has carried out greater engagement on these latter areas, targeting the 'collaborate' level of engagement with customers (as per the IAP2 Spectrum of Public Participation⁵).

5.1.1 Interpreting costs

Note on presentation of costs in this chapter: AusNet states that

"All dollar values in the Capex chapter have been expressed in direct costs (excluding real cost escalation, contractor support costs and network overheads) and real 2023-24 terms (unless otherwise stated)" p92.

The majority of the summary tables are then presented in \$2025-26 and, by inference include real cost escalation, contractor support costs and network overheads. Figure 6-3719 (sic) says it is in "\$m real Jun 2026". There are also multiple ways to "slice and dice" costs. Replacement expenditure is quoted on p95 as \$998.1m, \$1,231.7m in table 6.2, \$772.6m in table 6.6 and \$831.2m on p125 (as well as \$1,316m in table 6.3, but this is at least labelled as "AER preferred categories" indicating a different split from AusNet's preferred presentation). The larger figures include expenditure from other categories,

⁵<u>https://iap2.org.au/resources/spectrum/</u>

such as resilience (which is a new category of expenditure). There are various explanations within the chapter that assist in reconciling these different figures, but given so many ways to present the expenditure, we suggest AusNet consider a reconciliation table for future presentation. In our discussion of individual cost categories in Appendix A, we have typically included two figures – the direct cost quoted in the relevant section and the summary cost which we assume is grossed up for overheads etc.

5.2 Overview of AusNet's proposal

Table 5.1 summarises recent history of AER allowances, actual and forecast capital expenditure spend in the current period and AusNet's proposed spend in 2026-31. The figures in the table below are net of customer contributions and asset disposals. It shows a significant increase in proposed capex compared to the forecast for the current period and the AER allowance for the current period.

				2026 - 2031			
2016 – 2020		2021 – 2026		Draft proposal	Final proposal		al
AER allowance	Actual	AER allowance	Actual / Forecast	Forecast	Forecast	% chg vs 2021-2026 AER allowance	% chg vs 2021-2026 Actual / Forecast
\$2,488	\$2,120	\$1,701	\$2,047	\$3,512	\$3,496	+106%	+71%

Table 5.1: Capital expenditure summary 2016-2020 to 2026-2031, \$m (2025/2026)

Forecast current period capex is 20 per cent or \$346m above the AER's allowance. Many factors have contributed including increased labour and materials costs and unanticipated demand growth. These factors are expected to continue driving capex in 2026-31. When compared to the current period actual total capex is forecast to increase 71 per cent with large rises in some components:

- A 346 per cent increase in demand driven augmentation expenditure given assumptions on population growth and electrification
- A 32 per cent increase in replacement expenditure given ageing assets
- New and expanded expenditure for resilience and expansion of sub-transmission capacity to facilitate renewables connection

During our consultation in developing AusNet's Draft Proposal, we asked AusNet to extrapolate the impact of the proposed capital expenditure into the next period, to provide some assurance that it was not building in ongoing price rises. While this exercise had to make several broad assumptions, it was still useful in helping us understand the longer-term implications on customer bills of this period's proposed investments and we appreciate AusNet's efforts. The exercise confirmed that there was not expected to be a material impact on average prices beyond 2031 from capital expenditure in the 2026 – 31 period.

5.3 **Our perspectives**

5.3.1 Overall conclusions

It's important to note the difficulty of providing unequivocal support for the specific proposal in particular the proposed level of expenditure, noting that:

- in many cases it is based on detailed technical analysis to which we have had at best a limited exposure
- amounts and inputs have changed, sometimes materially, since our deliberations on a specific area
- it is the AER's role to assess the prudent and efficient levels of capital expenditure.

We therefore (qualitatively) support the proposed expenditures noting some areas have residual concerns and questions as summarised in Section 5.3.3 and expended on in Appendix A.

Notwithstanding our residual concerns, we consider:

- AusNet has done a good job overall of eliciting customer views, consulting and even collaborating with customers.
- AusNet's capital expenditure proposal is broadly consistent with customer preferences for the relevant types of investments.
- AusNet's capital expenditure proposal generally reflects the views and feedback expressed by the Coordination Group and the Panels.

5.3.2 Overarching considerations

In reaching our conclusions we note that customers have at least been at an IAP2 spectrum consult level or higher on approximately 25 per cent of total capex (\$754m). Additionally, AusNet engaged on some key inputs into other areas of capex, notably the design of its QCV research (as mentioned in our previous report) and its high level demand forecasting approach.

Robust governance is important in respect of discretionary, customer-driven capex that is allowed by the AER to ensure either that AusNet delivers what it has promised to customers, or that AusNet has a good explanation for why it has been unable to/decided not to deliver these outcomes paid for by customers.

Even where there is clear customer support for capex projects, that should not preclude the AER testing the capex for prudency and efficiency. We consider there is a partial exception to this principle in the case of worst served customer expenditure, which is discussed further in the reliability section in Appendix A.

Total capex proposed for the five-year period is \$3,496m, which is \$16m less than in AusNet's Draft Proposal. This can be disaggregated into two types of changes.

1) Response to affordability concerns

Page 93 of AusNet's Regulatory Proposal explains that they "have implemented some cost constraint measures" in response to customer cost-of-living concerns, totalling \$145m.

The measures include two permanent reductions and two deferrals into the next regulatory period. The permanent reductions are a \$42m "top-down adjustment" in response to updated AEMO demand forecasts and \$4m due to overhead productivity gains. The deferrals are a further \$29m of demand-driven augmentation expenditure (augex) due to their flexible services proposal and \$70m of network hardening (resilience). In practice, capex plans evolve over time as NSPs update their assumptions, obtain new information and revise investment analysis.

However, we appreciate AusNet reviewing its capex plans to find ways to reduce expenditure while still delivering against consumer preferences, which is consistent with our comment on page 2 of our report on AusNet's Draft Proposal that "the business

should consider now if there are opportunities to reduce costs in certain areas or avoid expenditure". We are of course unable to verify how thorough this review was or is.

The net effect of other changes as AusNet has refined cost estimates and updated its assumptions is an increase of \$165m (almost 5 per cent) on the Draft Proposal. While this includes a mixture of increases and decreases, the major component is an uplift due to AusNet's change in service provider from Downer to Zinfra, which primarily impacts fleet capex and replacement capital expenditure (repex). AusNet's rationale as outlined on page 105 of its Regulatory Proposal for this change is to:

- deliver better performance and outcomes for customers and stakeholders;
- improve visibility and control, and;
- strengthen community presence and increase control over operational assets.

The timing of the change creates some presentational challenges for AusNet. It had to increase some unit costs compared to the Draft Proposal, but it considers that it would ultimately have had to revise Downer unit rates upwards and that these would have been even higher than Zinfra. We note that connections expenditure has yet to be updated for Zinfra unit rates, so there could be further increases.

2) Building in a 'risk margin'

AusNet has built in a "risk margin to reflect contractual exposure to actual costs". It is unclear how this risk margin has been calculated whether it is higher or lower than any risk margin allowed under the Downer contract, or how this interacts with existing uncertainty and risk sharing mechanisms in the regulatory framework – for example AusNet proposes to have a Capital Efficiency Sharing Scheme (CESS) starting in the new regulatory period. The CESS will share cost variances between consumers and the business. Unsurprisingly the unit rates document has redacted the actual unit rates for confidentiality, so we must rely on the AER to evaluate these issues.

5.3.3 Perspectives on specific components of the capital expenditure proposal

The table below summarises the perspectives and residual concerns by category of proposed expenditure and includes the relevant Section reference from AusNet's Regulatory Proposal.

Appendix A provides additional detail and discussion on each of these categories.

Table 5.2: Coordination Group perspectives and residual concerns by capital expenditure category

Category	\$m, real 2025-26	Coordination Group perspectives	Residual concerns	Customer perspectives (directional)
Demand driven augex (Section 6.6)	\$431	 Support attempts to use other tools to manage peak demand Support use of AusNet QCV Support principle of conservative demand forecasting 	 Unclear what impacts are if tariffs and other tools don't constrain peak demand. Unclear how proposed pass-through for electrification will work in practice and if best risk management tool. 	 Customers want reliability to be maintained as their aggregate demand grows
Repex (Section 6.7)	\$998	 Support use of AusNet residential QCV Support reliability maintenance level of repex 	● n/a	• n/a

Category	\$m, real 2025-26	Coordination Group perspectives	Residual concerns	Customer perspectives (directional)
CER capex (Section 6.8)	\$43	 Support economically efficient enabling of export. 	• n/a	Customers expect AusNet to facilitate the energy transition
Reliability (Section 6.9)	\$148	 Support uplifting reliability for worst served customers beyond "economically efficient" levels 	 Governance of RRA important to get right, especially given \$ level proposed 	Customers support principles of uplifting reliability for worst served customers
Connections (net) (Section 6.10)	\$342	 Support AusNet seeking to manage uncontrollable risk of "new energy" connections 	 Look to AER to confirm if CESS exemption is best risk management tool 	Customers expect timely and cost- effective connections
Large renewables enablement (Section 6.11)	\$194	 Support AusNet investment to enable large renewables on Distribution network where efficient to do so 	 Is calculation of net benefits robust? All Victorian consumers benefit, but only AusNet customers pay 	Customers expect AusNet to facilitate the energy transition
Resilience (Section 6.12)	\$279	 AusNet has demonstrated Panel and customer support for some network hardening investment 	 Challenges in pinpointing climate risks to granular enough level to support investment case, have AusNet co- optimised with hazard tree reduction? 	Customers support additional resilience where affordable
ICT (Section 6.13)	\$422	Supportive of ICT to improve customer service	• n/a	Customers support improved customer services where affordable
Safety (incl. Rapid Earth Fault Current Limited - REFCL) (Section 6.14)	\$260	 Inform level engagement only 	• n/a	• n/a
Compliance (Section 6.15)	\$60	Inform level engagement only	• n/a	• n/a
Non-network (Section 6.16)	\$323	 Inform level engagement only 	• n/a	• n/a
Other	\$2	• n/a	• n/a	• n/a
Metering SCS	\$32	• n/a	• n/a	• n/a

6 Operating expenditure

This chapter provides a summary of the operating expenditure elements of AusNet's Regulatory Proposal and our overall perspectives. Further detail on our perspectives on specific elements of their operating expenditure proposal is contained in Appendix B.

6.1 Introduction

Operating expenditure (opex) is a key component of the overall revenue requirements making up 37% of the total nominal revenue AusNet is seeking in 2026-31. It is what is referred to as 'fast money' in that the network gets an immediate return of what it is spent – costs flow immediately into prices. This is in contrast to capital expenditure where the network gets a return on (Weighted Average Cost of Capital or WACC) and a return of (depreciation) capital over the life of the asset which could vary from 5 to 40 years - 'slow money'. This is why the 'efficiency' and 'productivity' of operating expenditure is so important.

The AER has an established methodology to assess a network's 'prudent and efficient' opex – it's called 'base, step, trend':

- 'base' the business as usual (BAU) starting point which is assessed based on the network's opex productivity position it a 'base year' (usually the last year in the current period that audited accounts are available for) against other networks drawing on the annual AER productivity analysis⁶; this is then subject to various adjustments to determine the base opex for the first year of the new period
- 'step' what new expenditure items are required some of which are the result of Government requirements and some are discretionary proposed by the network following consumer engagement, and
- 'trend' to take account of higher prices and more assets to maintain over the 2026-31 period; this is also calculated based on a standard AER approach.

The AER methodology also includes category specific forecasts and the application of the Efficiency Benefits Sharing Scheme (EBSS) that provides a continuous incentive for AusNet to pursue efficiency improvements in opex that are shared with consumers. AusNet has followed this established methodology. The result is that a large proportion of opex was not the topic of consumer engagement. Consumer engagement focusses on a few step changes proposed by AusNet which add up to less than 5 per cent of total opex. In addition, the Coordination Group also engaged on the complex issues around network productivity.

6.2 Overview of AusNet's proposal

Table 6.1 summarises recent history of AER allowances, actual and forecast spend in the current period and AusNet's proposed spend in 2026-31. It shows the significant increase in proposed operating expenditure compared with the forecast for the current period and the AER allowance for the current period.

⁶ For the most recent analysis published in November 2024 and covering 2022-23, see <u>https://www.aer.gov.au/documents/aer-2024-annual-benchmarking-report-electricity-distribution-network-service-providers-november-2024</u>

able 6.1: Operating expenditure summar	y excluding debt raising 2016-20)20 to 2026-2031, \$m (2025/2026)
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				2026 - 2031			
2016 – 2020		2021 – 2026		Draft proposal	Final proposal		
AER allowance	Actual	AER allowance	Actual / Forecast	Forecast	Forecast	% chg vs 2021-2026 AER allowance	% chg vs 2021-2026 Actual / Forecast
\$1,575	\$1,421	\$1,587	\$1,470.6 ¹	\$1,700	\$1,683.7	+6%	+14%

1. Excludes any pass through amount the AER may approve as a result of the September 2024 storms

AusNet provides no detailed explanation for the forecast underspend in the current period.

AusNet's application of the AER's 'base, step, trend' methodology is shown in Table 6.2.

 Table 6.2: Overview of AusNet operating expenditure approach

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Component	Detail
Base	• 2022-23 has been selected as the Base Year because it reflects ongoing efficient capex and audited actual expenditure is available
	 2023-24 was impacted by severe storm costs and GSL payments 2024-25 costs are not yet available
	• This has then been adjusted upwards \$62.3m by measures including:
	 Expensing capitalised corporate overheads from 2026-27 \$16m movement in provisions \$30m of inflation
	• The latest AER Benchmarking Report (2024 for 2022-23) shows that AusNet is 'not materially inefficient' so expects the AER to accept the Base Year forecast
Step	There are 11 step changes – 9 that add costs and 2 that reduce costs at a total net cost increase of \$131.7m or nearly 8% of total opex for the period; while this is slightly above the Regulatory Proposal increase of \$126.8m, the Regulatory Proposal did not include the large digital costs. The major positive i.e. increased costs, step changes are:
	 \$39.9m - digital - new initiative and opex associated with increased capex \$21.6m - regulatory obligation under the Emergency Backstop Mechanism \$15.7m - customer relationship management - customer driven initiative \$15.0m - hazard tree reduction as an opex/capex trade-off; this may increase in the revised proposal depending on development of the 3D LiDAR model which will allow identification of electrical line clearance breaches and encroachments of foreign objects such as vegetation and building or structure. \$10.5m - increased insurance premiums
	 \$9.2m – emergency preparedness and response \$8.0m – ESV direction for more frequent pole inspections
	The major negative i.e. lower cost, step change is digital efficiencies of -\$3.9m
Trend	The efficient base year is trended forward over 2026-31 to reflect changes in price, outputs and productivity. AusNet has followed the AER methodology on:
	real price growth for labour and materialsoutput growth

Component	Detail
	 the AER required minimum productivity growth of 0.5% per year (\$21.8m reduction) together with a range of affordability measures with a value of \$33m.
Category specific forecasts	 \$7.7m – innovation \$54.0m – Guaranteed Service Levels (GSLs)
Incentive scheme	Support application of Efficiency Benefit Sharing Scheme.

Many of the step changes reflect customer engagement outcomes where consumers indicated support for a range of additional services, particularly related to improved resilience. AusNet is also aware of the affordability pressures facing customers and which have been highlighted by the Co-ordination Group. AusNet has proposed a range of measures totalling \$62m to reduce forecast opex.

AusNet propose to apply the EBSS in the forecast period which is dependent on the base, step, trend forecasting methodology.

6.3 **Our perspectives**

6.3.1 Overall conclusions

Our overall conclusions are:

- AusNet has done a good job overall of eliciting customer views for the step changes where there was engagement (i.e. customer relationship management, flexible services and non-network solutions, innovation and hazard tree/resilience program), at times consulting and even collaborating with customers.
- their operating expenditure proposal for those step changes is broadly consistent with customer preferences and generally reflects the views and feedback expressed by the Coordination Group and the Panels, though we have comments on the hazard tree analysis.
- we generally support the categories of the discretionary step changes but agree with the AER's proposed priority assessment of the prudency and efficiency of all step changes.
- to note, as the AER does in its Issues Paper, that the number and total size of step changes is not consistent with the Better Reset Handbook expectations of step changes being small in number.
- notwithstanding the consistency with the AER's methodology we believe AusNet should be more ambitious in their opex productivity and look forward to the AER review of the methodology in 2026.

6.3.2 Overarching considerations

As noted above, while the Opex and Benchmarking Panel engaged extensively with AusNet, AER processes limit the ability of consumer engagement to influence total opex to <5 per cent of total opex. Accordingly, AusNet's engagement with the panel was generally at IAP2 Spectrum of Public Participation⁷ levels of 'inform' and 'consult'.

⁷ <u>https://iap2.org.au/resources/spectrum/</u>

Nevertheless, there are important issues for consumers that cover not just AusNet's expenditure plans, but also how the AER assesses opex efficiency across networks.

Affordability

A key issue across the whole proposal has been affordability. In our submission on AusNet's Draft Proposal, we highlighted that AusNet included only two specific affordability measures that totalled \$12m or 0.7 per cent of total opex.

AusNet's Regulatory Proposal expands this to eight specific affordability measures totalling \$62m or ~3.7% of total opex. However, only \$40m of these are measures AusNet has voluntarily offered. The \$21.8m from the 0.5 per cent per year productivity gain is an AER requirement, so the voluntary measures are 2.4 per cent of forecast opex. Many of the remaining costs are AusNet estimates of what it considers it could have asked for in the step changes but did not. This assumes had they asked for the additional costs the AER would have approved that addition. This seems to be the case for the 'saving'.

For example, in the case of the "Synergies between customer relationship managers and emergency preparedness staff (\$9m)." (page 239 of AusNet's Regulatory Proposal) there is also no description of how this amount was arrived at in Section 7.9.7 of AusNet's Regulatory Proposal that discusses the customer relationship manager step change. It is therefore difficult for the Co-ordination Group to judge whether the savings are 'real'. Subsequent advice from AusNet provided more detail on the operation synergies e.g. uplifting customer testing through establishing a panel at no additional cost and leveraging internal resources to cover expected DSO activities. Nevertheless, the assumption is that the AER would have approved that \$9m had it been included.

In summary, we find it difficult to assess whether all the proposed opex 'affordability' measures are indeed savings from what the AER would have approved were the additional cost included in the proposal – but acknowledge that AusNet has taken affordability seriously enough to revisit their Draft Proposal and find more opportunities to reduce expenditure.

Impact of higher capex on opex

The Benchmarking and Opex Panel put the proposition to AusNet that the large increase in capex spending in 2026-31 should have some influence on reducing opex. The repex discussion notes a key driver as (page 126 of the AusNet Regulatory Proposal):

"Deterioration in asset condition associated with increasing asset age which, if not addressed through risk- and inspection-based asset replacement, would give rise to increased network risk and unacceptable reliability and safety outcomes for our customers. This is driving the need for higher replacement volumes for some asset classes, such as poles and switchgear, in order to maintain service levels. Ageing assets are also difficult and costly to maintain due to reduced availability of spares, lack of manufacturer support and technical obsolescence."

While we recognise that a newer capital stock will not lead to a change in regular mandated inspections, we asked whether it would have an impact on repair costs as the newer investment were more reliable. AusNet says (p.231) that they considered this idea and found no reduction is warranted given mandated inspection schedules, no matter the asset age. AusNet also argues that as the remaining assets age, their maintenance cost increases to offset the lower maintenance costs from the new assets. Given these 'swings and roundabouts', AusNet's conclusion is that any lower repair costs are expected to be 'immaterial'.

We would encourage the AER to test this conclusion using their extensive historical datasets.

6.3.3 Perspectives on specific components of the operating expenditure proposal

The table below provides further perspectives and residual concerns for the step changes or other areas where there was consumer engagement and includes the relevant Section reference from AusNet's Regulatory Proposal.

Appendix B provides additional detail and discussion on all key components of AusNet's operating expenditure proposal.

Table 6.3: Coordination Group perspectives and residual concerns for step changes / other areas involving consumer engagement

Step Change Item	\$m, real 2025-26	Coordination Group perspectives	Residual concerns	Customer perspectives (directional)
Flexible services / non network solutions (Section 7.9.5)	\$8.5m	 Supported: will facilitate expansion and uptake of CER. 	• n/a	 Customers expect AusNet to facilitate the energy transition.
Customer relationship management (Section 7.9.7)	\$15.7m	 Support appointment of customer relationship managers across the network 	 The Customer Consultative Committee will need to monitor progress and commitments of not paying for this twice 	 Strong customer support
Hazard tree program (Section 7.9.9)	\$15.0m	 We support this expenditure category as a step change 	 There was insufficient evidence provided to support the proposed opex (\$15m) /capex (\$207.2m) is the optimum mix e.g. would more opex/less capex been more prudent and efficient? 	 There was clear support for this expenditure from consumer engagement
Innovation (Section 7.10.3)	\$7.7m	 Support this expenditure given conditions of "use it or lose it" and no EBSS. 	• n/a	 Supports increased CER which is a key initiative for customers

7 Incentive schemes and innovation

7.1 Introduction

In the current period, the AER approved a \$7.5m innovation fund for AusNet's innovation projects. At the start of the current period, AusNet formed an Innovation Advisory Committee (IAC) – comprising customer representatives, technical specialists, and representatives of other Victorian distribution networks – to bring a range of stakeholders into the process for prioritising and developing projects, and to support transparency and knowledge sharing. IAC members also proposed a new project – to understand customer and network impacts of electrification – which was developed and is currently underway and already giving useful results.

In 2024 AusNet sought feedback and suggestions from the IAC on improving the innovation program, including aspects such as criteria for projects, and governance arrangements. The IAC re-emphasised key aspects of the program such as the need to focus on customer benefits, collaborate and share findings with industry and other partners, to avoid duplicating work already being done elsewhere, and to retain flexibility to generate new projects as the need emerges over the period. The IAC also reaffirmed the importance of:

- The governance arrangements giving a range of external stakeholders the opportunity to have some oversight and bring transparency to it, helping to shape the program.
- The active advisory role of the IAC, empowered to propose projects and to interrogate the business as to how projects meet the criteria.
- Engagement with local communities where projects have local impact.
- Selecting projects based on their potential for creating value for all customers including commitments to collaborate and share outcomes – and the recognition that eligible projects could not proceed without innovation funding.

To be clear, these have already been features of the current innovation program, with the IAC having been formed partway through the current period and the stakeholder engagement and governance role being developed over that time. The IAC's request to the business was to retain and enhance them for the next period, and AusNet has committed to this.

7.2 Overview of AusNet's proposal

7.2.1 Innovation fund

AusNet has proposed a \$15m innovation fund (increased from \$7.5m in the 2021–26 period) for developing and trialling new approaches and techniques to address emerging challenges – with a focus on new customer services and tariffs, managing changing energy usage and demand, and network management. This is in addition to the proposed \$4.76m demand management incentive allowance (DMIA), for projects focused on managing customers' demand.

7.2.2 Incentive schemes

Demand Management Incentive Scheme (DMIS) and Demand Management Innovation Allowance (DMIA)

Consistent with the DMIS's objective to support non-network solutions as an alternative to augmentation expenditure to meet demand, AusNet has proposed a DMIA of \$4.76m (in line with the AER's approach to setting the allowance) for innovation projects to

support dynamic demand management – with a specific focus on managing minimum demand and developing critical peak pricing for large customers. Specific projects have not been nominated, favouring flexibility to meet emerging needs.

Service Target Performance Incentive Scheme (STPIS)

This is discussed more fully in Section 5 (capital expenditure).

Key issues have included:

- The interaction between reliability and Guaranteed Service Levels (GSLs) higher levels of reliability should result in lower GSL payments, so GSL forecasts should be lower than historical averages.
- Similarly, because reliability investment will improve service delivery, STPIS targets should rise over the period rather than be held constant; or AusNet should commit to fund some of the reliability program from STPIS rewards.

We note that AusNet have committed to both of these, which we welcome.

Capital Efficiency Sharing Scheme (CESS) and Efficiency Benefit Sharing Scheme (EBSS)

AusNet proposes that it should be subject to these incentive schemes, except to the extent noted in the issues paragraph below. These are discussed more fully in the Sections 5 (capital expenditure) and 6 (operating expenditure).

Key issues include:

- Exclusion from the CESS of certain types of expenditure such as connection costs related to new customer types (Public EV chargers, hybrid facilities, community and grid-scale batteries, and data centres) to limit adverse impacts on other customers, due to considerable forecasting uncertainty.
- Exclusion from the CESS and EBSS of innovation and Regional Reliability Allowance (RRA) expenditure because AusNet has committed not to seek to profit by underspending and funding for these is these is capped. These allowances are proposed on a "use it or lose it" basis.

Customer Service Incentive Scheme (CSIS)

Customer service improvements continue to be a stated customer preference. AusNet engaged significantly with customers and other stakeholders on the performance of the CSIS and on how it could be improved. In response to this engagement, some metrics were changed and revenue at risk was increased from $\pm 0.5\%$ to $\pm 1\%$.

Export Service Incentive Scheme (ESIS)

AusNet adopted the recommendation of the Future Networks Stakeholder Panel to not proceed with an ESIS because there were no clear 'pain points' that were not being dealt with by existing programs and expenditure.

7.3 Our perspectives

7.3.1 Innovation

The Coordination Group support the proposed expansion of AusNet's innovation fund to \$15m in recognition of the value to customers of the program.

7.3.2 Incentive schemes

The approach for the DMIA and DMIS are supported by the Coordination Group and reflects customer preferences to build in flexibility to respond to uncertainty.

The Coordination Group supports the proposed CSIS, provided that the metrics are sufficiently challenging and that customers are not paying twice – i.e. they are not funding the CSIS and a significant increase in capital expenditure to meet CSIS targets.

The Coordination Group also supports the ESIS and STPIS approaches as noted above.

8 Metering

8.1 Introduction

AusNet installed most Advanced Metering Infrastructure (AMI) meters between 2009 and 2014. Currently 99% of their 840,000 residential and small business customers have AMI meters, which are also used for voltage compliance monitoring for 95% of their customers. The oldest AMI meters are beyond their 15-year economic life, and the number of meter faults is expected to escalate over the next regulatory period.

8.2 Overview of AusNet's proposal

AusNet proposes to proactively replace AMI meters – 'smart meters' – for all residential and small business customers beginning 2028–29. The metering proposal also encompasses augmenting the AMI communications system and associated IT system, and an approach to encourage smart meter uptake by customers without them (and to reduce cross-subsidisation of manual meter reads by smart meter customers). The metering services program is described in chapter 16 of AusNet's Regulatory Proposal.

AusNet notes this approach as the most efficient way to meet the minimum service level obligations by avoiding the customer and cost impacts of meter faults and the high costs of a growing number of ad hoc replacements. The replacement meters, with the upgrades to the related IT and comms systems, also have improved functionality for the business (such as improved reliability needed for compliance with the National Electricity Rules and Victorian obligations, and greater capacity to record network performance data such as voltage variance) and for customers (such as increased ability to connect in-home devices and interface with third-party services).

8.2.1 Non smart meter customers

AusNet has also proposed an approach to manage the small number (5,500) of non-smart meter customers:

- not passing on the metering cost reduction to non-smart meter customers, to reflect that manual reading is a higher cost and to incentivise smart meter uptake; and
- offering fence-line or pole-top meter cabinets to customers concerned about proximity of smart meters to premises or whether other issues preclude installation on premise.

8.3 Our perspectives

The Coordination Group considers that while stakeholder engagement was more limited on this issue than on some other aspects of the proposal, AusNet has sought and considered stakeholder views and customer agency, and the proposal reflects these considerations.

Stakeholders supported the approach for non-smart metered customers as a nuanced way to increase smart meter penetration and lower metering costs going forward without compromising customers' agency.

9 Overall Regulatory Proposal conclusions

This section provides a summary of our conclusions on AusNet's proposed revenue requirement and resultant average customer prices in the Regulatory Proposal.

9.1 Introduction

The regulatory framework requires the AER to approve the maximum revenue ("revenue cap") that an electricity network can collect from customers over the duration of the regulatory period, in this case 2026 - 2031.

The [5-year] regulatory period is designed to create a stable investment environment. However in a period of high uncertainty and energy transition this can also pose risks of locking in inaccurate forecasts. The NER includes some mechanisms for dealing with select uncertainties (e.g. cost pass-through triggers and contingent investment projects) that can allow for costs that were not clear at the time of a revenue determination.

A network's revenue requirement is based on a building block approach that aggregates a number of inputs and components, most of which were not the subject of engagement with the Coordination Group or the Panels.

The components in the building block are:

- **Return on capital** based on the Regulatory Asset Base (RAB) and a weighted average cost of capital (approved by the AER). The RAB is an accumulation of the value of historic investments that an electricity network has made based on assets' useful lives and capital expenditure as discussed in Section 5 of this report.
- **Regulatory depreciation** based on an AER approved methodology applied to the RAB.
- **Operating expenditure** as discussed in Section 6 of this report.
- **Revenue adjustments** based on an AER methodology that allows for inputs such as the incentive schemes and innovation fund allowances as discussed in Section 7 of this report.
- Net tax allowances based on an AER methodology to allow for a benchmark tax liability amount.

The most material components within the building block are return on capital and operating expenditure which account for the majority of an electricity network's revenue requirement.

9.2 Overview of AusNet's proposal

9.2.1 Revenue requirement

AusNet has proposed a total revenue requirement in \$2025/26 real dollar terms of \$4,619m or a 13 per cent increase over the approved revenues in the current regulatory period. This increase in revenue is driven (in part) by the increased expenditure in areas already discussed in this report such as worst served customers, improved resilience, electrification and improved customer service.

For simplicity in the Regulatory Proposal, AusNet has proposed a "smoothed" phasing of the revenue requirement across the five-year period; in practice AusNet has some discretion on the phasing of the revenue.

Table 9.1 provides a summary of AusNet's overall (smoothed) revenue requirement excluding incentives (STPIS / S factor, H factor and F factor) for the 2026-2031 period and a comparison against the current and prior periods.

				2026 - 2031			
2016 – 2020		2021 – 2026		Draft proposal		Final propos	al
AER allowance	Actual	AER allowance	Actual / Forecast	Forecast	Forecast	% chg vs 2021-2026 AER allowance	% chg vs 2021-2026 Actual / Forecast
\$3 <i>,</i> 885	\$3,921	\$4,078	\$4,175	\$4,633	\$4,619	+13%	+11%

Γable 9.1: Revenue requirement summar	y 2016-2020 to 2026-2031, \$m (2025/2026)
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9.2.2 Affordability considerations

In the Regulatory Proposal (page 12) AusNet has noted that

"many customers are struggling with cost-of-living pressures, and we have consistently heard that they want keeping prices low to be our number one priority. Accordingly, we have had a firm eye on opportunities to reduce the cost of our plans for customers without compromising too much on service and reliability outcomes the whole way through our planning process. "

Table 0-1 (page 12) in AusNet's Regulatory Proposal identifies a number of measures aimed at addressing affordability, which AusNet are estimating will reduce costs by \$13 per year for an average residential customer and \$65 per year for an average business customer.

9.2.3 Forecast average prices

Whilst total revenues are expected to significantly increase over the coming regulatory period AusNet is forecasting average customer prices to be relatively flat. This is driven by the forecast increase in consumption which spreads the increased revenue across a larger customer and consumption base. For example, AusNet is forecasting:

- Households with gas and no electric vehicles to experience a 1 per cent real average price reduction over the 2026 2031 period.
- Households with all electric appliances and an electric vehicle to experience no real change in prices over the 2026 2031 period.
- Businesses' price impacts will depend on their size and range from no real change (small business) to a 2 per cent real average price increase (medium and large businesses) over the 2026 – 2031 period.

9.3 Our perspectives

As noted earlier the majority of the building block components are based on AER technical methodologies, and were not explicitly the subject of consultation with the Coordination Group or the panels. Accordingly, our perspectives on the overall revenue requirement and proposal are general and any detail is limited to those areas we have already discussed in earlier sections of this report.

In brief we believe:

- AusNet has done a good job overall of engaging with customers to elicit their views for those building blocks and components on those aspects of its proposal where it sought customer views (i.e. specific operating and capital expenditure items, incentive schemes and the innovation fund).
- The building block components where there was engagement are broadly consistent with customer preferences and generally reflect the views and feedback expressed by

the Coordination Group and panels – noting some areas have comments as previously discussed.

• That changing primary contractors was designed to provide opportunities for AusNet, however this change combined with the size of the increased capital expenditure, at a time of significant infrastructure development not just across Victoria but across eastern states, will also present risks for AusNet to deliver on their commitments.

9.3.1 Affordability

We support and note that AusNet explicitly considered affordability in revising their Draft Proposal and AusNet identified further opportunities to reduce expenditure.

However as previously discussed in aggregate these expenditure savings are relatively modest and we find it difficult to assess whether all the proposed 'affordability' measures are savings beyond what the AER would have approved in any event.

We also note that average customer prices, and hence affordability are heavily dependent on the achievement of the uncertain increased demand forecasts. These are influenced by factors such as electrification of gas appliances, electrical vehicle uptake and government policy settings including tariffs and consumer behaviour. Lower electricity demand, e.g. through a slower take-up of electrification of gas loads, could result in significantly higher prices.

To better address affordability concerns and the uncertainties discussed we encourage the AER and AusNet to consider:

- Where possible, efficient, prudent and practical "back-ending" cost recoveries to the end of the regulatory period.
 We believe this can increase flexibility to allow AusNet to promote certain products and services and encourage consumer demand if demand forecasts are below expectations. We also believe it will provide relief in the context of affordability given the current economic climate would appear to be more prolonged than many may
- like.
 Identification and development of specific "reopeners" which may require regulatory change. These reopeners can allow for specific events related to demand forecasts not currently realised.
- AusNet to uplift their information and education to influence the demand forecasts if needed along with promoting connection agreements and dynamic controls as proposed as this can offer real value to consumers.
- Continuing its strong advocacy to Government on areas such as tariff reform which can assist in reducing costs to consumers.

A. Capital expenditure – further detail

This Appendix provides further detail and our perspectives on key considerations influencing the capital expenditure proposal and the categories of the proposed capital expenditure.

Demand forecasting and uncertainty

Uncertainty is an inherent feature of the regulatory framework for energy networks, based as it is on ex ante forecasts of efficient costs of delivering network services to meet forecast demand – up to seven years out from the actual expenditure. Most of the underlying inputs are subject to a degree of uncertainty. There is a sense, however, that the energy transition is driving greater levels of uncertainty than before. As noted in the Regulatory Proposal:

"We acknowledge the future is difficult to forecast, and while our [AusNet's] investment plans are underpinned by robust demand forecasts, there is a need for greater flexibility within the regulatory framework to manage uncertainty over the pace of the transition" (p. 10)

And:

"Compared to previous price reviews, the energy transition is creating greater uncertainty when forecasting future trends and developments that will impact the electricity distribution sector." (p.15)

However, the same framework requires that networks' proposal is for a specific amount, based on point estimates for each of the building block categories and sub-categories. This underplays the uncertainty. Additionally, when testing their proposals with customers, networks must balance the need to present information in easily comprehensible formats against the richer information that comes from showing the uncertainties underlying the proposals.

Notwithstanding these issues, we consider it is important for both networks and the AER to continue to explore ways to account for the inherent uncertainties in this process.

In our report (page 3) on AusNet's Draft Proposal, we advised that:

"The uncertainty and impact of not achieving the expected demand forecasts and implications on customer costs should be further explored as too should any risk allocation in this regard. This could be via a scenario analysis or sensitivities"

Having Regulatory Proposals give a clearer picture of the range of possible outcomes from uncertain forecasts, as welcome as it would be, is not enough in this time of rapid change. We consider it is critically important to explore regulatory reform to establish new mechanisms to manage uncertainty and to allocate risk appropriately. Without this, consumers will be left carrying the can.

We are encouraged that AusNet is collaborating with other networks through their industry association, Energy Networks Australia (ENA) to carry out work in this area.

In the absence of such reform, AusNet's approach has been to develop its forecasting methodology to:

- better understand the expected scope of uncertainty
- make point forecasts as required by the current regulatory framework

 seek to protect itself against being obliged to spend in excess of its allowance to maintain service standards if demand is materially higher than expected, or if input costs are higher than expected.

To this end, AusNet has proposed three new pass-through events in addition to the five existing defined events. Two of these could impact capex – the supply chain disruption event and the electrification (i.e. demand increase higher than forecast) event. AusNet is also seeking an exemption from the capital expenditure incentive (CESS) for their large customer connections (discussed below).

While the volume and type of connections is customer driven and thus outside AusNet's control, the picture is more complex with respect to demand (load), which is another significant driver of capex - primarily demand-driven augex. This lies somewhere along the spectrum from exogenous/uncontrollable to endogenous/fully controllable.

Where it lies on the spectrum depends on a range of factors, including:

- customers' willingness and ability to be flexible with their load (or allow another party to control load)
- networks' efforts to induce load shifting through tariffs, network support payments and other tools
- the regulatory and legislative framework that governs the ability of networks and other parties to use load management tools.

In respect of this last factor, we note that AusNet's ability to use tariff signals widely is constrained by the Victorian Government's legislated policy on this matter. AusNet's research also indicates low level of interest from customers in responding to price signals (although they consider their demand tariff for commercial customers to have been effective).

In this light, we are supportive of the elements of AusNet's proposal – such as flexible services and flexible exports – that seek to utilise customer response and/or management of customer resources to avoid more expensive augex but note the uncertainties in achieving these outcomes. In the revised proposal, we consider there would be value in presenting more analysis of the alternative actions AusNet will have to take if some of these initiatives are not as successful as assumed for the purposes of the proposal, and what the incremental cost impact will be for customers. The outcomes of such analysis could be useful elements of AusNet's proposed communications plan in which it will be promoting the benefits of customer flexibility.

Values of customer reliability and resilience

AusNet's network investment is assessed on the net benefit it delivers for consumers. This includes reliability benefits, for which it uses a value of customer reliability (VCR) metric expressed as \$/kWh of avoided outages. The AER has a survey program to determine VCR values for different customer groups. Networks can then use those VCR values into their project assessments, covering different values for different customer segments e.g. residential consumers (by State/Territory and 'climate zone') business (agricultural, commercial and industrial) and very large businesses. The VCR survey is reviewed and undertaken every five years with the value in intermediate years being adjusted by CPI. When AusNet was preparing its proposal, it used VCR values from the 2019 survey with CPI escalation to 2023.

AusNet has carried out its own survey and using the AER's methodology along with more network specific data has arrived at its own VCR values (which it calls QCV). Their residential QCV values were well above the corresponding AER VCR values. Notably, due

to methodological differences between the QCV and VCR in sampling 'business' customers, AusNet considered it appropriate to use the AER's VCR for business ('agriculture', 'commercial' and 'industrial') customers and their QCV values for residential customers. As it happens at the time of this decision, this resulted in the highest figures being used in each customer segment (the higher the VCR, the more investment is justified). The CG advised AusNet to ensure they could robustly defend this decision so that it did not look like cherry picking, but aside from this point, we are supportive in principle of AusNet's use of QCV data given it is specific to its customers, but we recognise it is ultimately the AER's decision whether to allow AusNet's values.

In December 2024, just as AusNet were finalising their proposal the AER released its latest VCR figures based on the 2024 survey data⁸. We note that VCRs have changed substantially, with residential VCRs almost doubling so that they are now close to AusNet's QCV, while business VCRs have fallen to below AusNet's QCV. AusNet has had no opportunity to consider the implications of this in its proposal, but the CG considers it would be consistent with AusNet's position to continue to use AER figures where it has determined to do so, but to update them for the latest data. This is something AusNet could consider in any revised proposal.

Table A.1 summarises the different values.

Table A.1: Comparison	of QCV and VCR
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Source		Residential	Agriculture	Commercial	Industrial
1.	Combined approach - QCV residential + AER 2023 for rest	\$52.42	\$44.40	\$52.20	\$74.79
2.	AER VCR 2023	\$25.13	\$44.40	\$52.20	\$74.79
3.	QCV residential + AER 2024 for rest	\$52.42	\$22.25	\$34.29	\$32.01

Line 1 is what AusNet have used in this proposal – combining QCV for residential customers with AER 2023 VCR for other customers. Line 3 is what the values would be if Ausnet continue with their 'combined approach' incorporating the December 2024 AER VCR update – the approach we think they should follow. Had AusNet used only the AER 2023 values then the resilience capex proposal would have been reduced Line 1 capex by \$65m⁹. We await AusNet's advice on what impact applying Line 3 would have on resilience capex – as well as other capex justified on VCR.

AusNet's QCV research also produced some figures that could potentially have been used as a Value of Network Resilience (VNR), albeit they seem surprisingly low on a \$/kWh basis. AusNet also considered using data from customers on actual costs incurred due to longer term outages as a proxy for VNR. In our report on the Draft Proposal, we noted that further work was required to prove up this approach – for example, what proportion of expenditure on a back-up generator should be included in the cost of a single extended outage? In parallel, the AER have been developing a VNR and AusNet have decided to use

⁸ https://www.aer.gov.au/industry/registers/resources/reviews/values-customer-reliability-2024/final-report

⁹ Table 6-6 of AusNet Regulatory Proposal p. 103

the AER methodology. As this methodology uses VCR as a starting point, AusNet will need to update for the 2024 VCR data.

Holistic assessment of impacts on reliability

The CG advised AusNet that several elements of their Draft Proposal could reasonably be expected to result in an incremental improvement in reliability. These include the worst served customer projects, the proposed RRA, the resilience program, as well as more frequent tree inspections, some of the planned digital investments aimed at customer service improvements, and the change in service provider. Use of a higher VCR would also logically improve reliability as more investments would deliver net benefits than under a lower VCR. Another initiative that AusNet qualitatively argues will have reliability benefits is the change in service provider. AusNet claims that this will:

"...deliver better performance and outcomes for our customers and stakeholders (including how we respond to major weather events)" (p105)

which implies there should be some benefit to general reliability performance as well.

Accordingly, we considered that AusNet's STPIS targets should be adjusted upwards and their GSL forecast should be adjusted downwards. We would also expect there to be a beneficial impact on maintenance, given higher levels of relevant investment.

We commend AusNet for taking this advice and making an adjustment for STPIS targets and for GSLs (although it seems that they do not expect reduced maintenance requirements). It is unclear whether the adjustments are the best estimate of STPIS and GSL impacts. The STPIS adjustment relate to only three initiatives, the worst served customers, the BN11 upgrade, and the network hardening program. No adjustment has been made for SAPS, which we understand from AusNet have an immaterial impact on network-wide reliability metrics.

We also expect that the RRA, given that it is over 3 times the worst served customer projects expenditure in dollar terms, ought at a minimum to have similar impact on STPIS rewards, and potentially higher. AusNet have assured us that they will factor in the relevant adjustment to the amounts they claim under the RRA, which is proposed to be a "use it or lose it" fund and so scrutiny of these adjustments should be embedded into the governance of the RRA.

AusNet have accounted for the STPIS adjustments by making incremental reductions to capex rather than adjusting targets. We are not aware that AusNet has tested this decision with customers (noting that it is a relatively technical matter). AusNet's view is that this delivers customer benefits because the lower capex is "banked" by customers at the time of the project, while STPIS outcomes may take a year or two to become evident. While this seems reasonable, it seems more straightforward to adjust the STPIS targets, but this is ultimately a decision for the AER.

Accordingly, we expect the AER to carefully consider whether AusNet's adjustments to STPIS and GSLs are adequate in the light of the expected reliability benefits of their proposal as a whole, and also how best to reflect the STPIS benefits. Importantly, however, we recognise the effort that AusNet has gone to benefit customers by including these adjustments in their proposal.

Benchmarking and capital productivity

The AER measures changes in the productivity of electricity distribution networks for both capital and operating expenditure and then total productivity. This appendix

focusses on total and capex productivity. The next appendix provides perspectives on operating expenditure productivity.

AusNet's view appears to be that they are performing well on productivity, particularly when looking at the partial performance indicators rather than the econometric results in the latest AER results published in November 2024 that analysed performance up to 2022-23¹⁰. AusNet's conclusion was that:

"The AER's analysis should therefore give stakeholders some confidence that our cost performance compares well with our peers and, therefore, our forecasts reflect efficient unit rates, planning and delivery processes." (p110).

This analysis showed AusNet's overall (capex + opex) productivity position as:

Figure A.1: AusNet productivity position

DNSP	2023	2022	Change	Change	Change
	Rank	Rank	(2023)	(2006–23)	(2012–23)
AusNet (AND)	11↓	10	-2.1%	-1.0%	-0.7%

The same report shows AusNet near the bottom of its peer group (p28) and that capex productivity has been on a long term decline – 'AND' in the chart below.





The CG has challenged AusNet over its productivity performance, and we note the AER's summary comments in the 2024 report on capex productivity (p. 25):

"Capital MPFP, increased by 0.5% on average in 2023 with Evoenergy being the best performer (7.9%) and AusNet the worst performer (-4.4%) in terms of capital MPFP change."

Further, given these results are only up to 2022-23, they do not show the impact of the substantial expansion in capex spend over subsequent years.

¹⁰ https://www.aer.gov.au/documents/aer-2024-annual-benchmarking-report-electricity-distributionnetwork-service-providers-november-2024

We note AusNet's view that it is disadvantaged by its particular network characteristics, but even so we do not consider that it is a strong performer on capital productivity.

The capital expenditure factors for electricity distribution networks set out in clause 6.5.7 (e) of the rules requires the AER to have regard to the following:

"(4) the most recent annual benchmarking report that has been published under rule 6.27 and the benchmark capital expenditure that would be incurred by an efficient Distribution Network Service Provider over the relevant control period"

While it is clear how the AER's benchmarking impacts on opex where econometric opex efficiency scores can be directly applied to base year opex, it is less clear how it impacts on capex. The difficulty in applying the AER's capex productivity results is that the AER measures the productivity of capital stock (transformers, power lines) not capex expenditure. This means the benchmarking results cannot be used deterministically in capex assessments in regulatory determinations. The long-lived nature of a network's capital stock, as well as the AER's use of capital volume (transformer MVA, circuit MVAkm), as opposed to a capex dollar value rolled into the Regulatory Asset Base, limits using the capital productivity results in capex assessments beyond providing context for movements in network or industry productivity.

Given long asset lives, capital stays in the RAB a long time and it is difficult to turn around poor capex productivity in the short term. Nevertheless, that only emphasises the need for close scrutiny of proposed capex to ensure it does not contribute to a continuation of the long-term capex productivity decline. The AER does use the capex productivity as one of many information sources when is assess forecast capex. We recommend that how it is used be more explicitly explained in the final decision, and for the AER to provide more guidance on how it applies the capex expenditure factors in their decisions. This is even more important given the AEMC Draft Decision on the Victorian Government rule change¹¹ that puts additional capex expenditure factors in the rules covering the new expenditure category of resilience.

Notwithstanding our view, discussed in Appendix B, that AusNet should set itself a stronger opex productivity target than 0.5% pa, we are pleased to see AusNet volunteer to apply the 0.5% opex productivity target to capitalised overhead.

Deliverability

For customers to derive value for money from AusNet's proposal, it is essential that AusNet has the capability to successfully deliver a 72% increase (period-on-period) in capex over the next period with a 56% increase in capex spend in 2026-27 (\$639.2m) vs 2025-6 (\$409.2m).

AusNet provides a brief discussion of their strategic delivery plan on p.112 of their Regulatory Proposal. As AusNet notes, there is high demand for electricity infrastructure skilled labour, parts and equipment both in Australia and globally, and the risk of supply chain bottlenecks is high. This is particularly the case in Victoria where VNI, the Western Renewables Link and Marinus will be under construction during the 2026-31 period. The deliverability discussion mentions that AusNet (p.112):

"...have deferred several augmentation projects beyond their economic timing, to smooth the ramp-up in our capital program during 2026-31 regulatory period and further mitigate delivery risks."

¹¹ <u>https://www.aemc.gov.au/rule-changes/including-distribution-network-resilience-national-electricity-rules</u>

The implication is that deferral is a way of meeting their deliverability schedule. The value of these deferred projects is not clear – are they the same as the \$29m deferred demand driven augex referred to on p.93? Also, it is not clear whether these projects have been deferred to later in the 2026-31 period or into the following period – if the former then that puts more strain on deliverability in the latter years - \$609m in 2026-27 but \$730-743m in the last three years. Then there is still the issue of how to deliver a 56% increase in 2026-27.

Additionally, AusNet is just changing service provider, and there will inevitably be some challenges in the early years of the contract, despite both parties' best intentions. Accordingly, we cannot take much comfort in AusNet's examples of their track record which refer only to individual projects or programs as it is the *totality* of the capex proposal that must be delivered. We expect this to be a key area of scrutiny by the AER.

Governance

As noted above, some elements of the capex program are discretionary and are being proposed on the basis that they represent customer preferences, rather than are necessary to meet service standards and applicable regulations. This includes the majority of AusNet's reliability and resilience programs, the enabling large renewables expenditure, innovation expenditure and some elements of digital expenditure and CER enablement.

Arguably, the lack of mandatory drivers for these investments could allow AusNet to change its mind during the period, especially if finds itself under financial pressure because it is overspending against other elements of its proposal. There is clearly some reputational risk to AusNet if it were to simply cancel programs, and we consider it unlikely that AusNet would act in such bad faith. However, there may be marginal areas where there may be ambiguity whether AusNet has delivered against its proposal.

Accordingly, there should be some appropriate governance arrangements that cover monitoring of and reporting on expenditure and outcomes in these areas. In general, the support of the Coordination Group and the panels for discretionary expenditure is contingent on robust governance. To its credit, AusNet has proposed the following:

- The RRA and the innovation allowance will be use-it-or-lose-it expenditure (as the innovation allowance is for the current period) so that AusNet does not retain any unspent funds.
- AusNet will set up steering groups for the RRA (which may be the Consumer Consultative Committee (CCC)) and the innovation allowance (the Innovation Advisory Committee) to review proposed individual projects and ensure they meet the relevant criteria.
- AusNet will report on progress of these and other discretionary initiatives through its CCC.
- AusNet will arrange a "handover" meeting between the CG and the CCC to ensure the CCC are aware of the areas of expenditure they need to monitor.

While these are all suitable initiatives, governance would be further strengthened by AER also monitoring these areas of proposed expenditure. Unlike the CCC, the AER has the power to require certain data to be reported (i.e. via the annual RIN process).

Capex categories

Demand driven augex (Section 6.6)

Demand driven augex (\$320.1m/\$430.7m)¹² is projected to increase significantly over recent years as AusNet responds to a combination of increased customer numbers, new energy connections (data centres, large renewable and storage projects) and increased demand due to electrification policies. As noted above, there is more uncertainty than in previous periods around these forecasts, although we note that some of the major projects are in response to existing demand pressures and so may have limited dependence on forecasts.

AusNet has consulted with customer representatives on key inputs to its augex program, namely its approach to demand forecasting and the QCV/VCR figures it has used (see above for more detailed discussion on these elements). Its use of these inputs is consistent with customer feedback. Specifically it considers its approach to demand forecasting to be conservative, thus contributing to the affordability of its overall proposal. The quid pro quo is that it is seeking to mitigate the risk that it has underforecast by seeking a new pass-through event.

AusNet considers its ability to mitigate underlying demand growth through tools such as tariffs to be limited, noting that for residential customers:

"... customer response to time of use tariffs has been historically low and insufficient to defer augmentation" (p113), and

"As moving to cost-reflective tariffs in Victoria is optional, we do not have certainty of tariff take-up, making it more difficult to estimate our customers' demand response" (p114)

while Section 6.6.2.1 talks about one factor supporting the joint second highest utilisation rate' being:

"Tariff innovation, with AusNet being the first network in the NEM to introduce Critical Peak Demand pricing for our C&I customers – a program that successfully runs today." (p.114)

Overall, AusNet has accounted for some tariff effect and also its flexible load program in determining the level of demand it will need to meet during the reset period. The expected impact of these initiatives is unclear. The flexible load program is costed on an avoided augmentation basis which provides some indication but of course if it successfully procures load flexibility at a lower cost than this, then there may be scope to expand this program further. It would be useful to understand what additional capex AusNet is proposing because of limitations placed on it in using more cost reflective tariffs to improve network utilisation.

As AusNet and other electricity distribution networks are proposing higher augex than previously periods, it is timely to consider what – if any – useful information can be gleaned from utilisation statistics, which the AER collects and publishes annually. AusNet note that "network utilisation is anticipated to reach 75%, up from 60% today, which is already much higher than the 40% average across the [NEM]"p12. It's unclear to stakeholders whether 75% represents an increased risk of demand-driven outages versus

¹² As noted in Section 5.1.1 of the main body of this report, different figures are cited in the proposal for each category of capex. In this appendix, the first figure is the direct cost estimate, in \$2023/24, which is used in the section of the proposal discussing that expenditure item. The second, higher figure includes overheads and real cost escalators and is also rebased to \$2025/26. This is the figure used in the summary of capex at the start of the capex section in the proposal.

efficient use of assets, and more clarity on how an optimal level of utilisation might be determined (if possible) would be informative.

Replacement (repex) (Section 6.7)

Repex is also expected to increase significantly up 29 per cent from the previous period to (\$831.2m/\$998.1m), albeit in this case the main driver is an ageing asset base. AusNet has presented on its repex strategy to the CG and we are supportive of an economically efficient repex program (as opposed to deliberately "sweating the assets" to minimise capex with the risk of more outages due to asset failure), but of course we have to defer to the AER to confirm if AusNet's program is efficient and will need to be reviewed for the impact of the 2024 VCR figures.

Customer feedback generally favours maintaining reliability levels, too.

CER enablement (Section 6.8)

AusNet engaged with the Future Networks Panel on this area of expenditure (\$35m/\$43m), which includes the development of a flexible exports offer and network augex to enable additional CER exports where efficient to do so (using AER derived values of emissions reduction and avoided curtailment of CER). The Panel agreed with Ausnet that economically justified CER enablement should "increase network utilisation and unlock value for all our customers" (p146). Customer research indicates that AusNet's customers are generally in favour of maximising utilisation of rooftop PV. AusNet's proposed expenditure in this area is also consistent with customer attitudes, which are generally in favour of enabling the use of CER and making the most of rooftop PV output.

We support the use of CER to enable better utilisation, two examples are flexible exports and tariffs. Flexible exports have the potential to be very effective however there may be limitations in the effectiveness of tariffs.

As with demand forecasting and augex, we note the tensions in the proposal between AusNet's ambitions to engage residential customers to respond to tariffs and participate in demand response and networks support programs on the one hand, their feedback that residential customers have shown limited response to date to price signals (see s6.6), and the uncertainty around the extent of other forms of demand response.

For example, AusNet's approach to optimising network utilisation is stated as (p.143)

"The CER strategy includes initiatives that optimise network utilisation through new and innovative tariffs, including a new optional two-way CER tariff for small customers, with rewards for evening exports."

In Section 6.6 of the Regulatory Proposal AusNet notes that residential customers have limited responsiveness to cost-reflective network tariffs to, the extent that it is unlikely to defer augmentation. This is further impacted by Victorian Government policies preventing mandatory tariff reassignment for most customers.

With regard to unlocking export capacity and managing minimum demand, Fig 6-31 in AusNet's Regulatory Proposal (p. 145) talks about demand side behavioural solutions including cost-reflective network tariffs and the optional two way CER tariff.

While Section 6.8.3.1.1 (p.145) refers to the complementary role of an opt-in Flexible Exports offer (curtailing exports when necessary but having a higher export allowance at all other times), assuming 70 per cent uptake. It seems reasonable that the CER tariff and flexible exports offering would generate more response than time-of-use tariffs, because

there is a clearer value proposition for customers and the response can be baked into the CER system design.

AusNet's estimate of 70 per cent uptake seems reasonable, based as it is on their own experience with internet connectivity constraints in rural areas and the experience of other networks with similar initiatives. However with limited experience of a novel service that requires some engagement and understanding from customers to opt-in to, there is a degree of uncertainty around the 70 per cent uptake assumption and the impact on CER capex if the uptake rate is lower is not clear. More clarity here would be welcome.

Reliability (Section 6.9)

As noted above, the standard regulatory approach to reliability is to target maintenance of current levels of reliability. Additionally, the STPIS incentive provides an incentive to spend money not included in the ex-ante building block assessment where a network can cost-effectively increase reliability at the margins (i.e. it is funded from the STPIS payments, rather than the building block). Reliability benefits are assessed by applying the prevailing VCR to cost-benefit analysis of projects. The STPIS incentive and standard reliability metrics are assessed on an average basis. This approach means that there are some customers - typically on long rural feeders, with low customer density – who experience much worse reliability than average but for whom there is never sufficient incentive for the network to improve their reliability.

AusNet customer surveys support in principle the concept that regional and rural customers deserve the same level of reliability as urban customers. AusNet's Willingness-to-Pay QCV research indicates that customers are willing to pay a modest increment to their bill to fund upgrades for such customers – almost \$30 per year. This is equivalent to a capital program of around \$800m, which is several times higher than AusNet's proposal in this regard. The Network Outage Review set up by the Victorian Government in the aftermath of the February 2024 storms event recommended minimum reliability standards across the state, although the Government has yet to commit to such a move. Nonetheless there is broad support for the concept of uplifting reliability for customers facing well below average levels of reliability even if the net benefit based on VCR values is negative.

AusNet's proposal has been well tested with its Availability Panel which endorsed the AusNet's worst served customer expenditure proposal and the principles behind the RRA. The optimal level of the RRA is less clear, but there was support during the Panel process for a material amount of money to be included in this allowance, contingent on robust governance arrangements along the lines of those set out in the proposal.

Accordingly, we consider that the AER should evaluate this element of the proposal given clear customer support and that it would not be appropriate for the AER to reject the expenditure purely on the basis that negative net benefit projects are not "prudent and efficient", though of course the AER may choose to substitute in a different amount. If the AER has concerns about the specifics of the proposal, we would expect them to propose an alternative approach to address the issues faced by "worst served customers".

Connections (Section 6.10)

AusNet is forecasting \$342m of connections expenditure net of customer contributions. Connections expenditure is primarily driven by demand from new/upgrading customers and so the volume of connections is outside AusNet's control, although they have scope to manage the costs of carrying out connections. AusNet is overspending against its ex

ante assumptions for the current period, including due to more new customer types, such as data centres, grid connected batteries and generation, and public/depot electric vehicle (EV) charging, and it expects these areas to continue growing into the next period. These connection types are often more expensive and may be more bespoke so are particularly hard to forecast ex ante. It is unclear how much flexibility AusNet has to change its connections policy regarding the level of customer contributions.

To manage this risk, AusNet is proposing an exemption from the CESS for these types of connections (\$88m). This would reduce its exposure to over/underspend against its forecast. There would still be some risk, as although the full expenditure would be rolled into the RAB at the start of the next period, AusNet would have foregone (or retained in the case of underspend) a return on capital for the period from when it incurred the expenditure to the start of the next period. This amount would be greater for over/underspend at the start of the period than near the end.

We have sympathy for AusNet's position and appreciate that unlike some other electricity distribution networks they have targeted their CESS exemption request only to those new types of connections that are especially hard to forecast. This approach was supported by the Future Networks Panel on the basis that AusNet has opportunities to reduce potential overspend via flexibility measures and appropriate settings for tariffs and connection fees, while customers stand to benefit from any underspend. It is unclear whether AusNet's proposed approach is the best way to mitigate customer risks. We welcome the AER exploring the full range of options available under the existing framework to manage such risks, providing they determine that it is appropriate to treat this category of expenditure differently from general capex.

We note that, unlike repex (see p. 125), the unit rates in the Zinfra contracts are not yet reflected in connections capex (see p. 165).

Large renewables enablement (Section 6.11)

Our report on the Draft Proposal noted that the Future Networks Panel had supported in principle AusNet investing money in enabling distribution-connected large renewables where that would deliver lower total system costs than otherwise. Expansion of renewables connections via spare capacity in the distribution system is likely to be both lower cost and quicker compared to building ISP projects that require significantly greater capex and social licence community engagement.

While AusNet argue that a driver for this investment is Government emission targets, these targets means that this expenditure will not deliver more renewables overall, just locate them in a different place and potentially deliver them slightly earlier if this approach avoids transmission bottlenecks. Thus, the market and emissions benefits AusNet cite (p172) are temporary at best. It's unclear if there is transmission investment consequent on AusNet's proposed investment i.e. expansion of the AusNet transmission network to ensure the increased renewables production is able to be exported to the demand centres.

However, AusNet's proposed (\$156m/\$194.1m) for this item is materially higher than the figure presented for Panel consideration, due to the addition of deferred unfunded projects from the current period. We do not have robust evidence of the proposition that this will result in lower total system costs. While it would almost certainly be more efficient to facilitate distribution connection where there is spare capacity on the network, the material investment upgrade required means that AusNet need to robustly demonstrate that their proposed approach is lowest cost. The analysis presented seeks to estimate the benefits in terms of the value of emissions reductions, the market benefits

from lower pool prices combined with customer support for the initiative rather than the marginal benefit of the augmentation in the AusNet distribution network compared to through an ISP project in Victoria.

The analysis concluded that (p.169):

"Our proposal is to unlock capacity in our sub-transmission network to enable more renewable generation and storage, in areas where the benefit of those investments outweighs the cost. Investing \$156m in the 2026-31 period will deliver \$382m of benefits..."

and (p.171):

"Our proposal is to unlock capacity in our sub-transmission network for renewable generation and storage, in areas where the benefit of those investments outweighs the cost. All Victorian and NEM customers benefit from this investment through lower wholesale energy prices, as more renewable energy is unlocked."

We do not support the implication that AusNet customers should be willing to pay capex up to \$382m (the full estimated benefits). Indeed as AusNet notes from their customer engagement on this issue:

"A caveat over support for the large renewable connections enablement proposal is that customers and stakeholders want AusNet to provide more evidence that customers would be better-off-overall. While customers in the workshop were generally comfortable with others benefitting (even if they were not directly paying), they did want confidence that AusNet customers would benefit."

There is no mention of contributions from connecting renewable generators so we assume the full capex cost will go into the RAB (recent experience is that actual cost of transmission projects is considerably above the initial estimate). AusNet seeks to, but fails to address the 'who pays' concerns of AusNet customers vs all Victorian customers:

"As highlighted, there is a significant opportunity to unlock more customer benefits through investment that enables large renewable generation in AusNet's sub transmission network. Our planned investment demonstrably delivers net benefits to our distribution customers whilst also providing benefits to the broader NEM. This approach ensures that the Large Renewable Enablement Program is consistent with the updated NEO and capital expenditure objectives of the National Electricity Rules. It also addresses stakeholder feedback regarding 'who pays' for the augmentation, by ensuring that distribution customers are net beneficiaries from any proposed augmentation of the sub-transmission network."

We are supportive of using the distribution network to hasten the connection of renewables but have our concerns about AusNet's approach to valuing the benefits to their customers of the proposed program. We consider there would be value in the AER developing a guideline for evaluating the benefits of this type of expenditure to provide clarity to electricity distribution networks and stakeholders.

We note that AusNet does not have the power to spread the costs more widely across all Victorian electricity users, which may explain the way they have attempted to justify this expenditure as delivering benefits to their customer base specifically in excess of the costs. Other electricity distribution networks are facing a similar dilemma and we consider policymakers should urgently address this issue and find a way to share the costs of DNSP investment that benefits all consumers in a region (and arguably has some NEM-wide benefit too).

We think it is unreasonable to expect AusNet customers to pay the full cost of the projects when the benefits of lower prices accrue to all Victorian customers, but this would be mitigated if it's clear that AusNet customers will also benefit from similar projects funded by other networks' customers. This is why a regulatory process that can consider costs and benefits across the entire region would have value.

We note that there was a diversity of views among customers and stakeholders on this issue, but also that many AusNet customers were broadly supportive of some investment to facilitate meeting broader emissions reduction and renewable energy targets, particularly when it brought net benefits.

Further, AusNet customers are effectively subsidising renewable generators to connect earlier which has a clear benefit to those generators which would otherwise be waiting for the completion of ISP projects.

Resilience (Section 6.12)

Resilience (\$226.4m/\$279.4m) is a new category of expenditure. It has been driven by AusNet responding to customer concerns with the extended power outages many of them faced during a series of major storms from 2021-2024 and a major bushfire in the 2019-20 summer. These storms were amongst the worst extreme weather incidents in AusNet's history and occurred at a far higher frequency than before. Accordingly, AusNet has developed a proposal for network hardening to improve the resilience of its network to extreme weather and for non-network solutions to improve its response to such events. These items have been tested with customer panels and have found broad in-principle support.

We note that the challenge with the network hardening proposal – albeit we appreciate AusNet has invested considerable resources in developing a long-range forecast of extreme weather risks and evaluating different options to strengthen the network against such risks – is that while climate modelling enables forecasting at the feeder level, there is still a risk that specific network hardening investments will not turn out to be in the specific locations hit hardest by future weather events and so the benefits may not materialise in the current or next period.

Notwithstanding these risks, customers have indicated support for proactive resilience investment and the general case for such expenditure has also been made by the Network Outage Review final report. AusNet has had to develop its proposal in a rapidly evolving regulatory environment, with two Victorian reviews and an AEMC rule change process on a rule change proposed by the Victorian Energy Minister in train. The AEMC Draft Decision¹³ provides for the new resilience expenditure factors it proposes would be taken into account by Victorian electricity distribution networks in their revised Regulatory Proposals and the AER must take these factors into account in its final determination for 2026-31. Initial advice from AusNet is that applying these expenditure factors would not change the resilience capex request.

As AusNet has noted, given the scale of its proposed resilience investment program, and the long-term nature of the benefits, it is a potential candidate for partial deferral, and this is reflected in the proposal which splits the program over two regulatory periods. Some customer representatives indicated a clear preference for carrying out the full program in the current period, even after accounting for the bill impact.

¹³ See p. iv <u>https://www.aemc.gov.au/sites/default/files/2025-02/draft_determination.pdf</u>

A complementary approach is to focus on preparing for a rapid and effective response to events. This has traditionally been the approach in Queensland for example. Recent analysis for Energy Consumers Australia ¹⁴has also supported this approach. AusNet has proposed \$13m investment in Community Hubs, Mobile generation and Batteries and Emergency Vehicles to allow it to better respond to extreme weather and provide alternatives for customers enduring prolonged outages.

AusNet has proposed \$6.2m for Stand-Alone Power Systems (SAPS) in suitable locations, generally at the ends of feeders in low customer density areas. AusNet's SAPS program was canvassed with the Availability Panel which supported the program on the premise that it was demonstrably cost effective. AusNet's proposal for 25 SAPS in the period is substantially lower than what the Panel was presented with, but we are satisfied that this adjustment is due to revised analysis of the net benefits.

Digital expenditure (Section 6.13)

AusNet proposes digital expenditure of (\$404.2m/\$422.4m), a 22 per cent increase on the previous period. ICT opex is also increasing. While there are some trade-offs between capex and opex (such as the trend towards cloud-based applications and software as a service), other digital investments require an increase in opex to monitor and maintain the outcomes of the investment.

Elements of this proposed expenditure have been discussed with customer panels – especially those investments where a key driver is customer satisfaction, resilience or supporting customers through the energy transition. These elements are consistent with panel support for the initiatives, but of course we defer to the AER to determine the prudency and efficiency of these initiatives.

Safety and environmental expenditure (Section 6.14)

Compliance (Section 6.15)

Non-network expenditure (Section 6.16)

There has been relatively little consumer engagement on these three areas with the first two being primarily driven by mandatory requirements. Note that non-network expenditure includes a material amount of expenditure to bring fleet vehicles in-house following the change in service provider. Naturally the AER will need to ensure this represents value for money for consumers in the context of the overall service contract and its impact on the proposal.

One exception is the voltage compliance program (\$23.3m) within the compliance category. This was considered by the Reliability Panel, who noting the low level of awareness of potential voltage issues, supported AusNet's lowest cost compliance approach over more expensive approaches targeting above-standard performance.

¹⁴ Approaches to electricity network resilience & consumer electricity resilience, Erne Energy, October 2024

B. Operating expenditure – further detail

This Appendix provides further detail and our perspectives on the building blocks of AusNet's operating expenditure proposal.

Base year opex

We agree with AusNet's analysis that the operation of EBSS means the forecast revenue requirement is unaffected by the choice of the base year.

The measure of base year efficiency and opex benchmarking

AusNet's narrative on the 2024 AER Benchmarking Report for 2022-23 is (p.232):

"...AusNet is efficient compared to its peers. AusNet has a long history of responding to the regulatory incentives by driving efficiency savings over time."

We discussed opex benchmarking in our submission on the Draft Proposal. The AER used this benchmarking to assess whether the proposed base year operating expenditure is 'not materially inefficient' drawing on the econometric cost function results. If it is materially inefficient then the AER reduces the Base Year cost to the 'not materially inefficient' level¹⁵. We provided the following data from the 2023 AER Benchmarking Report (data up to 2021-22) that the AER uses in its assessment and this table now adds the results of the 2024 Report that includes results up to and including 2022-23¹⁶.

Table B.2: AusNet operating expenditure productivity ranking

AFD methodology	AusNet rank ¹		
ALK Methodology	2023 Report	2024 Report	
MPFP (2006-22/2006-23)	12 th	9 th	
Econometric model average (2006- 2022/2006-2023)	6 th	6 th	
Econometric model average (2012-2022/ 2012-2023)	5 th	5 th	

1. Addressing capitalisation differences, ranked out of 13 electricity distribution networks

The 2024 AER report shows:

- the long-term trend is for the electricity distribution networks' operating expenditure productivity to converge, with the most efficient firms experiencing declining productivity
- overall productivity (total factor productivity) declined from 2006-2015 at an annual average of 1.4 per cent but has increased at an annual average of 0.9 per cent since 2015 driven by increased opex productivity; AusNet's overall productivity has fallen at an average annual rate of 1 per cent for 2006-23 and 0.7 per cent for 2012-23
- productivity for all electricity distribution networks decreased by 2.5 per cent in 2023, the largest year-on-year decrease in distribution industry productivity since 2012;

¹⁵ For an example, see the discussion at pp 2-3 of the AER's Draft Decision on Ergon for 2025-30 https://www.aer.gov.au/system/files/2024-09/AER%20-%20Draft%20Decision%20Attachment%206%20-%200perating%20expenditure%20-%20Ergon%20Energy%20-%202025-

^{30%20}Distribution%20revenue%20proposal%20-%20September%202024.pdf

¹⁶ <u>https://www.aer.gov.au/industry/registers/resources/reviews/annual-benchmarking-reports-2024</u>

driven primarily by an increase in opex (contributing -3.2 percentage points to productivity growth in 2023)

 AusNet is ranked below the median (with 13 electricity distribution networks, the median is between the 6th and 7th ranked DNSP) on MPFP, and just above the median on the econometric model.

It's hard to reconcile these rankings with AusNet's statement that it is efficient compared to its peers.

The 'not materially inefficient' opex productivity threshold is 0.75 where the best (the 'efficiency frontier') is 0.95-1.0. Powercor is just below 1.0 for both 2006-23 and 2012-23. This says is that an electricity distribution network that is 25 per cent below the most efficient network is still considered 'not materially inefficient' and there is no downward adjustment in their base year opex. AusNet was 0.80 for 2006-23 and 0.76 for 2012-23. So AusNet is in the middle of a group that are, at best, not improving much over time.

There is a perennial debate between networks and the AER on the usefulness and accuracy of the AER benchmarking data. Every network considers they are 'special' and the results do not accurately reflect their specific Operating Environment Factors (OEF). The AER does apply an OEF adjustment factor but this is considered inadequate by poorer performing networks. AusNet has some reason to argue its case given the densely vegetated landscape of much of its service area leaves it open to a higher incidence of bushfires and storm damage as well as the consumer profile (dominance of residential leading to lowest average consumption and average maximum coincident demand), which disadvantages it in the productivity calculation. AusNet also consider their service area has an unusually unfavourable topology (i.e. it's hillier than most DNSP areas).

Even if AusNet were to benefit from a further OEF adjustment, there is still the fundamental issue of the 0.75 benchmark and why a company that is 25 per cent less efficient than the most efficient should still be classified as 'not materially inefficient'. While consideration of this level was not within scope of the 2018 AER review that led to the requirement of a minimum 0.5 per cent per year productivity factor, it was a matter raised in the AER CCP submission as important for the AER to review¹⁷. The 0.75 level was originally set in 2015 when there was considerably less productivity data available than today. This lack of data (and the context of court action against the AER over opex productivity decisions when merits review was still available to networks) led the AER to be very conservative in setting the benchmark.

The AER has announced that a review of this benchmark will proceed in 2025-26¹⁸. We infer that this means that any decision will be too late to be applied to the 2026-31 period.

In summary:

 While the claim that 'AusNet is efficient compared to its peers' is correct in the context of the AER's methodology, our view is that AusNet is in the middle of the pack in a group that is collectively struggling to reverse a long term decline in productivity, and

¹⁷ <u>https://www.aer.gov.au/system/files/CCP%20-</u>

<u>%20Submission%20to%20the%20AER%20Opex%20Productivity%20Growth%20Forecast%20Review%20Draft</u> <u>%20Decision%20Paper%20-%2020%20December%202018.pdf</u>

¹⁸ See discussion on pp. 65-66 <u>https://www.aer.gov.au/system/files/2024-11/AER%20-</u>

^{%202024%20}Annual%20Benchmarking%20Report%20-

^{%20}Electricity%20distribution%20network%20service%20providers%20-%20November%202024_4.pdf

- AusNet's long term fall in productivity is not really indicative of having "...a long history of responding to the regulatory incentives by driving efficiency savings over time."
- But the lack of clarity about how the AER measures productivity and what the metric objectively indicates (both individually and comparatively) means it is difficult to discuss these conclusively. We look forward to an improved approach following the AER's review of the 0.75 'not materially inefficient benchmark in 2026.

This is why the Benchmarking and Opex Panel challenged AusNet to adopt a 1 per cent per year productivity factor rather than the minimum 0.5 per cent per year they are required to have and have proposed. AusNet's response is that other measures they have taken mean they have effectively provided a 1 per cent annual productivity improvement. This is discussed further below.

Step changes

There are an unusually large number of step changes that relate to:

- Regulatory changes Emergency Backstop (\$21.6m), Energy Safe Victoria (ESV) direction for more frequent pole inspections (\$8.0m) and AEMO Fees (\$0 placeholder),
- Accounting treatment in a capex/opex tradeoff e.g. digital efficiencies, flexible services and fleet electrification, and
- Opex costs associated with proposed capex and customer driven initiatives ego digital, customer relationship management and broad communications and early fault detection

The total proposed costs of the nine positive and two negative step changes is \$131.7m or 8.4% of total forecast opex. This unusually high level extends to 15.6% for PowerCor, 12.8% for CitiPower, 16.8% for United Energy and 7.2% for Jemena – reflecting, in part, the common regulatory changes all Victorian electricity distribution networks face. By contrast, in their 2025-30 proposals, step changes were 0.6% opex for Energex, 0.3% for Ergon and 5.6% for SAPN; for 2024-29 resets Ausgrid was 2.7%.

Apart from the ESV direction on more frequent pole inspection, we do not offer comments and leave the AER to assess, where required, whether the proposed expenditure is prudent and efficient. Our focus is on the other step changes with many resulting from AusNet responding to customer issues raised during engagement. Our comments are more qualitative as we leave it to the AER to assess the prudency and efficiency of the proposed expenditure.

ESV direction on pole inspections

AusNet has sought a step change for the increased frequency of pole inspections (from every six years to every five years) required since 2024 (i.e. after the base year) by the state regulator, ESV, as part of its Bushfire Mitigation Plan. This follows a change in 2018 when AusNet moved from five-yearly to six-yearly inspections. In other words, inspection frequency has returned to where it was in 2018 and earlier. Yet AusNet did not propose a negative step change in the 2021-26 reset as it considered the overall costs had not decreased (due to "other factors")¹⁹. This implies that customers may have been paying for negative productivity in this activity.

AusNet's arguments that its costs did not reduce after 2018 are illustrated by Figure 7-11 (p. 244) of their Regulatory Proposal which indicates annual pole asset inspection costs

¹⁹ See pp 142-143 <u>https://www.aer.gov.au/system/files/AusNet%20Services%20-%20EDPR%202022-</u> 26%20Regulatory%20Proposal%20Part%20III%20%20-%2031%20January%202020_0.pdf

were just over \$8m in 2018 and are forecast to be just over \$12m in FY 2031. This is around 50 per cent in real terms, which is around a 3 ½ per cent increase annually. However AusNet is compensated for trend changes (less the 0.5 per cent pa productivity assumption), so the question is whether costs are expected to materially exceed costs for which it is automatically compensated. As a reference point, AusNet's base year calculations include an annualised 2.4 per cent uplift for trend from 22/23 to 25/26.

AusNet argues that because the ESV directive was issued after the 2022-23 base year, a step change to manage the increased frequency obligation is consistent with the opex step change framework. Their calculation has avoided overlaps with trend by not including the impacts of network growth (additional poles) on inspection costs, just the impact of inspection frequency.

We look to the AER to scrutinise the proposed step change closely.

Digital (incl SaaS and licences)

This cost is substantially driven by new ICT capex, particularly a new ADMS system as it implements the recommendations of the NOUS Review. So we leave it the AER to assess the prudency and efficiency of the capex as a precursor to the prudency and efficiency of the opex.

What is unclear, both in this category and in the CRM category discussed below, is whether customers are effectively being asked to pay for a step change that in part is to remedy avoidable poor operational performance, i.e. to get AusNet to a level that it should have been at in any case and has been funded sufficiently to achieve. For example, in the Regulatory Proposal AusNet admits (p245) that

"...reviews of the February 2024 storm also highlighted limitations in our field management practices that need to be addressed to improve our outage management capability, reduce restoration timeframes, and improve customer outcomes, as extreme weather events become more severe and larger in magnitude." (pp245-6)

Were these limitations due to poor operational management or implementation of previous initiatives, or were they simply due to increased demands on field staff that had not been foreseen? Recognising there is unlikely to be an objective answer to such questions we nonetheless urge the AER to consider carefully whether any of these initiatives should, at least, be partly self-funded by the business.

Digital efficiencies

The savings here come from the expanded capex investment in digital capability – assuming that the associated capex is approved. It provides an additional source of opex productivity. The general track record of all networks on ICT investments is they are highly likely to go over budget and take longer than initially planned to implement. Given this, we welcome AusNet's commitment to make this negative step change independent of the ADMS and customer platform capex project timetable.

Flexible services and non-network solutions

This initiative is in response to feedback from consumer engagement that strongly supported the benefits of facilitating the expansion and uptake of CER and at the same time improving network utilisation. There was extensive consultation with various Panels on the proposed communication campaign around the energy transition. The step change is designed to support a number of dynamic network management initiatives to help

reduce the infrastructure augmentation needed to accommodate new technologies and changing usage, such as:

- Flexible exports for solar customers to allow higher exports outside times of network constraint or minimum demand;
- Flexible connection options for flexible loads to reduce the need for network upgrades to support large loads like commercial batteries and EV charging providers; and
- A flexible services system to procure network services from third parties with flexible loads or storage when and where needed to address network issues.

The proposed expenditure will cover personnel to manage the implementation of flexible connections, dynamic management of load customers such as batteries and EV charging stations and to manage the anticipated AEMO CER Data Exchange. It will also cover non-network solutions procurement in the LV network.

These programs were broadly supported by customers AusNet engaged with on the challenges of the energy transition and growth of CER, and possible solutions to the network impacts. AusNet also engaged extensively on this with the Future Networks Panel, which is supportive of the initiatives.

Customer relationship management

This covers the cost of 14 new customer relationship managers located across the network with a particular focus on commercial customer and community engagement and reflects clear preferences expressed by customers over the engagement process. We know that C&I customers have expressed concerns in the past about their inability to engage directly and efficiently with AusNet across a range of issues like connections and planned/unplanned outages. These managers are expected to fill that gap.

We discussed this proposal extensively with AusNet and sought assurances around customers not paying twice (step change + CSIS rewards) and reporting to the Customer Consultative Committee. These assurances are provided in the proposal, but we also look to the AER to monitor that AusNet follows through on this and other areas of accountability for customer-supported discretionary spending.

Early fault detection

This is a new initiative with a technology that tests indicate could reduce bushfire risk on Single Wire Earth Return (SWER) lines similar to the benefits of RFCLs for multi-wire lines. The opex covers software and servicing costs associated with proposed capex to install early fault detection devise on the SWER network. Benefits are difficult to measure and are likely to be low given the very low customer density on these lines. However, installation is consistent with AusNet's obligations to meet safety legislation requirements to innovate and be across new technology.

We can support the idea and leave the AER to assess prudency and efficiency given the difficulty to assess benefits.

Resilience (hazard tree program)

Hazard trees are those with some sort of structural deficit outside of the regulated clearance zone. AusNet assesses that an annual cost of \$3m will bring annual benefits of \$8m. This is based on AusNet's current VCR values, they do not take into account the updated AER VCR values published in December 2024 that we discussed in the previous section.

This step change responds to the clear message from customer engagement that supported additional expenditure to limit the exposure of the network to major storms.

The issue of whether interruptions from vegetation falling on lines was a reliability or resilience event were not canvassed and that probably does not matter to those consumers.

On pp 182-3 AusNet say:

"Our existing hazard tree program is prioritised to target the highest risk hazard trees first. While expanding the hazard tree program would allow a larger scope of works, we note that it would be limited by amenity priority, yet nevertheless important to address to avoid tree falls onto powerlines."

There is a reasonable basis for saying that the proposed \$3m/yr spend will have net benefits – even given the uncertainties in benefit measurement, a 2.5 cost to benefit ratio (annual benefits of \$8m) has a reasonable amount of 'headroom' to account for sensitivity in benefit calculation assumptions. AusNet in their Regulatory Proposal on page 256 justify the expenditure as an opex/capex trade-off:

"This cost increase, which we consider is material, is consistent with the AER's step change framework as it is driven by a capex/opex trade-off (avoided additional capex to manage climate risk) and is not funded through any other component of the opex forecast. It is also consistent with the NEO as it provides net benefits to customers and, thus, is in their long-term interests."

We suggest that AusNet has not provided sufficient analysis to justify the proposed expenditure as an efficient opex/capex trade-off. While the resilience proposal was tested during consumer engagement sessions there was no detail provided on various opex/capex trade-offs e.g. more or less opex for hazard tree removal vs more or less resilience capex and their business case for each. So it was not surprising that there was no specific feedback on the balance between opex and capex to address resilience.

There was more explicit engagement with the Coordination Group and Panels as part of the August 2024 offsite meeting. AusNet presented four options for different levels of network hardening (\$300/150/105/75m) with each having \$8m in hazard tree opex. The higher the capex the lower the increase in average outage minutes across the network in 2031. The assumption was that AusNet:

"...did not think it was practical for network hardening to fully mitigate the additional outage risk caused by climate change by 2031"

So even a \$300m capex spend resulted in an average network wide outage increase of 7 minutes in 2031.

At the August 2024 offsite meeting we were asked to assess the options on two criteria - speed of implementation and price impact with data shown on the latter for each option. There was no opportunity to trade-off higher hazard tree spend against lower network hardening. The only explanation provided was the apparent ceiling on hazard tree analysis (pp182-3):

"While expanding the hazard tree program would allow a larger scope of works, we note that it would be limited by amenity concerns. Specifically, a larger scope of works would allow is to commence work on trees in priority yet nevertheless important to address to avoid tree falls onto powerlines."

The increase in annual benefits from \$8m (in the Draft Proposal) to \$15m (in the Regulatory Proposal) seems to have been the result of further analysis of the 'average annual value of hazard tree caused outage' (p. 255) with no mention of why the loss of

amenity from \$15m rather than \$8m was acceptable to consumers. AusNet has noted to the CG that:

"...we can only remove trees where a defect (that can impair assets) can be observed by our arborists which also limits the number of hazard tree removals"

which suggests that amenity may be secondary to what the arborist thinks. But then AusNet has yet to start the task of identifying which trees might be hazard trees in 2026-31 to even begin to assessment amenity loss. We recognise that it is difficult to land on an appropriate opex/capex trade-off and whether the proposed \$15m/\$207.2m network hardening capex combination is the right one.

A lot more discussion – both AER guidance and consumer engagement – is required to help networks make these tough decisions. Hopefully the discussion will be helped by the AER's development of a Resilience Guidance Note flowing from the current AEMC review on the Victorian Government's resilience rule change proposal²⁰. We leave the AER to assess whether AusNet has provided the required rigour of an optimal opex/capex trade-off given the current state of understanding of the issue.

Insurance

We received a detailed briefing from AusNet on the changes in the insurance market described in the Proposal. We have not had access to the confidential information in the Proposal. We made the following points in our engagement:

- Supported continued use of AusNet's Captive Insurer to keep costs down
- AusNet to consider further increasing the deductible to share the increased risk with customers; in the current period forecast premium increases were moderated by increasing the deductible from \$10m to \$25m to manage premium costs

The Proposal continues the former but does not continue the latter. We did propose that AusNet consider a further increase in the deductable citing the absence of an insurance step change in either Ergon or Energex's 2025-30 proposals. AusNet highlighted that this increases the pass through risk to consumers.

The issue of insurance, particularly how risk is shared between networks and consumers, is becoming a significant issue as network resilience is becoming a significant issue. How much should networks use opex and capex to minimise risk and how much should consumers rely on insurance, in the market where increased resilience risk is making insurance more expensive? It is an issue we hope the AER takes up in its Resilience Guideline referred to above.

<u>Trend</u>

Real price growth

This is calculated using standard AER methodologies for labour and materials. Annual real labour escalation varies from 0.84% to 1.22% and materials growth is assumed to be at CPI – i.e. no real price growth. AusNet notes that:

"The real cost escalators associated with labour costs are low compared to the actual real labour increases we have seen in the current period and expect to continue to face. This is an issue across Australia, and is evident through recent and ongoing EBA outcomes, which far exceed the cost escalators applied under the AER's standard forecasting approach."

²⁰ <u>https://www.aemc.gov.au/rule-changes/including-distribution-network-resilience-national-electricity-rules</u>

As a result, AusNet says that it is absorbing \$20m (presumably \$25-26 and all related to opex expenditure) in additional EBA costs above what the AER methodology allows. This \$20m is an 'indicative' estimate of the additional labour costs AusNet would not be funded for based on the additional costs under the EBA above the AER allowance. AusNet argue that because much of the expenditure is reactive based on asset condition and reflective of licence obligations (e.g. pole inspections), there is limited scope to defer these increased costs. In any case given EBSS, consumers will end up paying 70% of the increase.

It is not clear how different the labour rates used in the opex forecasts are from those in the capex forecasts. Capex forecasts are based on forecast unit rates which presumably are not constrained by the opex labour cost escalation methodology. AusNet note (p. 162):

"Our unit rates are based on actual project costs and prices provided by contracted service provider agreements, adjusted to account for the impact of inflation and labour market factors e.g., work force OHS requirements."

"Additionally, these unit rates also apply to our project specific cost estimates."

It remains to be seen if AusNet can achieve this \$20m productivity benefit if indeed it applies just to opex. AusNet does have the option of not deferring, going over the allowance and incurring an EBSS penalty. Implicitly, real wage increases are meant to be traded off for productivity gains, so it's not unreasonable to expect AusNet to be able to find those gains through the course of the period. In any case it would undermine EBA negotiations if the AER's approach was to allow actual EBA increases into opex forecasts.

Productivity

In our report on the Draft Proposal, we discussed the reason why we had proposed a 1 per cent per year productivity factor rather than the 0.5 per cent per year the AER requires and AusNet was proposing then and has proposed in this Proposal:

- Its performance against its peers discussed above
- The very conservative definition of 'not materially inefficient'
- The prevalence of positive step changes new categories of expenditure are likely to be more amenable to productivity gains
- The importance of affordability

AusNet is proposing the standard 0.5 per cent per year productivity factor required by the AER at a cost of \$21.8m. The Opex and Benchmarking Panel proposed 1%/yr given the benchmarking discussion above and the importance of affordability.

AusNet argues that it has implemented a wider range of affordability measures than were discussed in the Draft Proposal - negative step changes discussed above, opex being absorbed, applying the 0.5 per cent productivity factor to capitalised overheads and following the AER's labour cost escalation methodology at a time of labour cost pressures we discussed above (which we suggested in our submission on the Draft Proposal could be an argument AusNet could use) – provides savings of ~\$33m which are greater than an additional 0.5%/yr productivity.

Bottom-up Forecasts

AusNet has proposed three forecast categories – GSL payments, innovation fund and debt raising costs that total \$61.6m or 3.6 per cent of total forecast opex. We support the Issues Paper decision to focus on GSL payments and the innovation fund.

GSL payments

We thank AusNet for taking up the Opex and Benchmarking Panel's suggestion to cover the costs of GSL payments that are within AusNet's control e.g. missed appointments and connection delays and not pass these costs on to consumers, consistent with the arrangements in the current regulatory period.

We also commend AusNet for taking up our suggestion to reduce the GSL forecast for the impact of reliability improvements. For context this reduction appears to be around 3 per cent of total forecast GSLs. What remains outstanding is consideration of whether other changes can also be expected to reduce GSLs. For example, the step change for hazard tree opex is justified based on avoided outages and the EFD program is designed to drive more proactive replacement of SWER assets instead of having to react to failure – which should result in shorter outages.

Innovation

This relates to the \$7.7m opex component of the total \$15m proposed for innovation. We support the proposed funding arrangements – only available in 2026-31, 'use it or lose it' and EBSS will not apply. There is further discussion of innovation in Section 7.

EBSS

We support AusNet's proposed approach to the calculation of EBSS in 2026-31 to exclude GSL payments, and innovation, regional reliability and DMIA allowances given they are 'use it or lose it'.