

## **AER REJECTS BIG INCREASES TO NETWORK CHARGES FOR VICTORIAN DISTRIBUTORS BUT PROVIDES FOR EFFICIENT NETWORK INVESTMENT**

The Australian Energy Regulator (AER) has issued its draft determination for Victoria's electricity distribution network service providers: Powercor, SP AusNet, Citipower, United Energy and Jemena Electricity for the period 1 January 2011 to 31 December 2015.

The Victorian distributors have each sought substantial increases in expenditure compared with recent trends. Overall, increases of over 66 per cent in capital spending and 38 per cent in operational expenditure have been proposed.

"These substantial increases in network expenditure are not justified when you consider the fundamental characteristics of the Victorian distribution network," Mr Andrew Reeves, acting AER Chairman, said today.

"On the whole, the Victorian distributors are efficient operators of a mature and comparatively reliable network. They have performed well over the current five year period and have also had the benefit of a strong economy and strong sales. Under the Regulator's rules, customers share in these gains at each price review."

The AER's draft decision would lead to a reduction in the average residential bill of around 2.3 per cent on average in the first year (2011) and increases in the following years of between 0.9 per cent and 1.1 per cent in nominal terms. The impact varies for each distributor.

"In a relatively stable environment, past expenditure is a good guide to future needs. However, additional expenditure is needed to maintain reliability, meet increased costs and growing demand.

"On this basis, the AER considers capital expenditure should increase on average by 16 per cent on actual expenditure in the current period to \$3.4 billion, or \$2 billion less (38 per cent) than that proposed by the distributors. A total operating expenditure allowance of \$2.2 billion over the forthcoming period, an increase of 2 per cent, is also seen as justifiable. We have also made allowance for the higher capital and financing costs that the firms now face," added Mr Reeves.

"The AER has also provided additional allowance for prudent bushfire mitigation in line with existing requirements, but has been careful not to pre-empt any changes in regulatory requirements for bushfire mitigation which are currently being considered by the Victorian Bushfires Royal Commission and the Victorian Government. In the event of new regulatory requirements, the AER will review any necessary increases in costs."

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The AER's draft decision would lead to initial reductions to network charges (in the first year of the new period) of around 5.8 per cent on average in nominal terms and increases of around 2.8 per cent in later years of the period. The initial reduction is necessary in order to realign revenues with efficient costs.

The 2005 determination set prices based on the forecast financial needs of the distributors and on forecasts of the volume of sales. The distributors have benefited from sales which have been substantially above forecast. At the same time, actual costs have turned out to be substantially less than forecast. This determination will re-set prices based on new sales forecasts to ensure that distributors receive revenues which match efficient costs. This is the major factor accounting for the initial reduction in allowable revenue and prices.

Network charges would generally increase in line with inflation in the later years. This reflects increases in revenue allowances due to growth in input costs and the additional capital expenditure, offset to some extent by reductions in allowances arising from efficiencies and service performance in the current period and from growth in electricity sales.

The AER's draft decision also makes determinations for charges on public lighting, fee-based and quoted services and a negotiating framework and pricing criteria for negotiated services.

In response to the AER's decision, the Victorian distributors are expected to provide a revised regulatory proposal by 21 July 2010. Submissions to the AER's draft decision and the revised regulatory proposals are invited from interested parties and are due by 19 August 2010. The AER's final decision will be made by the end of October 2010.

In making this decision, the AER took into account advice from independent experts and submissions from interested parties. All documents are on the AER's website.

#### **Media Inquiries**

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**NR 04/10**

**4 June 2010**

#### **Background**

Distribution charges represent 40 per cent of the total cost of supplying electricity to residential customers. Typically these customers do not see distribution charges on their electricity bills. Instead, the charges are included in electricity tariffs charged by electricity retailers, such as Origin and AGL. The AER's final decision on distribution charges will be incorporated into retail tariffs from 1 January 2011.

The Victorian distributors supply electricity to more than 2.5 million customers and businesses across a total distribution area of more than 232,000 square kilometres ranging from Citipower's largely CBD and inner city network to the large substantially rural networks of Powercor in the west and SP AusNet in the north-east, with United Energy's and Jemena's largely urban-based networks sitting in between.

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