RCP REPORT ON AUSGRID REVISED PROPOSAL

Chair's Foreword

This report, the fourth produced by the Ausgrid Reset Customer Panel (Panel or RCP), concludes the formal task assigned to us since our establishment over 2 years ago. In co-designing the customer engagement program which underpins Ausgrid's 2024-29 revenue proposal we sought to ensure that the needs, preferences and expectations of customers were captured in the plans Ausgrid made for the 2024-29 period. We appreciate the AER's recognition of our work in its Draft Decision and hope that other distributors will build on it in future resets.

The Panel brought together seven individuals with varied backgrounds, some of whom had never worked with other members previously. To my fellow members – Louise Benjamin, Jan Kucic-Riker, Iain Maitland, Mark Grenning, Gavin Dufty and Mike Swanston – I offer sincere thanks for their untiring efforts. Their determination to ensure that Ausgrid's customer engagement was as fulsome as it could possibly be, and that Ausgrid's revenue proposal reflected its customer preferences and delivered outcomes that customers valued, was clear to everyone they dealt with.

As with every revenue reset there are valuable learnings and we hope that the AER, distributors and relevant actors, including other utilities and councils, benefit from the work that Ausgrid commissioned. In particular, anticipated impacts on networks and the customers they serve from extreme weather events as a result of climate change is a challenge that is forcing new thinking and planning. Ausgrid has made a very important start through the work it initiated but it needs to be furthered for its full value to be realised.

A big thanks is due to countless Ausgrid staff who assisted us in our endeavours and whose patience we tried at times through our frequent requests for additional information and explanation. At no time did they do anything else than fully support our work and we are confident this culture of wanting to improve the business further and focus on delivering on customer outcomes is deeply entrenched. We started our work under CEO Richard Gross and we conclude it under CEO Marc England and we continue to observe the ongoing customer centric culture being reinforced by the Ausgrid Board and senior leadership team.

Finally, my thanks to the many Ausgrid customers who assisted us through their involvement in the Voice of Community Panel (VoCP) and the Port Stephens, Central Coast and Lake Macquarie resilience workshop groups. Over many months these individuals shared with us their perspectives, some of them borne of difficult times following major storms and prolonged outages. Their contribution has been invaluable.

Tony Robinson
Chair, Reset Customer Panel
29 November 2023

Introduction

This report, the fourth produced by the RCP, responds to Ausgrid's Revised Proposal. It follows our earlier reports on Ausgrid's Draft Plan (August 2022), Initial Proposal (January 2023) and Resilience Investment Business Case (July 2023)[1]. The focus of this report is primarily on customer engagement since the Draft Decision as well as commentary on selected aspects of the building blocks where customer views are relevant.

The AER's Draft Decision accepted many aspects of Ausgrid's Initial Proposal but requested additional information to support the prudency and efficiency of parts of the proposal.

We acknowledge in particular the AER's finding that the customer engagement undertaken by Ausgrid was robust and that our role has:

> *"…provided constructive challenge to the business to ensure its proposal is delivering value for its customers. The RCP has been committed to challenging Ausgrid in its engagement and helping guide and shape the regulatory proposal."*[2]

This report has three parts:

1. commentary on Ausgrid's engagement with customers since the AER's Draft Decision;
2. observations from the Panel on elements of Ausgrid's Revised Proposal; and
3. RCP observations on wider regulatory framework issues, such as our experience with the operation of the Better Resets Handbook (Handbook).

Appendix A lists the engagement activities the RCP was involved in since the Third RCP Resilience Report in July.

In accordance with Section 3.4.2 of the Handbook RCP members confirm that this report, along with all other reports in our name, was written by ourselves without any outside assistance.

[1] See First RCP Report 29 August 2022; Second RCP Report 27 January 2023 and Third RCP Resilience Report 14 July 2023

[2] See AER Draft Decision Overview - Ausgrid - 2024-29 Distribution revenue proposal – September 2023 at p. ix

Key points in this Report

- Customer engagement undertaken by Ausgrid since the AER's Draft Decision is consistent with the guidance provided in the AER's Handbook.

- Ausgrid has fulfilled its undertaking to again consult with customers about affordability.

- The RCP agrees with Ausgrid that it has taken a considered and pragmatic approach to ease the impact of bill increases in 2024-29. It has reduced the estimated bill impacts for factors within its control to $25 average bill impact in FY29 by introducing a total of affordability initiatives of -$48 against a forecast increase in bill of $241 due to factors outside its control.

- Ausgrid has modified elements of the Revised Proposal in response to customer and AER feedback.

- The RCP supports Ausgrid's proposal that its SaaS investment be treated as capex for this 2024-29 period on the basis that this contributes to lower costs for customers.

- The RCP does not support the AER's Draft Decision view that Ausgrid should waive that part of its CESS payment arising from the compulsory acquisition of the Bligh Street property, nor the associated recommendation that Ausgrid consult with customers on the matter.

- The RCP supports Ausgrid's tariff assignment policy.

- Because Ausgrid has listened and responded meaningfully to customer views the RCP believes that apart from two qualifications detailed below, the RCP believes that Ausgrid's Revised Proposal is capable of acceptance by the AER if it finds the revised capex and opex step changes are prudent and efficient. These two qualifications relate to the innovation capex and opex step change and the climate resilience opex step change, where we support these proposed expenditures being assessed for the 2024-29 reset based on the primacy of the quality of the engagement and the commitments Ausgrid has made around that expenditure.

- In its Draft Decision the AER was led to an unbalanced judgement regarding Ausgrid's cyber-security investment proposal because it relied on EMCa's analysis which we believe is questionable.

- The regulatory reset process can be improved in a number of ways which are detailed in Part 3 below.

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PART 1 Engagement since the Draft Decision

In this Part of our report we discuss:

- the three LGA workshop 4 sessions with Port Stephens on 10 October 2023, Lake Macquarie on 11 October 2023 and Central Coast on 12 October 2023;
- the Day 3 VoCP workshop on 21 October 2023; and
- how Ausgrid has responded to that engagement in its Revised Proposal.

<u>Introduction</u>

As part of the engagement supporting its Initial Proposal and subsequent Resilience Investment Business Case lodged with the AER in July 2023, Ausgrid pre-committed to these 4 engagement sessions with customers following the Draft Decision. In the Draft Decision on 30 September 2023 the AER included very significantly reduced placeholders for each of the resilience, cyber, CER integration, innovation and ICT (ERP) expenditure programs. The planning and execution of these 4 engagement sessions posed significant challenges for Ausgrid and the RCP due to:

- the unexpected deeply reduced placeholders included by the AER in the Draft Decision for the expenditure programs that customers had shaped the most[3];
- the very fast turn-around between 30 September and the mid-October sessions;
- the RCP having less opportunity to influence the design of the engagement;
- Ausgrid staff movements due to the recent corporate restructure; and
- Ausgrid staff being very busy in revising modelling in the short 45 days between the Draft Decision and lodgement of its Revised Proposal.

In the limited time available to influence the engagement we stressed the following things:

1. Ausgrid staff should present the AER's Draft Decision in a neutral and transparent way, despite their deep disappointment with aspects of it.
2. Ausgrid's promise to its customers needed to be very clear so that customers understood where Ausgrid was 'informing' them about the Draft Decision and how Ausgrid intended to respond to the AER and where Ausgrid was 'seeking feedback' from customers that it committed to respond to in its Revised Proposal.[4]
3. Ausgrid should reduce the time for engagement so as not to waste customers' time, given their opportunity to influence the next steps was reduced from when the engagement sessions were originally planned.

Some of the above matters are also the subject of commentary in Part 3 below.

[3] We discussed the intense and deep deliberative engagement with customers over more than 18 months in our three earlier reports

[4] See Section 3.3.4 of the Handbook at p. 16: *"Engagement should consider the IAP2 Spectrum of Public Participation, in particular the different levels of participation and range of influence (ranging from inform to empower) consumers have on the regulatory proposal."*

LGA engagement

The Panel has reviewed a draft of the Workshop 4 Outcomes Report from the 3 LGA Resilience Forums prepared by bd infrastructure (bd LGA Engagement Report).[5] At least 4 RCP members observed each of the workshops and the Panel confirms that the outcomes from the 3 sessions are accurately described in the bd LGA Engagement Report.

The format of the LGA engagement sessions was structured to 'inform' customers and allow them to reflect on what they heard and this was made very clear to participants. As bd notes:

> *"It was anticipated that Forum participants would be disappointed in the AER's response. The Ausgrid team, aided by bd infrastructure, therefore carefully crafted the workshop to enable participants to reflect on the response, ask questions, be reassured of the value they brought to the process, and look forward to the next steps."*[6]

The LGA forums had 3 parts:

1. an overview from Ausgrid of the VoCP willingness to pay feedback and the AER's Draft Decision (inform);
2. an overview of how Ausgrid intended to respond to the AER's Draft decision (inform); and
3. an opportunity for participants to provide feedback on the LGA engagement process as well as crafting messages for community members in future engagement around Ausgrid's resilience program (Ausgrid in listening mode).

<u>Customer feedback on the AER's Draft Decision on resilience</u>

Customer feedback observed by the RCP was mixed. As anticipated, some customers expressed disappointment, believing their physical and emotional investment was worthy of greater recognition. Others thought the AER didn't properly understand their lived experience as residents in regional areas. On hearing that the AER needed additional information to justify approving more of the proposed investment, some questioned the AER's modelling while others were curious about what evidence was required and Ausgrid's level of confidence that it could be provided.

<u>RCP observations on the LGA engagement</u>

The aim of informing participants of the Draft Decision insofar as it impacted the proposed resilience investment was met, although there was an iterative character to the forums, which was not surprising given the unprecedented nature of this part of the engagement and the very quick preparation time.

Key RCP reflections on the engagement are:

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[5] A copy of the bd LGA Engagement Report is Attachment 5.5.5 to the Revised Proposal

[6] See Bd LGA Engagement Report at p. 4

- too much time was permitted for reflection and discussion in the first workshop (Port Stephens) which unhelpfully led to some participants relitigating discussions from earlier in the year.
- In the Port Stephens forum one participant raised a claim of Ausgrid or AER bias against undergrounding which the RCP Chair, at the invitation of the moderator, was able to dispel.
- Ausgrid did not provide a comprehensive explanation of the AER's justification for not supporting much of the proposed investment in the first forum (Port Stephens).
- At the following two forums in Lake Macquarie and Central Coast Ausgrid avoided this distraction by more transparently acknowledging where it failed to 'meet the requirements of the AER's resilience guideline'.
- Adequate time was provided for participants to provide feedback. At Port Stephens the sentiment seemed more disappointment than acceptance whereas at Lake Macquarie and the Central Coast the reaction was more evenly split. The RCP believes that the mood of the Port Stephens meeting might be due to the longer format applied in the first of the workshop 4 forums.
- We commend Ausgrid for adapting overnight between the Port Stephens and Lake Macquarie forums and for including 2 members of the senior executive team in the Lake Macquarie and Central Coast forums.
- Participants freely expressed their feelings throughout the sessions. Memorable quotes included: *'We get hit by quite a few things yet the AER looks for straight forward answers to things which is not the reality'* (Port Stephens) and *'If I was the AER I would want justification'* (Port Stephens).
- Ausgrid was challenged in our view by having to explain the AER's Draft Decision, something we comment on in Section 5 in Part 3 below.

Overall, the sessions were worthwhile. We believe that the sessions met the relevant expectations in Chapter 3 of the Handbook, although as we noted above these sessions were designed to inform participants rather than invite them to help further shape Ausgrid's Revised Proposal. The changes we recommended following the Port Stephens event increased the transparency of the sessions. The workshops were important as they gave Ausgrid the opportunity to reassure customers that the AER had accepted the climate modelling and the validity of their preferences expressed during their engagement.

It is clear that strong support still exists for local resilience investment, albeit up to half the participants expressed views that supported the AER's need for information and justification with one participant commenting:

> '*We are not defeated still need Ausgrid to stand up for the community in the final draft to push forward'.*

The feedback from participants on the overall process in the bd LGA Engagement Report in Sections 2.1.2; 2.2.2 and 2.3.2 confirms several of our observations which we set out in a Learnings Section in the Third RCP Resilience Report.[7] Specifically, participants stressed the need for the engagement to be face-to-face focussing on local solutions and local needs,

[7] See Third RCP Resilience Report at pp 43-44

allowing more time for the engagement by starting earlier in the process and that the local engagement was a pilot process starting an ongoing conversation between the LGAs, Ausgrid and the AER.

Ausgrid's response to the LGA feedback in its Revised Proposal

The RCP acknowledges the respectful way in which Ausgrid listened to the feedback it received, and the commitment given to return in 2024 to reprioritise the final approved investment.

VoCP engagement

The Panel has reviewed a near final draft of the Voice of Community Panel 2023 Day 3 workshop 'What Was Said' Report prepared by Mosaic (Mosaic VoCP Report).[8] Five RCP members observed the VoCP Day 3 workshop, and the Panel confirms that the outcomes from the workshop are accurately described in the Mosaic VoCP Report.

The VoCP October session enabled participants to provide feedback on five items:

1. an overview of the AER Draft Decision; (inform)
2. testing of a revised the extreme heat program; (consult)
3. the two way tariff fact sheet; (involve)
4. retesting affordability sentiment; (involve); and
5. an update on Ausgrid's advocacy for regulatory reform (inform).

Customer feedback

In relation to the Draft Decision participants expressed disappointment particularly around the failure to secure approval of the Innovation investment. Notable quotes were:

> *'Can't they work together on this?'*
>
> *'What would it take for AER to approve?'*
>
> *'Did AER already have a fixed budget and were we always going to be knocked back?'*

The Extreme Heat Program briefing provided new information to customers, including advice from an expert on the benefits of tree canopy in mitigating urban heat. This helped inform the presentation of the proposed Aerial Bundled Cable (ABC) initiative but triggered questions as to how much bundled cable the investment would deliver and where on the network it would be located. When put to the L test 62% of participants supported a 50/50 funding deal up to $6m with local government.[9]

Constructive feedback was offered to Ausgrid about the Two-Way Tariff Fact Sheet. Participants indicated their preference for a shorter, simpler and clearer version with advice

[8] A copy of the Mosaic VoCP Report is Attachment 3.1 to the Revised Proposal
[9] See Mosaic VoCP Report at p. 22

on how customers could act to benefit (or reduce the impacts) of the tariff. They also requested a rationale be included as to the reason for the tariff.

Affordability sentiment was re-tested in keeping with Ausgrid's commitment to do this a second time in 2023. After a comprehensive explanation of the cost elements participants were invited to express their comfort level. Some 58% expressed a Live/Like/Love response.[10] To confirm the accuracy of the response, participants were invited to consider their response over the afternoon break. Some quotes include[11]:

> '*On Ausgrid's part there is a net -$3, that seems very fair for investment into the future. Costs are not going to come down in the future if we don't weather the near-term pain of investment. You can't save your way out of climate change.*'
>
> '*I am comfortable with the overall proposal as I feel that the aspects that were rejected by the AER (innovation, movement to net zero) need to be implemented to future-proof the network. Also, the additional spend is offset by the savings found.*'
>
> '*Actually, I accept the benefits are worthwhile, but overall inflation is killing most people's budgets. This is especially true for those on fixed incomes (elderly, etc.). It is time to call a time out and let the federal and state governments to realise.*'

<u>RCP observations on the VoCP engagement</u>

The RCP observed a healthy attendance at the VoCP which is a tribute to the energy and commitment of participants at the end of a long engagement. The moderation of the session was professional at all times and was assisted by the presence of senior Ausgrid executives. Participants were given numerous opportunities in well-structured sessions to express their thoughts.

As mentioned earlier the ABC initiative within the Extreme Heat Program featured an external expert who RCP hadn't previously met.[12] The new information regarding canopy/cooling benefits of unpruned trees was interesting but this had not previously been presented to customers or viewed by the RCP. The presenter's later engagement in the chat, albeit briefly, introduced an unwelcome bias in favour of Ausgrid's involvement in supporting tree canopy although we cannot say this influenced the subsequent expression of support. The discussion amongst participants was rich and based on a variety of experiences. Numerous questions arose including some focussed on where the ABC would be located. These were followed by an L test which showed 62% support for a 50/50 funding agreement. Given the Extreme Heat Project is still under development, the recency of the presentation by the external expert and the brevity of the discussion, care needs to be taken in relying on this as conclusive support. We discuss the Extreme Heat Project further in the resilience Section of Part 2 below.

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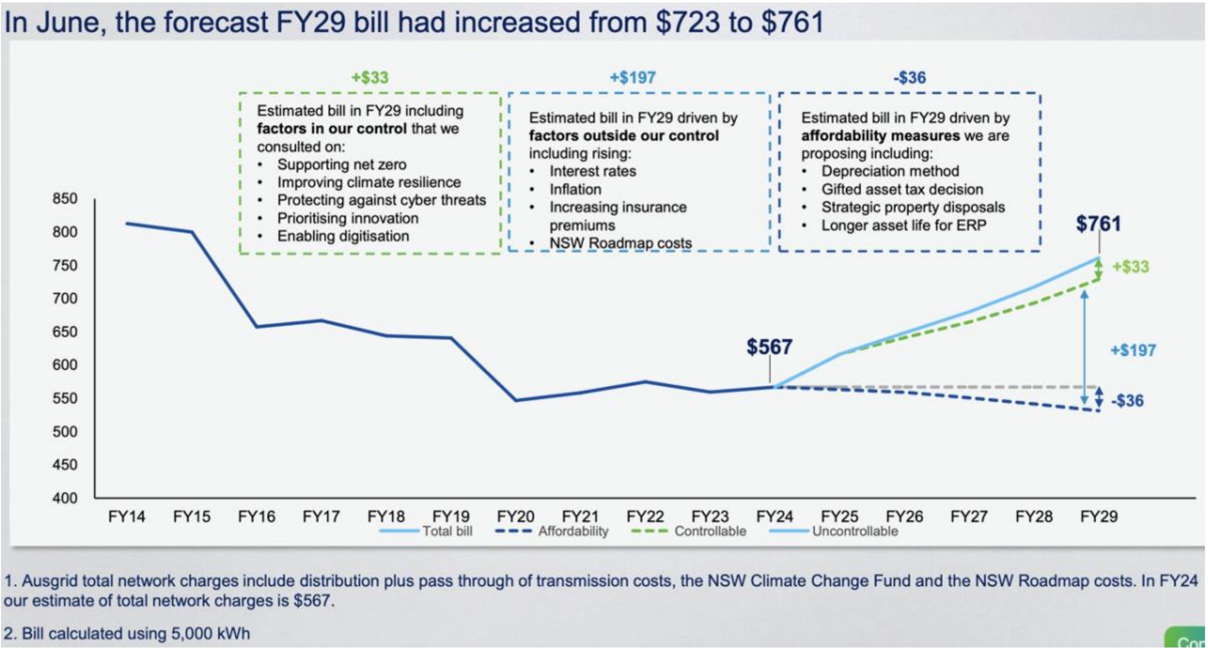
[10] See Mosaic VoCP Report at p. 38

[11] Ibid at p. 38 and p. 42

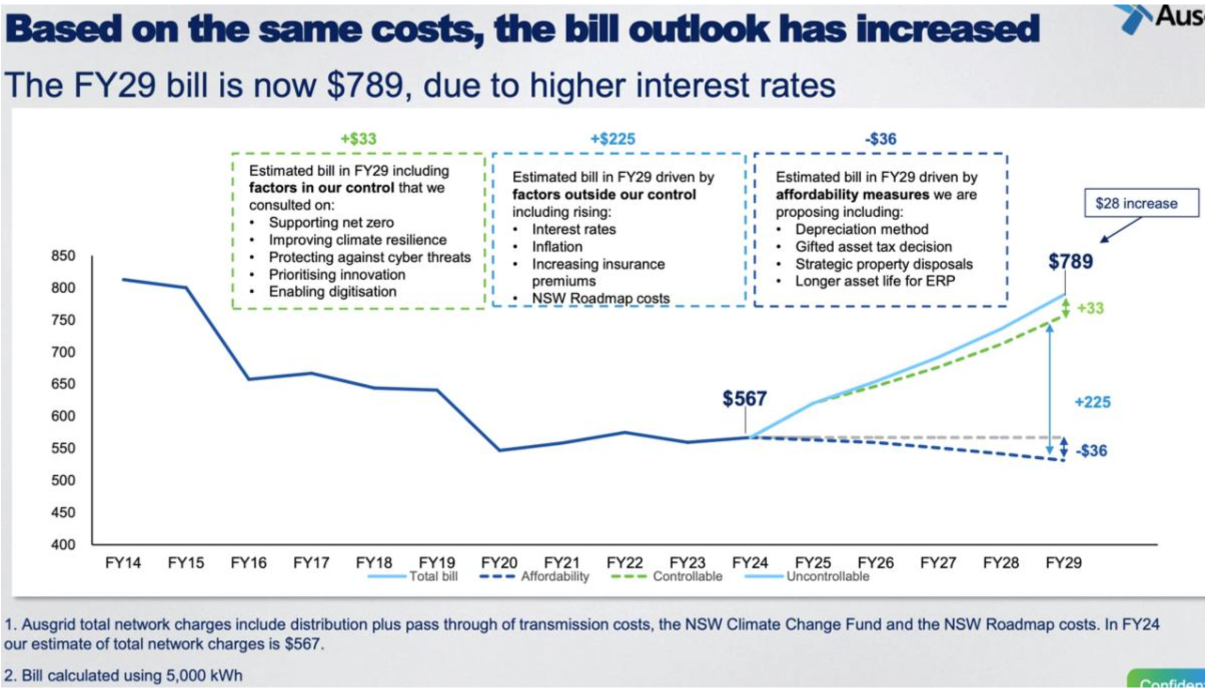
[12] Ausgrid had discussed the benefits of tree canopy with RCP members as part of the preparation of the new Extreme Heat Project in the Climate Resilience business case discussed in section 2 below

Ausgrid continued with its consistent updating around affordability to reflect broader macroeconomic factors. In the June 2023 VoCP sessions Ausgrid had informed the VoCP that Ausgrid estimated that its share of the average bill would rise from the previously forecast $723 (FY 29) to $761. The increase was due to factors outside Ausgrid's control including interest rates, inflation, insurance and NSW Roadmap costs. The following graph was shared with both VoCP June sessions[13] which was a point in time presentation with the updated numbers now in the Revised Proposal:



In the 4 months between 24 June and 21 October 2023 Ausgrid informed the VoCP that Ausgrid's revised estimate of its proportion of the bill in FY29 had increased further by an estimated $28 from $761 to $789, again due to an increase in the factors outside Ausgrid's control. The following graph was shared with the combined VoCP on 21 October 2023:

[13] 17 June 2023 held in Newcastle and 24 June 2023 held in Sydney



Ausgrid provided a very solid explanation of what the average bill would deliver and didn't hide the rising interest rate effect on bills. Participants were given ample opportunity to question Ausgrid staff. It was clear to the RCP that the VoCP participants were more concerned in October 2023 about rising costs than they were earlier in the year and the L scale test confirmed this. To accommodate the mood and interest of participants further reflection was invited through the afternoon break and the test was reapplied. There was a slight drop in support from 58 to 57.

A clear takeout from the session was that despite overall support, customers expected Ausgrid to work on finding additional savings, and some were not as strongly wedded to some elements of the proposal as they were previously (e.g. innovation). However they stressed the top priority for them remained CER integration. In response to the increase in VoCP concerns about affordability Ausgrid made a commitment to participants to look for additional affordability initiatives in its Revised Proposal without compromising on delivering the customer priorities.

The RCP believes that the VoCP session meets the requirements in Chapter 3 of the Handbook in the following ways:

- the engagement demonstrated Ausgrid's sincerity through the attendance of senior executives, as recommended by the Handbook (p. 13);
- the engagement was sincere in that Ausgrid honoured its commitment to again test customer views on affordability, notwithstanding its awareness of the likelihood of declining support. This reflects positively Ausgrid's intent to achieve the high quality engagement sought by the Handbook (p. 13);
- the high quality of the engagement was further demonstrated by the impact of customer views on affordability which led to Ausgrid subsequently including additional affordability initiatives in the Revised Proposal designed to reduce costs;

- the session was one of a number in the current reset engagement and participants were able to comment on a range of items within Ausgrid's proposal. This satisfies the Handbook's depth and breadth expectations (p. 12); and
- the final discussion involving the VoCP related to advocacy and how they could work with Ausgrid to shape the future regulatory environment. In this sense the interaction aligned with the Handbook's encouragement of consultation '*on long-term outcomes, and not be confined to outcomes desired for the period covered by the regulatory proposal*.' (p. 15)

How did Ausgrid respond to the VoCP feedback in its Revised Proposal?

Ausgrid acted on the feedback provided at the VoCP in the following ways:

- It modified the Extreme Heat Program to include $250k research in option C and agreed to consider governance arrangements about how that investment, if approved, would be spent.

- Ausgrid redrafted the Two-Way Tariff Fact Sheet[14] by incorporating both VoCP and Pricing Working Group (PWG) feedback. Ausgrid acknowledged the customer influence in helping shape this decision: *'Customers wanted the factsheet to be simpler and clearer and describe how customers could benefit from the reward price. The factsheet has been amended to allow for this feedback, including shortening it to two pages in length.'*[15]

  The VoCP also asked Ausgrid to reduce the number of customer impact graphs as part of making it simpler, which it has done on the final fact sheet. We discuss the fact sheet further in the smart meter and tariffs section in Part 2 below.

- In response to VoCP feedback on affordability Ausgrid subsequently informed the RCP and AER that it explored extending asset lives, capex/opex trade-offs, reducing and/or delaying expenditure and self-funding a component of innovation before arriving at the additional affordability initiatives included in the Revised Proposal. Ausgrid advised the RCP (and AER staff in attendance) in a meeting on 10 November of the proposed additional affordability initiatives totalling $93 million. The following slide was presented by Ausgrid to the RCP and the AER on 28 November 2023 following Ausgrid Board approval. The additional affordability initiatives total $121m in revenue with an average bill impact of $14.70:

[14] The two-way pricing fact sheet is Attachment 8.14 to Ausgrid's Revised Proposal
[15] See Ausgrid Revised Proposal Overview at p. 51

Affordability initiatives

We have included a new suite of affordability initiatives to address increasing customer concerns about cost of living

Initiatives[1] ($ million nominal except nominal bill in $)	SCS Revenue	Residential network bill[2]
	FY25-29 total	FY29
Revenue with initiatives	9,737	799.7
Δ with initiatives		
1. Lower repex benchmark unit rates for one project	(6)	(0.6)
2. Smooth resilience expenditure over 4 periods	(3)	(0.3)
3. Defer solar curtailment capex	(1)	(0.1)
4. Shared funding model for innovation; efficiencies in cyber expenditure	(4)	(0.0)
5. Macquarie Park contingent project – apply for capex when expenditure becomes more certain[3]	(13)	(1.9)
6. Continue to treat SaaS as capex, smoothing impact to customers over 5-15 years	(95)	(11.6)
Total[4]	(121)	(14.7)

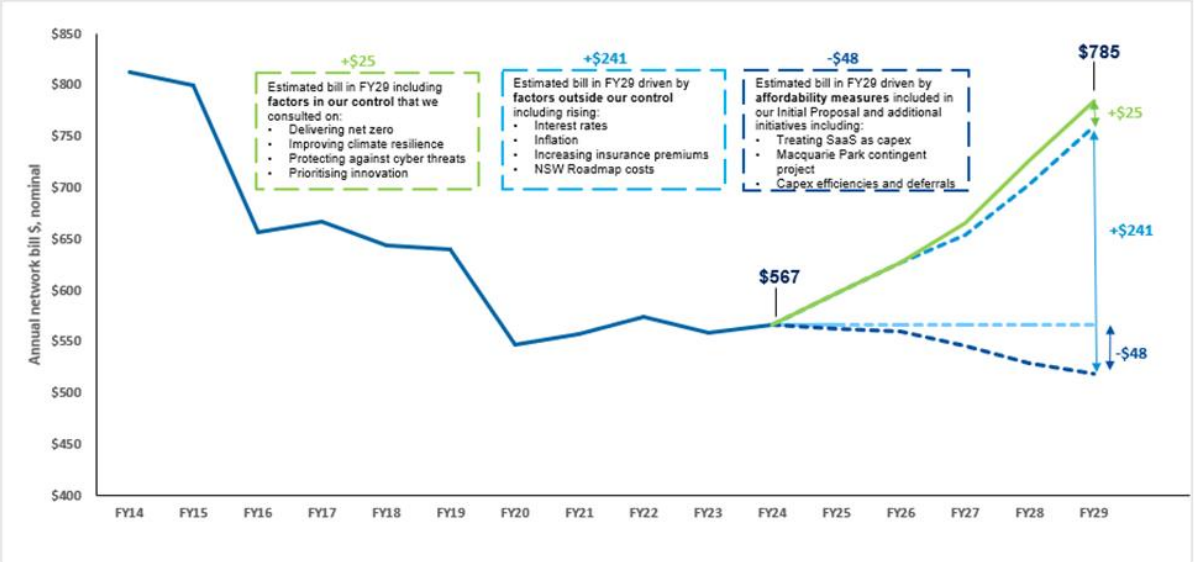
1. Results are influenced by the order in which initiatives are modelled
2. Network bill provided to VoC Panel 21 October 2023
3. Subject to AER approval of contingent project
4. Totals may not sum due to rounding

- Ausgrid has also proposed delaying the Macquarie Park augmentation capex and asked the AER to treat its SaaS investment as capex, both of which would further assist customer affordability concerns in 2024-29. The RCP supported these initiatives on 10 November, noting that this was the first time we had become aware of them. We discuss these initiatives further in Section 1 of Part 2 below.

Ausgrid has included these additional affordability initiatives in the Revised Proposal. Ausgrid has also calculated the bill impacts as an additional average -$14.7 bill impact in FY 29. This is over and above the initial affordability initiatives in the Initial Proposal totalling -$34 average bill impact in FY 29.[16] We commend Ausgrid for consistently and clearly presenting to the RCP, its customers and the AER the information about what outcomes customers have been able to influence and what is outside Ausgrid's control. We have seen the approach in the following graphs become the new benchmark for other networks. The following information in the Revised Proposal shows the impact of Ausgrid's initial and additional affordability initiatives ($34 + $14.70 which delivers a reduction of -$48) in FY29 network charges.[17]

[16] Ausgrid advised the RCP that the $34 affordability measures in the Initial Proposal graph are already embedded in the modelling of revenue and bill impacts in the Revised Proposal graph: "*The weighted average remaining life RAB depreciation method, longer asset life for ERP, strategic property disposals and other Initial Proposal affordability measures have been included or factored in as base inputs for Revised Proposal revenue. Accordingly, the $15 affordability initiatives are additional to those initial $34 affordability measures*"

[17] See Ausgrid Revised Proposal at p. 13



Note:
1. Ausgrid total network charges include distribution plus pass through of transmission costs, the NSW Climate Change Fund and the NSW Roadmap costs. In FY24 our estimate of total network charges is $567.
2. Bill calculated using 5,000 kWh per year on EA010 to FY23 and EA116 from FY24 onwards.

The Revised Proposal results in an average annual residential bill increase of 6.7%, which is 2.3% higher than the Initial Proposal. If Ausgrid's Revised Proposal is accepted, Ausgrid estimates its total network charges (i.e. transmission, distribution, the NSW Climate Change Fund and NSW Electricity Infrastructure Investment Roadmap (NSW Roadmap) scheme recoveries) would increase in real terms (adjusting for inflation) by 3.8% for households and 4.2% for small businesses in each year of the 2024-29 period.[18]

The RCP agrees with Ausgrid that it has taken a considered and pragmatic approach to ease the impact of bill increases in 2024-29. It has reduced the estimated bill impacts for factors within its control to $25 average bill impact in FY29 by introducing affordability initiatives totalling -$48 against a forecast increase in bill of $241 due to factors outside its control.

[18] See Revised Proposal Chapter 2 at p. 13

Part 2 Observations on the Draft Decision and Ausgrid's Revised Proposal

In this Part of our report we discuss the AER's Draft Decision and parts of Ausgrid's Revised Proposal.

The AER's Draft Decision

The AER's Draft Decision includes many positive statements and findings about Ausgrid's Initial Proposal and Ausgrid's transformation since the previous revenue reset in 2019. Some examples include:

1. Ausgrid's leadership role in engagement[19] undertaking the most comprehensive engagement program to date by a network extending to bespoke programs for CALD, C&I, youth and First Nations customers;
2. The measures to address affordability that has set a benchmark for these measures with other networks e.g. longer depreciation periods, property rationalisation and productivity on capex overheads;
3. The very significant efficiency improvement in opex with annual productivity improvement of 1.8% p.a. compared to the industry average of 0.5%, resulting in Ausgrid being ranked third in the AER's FY22 opex benchmarking[20];
4. The AER's increased confidence in Ausgrid's capex governance/business case modelling[21] with virtually 100% of Ausgrid's business as usual recurring expenditure being accepted by the AER;
5. The TSS being accepted virtually in full[22] with industry leadership on embedded network tariffs[23];
6. Strong participation by the CCC in the development of the 2024-29 proposal;
7. Establishing, supporting and funding the RCP as the first independent consumer panel under the Handbook;
8. Frequent director involvement with the RCP from the beginning of our engagement, including Chair, CEO and senior executive participation in the engagement[24];
9. Stakeholder support for Ausgrid's improved relationships. For example SSROC made the following comment in its public submission to the AER:

   "Consultations with Ausgrid have been conducted in a transparent manner over the past six months with Ausgrid offering SSROC wide-ranging access to its analyst and its price modelling. SSROC has been given the opportunity to question

[19] Acknowledged by the AER in its Draft Decision Overview at p. x

[20] Ausgrid has informed the RCP that the AER's Benchmarking report will be published 28 November 2023

[21] AER Draft Decision at p. 74

[22] "*We are satisfied most elements of the proposed tariff structure statement comply with the pricing principles and contribute to the achievement of the network pricing objective. We consider that Ausgrid's proposal includes tariffs with strong cost reflective price signals and assignment policies that balance advancing reform against appropriate transitional mechanisms to manage adverse customer impacts."* See AER Draft Decision Attachment 9 at p. 4

[23] Ibid at p. 34

[24] Senior executive participation is highlighted by the AER as an important feature of sincere engagement see Handbook at pp 12-13

and challenge key assumptions, several of which were subsequently revised. Ausgrid kept SSROC informed about key changes to its model as it developed and the impact on pricing. This degree of transparency and responsiveness is to be commended and is unlike many previous reviews that SSROC has been involved with."'[25]

10. Ausgrid's leadership in new categories of expenditure that are prioritised and highly valued by customers particularly in resilience, innovation and cyber security.

The Panel commends Ausgrid's senior leadership team and former CEO Richard Gross for this remarkable achievement in just 5 years. In the Panel's experience utility businesses are normally very slow to change given their long lived assets and stable conservative regulatory environment and investment profiles.

Despite these strong improvements Ausgrid was very disappointed by other aspects of the Draft Decision and this was highlighted by Marc England at the AER's Public Forum on 9 October 2023. Specifically Ausgrid was disappointed and surprised by the AER's decision to include significantly reduced placeholders for the resilience, innovation, CER Integration, cyber and ERP/ICT expenditure programs (in some cases 0%). These decisions were felt keenly by Ausgrid staff as these are the five expenditure programs that had been the subject of deep engagement between Ausgrid and its customers and are the programs which are the foundation to deliver on customers' expectations. In the case of the resilience, innovation and cyber programs Ausgrid had taken public leadership positions, which the AER acknowledged.[26] The AER acknowledges each of these categories are new and evolving and the AER's frameworks are less settled for these less certain categories of expenditure. In a sense the AER, networks and customers are learning by doing in these resets but this did cause unexpected challenges for the customer engagement post the Draft Decision as we discussed in Part 1 above.

The AER's Draft Decision makes clear that in the case of Ausgrid's resilience, CER integration and ERP programs the AER believes that Ausgrid's modelling and business case preparation was lacking. For these reasons the AER was unable to conclude that those programs were prudent and efficient and the AER made substitute placeholder decisions. Ausgrid's CEO publicly acknowledged this deficiency in Ausgrid's modelling at the Public Forum as did Ausgrid senior executives in each of the engagement sessions discussed above. We commend them for this transparency, which is continued in the Revised Proposal.

In some respects we believe that Ausgrid may have disadvantaged itself in the preparation of its Initial Proposal by a series of internal decisions about resource allocation. Staff turn-over and staff movements have complicated delivery of the resilience program in particular. Ausgrid has also been let down by its reliance on external consultants to help with modelling in these new areas. We have recommended to Ausgrid that its internal modelling

[25] See SSROC submission 12 May 2023 at p. 2

[26] "*We acknowledge the significant work Ausgrid has undertaken to understand these challenging areas of expenditure and the considerable and genuine efforts to engage with customers to understand their preferences*." See AER Draft Decision Overview at p. vii

capability should be reviewed several years out from the development of the 2029-34 reset to increase internal capability, especially in these emerging areas.

The AER set out a lot of very helpful and specific guidance for Ausgrid in its Draft Decision to assist Ausgrid to improve its modelling for the Revised Proposal for these five expenditure programs. As we discuss below, Ausgrid believes that its Revised Proposal has responded directly to the AER feedback in the Draft Decision and that the CER integration, ERP and climate resilience programs should now be capable of acceptance by the AER. In the case of the innovation and cyber security programs, however, for the reasons we discuss below we believe that the AER's Draft Decision and its reasoning fails to find the right balance between network and customer expectations and prudent investment.

Ausgrid's Revised Proposal

Apart from two qualifications detailed below, the RCP believes that Ausgrid's Revised Proposal is capable of acceptance by the AER if it finds the revised capex and opex step changes are prudent and efficient. These two qualifications relate to the innovation capex and opex step change and the climate resilience opex step change.

From our observations of the deep engagement undertaken and a review of the still developing AER frameworks for prudent and efficient innovation and resilience expenditure, we support these proposed expenditures being assessed for the 2024-29 reset based on the primacy of the quality of the engagement and the commitments Ausgrid has made around that expenditure.

1. In the case of the **climate resilience opex step change**, the Ausgrid program:

- has been the subject of deep bespoke local engagement with customers in the 3 LGAs to ensure that the initiatives are valued and are complementary to existing services provided by other resilience actors;
- continues to have strong support from Ausgrid's broader customer base; and
- the investments are subject to the performance monitoring and assurance governance in the Climate Resilience Framework, which includes post implementation reviews to measure their effectiveness.

2. In the case of the **innovation capex and opex step change**, the Ausgrid program:

- has been the subject of deep engagement with customers and the NIAC;
- continues to have strong customer support;
- is a partial self-funding model from shareholder funds; and
- has embedded many of the features and governance that we recommend the AER include in an innovation guideline (see Section 6 in Part 3).

As much of Ausgrid's expenditure and draft Tariff Structure Statement (TSS) was accepted by the AER in its Draft Decision there are many areas of the Revised Proposal where we make no comment. The following table summarises the categories in the Revised Proposal where we have commented.

Category	**Initial Proposal**	**Draft Decision**	**VoCP**	**Revised Proposal**	**RCP comment**
Capex $m					
Repex	1446	1358	1480	1428	No
Growth	190	190	312	190	Yes (1 see p. 19)
Resilience	194	26	138	114	Yes (2 see p. 21)
CER integration	47	8	47	37	Yes (3 see p. 28)
Operational technology (cyber)	68	42	68	60	Yes (4 see p. 33)
Innovation	49	0	49	45	Yes (5 see p. 38)
ICT (incl ERP excl SaaS)	301	202	276	273	Yes (3 see p. 28)
Fleet	148	148	148	147	Yes (6 see p. 41)
Property	145	145	145	145	no
Overheads	724	686	730	732	no
Opex SaaS Base year adjustment	154.7	74.3	132	0	Yes (1 see p. 19)
Opex step changes $m					
CER ICT	10.4	4.6	10.4	6.4	Yes (3 see p. 28)
Smart meter	24.9	10.7	10.7	10.2	Yes (8 see p. 43)
Innovation	5.0	0	5.0	4.5	Yes (5 see p. 37)
Property	-14.5	-14.5	-14.5	-15.3	no
Insurance	9.5	0	9.5	11.3	no
Climate resilience	8.4	0	5	5.9	Yes (2 see p. 21)
Cyber security	20.6	19	20.6	18.1	Yes (4 see p. 33)
Incentive schemes					
CESS	134.3	110	64.4	69.8	Yes (7 see p. 42)
Tariffs					
Embedded networks					Yes (8 see p. 43)
Two way tariffs					Yes (8 see p. 43)

1. **Affordability initiatives: Macquarie Park Substation and retain SaaS as capex**

As we noted in Part 1 above, Ausgrid has proposed 6 additional affordability initiatives in its Revised Proposal to respond directly to the VoCP affordability concerns. Most of these initiatives involve traditional approaches to finding efficiencies such as the application of lower unit rates to repex; the refinement of modelling for resilience; the deferment of expenditure for CER augmentation; and the inclusion of the Macquarie Park substation augmentation as a contingent project. The remaining two initiatives (partially self-funding innovation and the deferment of the SaaS accounting change until 2029-34) are more creative in their approach. We commend Ausgrid for these lateral additional affordability initiatives and we comment on the Macquarie Park substation contingent project, the self-funded innovation program and the SaaS deferral in this Part of our report. The RCP believes that other networks should be encouraged to seek out these and other opportunities to find ways within the regulatory framework to reduce bill impacts in the medium term to enable increased investment (period to period) in the areas that have strong customer support.

Macquarie Park additional growth capex

Ausgrid has advised that it has received connection enquiries from customers with large load requirements for connection services in Macquarie Park for new significant loads.[27] Ausgrid estimates this will require it to invest an additional $128m to build a new substation to support these new loads. This capex was included in the bill impacts information presented to the VoCP in October but the specific project was not highlighted during the engagement. In response to the VoCP request to find ways to defer the impacts of investments given cost of living pressures, Ausgrid proposed to the RCP and AER staff on 10 November 2023 structuring this investment by delaying the inclusion of the revenue in its allowance until 2029. This would enable it to defer the expenditure being included in the RAB in 2024-29, by which time Ausgrid advised agreements would be in place with these customers with major loads to cover the costs of the augmentation.

At the RCP meeting on 10 November 2023, AER staff asked if Ausgrid had considered including this project as a contingent project in its Revised Proposal instead of including it as additional growth capex. Ausgrid confirmed that they had considered this approach but that at that time they didn't believe that was the optimal approach. The RCP first became aware that the Macquarie Park substation project was being included in the Revised Proposal as a contingent Project on 22 November 2023, when the RCP received Ausgrid's draft Revised Proposal.

The RCP has not had sufficient time to form a concluded view about 2 aspects of the contingent project.

- First, we are concerned to ensure that the considered protections for customers that Ausgrid proposed in the 10 November 2023 meeting are included in the implementation of the contingent project. For example the timing of the expenditure being included in the RAB and the steps Ausgrid takes to ensure that

[27] See Attachment 5.1 Proposed Capital Expenditure at p. 37

the revenue recovered from the customers with major loads will offset the return on and return of capital costs for other customers once the expenditure is added to the RAB in the 2029-34 reset. Ausgrid has confirmed that it will discuss these issues with the CCC when it makes its contingent project application.

- Second, we note Ausgrid's comments on p. 39 of Attachment 5.1 that the wording of the two-limb trigger is modelled on the wording that the AER approved in Endeavour's 2019-24 draft decision in relation to the Western Sydney Airport contingent project. We acknowledge that approach seems sensible at this late stage of the reset process. However, in and of itself adopting similar approved language for a different project does not mean that the wording meets the relevant tests under the NER and we welcome the AER's scrutiny of the contingent project.

Subject to the concern we raise above and the AER's review of the prudency of the contingent project and the wording of the trigger, the RCP supports in principle the delay to the inclusion of the revenue for the Macquarie Park substation upgrade in Ausgrid's 2024-29 allowance as this approach has improved consumer outcomes in several ways:

- Ausgrid has found a way to reduce costs to all consumers with this type of connection;
- it improves network utilisation over time, which is in the long term interests of consumers;
- Macquarie Park has been recently identified by the NSW Government as a target area for increased housing growth[28]; and
- it has broader economic growth outcomes for NSW.

SaaS ICT implementation opex/capex trade off

In its Initial Proposal Ausgrid noted that in April 2021 a binding change in international accounting reporting treatment of costs associated with implementing SaaS IT solutions was introduced. The effect of this is that that Ausgrid will not be able to capitalise the significant costs it has proposed as part of its ERP/ICT investment for accounting purposes. The AER's standard approach is to treat SaaS costs as capex in the current period for regulatory purposes. The RCP understands that the AER had agreed with Ausgrid and other networks that the reporting of these costs would be changed for Ausgrid and other networks for regulatory purposes from 2024-29.

Ausgrid is one of the last major networks to do its SAP upgrade (ERP) and it has proposed a significant investment for the 2024-29 period and in response to the AER Draft Decision it has deferred some of the investment until 2029-34. This means that the capex opex trade off required by this change in regulatory reporting is much higher on Ausgrid than the other NSW businesses. In its Revised Proposal Ausgrid has proposed deferring this change in regulatory reporting of SaaS costs as opex. Given the relatively short life of these capital expenses the RCP understood from Ausgrid that this deferral could largely avoid the bill

[28] See https://www.smh.com.au/politics/nsw/plan-to-fit-3000-homes-between-two-metro-stations-in-northern-sydney-revealed-20231108-p5eij8.html

impacts for Ausgrid's customers. We note that the Revised Proposal refers to the SaaS implementation costs being capitalised over 5-15 years[29] and the ERP project being staged over 2 regulatory periods. Consequently, we asked Ausgrid to confirm what % of the assets would have a life longer than 5 years. Ausgrid has since advised that "*45% of SaaS capex is ERP (15 years) and 55% non-ERP (5 years). In FY30-34 the ERP expenditure contributes $21m depreciation and non-ERP contributes $43m (both numbers real $FY24).*" This information is relevant to whether a similar affordability issue will arise as part of the 2029-34 reset.

AER staff indicated to Ausgrid and RCP on 10 November 2023 that it will consider this request and will check for any unintended consequences from the deferral, including likely bill impacts in 2029-34 if the reporting change is introduced at that time. Given the strong focus in the Draft Decision on affordability and cost of living concerns which we discuss in Section 1 of Part 3 below, the RCP encourages the AER to carefully consider this approach as Ausgrid has estimated a significant saving per average customer of $2.30 per annum.[30]

2. Resilience

This is a new and emerging category of expenditure for the AER and networks following publication by the AER in April 2022 of its Resilience Guidance Note and has been a feature of Ausgrid's 2024-29 revenue proposal. The RCP has written extensively about Ausgrid's efforts and leadership in this area in our previous 3 reports. The most extensive commentary in the AER's Draft Decision about Ausgrid's capex expenditure is on the climate resilience program where it acknowledged Ausgrid's leadership:

> *"In coming to our draft decision, we are cognisant of Ausgrid's efforts to better understand the impact of climate effects on its network. It has taken the lead on a very challenging and difficult topic, investing in a number of models and engaging extensively with its customers about their preferences. We also appreciate Ausgrid's efforts to adhere to our guidance note on resilience."*[31]

The AER's Draft Decision reinforces key elements in Ausgrid's approach, namely the climate projection modelling and the customer engagement undertaken at LGA level and with the VoCP, which confirmed customers' willingness to pay. The AER noted:

> *"We appreciate the challenges to engage with consumers on the network impacts from climate change and acknowledge Ausgrid's efforts to better understand its customer's preferences for resilience-related expenditure…………*
>
> *Overall, we consider that Ausgrid has undertaken an extensive and ambitious customer engagement process in a new area of expenditure. We commend Ausgrid for its efforts to take on that challenge. We are also cognisant that Ausgrid has led the charge in investing in different ways to engage with its stakeholders."*[32]

[29] See Revised Proposal at p. 9
[30] Ibid at p. 33
[31] See AER Draft Decision Attachment 5 Capital expenditure at p. 27
[32] Ibid at p. 29

The AER notes the extent of Ausgrid's bespoke LGA and VoCP engagement, which we discussed extensively in the Third RCP Resilience Report.[33]

The AER highlighted the criteria which it believed Ausgrid had not satisfied in the Resilience Guidance Note and that needed to be addressed in the Revised Proposal:

- the causal link between the impact on the network and the climate risk (the network impact model); and
- demonstrating that the proposed investments are likely to have greatest benefit to customers (the solutions and optimisation model).[34]

As this is the first time the AER has considered climate resilience expenditure, and given Ausgrid's Resilience Investment Business Case was not lodged with the AER until July 2023, there was insufficient time for Ausgrid to respond to the AER's feedback before the Draft Decision. It is therefore not surprising that the AER did not approve the climate resilience program in the Draft Decision. However, the RCP was disappointed by the insufficiently robust network impact model that had been developed for Ausgrid by external consultants. We welcome Ausgrid's acknowledgement of the challenges this created for the AER:

> *"Ausgrid notes that it has learnt valuable lessons in the preparation of the FY24-29 Climate Resilience Regulatory Proposal, especially the importance of providing modelling that is transparent and accessible for regulatory scrutiny. In the next period, we want to continue on this journey, ensuring that we are utilising the latest science in our models, and are producing further evidence of effectiveness of the network solutions."*[35]

Following the Draft Decision the AER shared its top down forecasting methodology used to reach the significantly reduced placeholder of $25.7m capex. We understand that since the Draft Decision the AER staff have worked closely with Ausgrid's resilience team in the development of Ausgrid's revised network impact model. A key issue is how the impacts of the less certain windstorm peril should be approached compared to the impacts of fire and flood. We acknowledge the AER's very constructive approach and the time they have invested in assisting the Ausgrid team to develop prudent modelling approaches in this developing area.

The RCP confirms that customers continue to give strong support to Ausgrid beginning to invest from 2024-29 in order to maintain network performance by 2050 in the face of projected climate impacts, as well as providing greater support for customers during extreme weather events. At the October 2023 VoCP workshop participants encouraged Ausgrid to review the resilience program so as to balance between the timing of network investments, the current affordability crisis and the evolving nature of climate modelling.

The Panel makes the following observations on the revised climate resilience business case in Attachment 5.5 to the Revised proposal:

[33] See Third RCP Resilience Report at pp 20-44
[34] AER Draft Decision Attachment 5 at p. 27
[35] See Attachment 5.5 at p. 44

General

1. Ausgrid has responded to VoCP affordability concerns by reducing the totex of the climate resilience business case to $119.6m including the $5.9m climate resilience opex step change from the $138m proposed to the VoCP in October 2023.
2. As the AER notes in the Draft Decision, Ausgrid's approach continues to evolve since the July Resilience Investment Business Case. The revised climate resilience program is no longer a pilot in 3 LGAs that will be scaled in the future. Rather the revised business case takes a longer term approach that seeks to reduce the forecast growth in climate risk across 4 regulatory periods. The Panel welcomes this approach as it removes much of the risk of the uncertain boundaries inherent in 'scaling'. This longer term approach is also consistent with the longer 25 year rolling approach in the Climate Resilience Framework.[36]
3. The revised 'program objective' makes it clearer that Ausgrid seeks to maintain current customer and community service outcomes by enhancing the resilience of electricity distribution services in line with the projected growth in risk of extreme climate events across the period FY25-50. We discuss the need for clarity in climate resilience programs in Section 2 in Part 3 below. Consistent with the Climate Resilience Framework Ausgrid's program seeks to manage climate risk over 4 regulatory periods, enabling it to prioritise the most efficient and prudent investments for 2024-29 but importantly with the opportunity to review effectiveness of investments before the next regulatory period.
4. Another important safeguard in the Climate Resilience Framework and in the revised climate resilience business case is Ausgrid's commitment to update the climate modelling every 5 years to see if there is any change to the 20 year climate risk growth. As part of its intended 2029-34 climate resilience program the RCP believes Ausgrid should retest both the program objective and customers' preferences for investments to maintain current network performance. This exercise should be underpinned by consumer risk preferences on high impact low probability events. Over the next few years community attitudes may change in the face of greater individual resilience due to greater CER and in the face of revised climate modelling. Considering risks will evolve, Ausgrid's focus should accordingly shift to address inequities and areas that stand to experience greater vulnerability - so a reassessment of vulnerability and inequities will need to be informed by more than just updated climate modelling in future regulatory periods.
5. We note that Ausgrid has applied 100% weighting to the mid-range climate scenario (RCP4.5) to align with other DNSPs. Ausgrid notes that this approach is inconsistent with

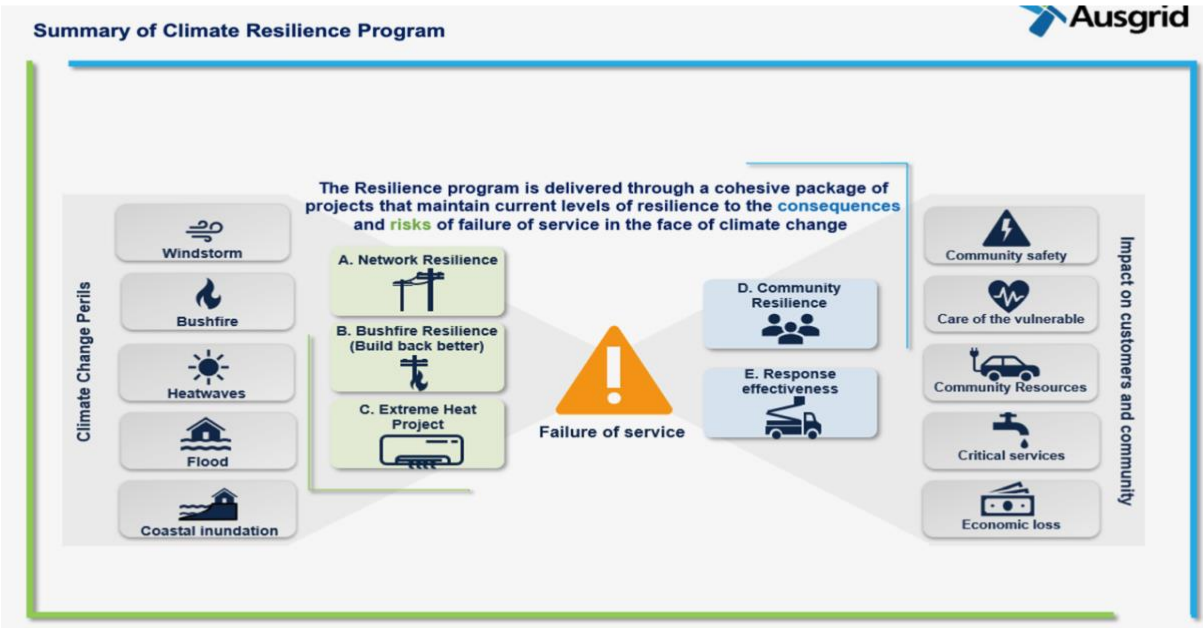
[36] The Climate Resilience Framework is Attachment 5.5c to Ausgrid's Initial Proposal. See for example: '*The Framework requires that climate impact assessments will be transparent about the confidence of scientists in the modelling projections for future impact of weather events. These forward-looking 25 year base cases will be updated in each subsequent regulatory period with refreshed climate modelling."* at p. 7 and: *"This Framework is intentionally forward looking, taking a rolling longer-term perspective, and a key feature of this Framework is its ability to adapt over time. The November 2021 AER Information Paper 'Regulating gas pipelines under uncertainty' highlights a new flexibility in the AER's approach to responding to uncertain long- term risks within each reset. For example, the AER has explored accelerated depreciation so that future gas network customers, which may be significantly less in number, do not pay too much for the long-term, fixed cost investments that current customers require today. A similar longer-term approach to resilience funding is reflected in this Framework."* at p. 10

the advice of its climate modellers and is conservative as it underestimates the likelihood of RCP8.5.[37] This weighting is an aspect of the model we believe should be retested as part of the climate modelling at the beginning of the next reset period.

6. The revised climate resilience business case includes five projects which Ausgrid has designed as a package of cohesive projects. Three of the projects (the Network, Bushfire and Extreme Heat Resilience Projects) involve significant investments designed to provide resistance to the wind, bushfire, and heat perils respectively. The other two projects (Community Resilience Project and Response Effectiveness Project) focus on community support and the effectiveness of Ausgrid's response during an extreme weather event. In relation to the latter two Projects Ausgrid highlights their importance to support the staged investment over the 4 regulatory periods:

   "As we are staging the network investments over twenty years, there is a risk of investing too late. We are managing this risk through our Response Effectiveness and Community Resilience projects. The Community Resilience Project manages the risk of delay for our most vulnerable communities – they have co-designed packages of initiatives that they know will work to protect their communities."[38]

   The evolution of the climate resilience program and the interactions between the projects is summarised in the following figure, which has become a central pillar of the revised climate resilience business case:[39]



7. The important performance monitoring and independent review is built into each of the five projects. We support this approach but also expect Ausgrid to meet the agreed assurance and governance expectations in Chapter 10 of the Climate Resilience Framework.

[37] See Attachment 5.5 at p. 8
[38] Ibid at p. 24
[39] Ibid at pp 4, 16 and 29

8. The AER's Draft Decision approved some of the capital investments for the Network Resilience, Bushfire Resilience and Response Effectiveness Projects. The AER did not approve funding for the Community Resilience Project despite the extensive customer engagement it had acknowledged. The Extreme Heat Resilience Project is a new project in the Revised Proposal. In this report we have focussed our project specific observations on the new Extreme Heat and Community Resilience Projects.

Project 1: Network Resilience

The RCP welcomes the staged approach that has resulted in Ausgrid's network investments supporting the needs of the most vulnerable first, by prioritising faster delivery in the 3 especially vulnerable LGA's.[40]

Project 2: Bushfire Resilience (Build Back Better and Fault Detectors)

As we noted in the Third RCP Resilience Report the VoCP gave equal highest priority[41] to Ausgrid's ability to Build Back Better and to fault detectors. Participants believed this would assist the network to be updated to better standards and would reduce the chance of subsequent outages.

Project 3: Extreme Heat

- Ausgrid has included this new project in its revised climate resilience business case in response to the stakeholder concerns presented at the AER Public Forum and directly to Ausgrid in October 2023. Ausgrid developed this project by seeking advice from extreme heat experts, engaging with stakeholders, including the RCP and, as we noted in Part 1 above, Ausgrid discussed the proposed project with the VoCP in October 2023.
- Ausgrid's Extreme Heat Project has 3 initiatives totalling $1.75m opex and $6m capex designed to:
    - research the impacts of heat on operating assets and update standards;
    - assess how Ausgrid's services should counter the increasing vulnerability of customers, including Life Support Customers, during the heatwaves expected with climate change; and
    - enable Ausgrid to operate in an adapting urban landscape that has resulted in a need for its infrastructure to co-exist with the "green infrastructure (trees)" that are central to the NSW Government's urban heat policies.[42]
- The RCP has consistently supported the need for Ausgrid to invest in research to identify how extreme heat will impact its network assets and we also support the second initiative to research the impact of extreme heat on Ausgrid's Life Support customers. Assuming that the AER finds it to be efficient we support the proposed $1.5m opex for Option B for Risk 1.
- The only area of contention amongst stakeholders is the 3rd initiative, responding to risk 2 in the business case and whether Ausgrid is able to justify expenditure to co-

[40] See Attachment 5.5 at p. 24
[41] See the Third RCP Resilience Report at p. 36
[42] See Attachment 5.5 at p. 53

invest in ABC with councils to support State and local governments tree canopy targets. We have highlighted our concerns with the co-funded ABC initiative in the Second RCP and Third RCP Resilience Reports.[43]

- We welcome Ausgrid's acknowledgement of some of the unresolved issues with any DNSP/council co-funded ABC program including:
  - *"As the electricity infrastructure has traditionally been given priority in the street landscape, who should pay to enable green infrastructure to coexist?*
  - *The collective community benefit of urban greening is acknowledged, however Ausgrid isn't able to factor in these wider economic and community benefits into investments cases. These benefits are factored in by others in their roles (e.g. councils, government).*
  - *Similarly, Councils' ability to invest in an asset that they do not own is limited by legislation. Whilst Federal Government grants are available to councils, they require co-contribution from the asset owners to meet their guidelines.*
  - *There are acknowledged benefits to Ausgrid to tree pruning from installation of ABC which are likely to grow as the tree canopy increases. However, these have not been quantified, and a suitable contribution (10%, 25%, 50%) has not been determined.*
  - *Enabling policy changes would be required across a complex array of partners in the Greater Sydney Heat Taskforce requiring considered focus."*[44]
- The RCP supports option B of $0.25m opex for Risk 2 to fund research enabling Ausgrid to establish evidence to support the role that Ausgrid should play in Urban Heat Collaborations. We understand that Ausgrid has important partnerships with local councils and Government urban task forces and that they are important stakeholders in this reset process. We recognise the strong support from stakeholders other than the RCP, for Option C, which would allow an additional $6m capex for a trial of a co-funded ABC program with $0.25m opex to review the effectiveness of that trial. We prefer the trial and review approach of Option C, which is an evolution from other ABC programs that we have reviewed. We acknowledge that an advantage of Ausgrid's commitments supporting Option C is that it will enable Ausgrid to make meaningful contributions to the Urban Heat Collaborations as well as provide stakeholders with clarity about the contribution that Ausgrid can make.
- We believe that it would be very timely for the AER to provide detailed guidance in the final determination of Ausgrid's climate resilience business case for networks, Councils and other stakeholders about the AER's approach to co-funded ABC programs to support green infrastructure and tree canopy targets.

Project 4: Community Resilience

- Customers in the 3 LGAs designed the initiatives within the Community Resilience Project in order to increase their self-resilience during extreme weather events. Ausgrid has refined its approach into the following 4 initiatives:
  - targeted energy resilience communications;

[43] See the Second RCP Report at p. 36 and the Third RCP Resilience Report at pp 61-62
[44] See attachment 5.5 at p. 59

    - flexible resources such as small mobile generators and generator ready connection points at local hubs;
    - liaison and planning resources; and
    - performance monitoring and independent review.
- In the Third RCP Resilience Report[45] we urged Ausgrid to look for efficiencies across the community resilience initiatives. We welcome the revised cost and approach in the Revised Proposal since the lodgement of Resilience Investment Business Case in July:
    1. communications activities streamlined into a single integrated program of work and tested with the market, reducing proposed costs from $2.1m to $1.85m (-$0.25m);
    2. community liaison role detailed and costed at $150,000 per annum with 23% oncosts and 30% overheads, resulting in a cost increase to $1.2m (+$0.2m); and
    3. scope of Central Coast Community Resilience Plan refined with other resilience actors to specify energy resilience components, reducing investment to $0.1m (from $0.4m), absorbable in forecast opex.[46]
- In the Draft Decision[47] the AER asked Ausgrid to detail costs and identify where it might absorb costs. Examples of costs Ausgrid has absorbed are:
    - $0.49m in strategic vegetation management for 24 substations;
    - $0.9m in opex costs related to the implementation of new investments, including training, coordination and processes; and
    - $0.35m for community resilience planning and uplift in outage messaging.[48]
- Following the review of efficiencies and the absorption of the costs referred to above Ausgrid's climate resilience business case concludes:

    "There remains $5.85m across the resilience program that are new costs driven by climate change (major external factor) that cannot be absorbed into forecast opex without compromising deliverability and undermining our capacity to cohesive program that meet customer expectations and maximises long-term benefit."[49]
- The community resilience initiatives remain a challenge for the AER and for Ausgrid as the AER does not have established approaches for valuing these programs. Ausgrid states they form an integral part of the holistic climate resilience program. The community resilience solutions remain strongly supported by customers and are contemplated in the AER's Resilience Guidance Note. These initiatives are driven by community value. Through the deliberative engagement process, customers have considered the costs and benefits of a range of options and thought carefully about affordability in their prioritisation of them. We encourage the AER in its final decision to set out detailed reasoning for why it does or does not support the community resilience opex step change. Given that the AER acknowledges that the community supports these activities and that customers are willing to pay for them, it is important that it indicates if Ausgrid is not funded to provide them, how and by whom it believes these activities should be provided.

[45] See the Third RCP Resilience Report at p. 47 and p. 52
[46] See Attachment 5.5 at p. 69
[47] AER Draft Decision Attachment 6 at p. 37
[48] See Attachment 5.5 at p. 69
[49] Ibid at p. 27

Project 5: Response Effectiveness

As we noted in the Third RCP Resilience Report[50] improving multi-agency data sharing was a very high priority for participants at both the Newcastle and Sydney VoCP sessions. Customers expect a co-ordinated, efficient holistic response from all essential service suppliers and emergency responders.

RCP conclusion

We welcome the AER's careful analysis of the climate resilience programs of the 3 NSW distributors, which are the first DNSPs responding to the AER's Resilience Guidance Note. Ausgrid has invested the most time and effort in its application of the AER's Resilience Guidance Note[51] for detailed scrutiny by the AER. By way of contrast we note the recent Victorian Government's Response to the Expert Panel's Resilience Review completed in May 2023. That review seems to provide for embedding resilience into the regulatory framework with 5 year network plans, assessing willingness to pay and other things that Ausgrid is proposing in its revised climate resilience business case e.g. supporting ex ante expenditure, partnering with communities and local councils, networks providing back-up generators etc. We strongly prefer the AER approach under the Resilience Guidance Note rather than more jurisdictional schemes being imposed on customers without the same degree of oversight.

Consistent with the RCP's role we leave the judgement as to prudency and efficiency of the proposed resilience capex to the AER. In the case of the $5.9m climate resilience opex step change, we support this expenditure being assessed for the 2024-29 reset based on the primacy of the quality of the engagement and the commitments Ausgrid has made around that expenditure whilst the AER continues to refine its approach to this emerging area. Ausgrid's climate resilience program:

- has been the subject of deep bespoke local engagement with customers in the 3 LGAs to ensure that the initiatives are valued and are complementary to existing services provided by other resilience actors;
- continues to have strong support from Ausgrid's broader customer base; and
- the investments are subject to the performance monitoring and assurance governance in the Climate Resilience Framework, which includes post implementation reviews to measure their effectiveness.

3. CER Integration

The top customer priority emerging from Ausgrid's 2 year engagement informing its 2024-29 revenue proposal is sufficient investment in its network (especially in its ICT platforms) to ensure fair, timely and transparent CER integration. In October 2023 the VoCP participants focussed on the implications for Ausgrid and customers of the recent change to the National Electricity Objective (NEO) to include emissions reductions as another way to reinforce their

[50] See the Third RCP Resilience Report at p. 36
[51] See PIAC's submission in response to the AER Issues Paper for NSW DNSPs 1 June 2023 at p.13 and AER Draft Decision Attachment 5 at p. 29

expectations that Ausgrid deliver these outcomes. Notable quotes from the Mosaic VoCP Report include:

> *'AER has responsibility from government to focus on climate emergency yet responding to Ausgrid by reducing the budget.'*
>
> *'Why has AER's response to delivering Net Zero been to reduce the expenditure, when Net Zero targets are at the forefront of organisations and governments to achieve? This seems like this expenditure on this, especially in terms of energy should be well spent to ensure better outcomes.'*
>
> *'The feeling is that while the government talks about the importance of net-zero and dealing with climate risks, it doesn't want to allow too much expenditure on actual investment in these areas.'*

Ausgrid's CER integration strategy intersects the Revised Proposal in numerous ways, including:

- the ERP investment to support dynamic pricing currently being trialled under the Network Innovation Advisory Committee (NIAC) oversight in Project Edith;
- the development of cost reflective and flexible tariff reform including two way pricing, controlled load tariffs and EV trials which we discuss in section 8 below;
- the smart meter data acquisition program currently being trialled under NIAC's oversight;
- the development of legacy meter retirement plans[52] following the AEMC's final metering decision;
- the CER Augmentation business case;
- the CER Dynamic Services business case;
- the ICT enablement program for CER integration opex step change; and
- Ausgrid's proposed approach to service classification including its aspiration for future regulation to become *"…a platform that will enable an accessible and lowest cost transition."*[53]

The RCP welcomes the clear integration of this strategy into Ausgrid's network strategy, its revenue proposal and TSS. This approach differs from the traditional building block approach and reflects a greater focus on customer preferences and more importantly the outcomes being delivered from these investments including pricing.

This section focusses on the CER Augmentation business case (Attachment 5.7), the CER Dynamic Services business case (Attachment 5.7.1) and the ICT enablement program for CER integration opex step change (Section 4.5 of Attachment 6.1). Most of the issues that the AER raised in its Draft Decision about this expenditure, relying on the advice of EMCa, focussed on highly technical modelling issues about this new area of investment. Ausgrid has responded with revised modelling in its Revised Proposal and we leave it to the AER to determine if the proposed investment is prudent and efficient.

[52] which will ideally focus initially on the roll out of smart meters to load only households in constrained areas
[53] See attachment 10.1 Service classification at p. 19 which we briefly discuss in section 9 below

We recognise the challenge the AER faces in deciding on the prudent balance for the efficient cost of investment in network assets to meet the uncertain future growth in CER in order to mitigate its impact on Ausgrid's network. The issue of uncertainty and where the balance should fall was central to EMCa's feedback to the AER on Ausgrid's CER business cases:

> *"…While it is important to undertake a degree of preparation for the future, the nature of non-network solutions to CER lends itself to taking a relatively agile approach that can leverage off technological and consumer behavioural changes as they become evident. An example of this is likely to be the way in which some combination of increasing EV uptake (with or without the addition of V2H and V2G capabilities), more cost-effective options for higher capacity home batteries and increased controlled electrification of storage hot water, may significantly reduce the incidence of PV exports and their impact on DNSPs' LV systems….*
>
> *In undertaking our assessments in this report, our consideration of these factors has led us to be wary of business cases that involve significant investments over the next regulatory period on the basis that they will solve supposed issues that will become evident or significant in 10 to 20 years' time. There is a balance to be struck between prudent preparation and the potential for over-investment that may burden consumers with costs that turn out to be excessive or not to be needed for a cost-effective energy transition."*[54]

In relation to Ausgrid's revised CER investment proposal the RCP makes the following observations:

- We welcome the fact that Ausgrid has responded to the AER and VoCP's affordability concerns by reducing the proposed CER augmentation from \$47m to \$37m.
- The recent smart meter data trial funded by the innovation program under the oversight of NIAC is providing more accurate congestion and curtailment data to support the revised CER integration modelling in the Revised Proposal.[55]
- Ausgrid has referenced that its revised modelling and analysis shows it has some of the highest overvoltage in the NEM.[56]
- The revised CER augmentation business case focusses on the estimated costs of EV risk of overload and supply interruption. We agree that the EV load should not be valued by applying the VCR as these loads are more flexible. We also note the comments about clustering of electric vehicles due to income and particular suburbs that have underpinned Ausgrid's approach. However, there appears to be no consideration of how non network third party EV charging options may influence residential consumer charging behaviour.[57] Nor does there appear to be detailed consideration of the impact of Ausgrid's tariffs or retailer EV pricing approaches on residential consumer charging behaviour.

[54] See EMCa Review of proposed expenditure on CER August 2023 at paragraphs 46 and 47
[55] See Figure 3 in attachment 5.7 at p. 16
[56] See Revised Proposal Chapter 5 at p. 30
[57] See Attachment 5.7 at p. 12

- More generally we agree with the AER and EMCa that the uncertainty about the speed and scope of investment by the community in CER gives rise for the potential of stranded asset risk and that this is a factor in finding the right balance of investment for the next 5 years.
- We note that in the sensitivity analysis of the CER Dynamic Services business case Ausgrid has included what it describes as a conservative *placeholder* of $30 per tonne of CO2e for the value of emissions.[58] We do not believe that it would be in customer's interests for Ausgrid to increase the expenditure it is seeking for any of the 2024-29 CER integration expenditure unless the formal guidance results in a materially higher value per tonne of CO2e.
- There is an interaction between the business cases in 5.7 and 5.71 that may not have been fully explored. The RCP supports the need for prudent CER augmentation investment for dynamic integration and to deliver dynamic services. However, we believe the implementation of this program including the dynamic pricing and DOEs currently being trialled as part of Project Edith may necessitate changes in the augmentation investment detailed in Attachment 5.7. We asked Ausgrid whether the extent of this overlap has been considered in its revised modelling, because it may contribute to the risk of over investment identified by the AER. Ausgrid advised us as follows (emphasis added by RCP):

    *"Project Edith and our Dynamic service proposal intends to build Dynamic Pricing and DOE capability during the FY25-29 period. During this time customer participation will be limited by the trial tariff threshold and by the nascent state of the VPP market. The impact of dynamic services **is further limited in this time** due to the focus on testing and development.*

    This means material deferral of augmentation is not likely to occur in this RCP nor impact our CER augmentation proposal. This is reflected in initial modelling submitted to the AER in our January submission which showed deferral of augmentation occurring after FY30.

    *Dynamic services are intended to be widely available **from FY2030 onwards**, with participation, and therefore impact on future augmentation need, expected to grow with the VPP market from then.*

    Our approach for the revised submission has been to separate the business cases for CER augmentation and Dynamic Services so we can more directly respond to the AER's feedback. This is reflected in our modelling approach which outlines a completely revised model for solar, EVs and results from Houston Kemp's analysis separate from the integrated model we submitted to the AER."
- Ausgrid refers to the VoCP engagement where:

    "….customers gave us clear support for proactive investment that met network performance expectations and provided a greater choice of low cost, zero emission energy solutions. They indicated that while they may not make

[58] See attachment 5.7.1 at p 6

investments in CER now they expected investment in CER to support their future aspirations."[59]

We note that in the VoCP22 final report in June 2022 customers did give strong support to Ausgrid for its CER investments, which has been confirmed in all further 2023 engagement sessions. However, the VoCP included important guardrails in their final recommendation in June 2022 on the scope of the CER investments as it sought an optimised program:

> *"Ausgrid should introduce a pro-active and targeted mixed investment plan between $100-$150 million to achieve net zero and minimise barriers for 85% of impacted customers. This investment plan may be offset by the introduction of a two-way tariff system."*[60]

In its final decision we believe the AER should err on the side of consumers, as the release of CER value in the first instance is a direct benefit to consumers. This is very important during a time of increasing costs and increased focus on emissions reduction with the change to the NEO.

Ausgrid has highlighted two potential jurisdictional schemes relevant to CER integration that might be needed to achieve NSW Government policy: community batteries outside the regulatory framework and distributed REZs.[61] We believe it is in the long-term interests of customers for the AER to continue assessing CER investment as part of revenue resets rather than for these to be implemented by the NSW Government with costs passed through to customers under jurisdictional schemes with less scrutiny.

This view also leads the RCP to a different perspective than EMCa on how the AER should balance overinvestment risks (unlocking more CER value and benefits for customers by optimising for efficient curtailment and investments in ERP to support platforms to enable dynamic pricing and DOEs) and underinvestment risks (possible constraints, inefficient curtailment and load shedding by networks) in determining Ausgrid's Revised Proposal. We believe the extent to which it believes networks have been appropriately funded to manage CER growth may be a material matter for the NSW Government in considering additional schemes. Our concern is that an AER decision which approves materially less CER investment may encourage the NSW Government to proceed with additional schemes leading to higher long-term costs for customers. We appreciate that the AER is required to determine the prudency and efficiency of a proposed investment but feel in this instance that it cannot be divorced from the NSW Government's energy transition activism and this is another factor in favour of the AER choosing the higher end of the prudent and efficient range.

Regardless of how it assesses Ausgrid's proposed CER investment, the RCP encourages the AER to do a category review of the CER programs for all New South Wales networks during

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[59] See Attachment 5.1 Revised Capital Expenditure at p. 20
[60] See the First RCP Report at p. 73
[61] See section 3 of Attachment 10.1

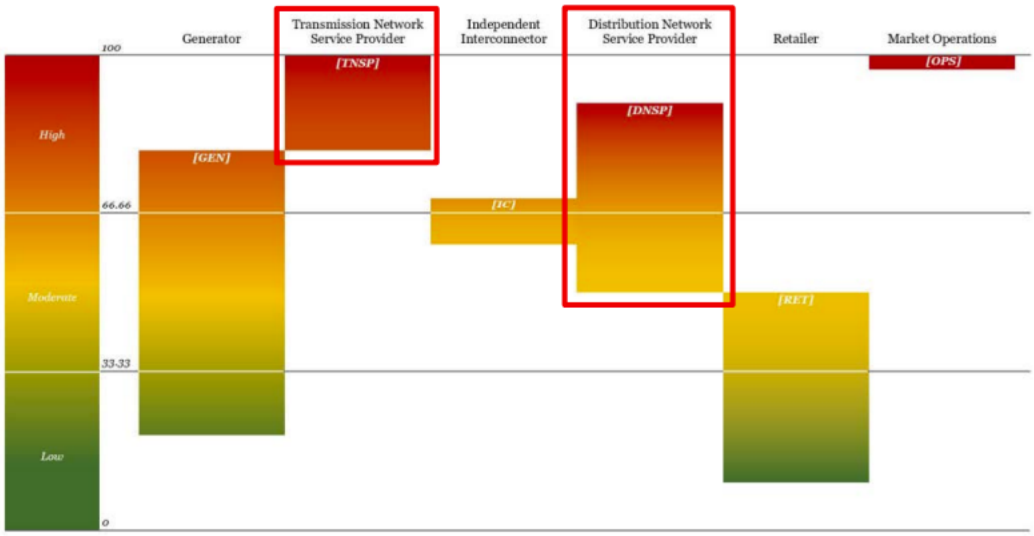
2024-29. All stakeholders including the NSW Government and especially customers will benefit from a better understanding of the interaction of supported non-network integration. It would also allow the risk identified by EMCa to be thoroughly analysed. For the same reason the RCP will request Ausgrid undertakes a PIR of its CER integration investments and pricing initiatives in preparation for the 2029-34 revenue reset to inform the AER's review of this expenditure.

4. Cyber security

As discussed in earlier RCP reports, cyber security has been the subject of extensive discussion between Ausgrid, the RCP and the VoCP. This discussion has occurred against the backdrop of increasing evidence of the cyber security risks for Australian companies and movement by the Australian Government towards mandatory requirements on companies considered high risk.

Ausgrid's argument is that it has been independently assessed as having 'high criticality' according to the Australian Energy Sector Cyber Security Framework (AESCF) criticality bands. This combined with Ausgrid's interpretation of its compliance obligations under the Security of Critical Infrastructure Act 2018, the Privacy Act 1988, Licence conditions and AESCF supported its position on SP-3, the highest security level. Further, Ausgrid clearly communicated to consumers during its reset engagement how the application of its Ausgrid Risk statement, Risk Appetite and Risk Matrix led to its choice of SP-3. This position was strongly endorsed at the end of that engagement process.

Figure 2.2: AESCSF E-CAT criticality bands for electricity sector – TNSPs and DNSPs highlighted



Source: AEMO, AESCSF Electricity Criticality Assessment Tool (E-CAT), per AESCSF V1

The Second RCP Report concluded that Ausgrid's proposal to achieve SP-3 Level, the highest possible, was justified because while not a Government requirement, it had the support of its customers. At the same time the RCP questioned the utility of further customer engagement on this issue given its complexity and the role of Government in potentially mandating protection requirements, and concluded that the AER should assess the prudency and efficiency of the proposal.[62]

The RCP is concerned that the AER's reliance on the EMCa review of Ausgrid's cyber program led it to an unbalanced judgement in respect of Ausgrid's proposed cyber-security investment. The EMCA Report[63] concluded that:

- while Ausgrid would benefit from SP-3, the AESCF does not create a legislative or regulatory obligation on Ausgrid to get to that level;
- Ausgrid overstated both the likelihood and consequence of cyber events; and
- Ausgrid did not provide a robust model to support its proposal.

EMCa went on to highlight that:

> *"AEMO also states that '[t]he CAT should be treated as general guidance only. Results obtained from the CAT do not indicate that an entity has obligations under or is compliant with applicable Commonwealth (Cth) legislation."*[64]

As a result, EMCA provided an alternative risk/consequence assessment based on its experience and judgement:

> *"Based on the occurrence of cyber breaches in the energy sector in Australia and in the rest of the world, we do however consider a rating of 'Possible' or 'Likely' is more appropriate for R1-R6 by 2029. In our view, risk R7 (regulatory non-compliance) is a Low risk because of the controls in place and the introduction of any new obligation would both allow time for compliance and the opportunity for Ausgrid to secure a pass-through of costs from the AER."*[65]

EMCa concluded that SP-3 had a negative NPV and Ausgrid should target a level of 'SP-3 Minus' as prudent and efficient. This EMCa devised standard was defined as:

- *"SP-X Plus infers that more than 100% SP-X practices are in place, but less than 50% of the higher maturity practices, for example,*
  – SP-2 Plus infers that (i) all of the 88 SP-1 practices and all of the 112 SP-2 practices under the AESCSF have been implemented and resources are established to sustain them and (ii) up to about 50% of the 82 SP-3 practices and anti-patterns are implemented; and
- *SP-X Minus infers more than 50% of the SP-X practices are in place, but not 100%, for example,*
  – SP-3 Minus infers that more than 50% of the 82 SP-3 practices are largely implemented (as opposed to fully implemented).

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62 See the Second RCP Report at p. 149

63 https://www.aer.gov.au/system/files/2023-10/AER%20-%20Ausgrid%202024-29%20-%20Draft%20Decision%20-%20EMCa%20report%20to%20AER%20on%20Ausgrid%2024-29%20ICT%20Cyber%20Security%20-%20PUBLIC.pdf Some footnote references to the EMCa report hereafter are to specific paragraphs in its report

64 Para 46

65 Para 102

In both instances above, we also assume a risk-based prioritisation approach; therefore, it can be assumed that implementing 50% of practices for a given SP level would require less than 50% of the cost of fully implementing that practice."[66]

In devising a new standard that is not recognised by the industry, AEMO nor the relevant legislation EMCa did not seem to meet the evidence standard it sought from Ausgrid in that it provided no details on why '*50%*' should be the metric or how '*largely implemented'* should be defined. Instead, EMCa relied on 'judgement'.

EMCa proposed that costs be determined by assuming 'a risk-based prioritisation approach', one in which:

"…it can be assumed that implementing 50% of practices for a given SP level would require less than 50% of the cost of fully implementing that practice."[67]

Unfortunately, EMCa provided no explanation of what this approach means. The calculated costs of the proposed SP-3 Minus were based on an analysis of 'peer' networks achieving the same standard but few details are given[68] apart from:

"The peer NSP's cyber maturity level appears to be approximately the same as Ausgrid's at the commencement of the next RCP (i.e. SP-2 Minus)."[69]

EMCa acknowledged the uncertainty in costs by having a ±20% variation in the cost estimate but no evidence was provided for this level of accuracy.

Even if SP-3 Minus is an appropriate security level, the EMCa report is confusing on the issue of how Ausgrid should account for the 'scope creep' of a particular security level during 2024-29. This is where the requirement to meet SP-3 Minus increases over 2024-29 as standards continue to be tightened.[70] The 2023 version of SP-3 Minus might be equivalent to SP-2 by 2029. Keeping up with SP3-Minus requirements would require additional funds over what would be required for a static SP-3 Minus.

In the RCP Second Report on the Initial Proposal[71] we noted the AESCF was under review with a new version to be published some time in 2023. A new version was published in October 2023. SP-1 volume of practices increased by 15% with a total practice change of 53%. In addition, SP-2 practice number increased by 15% with a total practice change of 58%. As the table below shows the new version effectively takes SP-2 closer to SP-3:

[66] Paras 165, 166
[67] Para 166
[68] Para 183
[69] See footnote 77 at p. 36
[70] This is similar to the requirements to meet a 5 star ANCAP car safety rating increase over time – a car that achieved a 5 star rating in 2010 would not achieve a 5 star rating in 2023
[71] See Second RCP Report at p. 140

Table 4 compares the breakdown of AESCSF v1 and v2 as relevant to the Security Profile (SP) and Maturity Indicator Level (MIL).

SP / MIL	AESCSF v1				AESCSF v2			
	MIL-1	MIL-2	MIL-3	Total	MIL-1	MIL-2	MIL-3	Total
SP-1	57	27	4	**88**	62 **(+5)**	57 **(+30)**	4 **(0)**	**123 (+35)**
SP-2	0	94	18	**200 (112+88)**	0	123 **(+29)**	29 **(+11)**	**275 (152+123) (+40)**
SP-3	0	0	82	**282 (82+200)**	0	0	79 **(-3)**	**354 (79+275) (-3)**

Table 4: AESCSF v2 Security Profile (SP) and Maturity Indicator Level (MIL) Comparative Summary

We expect these revisions to be continual, (including increases in SP-3 requirements) as the threat levels increase. We consider it a high probability that all electricity networks will have mandated security levels over the reset period and in our judgement we consider consumer interests are best served by this being an outcome from the start rather than being handled though a cost pass through. The cost of this scope creep was a factor in the Initial Proposal. However Ausgrid has confirmed that no creep was included in the Revised Proposal as Ausgrid reduced expenditure, to fit SP-3 initiatives into the smaller envelope and they accepted the AER's Draft Decision on the cyber opex step change.

EMCa's consideration of this 'scope creep' issue is confusing:

> *"The possibility of future obligations arising should not be taken into account in expenditure forecasts for regulatory resets - rather if new obligations arise, NSPs have recourse to the AER for additional costs. However, it is likely that the AESCSF will expand to include more practices to achieve SP-3, so we consider that it is reasonable for Ausgrid to take this into account in its expenditure forecast."*[72]

EMCa is unclear on whether Ausgrid should seek additional 'scope creep' funding in its Revised Proposal or wait for an allowed cost pass through event. In the absence of that advice, or clarification from the AER, should Ausgrid prepare a detailed base case narrative for each of the 82 additional practices and anti-patterns (now reduced to 79 for SP-3 vs SP-2) to see which ones exceeding 50% they should '*largely implement'* in order to justify any future pass through event?

In its Draft Decision the AER concluded that it had:

> *"…carefully balanced the increasing threat landscape and uncertainty with our assessment against the expenditure criteria so that customers pay no more than necessary for a reliable and secure electricity network."*[73]

Ausgrid customer engagement clearly supported Ausgrid getting the higher level of risk protection with the decision on what was the prudent and efficient expenditure to achieve

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[72] Para 155

[73] See p. 18 https://www.aer.gov.au/system/files/2023-10/AER%20-%20Draft%20Decision%20Attachment%205%20-%20Capital%20expenditure%20-%20Ausgrid%20-%202024-29%20Distribution%20revenue%20proposal%20-%20September%202023.pdf

that objective left to the AER. However, the AER accepted EMCA's advice on the SP-3-Minus security level. We contrast this approach with that taken for Transgrid's 2023-28 cyber proposal in which EMCa recommended, and the AER agreed that:[74]

> *"Transgrid should aim to achieve an AESCSF cyber security maturity level of SP-3 as soon as practicable."*

The EMCa/AER's position seems anomalous insofar as Transgrid is under no legislative obligation to achieve this standard. EMCa claims that the Transgrid proposal '*is responding to a new legislative and likely regulatory obligations to achieve a prescribed and measurable level of cyber security maturity within the next RCP'*[75] but makes no reference to a current specific obligation to get to SP-3 over 2023-28. In place of a mandated requirement, EMCa accepts an imperative arising from analysis of risk trends and language:

> *"Transgrid has provided a compelling analysis of the Federal and State legislation changes and timing to support its position that it is appropriate for it to achieve an AESCSF maturity indication level of SP-3 based on the combination of legislation, appropriate risk management, and the urgent request of the Australian Cyber Security Centre (ACSC) to adopt an enhanced cyber security posture."*[76]

It is not apparent to the RCP, nor we suggest to any other observer, why Transgrid's cyber-security needs are treated differently to Ausgrid's by EMCa and the AER. As far as we can tell all Transgrid has done is create an impression that it expects new legislation to mandate SP-3.[77]

We think that EMCa's analysis of Ausgrid's cyber-security business case is deficient and has led the AER to an unbalanced decision. We support Ausgrid's revised cyber security proposal and urge the AER to consider it, along with the following key observations we have made:

- Ausgrid's consumer engagement shows a clear preference for the highest security level with the AER to assess the prudent and efficient costs of achieving that protection;
- the AER has adopted an EMCa devised standard that does not meet the same burden of proof EMCa requires from Ausgrid; and
- EMCa's unclear advice on how Ausgrid is to consider 'scope creep' that has already occurred since the Initial Proposal.

Ausgrid's Revised Proposal maintains the SP-3 security level. The capex sought is \$21m less than in the Initial Proposal with opex sought similar to what was in the Draft Decision,

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[74] See p. 16 https://www.aer.gov.au/system/files/AER%20-%20Transgrid%202023-28%20-%20Draft%20decision%20-%20EMCa%20report%20to%20AER%20on%20aspects%20of%20Transgrid%20revenue%20proposal%20-%20August%202022%20-%20PUBLIC.pdf
[75] Para 490
[76] Para 495
[77] See the discussion on pp 4-5 https://www.aer.gov.au/system/files/Transgrid%20-%20Critical%20Infrastructure%20Security%20Costs%20-%2014%20Jul%202021%20-%20PUBLIC.pdf

reflecting efficiency savings partially offset by the introduction of version 2 of the AESCSF and the competitive labour market for the required skills.

On the basis of Ausgrid's consumer engagement the RCP continues to support SP-3. Were the AER to retain the Draft Decision position of SP3-Minus we would recommend the AER provide additional analysis to explain that decision more fully to Ausgrid and its customers.

5. Innovation

All RCP reports (including this one) discuss 6 consistently revealed preferences from Ausgrid's customers:

- affordability and the need for Ausgrid to find the right balance between cost and delivering outcomes;
- network resilience in the face of increasing cyber security risks and extreme weather events;
- helping all customers to benefit from the investments by some customers in CER through staged CER integration (including by shared storage solutions such as community batteries) and appropriate tariff reform;
- investing in ICT and smart meter data to increase network utilisation and stage network investment;
- maintaining communication especially during planned and unplanned outages and about ways customers can reduce their energy costs with a focus on the vulnerable including Life Support customers and CALD customers; and
- advocating for reform to remove regulatory barriers to Ausgrid's delivery of services to achieve these preferences.

At all times customers have seen innovation as the foundation for the delivery of these outcomes at the lowest cost to customers over the long term. In 2022 the VoCP urged Ausgrid to lift its ambition in innovation and its investment for 2024-29 above the current period. Given this the RCP was surprised with the Draft Decision of zero for capex and opex, even with the proviso that they were 'placeholders' awaiting more information form Ausgrid on the prudency and efficiency of the program. The VoCP shared the RCP's surprise and reaffirmed its strong support for the network innovation program (NIP) in October 2023. We note the independent members of NIAC[78] are preparing a submission to the AER in response to the Draft Decision and the revised NIP in the Revised Proposal.

The AER acknowledges the need for networks to invest in innovation in its Draft Decision:

> "*We support the need and objective of innovation proposals, and we acknowledge this as part of enabling dynamic efficiency as part of the efficiency objectives in the NEO."*[79]

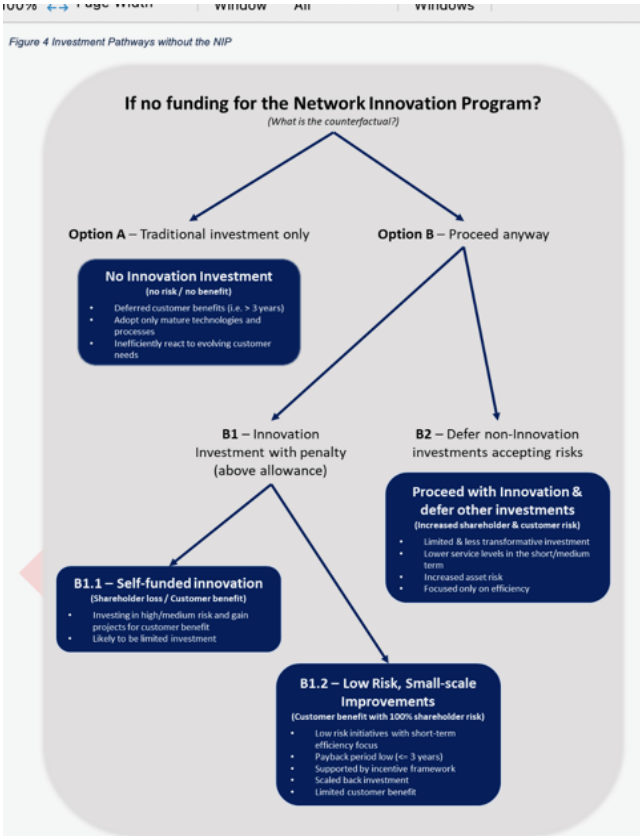
[78] 4 members of the RCP are also independent members of NIAC
[79] See AER Draft Decision Attachment 5 at p. 47

However the AER's Draft Decision reveals a preference for Ausgrid to find other ways for the innovation programs to be funded than via an approved dedicated NIP.[80] We believe this view has arisen because the AER's traditional modelling tools and frameworks do not enable it to easily assess and justify innovation expenditure.[81] As part of this reset the AER has acknowledged in the Draft Decision that it continues to evolve its approach in the new and emerging areas of cyber security, network resilience, CER integration and emissions reductions. In the last 3 years the AER has prioritised the development of new frameworks and guidance for networks for CER integration, resilience and emissions reduction following the recent change to the NEO. The RCP recommends that the AER now prioritise the development of an innovation guideline. We discuss this in section 7 in Part 3 below.

The AER gave detailed guidance in the Draft Decision about the type of information that would assist the AER to assess and justify the expenditure in Ausgrid's NIP. Ausgrid has responded with this information in Attachment 5.8 of its Revised Proposal. The RCP makes the following observations as part of the AER's reconsideration of Ausgrid's NIP for 2024-29:

- Ausgrid's self-funding of 10% of the NIP, via external funding or shareholders, is based on the UK's Ofgem approach. Ausgrid has confirmed that whether the 10% is shareholder funded or funded from other sources would be subject to project by project discussion with NIAC;
- We understand that the AER is keen for networks to self-fund most of their innovation programs from their CESS and EBSS rewards or other shareholder funds. BAU network improvements and less risky trials are already funded via the CESS and EBSS incentive schemes. For example Ausgrid's current covered conductor thin trial is funded outside of NIAC oversight and once rolled out we understand it will lead to significant reduction in unit rates and an appropriate CESS reward for Ausgrid.
- As a condition of NIAC funding approval in the current period, Ausgrid had already committed to seeking external and alternate funding where possible. In the Revised Proposal Ausgrid details the external and alternative funding it has secured under the DMIA and from the Federal Department of Climate Change, Energy, the Environment & Water (DCCEEW).[82] As part of NIAC's approval of the co-funding of the community battery pilot with DCCEEW, NIAC also asked Ausgrid to try to secure NSW Government grant funding for future trials. In addition to the DMIA and DCCEEW funding Ausgrid has applied for ARENA grant funding for Round 1 of the Community Batteries Funding Program. Any grant funding received from ARENA would operate under the AER's waiver arrangements and outside the NIP in 2024-29;
- Ausgrid has presented the following counterfactual to show that in the absence of an approved NIP, shareholder funds are unlikely to be available to fund unproven trials or truly transformative trials and pilots[83] that are not suitable for other external sources of funding:

[80] Ibid at p. 50
[81] "*It remains important, even in responding to emerging and uncertain challenges, that there is sufficient information and a sound basis to justify expenditure*." See Attachment 5 at p. 50
[82] See Attachment 5.8 at pp 14-15
[83] Ibid at p. 12



- We welcome Ausgrid's submission that it believes this level of innovation investment will peak in 2034, reflecting the speed and pace of the current transition in the next decade:

> *"We consider that the NIP for the 2019-24, 2024-29 and 2029-34 periods will represent the likely peak scale of ongoing investment required, and that into future regulatory periods the required scale will decrease. The proposed NIP customer-funded capex for the 2024-29 period represents approximately 1.3% of total proposed capex and proposed NIP customer-funded opex for the 2024-29 period represents approximately 0.2% of total proposed opex. We consider the proposed program to be sufficient to test and drive significant benefits for customers, whilst also allowing us to sustainably embed change across a network of long-lived assets. We suggest that the longer-term trend beyond the energy transition would be less than 1.0% of total capex, and less than 0.2% of total opex."*[84]

- Ausgrid has increased the threshold for the potential projects over and above the extensive NIAC governance by only including projects where benefits are predicted to be at least 50% more than the estimated costs, acknowledging that these are very early stage CBAs and some projects may fail. We share Ausgrid's concern that it is unrealistic for the AER to apply its similar analytical business case approach to a program of possible transformative trials and pilots in 2023 that might be delivered

[84] Ibid at p. 11

in 2028-29. This approach also ignores the current NIAC experience of proposals to trial improvements in technology that are emerging in real time that were not in contemplation in 2019. This is why the independent NIAC members supported a more flexible program/stream approach in its submission to the AER in response to Ausgrid's Initial Proposal on the NIP, whilst still stressing the need for sufficient cost benefit analysis.[85]

- As we discuss elsewhere in this report, the AER's Draft Decision rejected Ausgrid's exclusion of any underspend in the NIP from the CESS incentive scheme. At this stage Ausgrid is forecasting a 5% underspend in the 2019-24 NIP.
- Finally the RCP acknowledges the very significant benefits for industry and all customers from Ausgrid's strong track record in knowledge sharing. This has been a consistent feature of the independent governance of NIAC since its inception.

Ausgrid believes that "*it has demonstrated that the program as a whole is efficient and represents costs that a prudent operator would require to achieve the objectives*."[86] If the AER cannot reach a conclusion that the 2024-29 NIP is prudent and efficient then, from our observations of the deep engagement undertaken and a review of the still developing AER frameworks for prudent and efficient innovation expenditure, the RCP supports the proposed capex and opex innovation expenditure being assessed for the 2024-29 reset based on the primacy of the quality of the engagement and the commitments Ausgrid has made around that expenditure. Ausgrid's innovation capex and opex expenditure program:

- has been the subject of deep engagement with customers and the NIAC;
- continues to have strong customer support;
- is a partial self-funding model from shareholder funds; and
- has embedded many of the features and governance that we recommend the AER include in an innovation guideline (see Section 7 in Part 3).

6. Fleet

In late-October the RCP was advised that Ausgrid was giving consideration to amending its fleet investment program with the aim of accelerating the planned electrification target. Upon learning of this we inquired as to the estimated cost and were advised that it involved tens of millions of dollars in additional capex. While some modest opex savings were anticipated, the net result of the plan would result in additional costs flowing through to customers from 2024. The RCP strongly resisted the plan and while acknowledging that it might play a role in stimulating the broader electrification of electricity sector fleet, we could not agree that it delivered customer benefit, particularly so at a time of rising cost pressure.

The RCP expressed its concerns on the proposal to the senior management of Ausgrid pointing to:

[85] See pp 16-17 Attachment 5.8h to the Initial Proposal NIAC Feedback on Innovation program January 2023
[86] See attachment 5.8 at p. 5

- the specific recommendation from the VoCP22 that "*Ausgrid should continue their internal Net Zero efforts by adopting appropriate technology as it becomes economically feasible."*[87]*;* and
- Ausgrid's discussion of the technical feasibility of fleet electrification in Ausgrid's Initial Proposal, which concluded that "*EV costs present a commercial risk to the business."*[88]

We are pleased that this contributed to its termination. We acknowledge the responsiveness of the business to our input on the matter. In the Revised Proposal Ausgrid refers to "*….a plan to investigate ways to self-fund an ambitious fleet electrification strategy in the 2024-29 period."*[89] The costs and benefits (including emissions reductions benefits) of this strategy would need to be reviewed by the AER as part of the 2029-34 revenue reset.

7. CESS

The AER's Draft Decision encouraged Ausgrid to consider waiving that part of its approved CESS payment arising from the compulsory acquisition of the Bligh Street property. The AER further suggested that Ausgrid engage with its customers over the matter.[90]

The RCP strongly supports the principle that distributors should not hold onto surplus property and informed Ausgrid of this view in 2022 when property disposal was first aired as a prelude to the initial affordability initiatives in the Initial Proposal. We appreciate that distributors at any point in time own significant property assets and that the CESS scheme helps encourage the consideration of disposal as an efficiency measure that can benefit customers as well as the business. That said, we do not believe we have enough information available to us to support a waiver of the CESS benefit. No RCP member is familiar with the history of the Bligh Street property beyond the Draft Decision and the brief discussion we subsequently observed between Ausgrid and AER representatives in November. The RCP has always made decisions after careful consideration of the available evidence, seeking additional information as and when required. Severe time constraints prevented us from gaining a more detailed understanding of the property's history and we are therefore not in a position to reach a conclusion on the AER's recommendation.

The RCP's inability to reach a decision on the AER's waiver recommendation is why we did not encourage Ausgrid to take up the AER's suggested conversation with customers about the waiver. Even had we been able to reach a decision we do not believe there would have been sufficient time to develop a sound methodology for testing a question that involves a degree of retrospectivity; having a conversation in 2023 about the history of a property extending back to at least 2009 brings with it risks of inaccuracy. While it is a matter of fact that the property was compulsorily acquired, comprehending today the thinking within Ausgrid at the time as to the function of the property under the different licence obligations

[87] See Recommendation 2 of the VoC Panel Report 4 June 2022
[88] See Attachment 5.10 pp 46-47 of Ausgrid's Initial Proposal
[89] See Revised Proposal Chapter 5 at p. 34
[90] Attachment 9 – Capital expenditure sharing scheme | Draft decision – Ausgrid distribution determination 2024–29 at p. 7

of N-2, is likely to rely upon people who are not working for Ausgrid at this time. Retrospective views cannot be tested in the same way as views relating to contemporary matters and we are not convinced this is a suitable way to build a credible customer informed evidence base.

While the RCP is unable to support the AER's Draft Decision in respect of the Bligh Street property we note the AER's view that the disposal of Bligh Street through compulsory acquisition processes "…*is not related to efficiency gains or related to providing the distribution business with an incentive to dispose of assets because the compulsory acquisition is beyond Ausgrid's control."*[91] Our inability to support the AER's Draft Decision should not be read as an endorsement of the efficiency of the Bligh Street disposal.

We recognise that the AER could amend the CESS Guideline to ensure that future compulsory property acquisitions are excluded in future in order that the current situation not be repeated. Done prospectively, we believe this change could be fair for distributors as well as their customers. Prior to introducing any change concerning property disposals through compulsory acquisitions, the AER would need to be satisfied that any such changes to the CESS Guideline would not lead to unintended consequences, such as the pre-emptive and perhaps inefficient disposal of properties by networks.

8. Smart meter data and tariffs

Smart meters

Ausgrid's Revised Proposal includes a reduced opex step change of $10.2m. The reduction reflects the AER's Draft Decision, which included benchmark information, as well as the AEMC final metering report. The Panel is concerned that as a result of the AEMC's final metring report that there will be some uncertainty on when and what access Ausgrid will have to customer data for no payment. We continue to support DNSPs having free access to the basic power quality data they need to manage the network in a safe and efficient manner that aligns with the long-term interests of consumers. However, the free basic power quality data and LV network visibility questions are contingent on the outcomes of the metering rule change and the recommendations in the reliability check-up. Ausgrid's Revised Proposal highlights the challenge it faced in forecasting its smart meter data opex step change given the uncertainty around the implementation of the AEMC review:

> *"We revisited the forecast step change amount to respond to the AER's feedback and have taken into account the AEMC's Final Decision on metering, which, when implemented, will allow networks access to basic smart meter data at least daily at no cost. We note there is significant uncertainty around the timing and detail of how this*

[91] Attachment 9 – Capital expenditure sharing scheme | Draft decision – Ausgrid distribution determination 2024–29 at p. 7

> *recommendation will be implemented, however our forecast assumes the likely provision of basic smart meter data through the new mechanisms from 1 January 2026."*[92]

To the extent that this remains uncertain and is not the subject of a regulatory obligation we believe that this is an area which would be suitable for a re-opener which we discuss in Section 4 in Part 3 below.

The RCP remains of the view that networks should be able to mandate a legacy meter roll out plan that prioritises load only houses in constrained areas to provide maximum opportunity to assist those who do not have the same opportunities to invest in CER. We acknowledge that the expected benefit of a smart meter for a load only household is contingent on retailers managing the risks associated with exposure to more cost reflective network tariffs and providing consumers with offerings that meet their needs and preferences including the option not to face the network signal through remaining on a flat retail offer.

<u>Tariffs</u>

The AER has largely accepted Ausgrid's draft TSS in its Draft Decision. The RCP makes the following brief observations[93] about the AER's Draft Decision and the revised TSS:

- Ausgrid has used its PWG[94] very effectively in the development of its TSS and the design of engagement with the VoCP and other customers.
- It is important that Ausgrid continues to use all sources of information including smart meter data and LV monitoring investments to ensure it has the most accurate visibility of the network congestion problem its two way tariff is designed to address.
- We support Ausgrid's tariff assignment policy. Ausgrid has done well to avoid complicating/delaying the transition to more cost reflective tariffs through limiting their use of 'transition tariffs' and 'transition periods'. These transitional tariffs do nothing for consumers and generally only benefit retailers through providing them with additional grace periods and opportunities for arbitrage.
- We support Ausgrid's EV tariff approach with its use of controlled load and time of use off-peak periods. The Panel notes that the PWG strongly supports the trials Ausgrid is undertaking such as their use of a super-off peak tariff.
- Relative to other NSW DNSPs, Ausgrid's embedded network tariff is the most cost-reflective/forward-looking. We are aware that Ausgrid has sought to find the right balance between its existing embedded network customers and other customers who subsidise these customers, through the use of thresholds and the 5 year glide path. Ausgrid has been seeking to address this growing cross subsidy for several years with the AER. We were disappointed that the Draft Decision did not fully accept Ausgrid's embedded network tariff instead asking Ausgrid to do further engagement with customers. We welcome the AER's subsequent confirmation to the PWG that no further customer engagement is needed on embedded networks, only

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[92] See Revised Proposal Overview at p. 42

[93] We are aware that PIAC will be raising separate concerns with aspects of Ausgrid's draft TSS and the AER's Draft Decision on Ausgrid's draft TSS in its independent submission to the AER

[94] 5 members of the RCP are also members of the PWG

the inclusion of additional customer impact modelling that Ausgrid has already given the AER. The RCP shares the concerns of many others that embedded networks are not justified on economic efficiency grounds.[95]

- In the recent Draft Decisions the AER requested all networks introducing two way tariffs to develop fact sheets "….*to assist both customers and retailers in understanding and incorporating these tariffs in retail offers*."[96] Ausgrid chose to consult with its PWG and the VoCP on its draft fact sheet and the customer impact modelling. Both groups raised concerns about the messaging of the fact sheet and its purpose. As we noted in Part 1 above, the VoCP participants highlighted the fact that it depended on how retailers chose to respond to the network tariff. The Panel believes that a customer information campaign will be more helpful for customers than a retailer fact sheet. We note that Ausgrid has committed to prepare pricing and charging information for customers who may be considering purchasing an EV and customers with CER that are able to make injections into the network.

9. Future regulation

Ausgrid has included a section in its Revised Proposal which sets out a revised strategy for how it believes that "*Ausgrid and other DNSPs can contribute to the energy transition in a way that benefits customers and the net zero transition."*[97] Section 3 in Attachment 10.1 refers to the potential for Ausgrid to use its network assets to support NSW Government policy by rolling out kerbside EV charging infrastructure (EVCI); owning and maintaining community batteries to support battery energy storage services (BESS) and participating in distributed REZs. Due to time constraints, the Panel has not provided any commentary on this in this report. Our lack of commentary should not be taken as an endorsement or rejection of Attachment 10.1s contents. All members of the Panel, other than the Chair, are members of Ausgrid's CCC and were invited to provide feedback to Ausgrid on the BESS and EVCI strategies at a CCC meeting earlier in November.

10. Next steps

Due to the short 45 day time period between the AER's Draft Decision and Ausgrid's submission of its Revised Proposal there are a few matters where the RCP has been unable to reach a final position or complete our final commentary. We intend to do this as part of a final submission to the AER in January 2024. The issues do not go to the prudency and efficiency of Ausgrid's Revised Proposal. Rather they go to understanding changes in the Revised Proposal and a consideration of what additional commitments might be needed from Ausgrid to support the implementation of its 2024-29 revenue proposal and the progress report on commitments given by Ausgrid as part of its 2019-24 Revised Proposal.

[95] See for example https://www.smh.com.au/national/nsw/apartments-locked-into-higher-power-bills-after-developers-partner-with-retailers-20230720-p5dpvr.html
[96] See Draft Decision Attachment 19 TSS at p. 28
[97] See Revised Proposal Overview at p. 58

PART 3 – RCP commentaries

This part of our report includes RCP commentary on 7 wider regulatory framework issues:

Section 1 - Affordability
Section 2 - More guidance on resilience
Section 3 - The nature of bargaining within NewReg
Section 4 - Re-openers
Section 5 - Explaining the AER's Draft Decision
Section 6 - Innovation
Section 7 - The Better Resets Handbook

1. Affordability

The RCP believes the AER's approach to affordability through the current revenue reset has been inconsistent. In the First RCP Report (August 2022) we provided a substantial commentary on how affordability of electricity prices was being challenged by rising cost of living pressures:

> *"When Ausgrid began its consumer engagement in mid-2021 the economic outlook generally, and the energy market in particular, were relatively benign. Even as recently as the Federal election campaign both parties were confidently promising large price falls in electricity prices.*
>
> *The change in the last few months has been dramatic. International and domestic developments have contributed to rapidly rising inflationary pressures, central banks responding with interest rate rises and rising concerns about a possible recession in many countries. Events in Ukraine plus local factors in the National Electricity Market (NEM) have contributed to significant rises in electricity and gas prices for Ausgrid customers and further increases are likely in the next 1-2 years. Cost of living pressures are very much centre of mind now for all customers small and large and the Panel expects that to continue throughout the remainder of Ausgrid's 2024-29 reset process."*[98]

The Second RCP Report (January 2023) detailed the way in which Ausgrid customers had been consulted about these pressures and been given the opportunity to express their sentiment.[99]

The RCP's awareness of affordability played itself out in a number of ways through our engagement. Upon learning of Ausgrid's discussions over the NSW government's ambitious Electricity Roadmap Plan, we initiated a dialogue with the relevant department over what the additional costs would be and when they were likely to be passed through to distributors. A copy of our letter to the NSW Department was included in the First RCP Report.[100] We incorporated willingness to pay and affordability sentiment testing into the VoCP sessions and secured an agreement from Ausgrid to test customer sentiment twice

[98] See First RCP Report at p. 6
[99] See the Second RCP Report at pp 19-20
[100] See First RCP Report at p. 100

more following the publication of its Initial Proposal in early 2023. And we sought and gained Ausgrid's agreement to initiate a number of specific affordability measures as part of the Initial Proposal, which have reduced the cost that customers will have to bear in future.

Notwithstanding our extensive activity the AER's subsequent Issues Paper (March 2023) failed to acknowledge the focus on affordability which has been a feature of the customer engagement we co-designed and have overseen. Indeed, of the 36 questions posed in the Issues Paper not one sought advice as to whether Ausgrid had adequately taken account of customer concerns about affordability.

Only with the publication of the Draft Decision in September 2023 has affordability become a central theme of the current reset for the AER. What surprises us is that only reports published in 2023 were cited in the Draft Decision despite public concerns and evidence about the affordability challenge facing electricity customers being available for at least a year beforehand. The Draft Decision was also deficient in our view for its failure to acknowledge that Ausgrid had incorporated a focus on affordability into its engagement with customers. In contrast, PIAC, in its submission responding to the AER's Issues Papers on the 3 NSW distributor Initial Proposals, acknowledged that Ausgrid's engagement and Initial Proposal demonstrated the most consistently evident response to affordability concerns of those distributors:

> *"Ausgrid made great efforts to undertake bill impact modelling at a granular level, present disaggregated proposal costs (factors in Ausgrid's control and factors outside Ausgrid's control), update bill impacts over the course of the program and demonstrate a commitment to make changes to reduce costs (or present cost reduction options) throughout the program to date. While the local resilience program has thus far been less successful in maintaining this structural focus on affordability, there is scope to address this in the remainder of the program, with further lessons for future engagement. In the prevailing circumstances, ensuring affordability is consistently and robustly presented and addressed as a priority has been a strength of Ausgrid's approach and should become the default starting point for all future engagement processes."*[101]

Following the Draft Decision, as noted earlier in this report, Ausgrid retested affordability sentiment in the VoCP in October 2023 and has introduced additional affordability measures in the Revised Proposal. We encourage the AER to acknowledge in its Final Decision that Ausgrid has worked more consistently on affordability than any other network in the current reset. As a result of Ausgrid's public focus on affordability we were able to push back on Ausgrid's consideration of an acceleration of its fleet electrification program on the basis that it would impose higher costs on consumers with no tangible benefit, whilst the technology remains uneconomic.

We think the reason for the AER's inconsistency on affordability throughout this reset arises as a result of the language used in the Handbook, which we discuss in Section 7 below.

[101] PIAC submission on AER Issues Paper 2024-29 Revenue Determinations: Ausgrid, Endeavour and Essential Energy 1 June 2023 at p. 3

2. More guidance on resilience

The AER should issue updated guidance on resilience following the final NSW distributor determinations. As a newly recognised investment category distributors have adopted different approaches to underpin their business cases. Providing additional guidance based on the assessments undertaken in 2023 will provide all distributors greater clarity about how resilience relates to other investment categories.

The concept of 'network resilience' remains poorly understood and insufficiently defined. This is due in part to the multifaceted nature of resilience making it difficult to extricate from interrelated concepts such as reliability, safety, and security.

Current guidelines have led network businesses to attempt to identify and isolate existing elements of expenditure related to resilience based on their self-assessment of the boundaries of the concept. As noted above, these boundaries are fluid and difficult to pin down. However, we have also observed that current guidelines raise the risk that network businesses view their existing expenditure as divorced from resilience outcomes and foster the impression amongst consumers and other stakeholders that the network's baseline level of resilience is zero.

We are concerned that both these approaches to assessing resilience are counterproductive and may result in an inefficient allocation of resources, and an incomplete understanding of system risks, uncertainties, vulnerabilities, and trade-offs of consumer preferences. As such, updated AER guidance should better reflect the holistic nature of resilience and facilitate greater consistency across interpretations of the concept.

We encourage the AER to outline how it expects network businesses to link consumer preferences to their proposals for managing climate risks and related costs. This advice should seek to ensure network businesses are eliciting meaningful preferences and not only testing support for specific technical interventions. Our observations suggest that current guidelines may produce a series of discrete resilience measures that are well supported by the community, but which do not represent the most effective implementation of the community's preferences on how network businesses should manage those risks over time.

Updated guidance on resilience should also be supported by further research into consumer risk preferences on high-impact low probability events. This is necessary to facilitate the development of business plans that accurately reflect the level of costs and risks consumers are willing to bear to minimise the likelihood or impact of such events.

We understand Ausgrid is working with the AER to develop transparency of the modelling for resilience-related asset risks. We welcome this effort and encourage Ausgrid to continue working constructively with the AER towards this end as a shared understanding will assist all stakeholders to develop prudent, efficient and flexible approaches.

3. The nature of bargaining within NewReg

In outlining its expectations of networks in the NewReg era the AER's Handbook highlighted how AusNet's Customer Forum, the first example of the new approach, acted as a credible counter-party to AusNet throughout its engagement.[102] The Customer Forum's Terms of Reference required it to negotiate with AusNet on behalf of customers with a view to ensuring that the revenue proposal submitted to the AER adequately represented their expectations and preferences.

Networks are free to choose how they seek and incorporate customer views into their revenue proposals but the spirit of NewReg inevitably leads independent groups such as the Customer Forum and the RCP to interaction with the network operator in a manner that resembles a bargaining process. Over many months a range of issues are explored and debated with both sides seeking to reach an accommodation of their respective needs.

The RCP's engagement with Ausgrid involved a substantial number of meetings as documented in our reports. From these meetings came a mutual understanding that elements of the Initial Proposal satisfied the requirements laid down in the Handbook because they were based on a well resourced, thoroughly prepared customer engagement program which has produced meaningful customer preferences which Ausgrid incorporated into its Initial Proposal.[103]

Central to the RCP's support was Ausgrid's support for a number of affordability initiatives, something we had advocated for during the second half of 2022 as we recognised and responded to customer sentiments around rising cost of living pressures.

Given the bargaining nature of the NewReg era, of which the discussion and consideration of Ausgrid's affordability initiatives are a prime example, a case can be made for the AER's reconsideration of the CESS exclusions. We do not speak for Ausgrid on this matter but it was apparent to us that at all times through our engagement with Ausgrid up until the Initial Proposal was submitted, that the business operated under the impression, as did we, that a CESS exclusion would apply for ADMS, cyber and the innovation programs as a result of an agreement that Ausgrid and customer advocates believed they had reached with the AER in 2018.[104]

We do not wish to re-litigate the arguments that have been advanced by Ausgrid and customer advocates on the matter but we do believe that there was a genuine belief as to the CESS exclusion that had a material value to Ausgrid and which underpinned at least some part of the good faith discussions it entered to into with the RCP ahead of its Initial Proposal being lodged with the AER.

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[102] See Handbook at p. 14

[103] See the Second RCP Report at p. 6

[104] Ausgrid has chosen not to include these exclusions from CESS in its Revised Proposal see Revised Proposal Overview at p. 46. This decision was reached by the Ausgrid board, despite customer advocates reconfirming the agreement reached in 2018

The AER's Draft Decision rejects the CESS exclusions but in so doing raises two key questions: What is the effect of a changed circumstance such as this on a distributor that has relied upon a different understanding at this stage of the revenue determination process? Furthermore, will the AER's decision have repercussions insofar as distributors in future might be reluctant to engage in a bargaining process to protect themselves from any unexpected elements of the regulator's draft decision?

Like the AER we appreciate the value of the NewReg approach, particularly how it encourages networks to be more customer centric and ambitious. This is intrinsically tied to the willingness of networks to engage in the bargaining process, and for that to be as meaningful as possible there needs to be complete confidence that understandings reached with the regulator are not changed before the commencement of the following revenue period.

4. Re-openers

It has become clear through this regulatory reset period that the rate and pace of change related to the energy transition is moving faster than the current regulatory framework.[105] The drivers behind these changes include consumers investing in CER including rooftop solar, home batteries, electric vehicles and other technologies.

Significant changes in the broader public policy landscape are arising regularly. These include national, state and territory governments becoming increasingly active in setting Net Zero targets, associated changes to the NEO to include emissions reductions, the introduction of moratoriums on new reticulated gas connections targets as part of electrification policy and the development of renewable energy zones within various jurisdictions.

In addition, the growing recognition of climate change impacts on electricity network infrastructure and the investment required to mitigate it, is bringing customers in areas most likely to be most affected by this change more and more into a growing conversation. Increasingly conscious of changing climatic impacts, households and communities are looking to help shape future investments to accommodate their various needs. There is also growing customer concern about cyber-attacks on network assets and the concern about prolonged outages.

In this dynamic and fast-moving landscape, we believe there is a strong case for enhancements to the current regulatory framework. Chapter 10 of the National Electricity Rules (NER) currently provides opportunity for networks to seek additional funding from the AER during the 5 year reset period in very specific circumstances. A cost pass through event is one that occurs beyond the reasonable control of a network business and has not been accounted for in its current 5 year revenue determination. Examples include new statutory obligations imposed on the business[106] or extensive damage to infrastructure caused by a natural disaster.[107]

Under the NER, a network business can submit a cost pass through application to the AER to recover its efficient costs incurred by the event provided that the network's costs have materially increased.[108]

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[105] Ausgrid notes several important energy policy and regulatory developments since its Initial Proposal in the Revised Proposal Overview at p. 3

[106] Such as the change in licence condition imposed on Essential Energy in February 2019 which resulted in a successful cost pass through application

[107] Such as Ausgrid's application for a cost pass through event related to the February 2020 storm

[108] The NER defines "materially" as: "For the purposes of the application of clause 6.6.1, an event results in a Distribution Network Service Provider incurring materially higher or materially lower costs if the change in costs (as opposed to the revenue impact) that the Distribution Network Service Provider has incurred and is likely to incur in any regulatory year of a regulatory control period, as a result of that event, exceeds 1% of the annual revenue requirement for the Distribution Network Service Provider for that regulatory year."

In particular, we believe that there is a limited but important case for ‘re-openers’ in key areas within the current 5 year regulatory cycles over and above the operation of the cost pass through regime.

Re-openers would not only ensure that network investment keeps pace with and supports the energy transition, ultimately delivering lowest cost and highest value to consumers and the community. It would also serve to mitigate the potential detrimental impact of rapidly emerging disruptive technologies and other unforeseen changes on consumers.

We believe that regular re-openers could be framed into two discreet categories.

Firstly, re-openers represent a means by which networks could more quickly respond to changing consumer driven needs and expectations. For example, re-openers that allow enhanced tariff structures and settings and/or the development and enhancement of customer services that are able to be incorporated into a CSIS can deliver quicker outcomes to customers than waiting for the next regulatory reset. Allowing distributors to access re-openers would encourage them to establish and maintain deep and meaningful *ongoing engagement* with consumers and communities.

Allowing re-openers would provide the AER with an opportunity to lay down in the Handbook guidance as to what process distributors would need to follow in order for their application to be considered. The AER could use a new re-opener channel to incentivise distributors to satisfy a higher standard of customer engagement or any other pre-requisite condition it deems appropriate. A distributor not prepared to ‘lift its game’ in relation to the preconditions would risk having to wait until the next scheduled revenue reset to secure its objective.

Secondly, the AER could use a re-opener channel to distinguish those investment areas it recognises as subject to rapidly changing external environments, and position itself to deliver decisions that better respond to that environment. Cyber security is an example of an investment that needs to respond to challenges which are emerging every day, which, in the absence of government mandating a specific new standard, falls short of the definition of a new statutory obligation under the cost pass through regime. Where broader community concerns about network security grow quicker than governments digest and respond through amended standards, the need for a regulatory re-consideration of an adjusted level of minimum protection also grows. Another area being increasingly discussed is the access networks have to smart meter data and the commercial terms of that access. These outcomes are contingent on the outcomes of the metering rule change and the recommendations in the reliability check-up and they may fall short of the materiality threshold of a cost pass through regime or the definition of a statutory obligation.

The modelling of climatic changes, which has been stimulated by the AER’s Resilience Guidance Note, is another example of where network knowledge will grow quickly between resets. We observed VoCP participants initiating a discussion about re-openers at the October session in response to the Draft Decision. For example one panel member asked *‘Is it possible for Ausgrid to go back to the AER in the next 5 years?’* (whilst they did not use the term ‘re-openers’ this was the essence) and Ausgrid’s answer was ‘no at the moment’. The

Panel member's response was *'....that is disappointing given rapid change over time'.* We believe that customers generally feel that when networks through their ongoing research identify causal links between climate change and network impacts and can substantiate prudent and efficient mitigation they should be permitted to make a case to the AER rather than wait until the next revenue reset application.

Re-openers would allow a nimbleness that is lacking in the current regulatory framework and would underpin and support the energy transition while releasing value to consumers and communities in a timely and meaningful way, when networks may not be incentivised to reallocate existing revenue to deliver these outcomes. It would also allow the AER to be more flexible in ensuring that networks can deliver services resulting from non-recurrent or less certain expenditure programs that the community values, in a prudent, efficient and staged way, provided important threshold/pre-requisites were satisfied to protect customers.

The RCP believes the AER might also consider re-openers on the basis of its current growing workload by redirecting some tasks which are currently part of every revenue reset. This consideration might be useful as the AER contemplates the future of the Early Signal Pathway (ESP). We discuss this further in Section 7 below.

5. Explaining the AER's Draft Decision

As the only NSW distributor not on the ESP, Ausgrid's engagement with customers continued beyond the AER's issuance of its Draft Decision. For Ausgrid this created a difficulty when reporting back to the three LGA based customer groups about the proposed resilience investment, as well as to the VoCP about the overall revenue proposal.

In both examples Ausgrid staff, after explaining the AER's Draft Decision, found themselves having to respond to customers who wanted to know how the AER had come to its decision. As RCP observers we noted the professional manner in which Ausgrid staff responded but it struck us as unsatisfactory that a distributor was being asked to explain a regulator's decision.

While we acknowledge the onus is on distribution businesses (and not the AER) to justify their revenue proposals, greater AER involvement in draft decision discussions would strengthen the feedback loop between distributors, consumers, and the regulator itself. The Panel believes customers stand to benefit when distributors continue to engage following an AER Draft Decision. However, in circumstances where it can be anticipated that customers will wish to understand why part of what they have helped shape has not been approved in the Draft Decision, we think it is incumbent on the AER to be available to explain its rationale. We believe that having a regulatory perspective is important in this situation as it removes the risk of inaccurate information being provided to customers and reminds participants of the distinct role that different parties have.

A qualification we offer on this matter is that the AER's need to explain its rationale would only arise where there is a material difference between what has been supported by customers in the Initial Proposal, and what has subsequently been approved by the AER in its Draft Decision.

6. Innovation

Ausgrid was the first network to propose a dedicated innovation program as part of the current 2019-24 revenue reset. A key part of the governance agreed with customer advocates in 2018 was that Ausgrid's innovation program would have a customer oversight committee (NIAC) and that the capex would be excluded from the operation of the CESS. The AER did not approve the $42m capex innovation program, instead it noted that it formed part of Ausgrid's capex expenditure as a whole in its Final Determination in 2019. The AER gave the following reason for its concerns about the innovation program:

> "*In our view, Ausgrid's innovation programs better fit as ordinary network augmentation programs. As such, these need to be subject to normal business case review and cost benefit assessment in accordance with capital expenditure criteria.*"[109]

In September 2020 the AER acknowledged that AusNet's $7.5m (totex) innovation program had been agreed with the Customer Forum as part of its 2021-26 reset. Building on Ausgrid's approach the AusNet innovation program included an independent Innovation Advisory Committee that was tasked with evaluating and prioritising the innovation projects that best reflect customer preferences. Again the capex was to be excluded from CESS. The AER expressed no concerns with the Ausnet innovation program.

As part of its recent 2024-29 Draft Decision for Endeavour the AER has used a similar approach and instead of approving Endeavour's $20m innovation program it has noted that it forms part of Endeavour's capex as a whole. Customer advocates have again pressed Endeavour for the establishment of an independent oversight committee.

The AER has not accepted Ausgrid's 2024-29 capex program as a whole in its Draft Decision and has rejected the continuation of Ausgrid's innovation program in its current form. The AER has instead included a placeholder of $0 for capex and $0 for opex. The AER has set out similar reasons in both the Ausgrid and Endeavour Draft Decisions about why the AER believes the innovation programs are not prudent.[110]

Ausgrid has responded to the detailed feedback the AER provided in the Draft Decision and the Revised Proposal is a 90/10 customer/network self-funded proposal with greater clarity around Ausgrid's successful efforts to access external funding from external sources including the Federal Government, ARENA and the NSW State Government. In its Revised Proposal Ausgrid has again sought to satisfy the AER's request for greater cost benefit analysis for specific projects to justify the program, although we question why the AER is insisting on applying its same economic models to innovation trials and pilots, which will generally have an unproved or uncertain business case. NIAC's oversight will continue in 2024-29 and the AER has noted that the NIAC governance arrangements "….*are a positive*

[109] See Attachment 5 Final Decision Ausgrid 2019-24 at p. 5-50
[110] See Attachment 5 Draft decision Ausgrid 2024-29 at pp 46-51

step to managing innovation within Ausgrid and involving independent membership with customer and technical representatives."[111]

We believe that the AER's ongoing reluctance to accept Ausgrid's (and other DNSPs) innovation programs on an ongoing and certain basis is out of step with customer, industry and policy expectations. There remains very strong customer support for Ausgrid's innovation program; the NIAC independent members remain very supportive of the program and continue to challenge Ausgrid to lift its analysis of customer benefit and deliver even greater industry knowledge sharing; Ausgrid's Project Edith trial recently won the ENA's innovation award; we are aware that the Victorian DNSPs are discussing innovation programs with their customer committees and we understand that the Federal Government relied on the learnings from Ausgrid's first community battery trials to inform the design of the Stream 1 community battery grants.

Ausgrid also leverages other innovation collaborations via its participation in RACE for 2030 programs; CSIRO via a senior researcher who is a member of the CCC; the UNSW Digital Grid Futures Institute via the Director who is an independent member of NIAC and its founding participation in the University of Oxford led International Community for Local Smart Grids (ICLSG). Ausgrid's purpose in joining the ICSLG knowledge sharing partnership with global networks was for collaboration and industry sharing globally to maximise innovative and affordable solutions for customers.[112] Each of these collaborations ensures that Ausgrid can maximise the use of its innovation funds.

The Panel believes that it is unsatisfactory that network innovation programs will only proceed where the AER is able to approve a network's expenditure as a whole. It appears that because innovation programs do not fit neatly into the AER's existing modelling approach, the AER feels it has no basis to expressly approve the programs. Given the uncertainty of the speed, scope and costs of the decarbonisation transition the Panel strongly believes that it is in customers' long term interests for those networks that choose to invest in trials and pilots and other innovation programs, to do so for the benefit of all customers.

Accordingly, the Panel strongly recommends that the AER publish an innovation guidance note (similar to the AER's Resilience Guidance Note) to inform networks and customers about the AER's expectations for innovation funding. This is needed to avoid the current uncertain and happenstance approach. When preparing the innovation guidance note the AER can build on the helpful guidance it included in Ausgrid's Draft Decision as well as drawing on Ausgrid's refreshed approach in its Revised Proposal. We also recommend that the AER review Ofgem's RIIO-2 NIA Governance Document that sets out arrangements for

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[111] Ibid at p. 49

[112] Ausgrid's former CEO, Richard Gross, described Ausgrid's objective in joining the ICSLG on 27 October 2021 as follows: '*We have joined the International Community for Local Smart Grids so we can collaborate with some of the best minds in the world to develop innovative, sustainable and affordable solutions for our customers*.'

the governance and administration of the RIIO-2 Network Innovation Allowance. The Ofgem approach includes the 90%/10% funding sharing approach which Ausgrid has agreed to implement on a project by project basis. The Ofgem RIIO approach also distinguishes between BAU and other innovation. Other local sources of information for an AER innovation guidance note include ARENA, which has set out its detailed knowledge sharing requirements for grants. This approach enables ARENA to publish its knowledge bank. The criteria for the ENA industry innovation award would also be helpful.[113]

We urge the AER to find a balance between the need for trials to satisfy the AER's standard approach to cost benefit analysis and a more realistic approach which allows networks to have limited flexible funds that can be brought to solve emerging problems. The AER could consider imposing a revenue cap for the innovation programs - for example, a maximum of 0.5% of revenue, which is close to the percentage of Ausgrid's totex innovation program for 2024-29.

An innovation guidance note will also give the AER the opportunity to explain where it sees the difference between '*transformative*' pilots and trials and '*core improvement'* which should be part of BAU.[114] The RIIO-2 NIA Governance Document includes a useful starting place for this distinction:

> *"Requirement 5 – be innovative*
>
> *3.14. Eligibility requirement 5: A project must be innovative (ie not a business as usual activity) and have an unproven business case entailing a degree of risk warranting a limited Research, Development or Demonstration Project to demonstrate its effectiveness. This could include Projects which are untested at scale, or in relation to which there are risks, which might prevent the widespread deployment of the equipment, technology or methodology."*[115]

Another area of friction between the AER and networks has been the exclusion of innovation programs from CESS and EBSS, given the AER's clear preference for no exclusions from the incentive schemes.[116] Rather than excluding the innovation programs from CESS and EBSS the innovation guidance note could make clear that networks could instead offer a commitment not to claim any underspends in the next period's incentive scheme claims.

As part of approving innovation funding in the guidance note the AER could require networks to publish a mid-program progress update including:

- a report from the independent members about governance issues and suggested areas for improvement;

[113] See the judging criteria for ENA's Innovation Award 2023 at p. 3. The 2023 innovation award was won by Ausgrid for Project Edith

[114] See AER Draft Decision Attachment 5 at p. 50

[115] See RIIO-2 NIA Governance Document at p. 15

[116] Although we note the AER agreed to innovation being excluded from EBSS (notwithstanding they didn't approve the expenditure) *"……as it is unlikely to be forecast on a revealed cost basis in the future given the nature of these costs."* See AER Draft Decision Attachment 8 EBSS at p. 8

- the progress of trials and pilots including an analysis of revenue spent, costs and customer benefits;
- the results of PIRs on selected programs (including of trials that are discontinued);
- summary of knowledge sharing activities;
- details of all external funding, (including other incentive schemes or sandbox opportunities) considered, secured or applied for;
- participation in knowledge sharing partnerships;
- evidence that the trial is not repeating work of other networks and is adding to the community of learnings and the steps that the network took to establish this; and
- evidence of BAU improvements (assuming that these are funded some other way than via the innovation program).

As part of a new approach to innovation the ENA could also consider re-creating the ENA knowledge bank database[117] to increase knowledge sharing and to avoid duplication of trials.

We believe the AER has an opportunity to develop its approach to innovation. Customers routinely stress the urgency for networks to partner with other stakeholders on innovative solutions to deliver services in the transition at lowest cost and they are looking for networks to lift their commitment to innovation to improve outcomes on their behalf.

[117] The link to the knowledge bank database on the ENA website is no longer functional

7. The Better Resets Handbook

Ausgrid is part of the first cohort of decisions the AER is making since publication of the Handbook. The objective of the Handbook is

> "*..to encourage networks to develop high quality proposals through genuine engagement with consumers and that meet the AER's expectations."*[118]

The AER states that it will reward businesses that meet the AER's expectations and the AER notes that the Handbook provides reputational and procedural incentives for networks to meet AER expectations.[119] The incentive is one of efficiency as the AER notes in the Purpose section of the Handbook:

> *"If regulatory proposals also meet our expectations, they are more likely to be accepted by us, earlier in the assessment process and thereby create a more efficient regulatory process for all stakeholders."*[120]

One of the stated aims of the targeted review process described in the Handbook is to reduce the work required (by both the AER and networks) at the later stages of the regulatory process.[121]

Whilst not specifically stated in the Handbook we do not believe that the AER intended this reward or efficiency to come at the expense of customers' short or long term interests. From a consumer perspective the aim of the Handbook is *"..to encourage networks to better engage with their customers and to have consumer preferences drive the development of regulatory proposals."*[122]

The AER has also trialled a new alternative ESP approach in the Handbook as part of the NSW resets in order "*to further encourage the development of high-quality regulatory proposals through genuine engagement."*[123] The bargain offered by the AER to those businesses on the ESP is that the AER will provide earlier formal feedback on aspects of the regulatory proposal – such as at the issues paper stage, in exchange for certain commitments[124] by the businesses. The Handbook notes:

> "*…the ESP is optional but that the AER's aim is that the ESP approach eventually becomes part of the business-as-usual approach to regulation."*[125]

In late 2021 Ausgrid applied to access the ESP. In March 2022 the AER informed Ausgrid that its application for the ESP had been unsuccessful. The AER advised Ausgrid and the RCP that the AER had received applications from all 3 NSW businesses to be on the ESP, but had decided to go with 2 of the 3 EOIs only for the initial trial of the ESP. The AER advised that it

[118] See Handbook at p. 3
[119] Ibid
[120] See Handbook at p. 1
[121] See Handbook at p. 4
[122] See Handbook at p. 1
[123] See Handbook at p. 5
[124] See Handbook at p. 5 and at p. 8
[125] Ibid

believed it had insufficient resources and capacity to fulfil the AER side of the ESP bargain for all 3 NSW networks.

Notwithstanding this decision, Ausgrid has sought to meet the intent of the Handbook and the AER's expectations in the development of its Initial Proposal. We have written about this extensively in our previous reports. The RCP has ensured that all our reports met the AER's requirements for independent customer reports in Section 3.4.2 of the Handbook. The AER has acknowledged in the recent Draft Decision many areas where Ausgrid has met the expectations of the Handbook. The AER has particularly called out Ausgrid's approach to engagement and its extensive engagement program as a material factor for accepting most of the expenditure proposed by Ausgrid in its Initial Proposal.[126]

Several members of the RCP have also been members of Endeavour and Essential Energy's 2024-29 revenue proposal processes, with experience of the ESP trial and non ESP approaches under the Handbook. In each of the 3 NSW Draft Decisions the AER acknowledges:

> *"We all continue to learn and develop throughout the process of applying the Handbook, and we will look to reflect with businesses on how engagement is providing the greatest value in understanding the long-term interests of consumers."*[127]

In that constructive, reflective and continuous improvement spirit, the Panel offers the following considerations for the AER's next review of the Handbook and the ESP trial, building on our collective experiences in the 3 NSW processes:

<u>The Handbook</u>

- The Panel recommends that following the final decisions in April 2024, the AER engage a third party to review the AER's application of the Handbook and the ESP to the current cohort of distribution businesses, to see if the Handbook's objectives of encouraging and rewarding high quality proposals has been met or could be improved. We encourage the review to reflect on the outcomes achieved under the Handbook and ESP for customers, networks and the AER to see if each of these stakeholders' objectives are being achieved. The review could also include feedback from customer advocates and independent engagement facilitators, given the very significant investment each of the networks made in engagement with customers and customer advocates.
- The roles of customer panels like the RCP and the Consumer Challenge Panel (CCP) need to be clarified. We note the AER's commitment to provide this clarity on the role of the CCP for those networks on the ESP.[128] However, this clarity of roles should be a commitment the AER gives every network, particularly in circumstances where an

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[126] See Draft Decision Overview at p. x
[127] Ibid
[128] "*For each pre-lodgement process we intend to outline the role of the Consumer Challenge Panel in the open letter to the network business that confirms their entry into the early signal pathway. This will ensure role clarity and minimise any duplication between the Consumer Challenge Panel and other consumer panels involved in the pre-lodgement process*." See Handbook at p. 9

independent customer panel is established like the RCP. The AER might also consider expanding the Handbook to build out how the roles of independent customer panels could be enhanced to assist those networks on the different paths.

- In the Handbook the AER expressly offers targeted reviews for aspects of all revenue proposals that meet the AER's expectations, irrespective of whether a network is on the ESP. In the same way the Handbook should be applied by the AER so that all aspects of proposals that do not meet the AER's expectations at the Issues Paper stage are treated equally, irrespective of whether a network is on the ESP.
- It is critical that businesses who have done extensive and genuine customer engagement who are not on the ESP, are not exposed to any unfairness due to aspects of their Draft Decision not being capable of acceptance at the Draft decision stage because the network did not have the opportunity to work with the AER staff to progress and refine modelling prior to the Draft Decision. We acknowledge that in Ausgrid's case the proposed resilience expenditure could never have been capable of acceptance in the Draft Decision due to the lateness of its submission and the significant issues, which Ausgrid has since acknowledged, in its asset impact modelling and options analysis. However, other areas that the AER did not accept at the Draft Decision stage, might have been substantially progressed before the Draft Decision if that same opportunity had been afforded to Ausgrid.
- As we discussed in Section 1 above, we think the reason for the AER's inconsistency on affordability throughout this reset arises as a result of the language used in the Handbook. While the AER details its expectation that electricity will be supplied to customers at a price that is '*affordable and efficient'*[129] it subsequently explains that consultation with customers should be focussed on '*long term outcomes*'. As a customer concern, affordability matters far more because of its immediate and near-term character than what it might present in the long term. The Handbook needs to be updated to get a balance between long term and short-term interests, something the NEO and the guidance emanating from it fails to do.
- There is an opportunity to significantly improve the material in chapter 7 of the Handbook around the AER's expectations on tariff structure statements. Specifically the AER should clarify to what extent it expects networks to engage with end customers on tariff design and assignment and to what extent it will accept network engagement with stakeholders including customer advocates and retailers. For example Section 7.1 inaccurately refers to network tariffs sending signals to "customers" rather than retailers. We agree that cost reflective signals allow retailers the opportunity to design retail products that can assist customers to minimise their bills but this depends both on retailer response as well as customers' ability to respond. As long as the AER sees an ongoing role for consumer engagement on network tariffs the role of retailers in these processes should be reconsidered/clarified and the AER should explain how it proposes to weigh the views of consumers against retailers, given the competing interests and different resources that each of these parties brings to bear on these discussions.

[129] See Handbook at p. 11

- In the Panel's experience from several revenue resets, CSIS remains contentious and consumer support for the full suite of initiatives and proposed benchmarks is inconsistent. That said, Ausgrid's engagement on CSIS was transparent and constructive, and their commitment to re-testing preferences and priorities, and responding to concerns should be commended.[130] Relative to Endeavour and Essential, Ausgrid has exhibited a particularly strong commitment to re-testing, verifying, and addressing consumer feedback on items like CSIS. (This may be a product of Ausgrid's shift in engagement culture as well as its non-ESP approach which facilitated more frequent retesting). Currently, the Handbook is silent on the AER's expectation for CSIS engagement – instead this was conveyed to Ausgrid by the relevant AER staff in discussions. The RCP recommends that the AER update the Handbook to set out its expectations on best practice engagement and what it sees as the roles and responsibilities (as well as the relevant parties) that should participate in service incentive scheme discussions.

<u>The ESP</u>

- The AER should allocate sufficient internal resources to ensure that all networks who apply to access the ESP and who meet the ESP requirements in Section 2.2.4.1 of the Handbook are accepted onto the ESP. This would be consistent with the AER's stated aim for the ESP approach to become BAU.
- It is important that there is no perceived unfairness to customers or networks on not being on the ESP. It is essential that all stakeholders maintain confidence in the regulatory process so that regardless of whether networks are on the ESP pathway or on the regular pathway that outcomes for customers and industry will be consistent. It does not seem to be consistent with the intent of the Handbook that businesses on the ESP who do not meet the AER's expectations in the Issues Paper should then be given the opportunity to work extensively with the AER to revise their Initial Proposal so that is then capable of acceptance at the Draft decision stage. Why for example would this opportunity not be offered to businesses not on the ESP who have engaged extensively with their customers and complied with the AER's customer engagement processes and other Handbook expectations? In this respect the AER does not appear to have followed its own processes in the Handbook, which is for those on the ESP to receive a targeted review only for areas that meet the AER's expectations. The Handbook does not state that the AER will work exclusively and closely with businesses on the ESP on the areas that fell short at the Issues paper stage. This is inconsistent with the objective of encouraging high quality proposals. Further it would be unfair for that to be the outcome of being "selected" to access the ESP.

[130] We commend Ausgrid for making it very clear to customers on 1 August 2023 what influence they could have over the design of the CSIS and what was non-negotiable. We note however that there were aspects of the scheme that were described by Ausgrid as non-negotiable without any explanation to the VoCP e.g. that the annual reward/penalty would be the 0.5% under the scheme and could not be reduced; and the scheme had to be symmetrical i.e. the reward and the penalty had to be evenly balanced. Customers had raised concerns about both of these issues in the earlier April 2023 engagement session and some were disappointed that they were unable to influence these aspects of the scheme.

- We also have a concern for the customers of networks who are on the ESP that they should not be disadvantaged. Figure 1 in the Handbook notes that key milestones in the ESP are the same as those under the current reset process. The AER publishes an Issues Paper, a Draft Decision and a Final Decision. In that sense the "process" has been the same for all 3 NSW networks where each network made an initial proposal that the AER responded to in its Draft decision. All businesses are then given the same opportunity to re-propose in their revised revenue proposal before the AER's final decision. However, in the current affordability crisis and the likely medium term outlook for high and increasing electricity bills, we believe there is a risk that customers facing a Draft Decision that the AER deems capable of acceptance will have limited further opportunity to raise affordability concerns and provide other meaningful feedback to those networks to shape the revised revenue proposal.
- The difference arises for the customers of networks, like Ausgrid, who committed to its customers before Ausgrid lodged its Initial Proposal, to ongoing meaningful customer engagement between the Draft Decision and the Revised Proposal. As we noted above, customers perceive a difference between a network being able to say to its customers '*the AER's draft decision has not yet found our initial proposal prudent and efficient*' and a network being able to say *'the AER has accepted our proposal'*. As a matter of fairness the AER should make it clear if it wants networks on the ESP (or networks who receive a Draft Decision capable of acceptance) to continue to genuinely engage with their customers following a Draft Decision. Or does the AER consider that customers' meaningful input is no longer needed because by that time the AER is already satisfied on prudency and efficiency of the proposal and further consumer engagement is part of the "*work that is saved in the later stages*"? If the latter, then the customers of those networks will be disadvantaged as they will have less meaningful opportunities to respond in greater ways to affordability concerns than those customers not on the ESP.

  Given the rapid changes in the energy market and the ongoing medium term affordability pressures we believe an outcome that effectively removes a network's incentive to keep retesting its revised proposal and to genuinely look for further savings is not in customers' short or long term interests. Ausgrid's customers have not faced this disadvantage as we challenged Ausgrid to commit to retest affordability concerns with its Revised Proposal in October, which has led to the additional affordability initiatives. In the absence of this commitment to its customers Ausgrid would not have been incentivised to retest its Revised Proposal in the same way, if it had received a Draft Decision capable of acceptance on the expenditure programs that are important to customers.

APPENDIX A - RCP activity

RCP only meetings

August 28, September 11 & 29, October 9, 23 & 30, November 6, 13, 20, 23 & 27.

RCP meetings with Ausgrid

September 15, October 12, 27 & November 10.

RCP-Ausgrid Resilience investment governance meetings

August 30, September 13 & 27, October 13, November 1, 8 & 22.

Customer engagement design and feedback meetings

September 12, October 18 & 27.

Ausgrid RREC

October 24.

Ausgrid Customer Consultative Committee

November 28

Resilience program discussion

September 26, October 3, 15 & 25.

AER pre-determination conference

October 9.

LGA based customer workshop 4

October 10 (Port Stephens), 11 (Lake Macquarie) & 12 (Central Coast).

Voice of Community Panel (on line)

October 21.