12 February 2010

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Chris,

AER Review of Victorian electricity distribution prices and distributors' proposals for the period 2011-2015

The Energy Users Association of Australia (EUAA) welcomes the opportunity to participate in this review and this opportunity to provide a submission to the Australian Energy Regulator (AER) on the Victorian electricity distributors' regulated revenue proposals for the period 2011-2015. Thank you for granting us a short extension of time in which to submit this.

In this submission we outline our views on the merits of these proposals and on the adverse impacts that the distributors' proposed expenditure increases would have on energy users. We particularly highlight the substantial tariff increases facing users if the AER accepts these proposals – on average an increase of 56% across the State over 2011-2016. These would deprive energy users of continuing to benefit from their share in the efficiency gains that the distributors have accumulated since the late 1990's. These shares are meant to be retained by energy users in perpetuity. Increases of the magnitude will adversely affect the operations of Victorian businesses that use electricity, including their operating costs, competitiveness (especially where they are trade exposed), investment opportunities and ability to create and sustain jobs in the State. They will also affect the Victorian economy more broadly including its productivity, growth prospects and inflation pressures.

The EUAA looks to the AER to discharge its regulatory obligations reasonably and fairly so as to protect the interests of users by setting approved costs and energy volume forecasts at no more than efficient levels. To achieve this outcome fully and satisfy users, the AER must fulfil the requirement under the National Electricity Rules to consider all the capex and opex factors, including the requirement to benchmark these expenditures. Whilst the AER would be well aware of the EUAA's disappointment that it has not applied the Rules in relation to benchmarking of opex and capex during recently completed regulatory reviews in NSW and Tasmania, we hope that they will still do so in relation to the Queensland, South Australia and Victorian reviews.

We urge the AER to fully consider the views of energy users throughout this review.

Yours sincerely,

Roman Domanski
Executive Director

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Submission to the AER on Victorian Electricity Distributors Regulatory Proposals for the Period 2010-2015

February 2010

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Executive Summary

This document is the Energy Users Association of Australia's (EUAA) submission to the AER on the regulatory revenue proposals by the five Victorian electricity distributors, Citipower, Jemena Networks, Powercor, SPI AusNet, and United Energy for the 2011 to 2015 regulatory period. We welcome the opportunity the review affords, to provide input from energy users, including through this submission.

The EUAA is a non-profit organisation with around 100 members, many of them major electricity users in Victoria. These members will be significantly affected by the expenditure increases and resultant distribution charge increases set out in the regulatory proposals submitted to the AER in November 2009. Such increases would come at a very inopportune time due to a convergence of pricing pressures on energy users caused by the Federal Government's climate change mitigation polices, including the CPRS and the recently expanded renewable energy target. The adverse impacts of these pressures are compounded by the continued risk of the global financial crisis and economic slowdown.

Furthermore, the EUAA expresses its grave concerns on behalf of all its members about the impact that large increases in electricity and gas network prices will have on their input costs, competitiveness, and ability to invest and maintain employment. Such rises have already resulted from recent decisions by the AER in New South Wales and Tasmania. Network charges can make up about half the delivered cost of electricity and we note that significant price increases will inevitably be passed through as higher prices or result in lost competitiveness. This has already been seen in the September 2009 quarter producer and consumer prices indices where electricity price rises were the largest single contributing factor. We call upon the Australian Energy Regulator to show heightened awareness of the impacts its decisions have on energy users, and in the economy more broadly, by ensuring that only efficient costs are allowed.

In this submission we outline our views on the merits of the Victorian distributors' proposals and outline the adverse impacts that the distributors' proposed expenditure increases would have on energy users. Figure E1 shows the average Victoria wide impacts on electricity prices if the proposals are approved by the AER.[1] The chart shows an expected real price increase of 28% in the first year, and a compounded 5-year real price increase by the end of the 2015 of 56%. This would cause retail price increases of around 10-15% in the first year and around 22-30 % from 2011-15

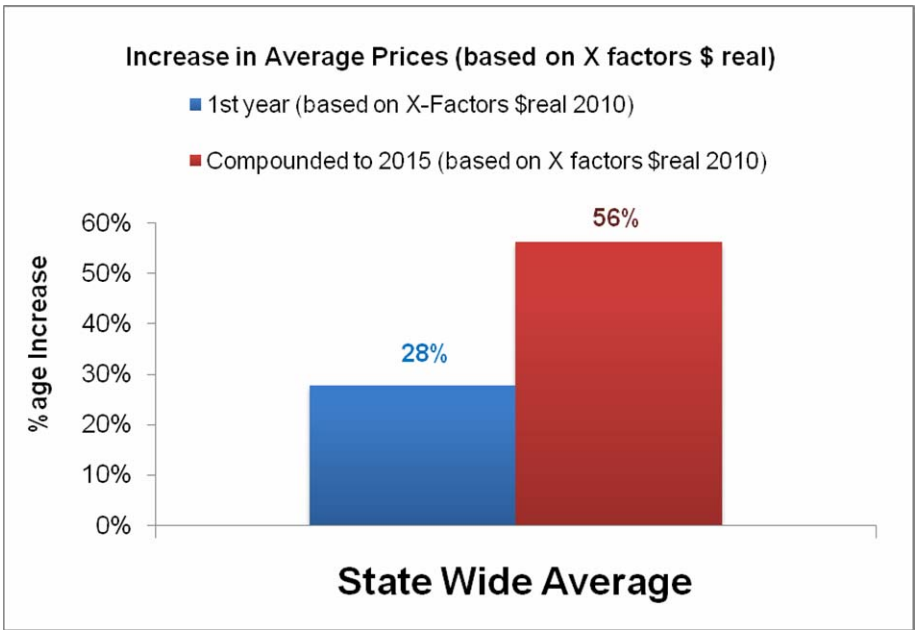
We have a concern that there is a significant element of regulatory gaming contained in the distributors' proposals that reflects incentives in the regulatory regime and 'copy cat' behaviour based on recent regulatory decisions by the AER

We also highlight evidence that shows the distributors' are significantly over-stating future opex and capex costs, and substantially understating forecast distribution system energy volumes. If accepted by the AER, this would deprive energy of their share of the efficiency gains that the distributors have been able to accumulate since the late 1990s, which are meant to be passed through to users in subsequent regulatory periods.

Both the Office of the Regulator-General (ORG), in 2000, and the Essential Services Commission (ESC), in 2005, ensured the distributors could retain achieved efficiency

[1] A more detailed overview of the pricing impacts across the five businesses is provided in the body of the submission.

Figure E 1: Victoria state wide average distribution price increases 2011 to 2015



benefits by implementing an "efficiency carry-over mechanism". The balancing part of this aspect of the 'regulatory compact' that was set up as part of the regulatory regime that is supposed to protect the long term interests of consumers (as required by the National Electricity Law), is that the efficiency gains are then transferred in full to energy users in perpetuity. The only way this balance can be achieved – and, therefore, the only way that energy users can gain access to their fair share of the 'efficiency gains' – is by the regulator approving cost and energy volume forecasts for the coming regulatory period that reflect a continuation of at least the level of efficient performance the distributors achieved in current and preceding regulatory periods.

Our concern, based on the data presented in this submission, is that the five Victorian distributors will capture benefits above efficient cost and revenue levels approved by regulators of more than $1 billion over the 10 years from 2000. The EUAA also notes that it is likely that the distributors achieved a similar outcome in the period from 1995 through 2000 based on the assumption that the ORG and ESC established revenue forecasts linked to 'efficient costs' and reasonable energy volume forecasts (an assumption that the EUAA does not accept).

The EUAA considers that the AER, as a national regulator, must discharge its obligations reasonably and fairly to achieve a better outcome for energy users than either the ORG or the ESC. This can be done by setting approved costs and energy volume forecasts at no more than efficient levels. To achieve this outcome, the AER must fulfil the requirement under the National Electricity Rules to benchmark these energy businesses. The AER would be well aware of the EUAA's disappointment that the AER has not applied the Rules in relation to benchmarking of opex and capex during recent regulatory reviews in NSW and Tasmania and in its draft decision for distributors in Queensland and South Australia. We encourage the AER to have regard to Ofgem's approach in this area and to apply benchmark analysis to this determination that would similarly assure Victorian electricity users that the DBs' allowances reflect genuinely efficient costs. The relevant section in the submission discusses this in more detail.

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1 Introduction

This document is the Energy Users Association of Australia's (EUAA) submission to the Australian Energy Regulator's (AER) review of regulated revenue proposals for the period 2011 to 2015 that have been submitted by the five Victorian electricity distributors. We welcome the opportunity the review affords us to provide this submission.

The EUAA is a non-profit organisation with around 100 members, many of them major electricity users in Victoria. These members will be significantly affected by the expenditure increases and resultant distribution charge increases as per the regulatory proposals recently submitted to the AER. Such increases come at a time of rising obligations on energy users to fund emissions reductions and renewable energy targets, and following the impact of the global financial crisis and world economic slowdown.

Furthermore, the EUAA expresses its grave concerns on behalf of all its affected members about the impact that the very large increases in electricity and gas network prices they are facing will have on their input costs, competitiveness, ability to invest and maintain employment. Network charges can make up about half the delivered cost of electricity and we note that such significant price increases would inevitably have to be either absorbed or (if possible) passed through in higher prices. This has already been seen in the September 2009 quarter Producer Price Index (PPI) and Consumer Price Index (CPI) rises where electricity prices were the largest single contributing factor, a major contributor to which was network prices following AER recent determinations for New South Wales and Tasmania.

We call upon the AER to show greater awareness of the impacts its decisions have on energy users and in the economy more broadly by ensuring that only efficient costs are allowed.

The EUAA sees that considerable value can be gained from the performance reporting framework developed through the last decade or more by the ORG and ESC. Data from the ORG/ESC performance reports, regulatory determinations and distributors' proposals has been combined and used in preparing this submission.

The remainder of this submission outlines what the EUAA considers would be acceptable as a fair and reasonable outcome from the AER's review process; based on preliminary estimates of efficient inputs to the AER's revenue determination using simple linear curve fitting applied to data published in the ESC's annual Performance Reports. This data is compared to the distributors' proposals in each case

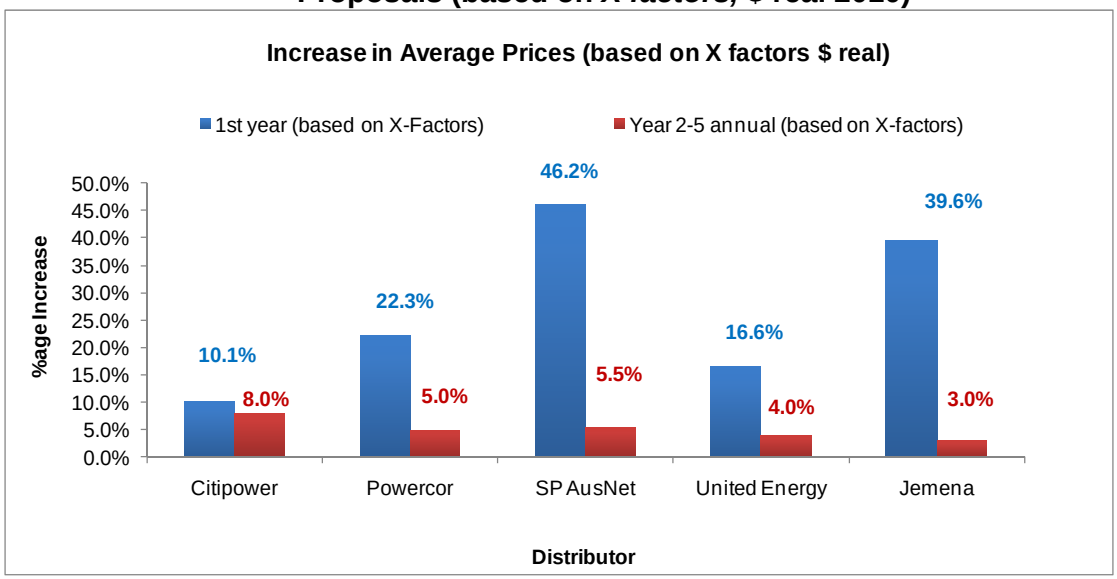
2 Pricing Impacts

From electricity users' point of view the single most aspect of the regulatory determination process in Victoria is the impact on electricity prices resulting from the determination. In this section we outline these price impacts for each of the five distribution businesses based on their proposals.

These proposals follow a pattern in keeping with the recent outcomes in New South Wales (NSW) distribution businesses, the NSW and Tasmanian transmission business, and the draft determination for the Queensland and South Australian distribution businesses. Victorian users are facing significant first year price shocks, as well as large 5-year compounded price increases. Chart 1 shows these first year

price shocks for each of the businesses (in blue colour), and the annual increases in the four years that follow (in red). These are real dollar increases computed from the *X-factors* set out in the regulatory proposals.

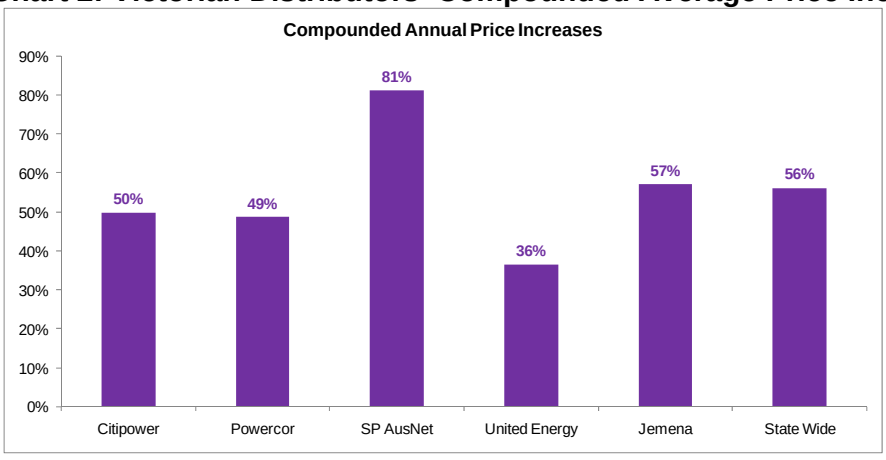
Chart 1: Average Price Increases from VIC Distributor's Regulatory Proposals (based on *X factors*, $ real 2010)



The chart shows that the first year price increases for Victorian electricity users range from a 10.1% increase for Citipower to 46.2% increases for SPI AusNet. The significant differences in the proposals is a matter that concerns energy users and once they would urge the AER to investigate.

Chart 2 shows the compounded 5-year increases in average prices over the next regulatory period resulting from the *X factors*. As mentioned previously, the EUAA's members are concerned not just about price increases over the full regulatory period, but particularly about year 1 price changes.

Chart 2: Victorian Distributors' Compounded Average Price Increases



2.1.1 Price impact and the National Electricity Objective

The EUAA notes that the NEO stated goal is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- *Price, quality, safety, reliability, and security of supply of electricity; and*
- *The reliability, safety and security of the national electricity system.*

Energy users would urge the AER to take fully into account the price impacts in this determination. The EUAA has concerns that price impacts have not been given sufficient weight in recent AER determinations.

2.1.2 The Need for early notification of price increases

We would like to emphasise that it is important that distributors provide users with sufficient notice of tariff increases. To do otherwise creates significant problems for energy users, including in their internal budgets. This is only accentuated when large price increases occur. As the AER is aware, this created significant problems in relation to its 2009 transmission and distribution determinations for New South Wales and Tasmania.

We welcome the pro-active approach the AER took in relation to this matter in its current reviews of Queensland and South Australian distribution and urge them to do the same here, including the Chair of the AER writing to the CEOs of the Victorian distributors in a similar manner. The EUAA would like to see early and ongoing consultation by the businesses with their customers on the matter of tariff changes, including communicating the tariff impacts of their proposals, the draft determination, their revised proposals and the final determination. Doing so can enhance user involvement in the AER reviews, as well as ensure that users are kept informed about the charges they are likely to face in future. EUAA would be prepared to work with the AER, the distributors and its members in ensuring this happens.

Whilst we appreciate that tariffs cannot be determined completely accurately until after the AER's Final Determination, nevertheless even indicative tariffs can assist users to better understand the likely impact on them and their operations.

3 Distributors' revenue forecasts

Chart 3 below provides a graphical summary of data taken from the ORG/ESC Performance Reports and regulatory determinations and compares this to data taken from DB proposals made to this and previous regulatory reviews.[2] There is a threefold purpose in presenting this data.

[2] Similar presentations are made in later sections of this submission to allow comparisons of opex and capex costs.

- The first is to demonstrate to the AER that there is a substantial body of data that can be used by the AER to inform its judgements on "efficient performance" by Victorian DBs.
- The second is to illustrate that application of even the simplest form of statistical analysis (in this case, linear curve fitting to time-dependent data) provides clear demonstration of the level of 'regulatory gaming' being applied by the DBs.
- The third is to illustrate to the AER that it has available information that can be used – in conjunction with benchmarking – to inform judgements on "efficient cost and revenue benchmarks" for the DBs.[3]

The data in Chart 3 represents the DBs' initial forecasts of their revenue requirements for each regulatory period, the ORG/ESC assessment of "efficient benchmark revenue" – based on assessment of forecast opex and capex costs and forecast energy volumes. For convenience, the actual data has been segregated into pre-2001 and post-2001 categories, reflecting the fact that the ORG was not involved in setting costs or revenue benchmarks for the 1996-2000 period.

The dotted lines in Chart 3 represent linear best fit curves for the relevant data; and are used in this Chart (and those following) to illustrate the differences between the DBs proposals, (supposedly) "efficient benchmarks" accepted by the ORG/ESC and actual outcomes achieved by the DBs. The linear best fit curves also establish rational criterion for assessing the DBs' proposals for the 2011-2015 period and for informing regulatory decisions about the DBs' proposals.

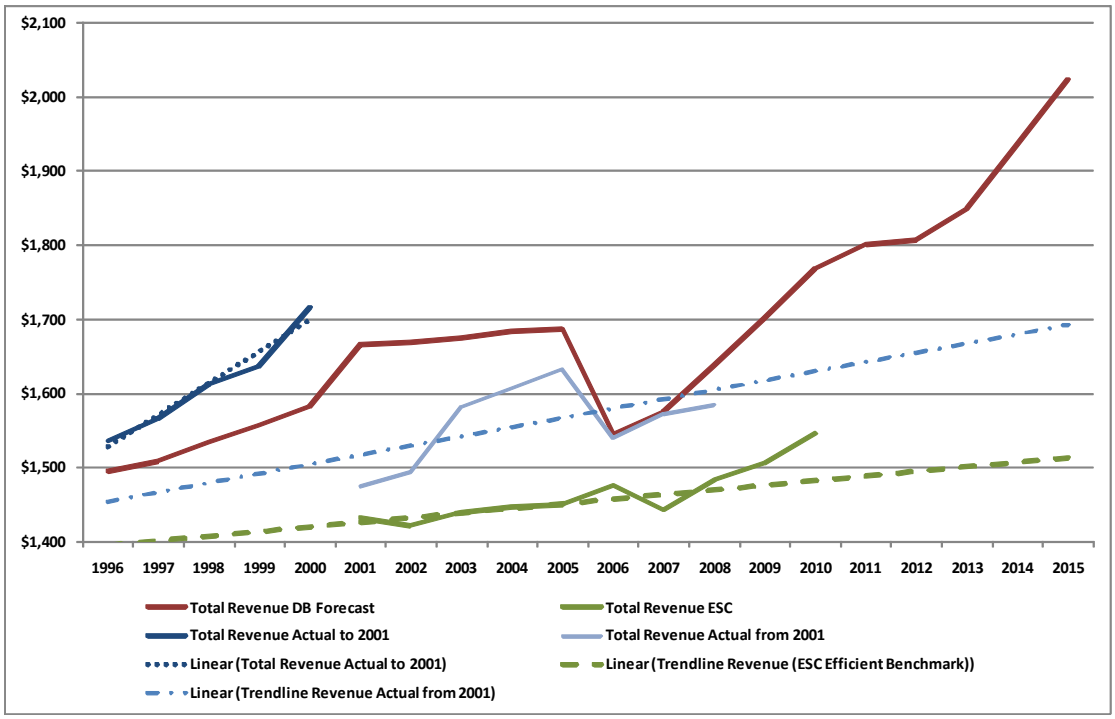
As demonstrated in Chart 3 below, if accepted by the AER, the distributors' proposals would mean that combined revenues in 2015 would be around 50% (or $650 million/year) higher than at the start of the 2001-2006 regulatory period.

The evidence presented in the Chart shows that – despite their 'best endeavours' – neither the ORG, nor the ESC, achieved a satisfactory balance in the 'regulatory compact' that exists between customers, the regulator and the distributors. An estimate from Chart 3 above, based on the assumption that the ORG and ESC established revenue forecasts linked to 'efficient costs' and reasonable energy volume forecasts (an assumption the AER should note that the EUAA does not accept), is that the five Victorian distributors will have captured financial benefits above efficient cost and revenue levels of more than $1 billion over the 10 years since 2000.

This unsatisfactory outcome – from the point of view of consumers – has been the result of overstating costs by the distributors and insufficiently rigorous analysis as part of the previous regulatory determination processes.

[3] The EUAA notes that this data has been presented in this submission for all five DBs combined. This is for simplicity only and reflects the limited resources available to the EUAA. The EUAA fully expects the AER to undertake detailed analysis of this data for individual DBs – applying the methods developed by Offer and Ofgem.

Chart 3: Timeline of Victorian distributors' revenue ($m June 2009)



The EUAA therefore believes that the AER should reject the distributors' revenue forecasts and base its determination on independently derived forecasts developed using the same approaches and techniques employed by Offer and Ofgem since 1994. This is the only way to ensure that customers are being fairly treated and costs are kept at efficient levels.

Based on the information provided and the trends of total expenditure, capex and opex implicit in the DB's proposals, we believe that the outcome, were the AER to accept these without significant modification, is that the Victorian DBs would move significantly towards the inefficiencies exhibited by the NSW distributors in the next regulatory period. Victorian consumers would pay the price of this and the AER needs to prevent it from happening.

4 Distributors' volume forecasts

The very substantial increase in revenue indicated in Chart 3 above occurs even though the distributors are forecasting a reduction in total energy volumes in their distribution networks – in contrast to the AEMO forecast for energy production in Victoria.

The EUAA recognises that the AEMO forecasts (of energy sent-out) include energy consumption by transmission-connected customers as well as exports to other NEM Regions (and the AER data includes net energy imports into Victoria from other NEM Regions). These differences mean that it is not possible to make a direct comparison between the AEMO and AER data and the DB forecasts. However, the EUAA is not aware of any evidence supporting marked divergence between energy volumes delivered through the distribution networks and energy delivered into the whole

Victorian Region of the NEM. The EUAA also notes that the marked difference in the slope of the lines for the distributors' forecasts and AEMO's forecast is possible evidence of 'regulatory gaming' that the AER must eliminate. Not eliminating this would result in unit prices being substantially higher than they should be (to deliver "efficient benchmark revenue").

The distributors assert that energy volumes will decline primarily as a result of a suite of Federal and State Government policies that seek to promote more efficient use of electricity. These policies include:

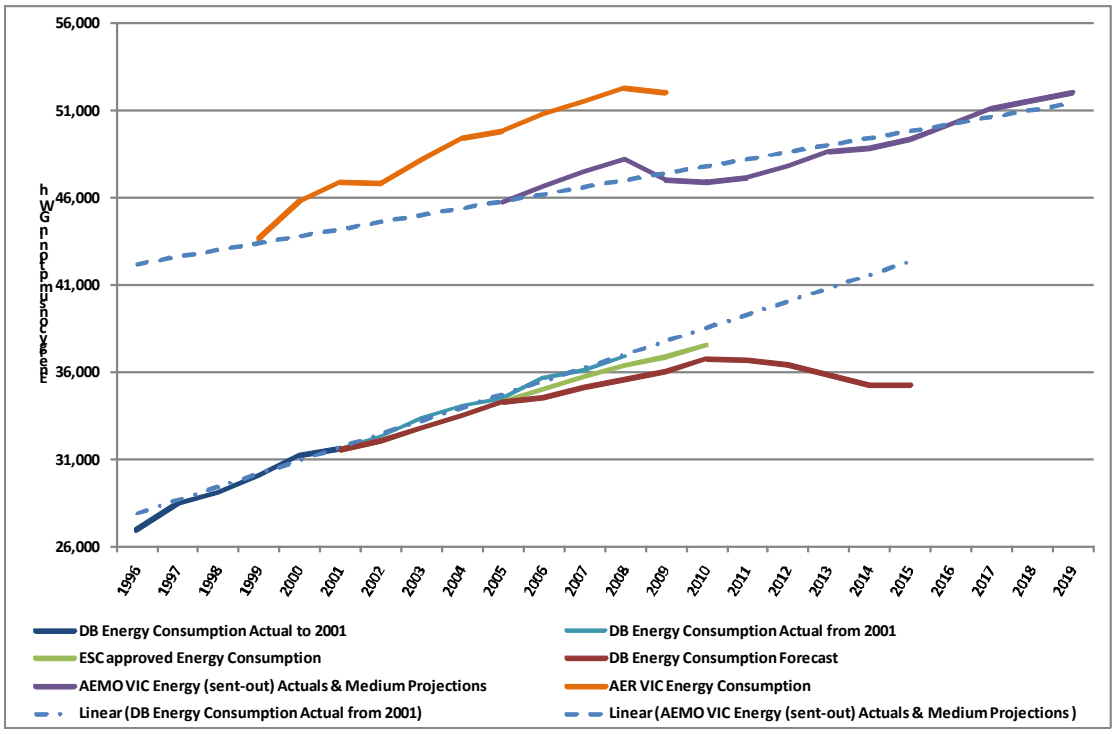
- Minimum Energy Efficiency and Performance Standards for appliances (MEPS) – particularly the phase out of incandescent lighting and progressive improvement in energy efficiency of new air conditioners.
- Requirement for equipment manufacturers to reduce standby power to no more than 1W for all new appliances by 2012.
- The Federal Government 'economic stimulus' Home Insulation program.
- An increase in distribution-connected embedded generation as a result of the Federal and State Government incentives supporting take-up of Solar PV systems.
- The impact from the Victorian Energy Efficiency Target (VEET) which creates obligations for energy retailers to reduce greenhouse gas emissions by assisting in implementation of household energy efficient programs.
- The impact of various measures that will impact on sales of electricity for hot water heating (e.g. incentives for Solar water heating, water efficient household appliances, etc).
- Increase in building thermal performance standards through amendment to Building Regulations.
- The impact of the Victorian Government's mandated Advanced Metering Infrastructure (AMI) roll-out.
- Promoting take-up of off-peak charged electricity vehicles.

In combination, the distributors assert that these policies would reduce energy volumes transported through their distribution networks by approximately 4% from 2008 levels compared to a projected increase of some 10% if the trend of the last decade continues (shown in Chart 4 below).

The EUAA acknowledges that the intent of the suite of Government policies listed by the distributors is to assist in reducing the energy intensity of the Victorian and Australian economies. However, the EUAA also notes that many of these policies are very uncertain in terms of their impact or relate to new appliances and new buildings, which means that the impact of the policies will be slow to develop (i.e significant impact is unlikely until well beyond the next regulatory period). For example:

- the change to building thermal performance impacts on only the 1% per year of new housing stock that is added;

Chart 4: Timeline of Victorian energy volumes



- the dramatic increase in the uptake of household air-conditioners from the mid-1990 means that a large proportion of households have lower efficiency air-conditioners that would not be replaced within the next decade – and a similar comment can be made about standby systems in appliances;
- the removal of incandescent lighting is subject to vagaries including dissatisfaction with the lighting performance of more energy efficient alternatives resulting in a return to incandescent light bulbs; and;
- the outcome of the VEET program remains to be seen (if the patchy track record of other similar programs elsewhere is to be taken into account, then this program needs to be treated with caution by the AER);
- electric vehicles are a technology that is still in the realm of possible large scale future adoption – even more so during the next regulatory period – and subject to many uncertainties, including the future price of oil and being overtaken by alternative technologies that could end up being more economic or more suitable to consumer preferences and tastes; and
- there is no indication that small consumers will be able, or have any incentive, to materially modify electricity consumption patterns in a sustainable manner as a result of the State Government's AMI program – even if energy retailers are prepared to develop more cost-reflective tariffs that will 'punish' high-cost, AC-using households, which is by no means obvious.

It is the EUAA's view that the AER should reject the distributors' energy volume forecasts and adopt total energy volume forecasts that at least match the rate of growth implied in the AEMO (sent out) energy forecasts of around 1%/year over the

next regulatory period. The AER should also request information about the DBs' forecasts and the reasons for them being lower than official ones from AEMO and its consultants.

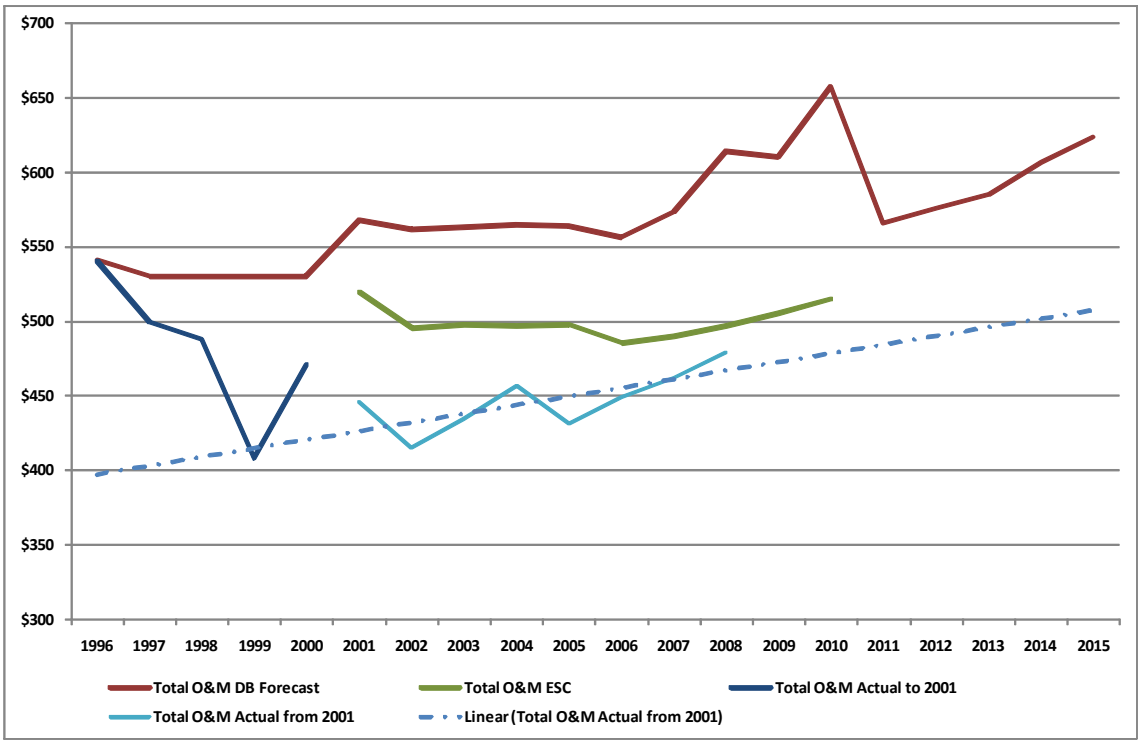
5 Distributors' opex forecasts

The distributors' forecast in revenue is also based on combined operations and maintenance expenditure – excluding expenditure on public lighting and the 'Smart meter' roll-out mandated by the Victorian Government – that is over $150million/year (~35%) higher than the actual costs incurred since the late 1990s (as shown in Chart 5 below).

The data in Chart 5 shows the distributors dramatically reduced total opex spend after privatisation from 1996, with the total annual opex hovering around $450 million/per year over the last decade. By comparison, the DBs have repeatedly forecast substantial increases in opex before each previous regulatory period – and achieved actual outcomes that have generally stayed around the $450M/year level. It is clear that increases proposed by the DBs above this level are highly questionable based on their track record.

The AER will need to establish the opex allowance for the next regulatory period robustly and clearly with an eye to all the opex factors listed in the NER, including by reference to benchmarking.

Chart 5: Timeline of Victorian distributors' opex ($m June 2009)



6 Distributors' capex forecasts

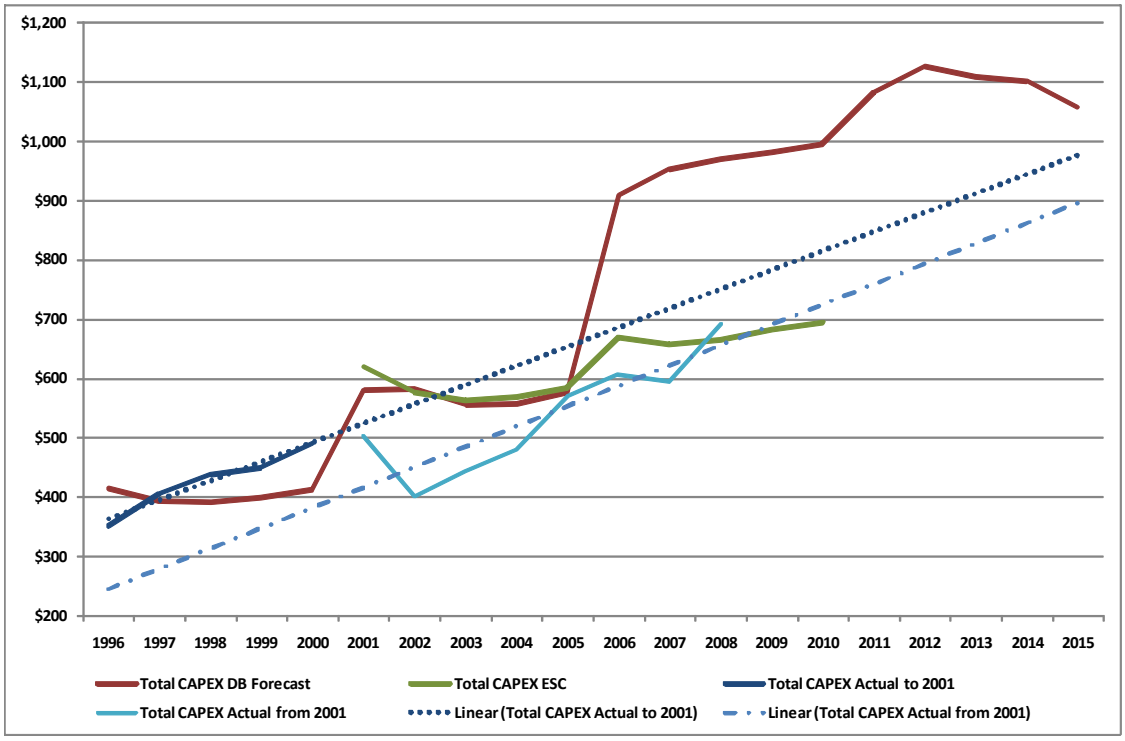
The revenue forecasts are also based on return on capital and depreciation from combined capital expenditure over the next regulatory period – again excluding public lighting and metering. We note that capex is forecast by the distributors to nearly double – from actual investment totalling some $2.9 billion over the 5 years to 2008 to around $5.5 billion for the next regulatory period. This is in line with the same orders of magnitude increases we have seen emerge during the AER's other recent (and current) network pricing reviews.

The data in Chart 6 shows the distributors significantly reduced total capex spend from 2001, to well below the forecast adopted by the ORG in 2000 and significantly below the forecast adopted by the ESC in 2005 – with the total annual capex increasing each year by around $35 million (on average) since 2001.

The EUAA notes that it is quite possible that reported actual capex will rise in 2009 – and possibly 2010 (as the distributors race to commit capex that would add to regulatory asset values from 2011).

The EUAA also accepts that an appropriate level of capital expenditure by the businesses is important to ensure quality, reliability and security of supply at the distribution level; and that there may be justification to increase it in some areas to meet rising peak demand. However, increases of the levels proposed by the businesses are clearly beyond that and excessive; and could include significant elements of 'copy cat' type behaviour based on other recent and current AER determinations.

Chart 6: Timelines of Victorian distributors' capex ($m June 2009)



Capex is a significant proportion of total proposed expenditure by the DB's over the period 2011-2016 and the AER needs to be very cautious in assessing this risk, which will have an important bearing on the DB's costs over the next regulatory period (that will flow through into distribution prices paid by Victorian electricity users).

The AER will need to establish capex robustly and clearly with an eye to all the capex factors listed in the NER, including by reference to benchmarking.

7 Conclusions about distributors' energy volume and cost forecasts

The above analysis highlights evidence that shows the distributors' are over-stating future costs, and understating forecast distributed energy volumes. If accepted by the AER, this would prevent energy users from accessing their share of the efficiency gains that the distributors have been able to accrue since the late 1990s.

These forecasts cannot be reconciled with continued performance of mature technology regulated utility businesses – rather they seem more like a volatile commodity businesses subject to large fluctuations in demand and supply, and going through boom conditions – particularly given that the ESC's Performance Reports show that service standards are being largely maintained at levels acceptable to customers within existing expenditure levels.

A key feature of the 'regulatory compact' adopted by governments and economic regulators is that the distributors are able to retain 'efficiency gains' achieved during any regulatory period for a full five years. Both the ORG, in 2000, and the ESC, in 2005, ensured the distributors could gain access to this benefit by implementing an 'efficiency carry-over mechanism'. The logical conclusion of the 'regulatory compact' that is supposed to protect the long term interests of consumers and the National Electricity Objective is that the efficiency gains are then transferred in full to energy users in perpetuity.

The only way this balance can be achieved – and, therefore, the only way that energy users can gain access to their fair share of the 'efficiency gains' – is by economic regulators approving cost and energy volume forecasts for the next regulatory period that reflect a continuation of at least the level of 'efficient performance' by the distributors in the current and preceding regulatory periods. [4]

8 Benchmarking

Benchmarking can play a critically important role in identifying and quantifying inefficient expenditure. The National Electricity Rules require that the AER "must" have regard to benchmarking of the expenditure proposals of distributors compared to the expenditure of an efficient distributor under the Rules. This is one of the opex

[4] The EUAA notes that Ofgem has also added 'efficiency incentives' where distributors are performing below the most efficient businesses. This is achieved by applying larger P_0 and X factors to the price paths approved for the (relatively) poorly performing distributors.

and capex factors to which the AER is required to have regard, in setting allowed capex and opex.

The EUAA considers that, given the move to national regulation of distribution and the reasons for it, the AER must discharge its obligations reasonably and fairly to achieve a better outcome for energy users than either the ORG or the ESC were able to. This can be done by setting approved costs and energy volume forecasts at no more than efficient levels.

To achieve this outcome to the satisfaction of users, the AER must fulfil all the requirements under the National Electricity Rules, including to benchmark these businesses.

As the AER is aware, the EUAA has drawn the AER's attention to its obligations under the Rules to benchmark the allowed capex and opex against that of an efficient network service provider. We draw the AER's attention specifically to:

- Our submission on the AER's Transend draft revenue control decision;
- Our submissions on the Energex, Ergon and ETSA revenue and price control proposals in August 2009;
- Our presentation and Carbon Market Economics' presentation (on our behalf) to the pre determination conferences for Energex and Ergon, held in Brisbane, and the ETSA, held in Adelaide, in December 2009;
- A letter from our Chairman to Steve Edwell on 24 December 2009 drawing the AER's attention to our concerns about the need to benchmark.

Despite having raised this issue on numerous occasions, we have continued to be disappointed that the AER has failed to satisfactorily meet its benchmarking obligation. Our forthcoming submissions on the AER's draft decisions for the price and revenue control decisions for Ergon, Energex and ETSA will provide additional detail on our disappointment with the AER's performance in this area.

We suggest it would be helpful if the AER had regard to Ofgem's approach on these issues.

We would be most interested to understand what benchmarking data the AER does have access to already and where it perceives there are such gaps as would prevent this from being utilised to fulfil its regulatory obligations under the NER. We would also be interested to know why the AER is not able to utilise its information gathering powers, such as the Regulatory Information Notice (RIN), to obtain such data relatively quickly so that it can be applied to this review.

The AER has called its benchmarking obligation under the Rules a "long term proposition" and said that the AER only uses benchmarking "to test its bottom up detailed conclusions and not to set allowances". We consider that the AER is incorrectly interpreting its obligations and note that:

- Benchmarking is not "a proposition" in the Rules – it is a mandatory obligation.
- The AER does not have discretion in deciding which obligations it will implement and which not.
- In determining expenditure allowances there is no scope in this for the AER to use benchmarking only to "test its bottom-up detailed conclusions". To do so would be to ignore the fundamental importance of 'top down' benchmarking and

the critical role it plays in regulatory processes (see for example, the most recent Ofgem distribution review and its predecessors).

In deciding the regulated revenues for these businesses, the AER must properly implement this obligation using widely recognised techniques and methods in the application of benchmarks in the economic regulation of electricity networks.

9 Pass through arrangements

We do not support pass-through as a matter of principle and believe that it will always be asymmetric in favour of the network businesses given their information advantages. Consequently, during any regulatory control period it is highly likely that only cost increases will be the subject of pass through and any cost reductions that emerge will almost certainly never be passed through. This situation is likely to be even more asymmetric at a time of large regulatory expenditure increases.

Whilst the National Electricity Rules and the National Electricity Law permit pass through and it has been feature of energy network regulation for some time, this asymmetry in outcomes ought to be recognised in the assessment of pass through arrangements. We would urge the AER to also consider this matter in the broader context of its regulation of network businesses, including the option of a Rule change that will lead to more balanced outcomes in future. In this context we note that the application of economic regulation to energy networks in Australia has been founded on the principle that the outcomes ought to mimic those found in competitive markets. With regard to pass through, this is clearly has limited application. In competitive markets, pass through only applies where costs are the result of factors outside the control of the business and then only if the business is in a position to be able to pass through these costs. In the case of regulated businesses, this needs to be recognised by the regulator with one eye to the risk of strategic behaviour by the regulated business.

The EUAA notes that the AER shares our concerns about the risk avoidance issues associated with open-ended pass through events including in relation section 7A(2) of the National Electricity Law, where it said that "*has the potential to undermine the incentive for the business to effectively manage risk"*[5].

Within the context of the existing regulatory approach, the EUAA has concerns over the proposals by the Victorian DNSPs on the application of pass-through provisions submitted to the AER. The Victorian businesses have proposed a large range of pass through events, which is of concern to users, and we would welcome a rigorous assessment of them by the AER to determine their validity. As would be expected, the pass through events that the businesses have applied for are symmetrical and include:

- National broadband network event
- CPRS event
- Retailer failure event
- Retailer of Last Resort Event

[5] ETSA Utilities Revised Regulatory Proposal 2010-2015 p. 141

- Transition to a national framework event
- Magnetic field exposure event
- Vegetation management event
- Insurance event
- *Force majeure* event
- Feed in tariff event; and
- Asbestos compensation event

The EUAA notes the AERs draft determination on pass through events for Energex and Ergon Energy. The EUAA expects that the precedents set by the AER in relation to the rejection of certain pass through applications of the Queensland DSNPs will be applied uniformly to the pass through applications by the Victorian DNSPs, examples include:

- Retailer failure event and retailer of last resort event; [6]
- Transition to national framework event;
- Magnetic field exposure event;
- *Force majeure* event; and
- National Broadband Network event. [7]

The EUAA also would like to draw specific attention to:

- United Energy's Vegetation Management Event proposal: the EUAA does not support vegetation management being considered as a pass through. Vegetation management is normally calculated as opex, as is the case in Queensland and NSW. We note that the AER has determined that a pass through cannot be accepted if there is a provision for those costs to be included in the capex or opex programs by a DNSP.
- CPRS Event: the EUAA notes that a distribution business in the electricity sector has very limited costs that it would incur as a result of the CPRS. All businesses in Australia will have some carbon impost and many will have to manage the risks associated with these costs internally and will have limited scope to pass them on to customers. Giving the DNSPs allowances to pass on costs associated with the CPRS would also allow them to eliminate any incentive on them to reduce these costs.
- Jemena's Insurer Credit Risk Event: energy users should not have to pay for insurance costs as it is a responsibility of any business to insure themselves appropriately and efficiently. This should also apply to the DBs and it is not up to users to bear these costs.
- Jemena's Asbestos Compensation Event: energy users should not have to pay for compensation claims resulting from potentially negligent behaviour by a DB. Jemena's application for this pass through is neither unforeseeable nor uncontrollable as it specifically mentions a plant that contains asbestos and should have been aware of this when it bought the business; thus, it does not meet the general nominated pass through criteria. In addition, it fails to meet

[6] AER Draft Determination Energex and Ergon Energy p. 343.
[7] Ibid p. 342.

the criteria for a specific nominated event, especially the *highly likely* criterion. Jemena is aware of where the asbestos is and its removal can be managed and avoided by prudent asbestos removal programs undertaken by Jemena itself or by an asbestos removal professional.