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Ms Paula Conboy
Chair
Australian Energy Regulator
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Dear Ms Conboy *Paula*,

Thank you for meeting with me on 24 September 2018, to brief me on the Australian Energy Regulator's (AER) 2019–24 draft revenue determination for the Power and Water Corporation's (PWC) network business.

As Treasurer, I am leading the Northern Territory Government's electricity reform program to deliver efficient, safe and reliable power for Territorians. The extensive reform program includes the progressive application of the National Electricity Law and Rules across the Territory and the implementation of a competitive wholesale electricity market in the Darwin-Katherine interconnected system.

The electricity reform program has resulted in a period of unprecedented change for PWC. I have observed a marked improvement in PWC's operations and performance, and I am pleased by its demonstrated commitment to evolve as a business to meet the challenges associated with transitioning to the national regulatory framework.

As Treasurer I have unique insight into the ongoing challenges faced by PWC and the expectations of Territorians. I am concerned that the AER's draft determination, which would significantly reduce PWC's allowance for operating expenditure compared to past actual expenditure and proposed expenditure, may be unsustainable and not consistent with Territorians' expectations for safe and reliable power.

PWC has already achieved substantial operating efficiencies in its network business of 18 per cent between 2013-14 and 2016-17. Building on this, PWC is introducing a new operating model to adopt best practice operating methodologies across its multi-utilities business including by identifying and leveraging off synergies, and improving asset management practices, operating systems and business processes. Recognising the efficiencies expected to result from this work, PWC's proposes further ambitious network operating expenditure efficiency improvements of up to 18 per cent of base year expenditure. It is unclear whether PWC has capacity to make further significant reductions in operating expenditure beyond this without compromising the quality of its network services.

Accordingly, I request that in making its final decision on PWC's operating expenditure, the AER give due consideration to the unique circumstances faced by PWC, many of which are external to its business and outside its reasonable control; and take into account community expectations for the provision of network services in the Territory. I have outlined my concerns in more detail below.

PWC's unique circumstances

PWC is not comparable to other network service providers regulated by the AER. Although I acknowledge and welcome the AER's recognition in its draft determination that the unique operating environment faced by PWC impacts its operations, I remain concerned that the AER has not fully accounted for such impacts in its draft decision on PWC's operating expenditure.

PWC is unique in that it services a small population over a large geographic area. Given this, it cannot achieve efficiencies from the scale of its operations as is the case for other network service providers. PWC's customer base is more than 50 per cent less than TasNetworks and spread over three distinct and geographically dispersed areas. Further, the geographic remoteness of PWC's three networks, both from each other and from other parts of Australia, impact the market for procurement of labour, goods and services. These factors negatively affect PWC's ability to provide network services at a comparable cost to other network businesses.

The Territory's harsh climate, with sustained high levels of heat and humidity through large periods of the year, is known to impact the productivity of field crews and increases staffing requirements. The tropical climate in the Territory's northern regions increases prudent maintenance and vegetation management expenditure.

The high rate of vegetation growth in the tropical environment particularly during the wet season (summer) requires more frequent trimming and vegetation management. This is important to ensure reliability of power supply, accessibility of the network and the safety of field crews. Further, decreasing the frequency of trimming in favour of more severe vegetation removal may result in reduced shade cover, and thus cooling, in built-up and suburban areas which is highly valued by the community due to the high temperatures experienced in the Territory.

Cyclones and severe tropical storms are frequent events in the Territory and PWC requires sufficient resources to be on-hand and available to respond quickly to restore power. As

you would be aware, PWC recently had to deal with the challenge of Tropical Cyclone Marcus, which caused extensive damage to the electricity network and resulted in widespread and sustained power outages across Darwin. Over 500 line spans were damaged and 28,000 customers (33 per cent of all customers) lost power with some customers left without power for up to 11 days. PWC's ability to respond with sufficient field crews in such short timeframes was instrumental in Darwin's recovery. It is important to ensure that PWC not only continues to be capable of responding to extreme weather events faced in the Territory, but that it can improve its responsiveness, particularly in rural areas where PWC's customers were faced with extended outages after Tropical Cyclone Marcus.

Community expectations for safe and reliable power

Notwithstanding the potentially higher expenditure required to maintain network reliability in the Territory, I support the AER's stated focus to improve the reliability of PWC's networks because I know this is important to Territorians and Territory businesses.

The catastrophic failure of the Casuarina Zone Substation in 2008 highlighted systemic issues with PWC's asset management practices and that PWC's asset maintenance expenditure was below the level required to meet good industry practice. PWC has improved its asset management and maintenance practices in response to this event, however there is still room for PWC to improve its performance to align with the community's expectations for reliability of supply. I request that the AER review its draft decision which proposed PWC reduce maintenance expenditure to ensure the final decision will enable PWC to build on past improvements in respect to reliability.

I understand the AER heard directly of the community's concerns regarding safety and reliability at the stakeholder forum held on 29 October 2018, in particular, community concerns about corroded poles in Alice Springs. Community consultation on this issue has reiterated that public safety (and the safety of PWC's field crews) is of paramount importance. While a risk assessment should inform which poles are targeted for rectification, the potential consequences of a pole failing should not be undervalued.

Rate of Return

In addition to my concerns regarding PWC's operating expenditure requirements, I also note that the AER's draft determination will lower PWC's rate of return on its investments as a result of the AER's proposal for PWC to transition to the AER's approach for determining the cost of debt.

In reaching a final decision on rate of return I ask that the AER give particular consideration to the implications of the Ministerial Direction issued by the former Treasurer on 19 June 2014. The Ministerial Direction created a unique situation whereby it effectively overrode the former regulator's determination and required PWC to recover a rate of return significantly lower than permitted under the 2014-19 Network Price Determination.

While PWC should not earn a rate of return that is any more than necessary, the AER should ensure there is no risk of PWC being undercompensated.

I look forward to continuing our relationship throughout this determination process, and trust that in preparing the final determination, particular consideration will be given to the impacts of PWC's operating environment on its costs, community expectations of a reliable and safe supply of power and PWC's rate of return, to ensure a beneficial outcome for Territorians.

Yours sincerely

A handwritten signature in blue ink, consisting of a series of loops and a long horizontal stroke at the end.

NICOLE MANISON

8 JAN 2019