Consumer

Challenge

Panel

CCP10 Response to the Endeavour Energy Revised Regulatory Proposal 2019-24 and AER Draft Determination

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Submitted to: NSW2019-24@aer.gov.au.

SECTION 1

Observations of the regulatory reset process in New South Wales and the Australian Capital Territory

OVERVIEW

This section is common to the four submissions that CCP 10 is making in responding to the AER Draft Decisions and subsequent Revised Revenue Proposals from the three New South Wales and the Australian Capital Territory electricity distribution businesses: namely Ausgrid, Endeavour Energy, Essential Energy and Evoenergy. Section 2 and beyond deals specifically with issues relating to each distributor.

The observations in this section relate to our activity during the past two years when we have been engaging with the businesses. We have sought to set out matters relevant to all 4 businesses and the processes that we have observed. It is not our intention to compare the four businesses, rather to derive the common issues. We recognise that while the 4 businesses have many technical issues in common, other aspects of the businesses are quite different - particularly governance and individual business culture.

In this section 1, we address three predominant aspects of the revenue reset process observed by CCP10:

- Firstly, we note the unique circumstances in which CCP10 has operated;
- the second part highlights our observations on emerging best practice in consumer engagement; and
- we then discuss the issues that we believe are emerging NEM wide and that need to be addressed by the AER, the businesses and all stakeholders in the medium term.

UNIQUE CIRCUMSTANCES

At the outset we acknowledge that the context in which the 2019- 24 regulatory processes have been developed is unique with a number of abnormal factors in play, particularly when compared to previous regulatory processes. We have made this point in all of our previous submissions, but we repeat the observations here because they are significant.

Ownership

Changes in ownership have been significant for Endeavour Energy and Ausgrid due to the partial sale of these businesses by the New South Wales government. While Essential Energy has remained under government ownership, it now needs to operate as a separate business just like the other two New South Wales distribution businesses. This means that the New South Wales businesses have dealt with the development of 2019-24 regulatory processes in a very different manner to the approach taken for the 2014-19 regulatory proposals, when the businesses acted as a group under the banner of Networks New South Wales. Evoenergy has changed its name from ActewAGL with this business being separated from other parts of the ActewAGL business group, with retail functions also being separated from network activity.

We recognise that changing ownership and governance arrangements and, in some cases, legislated operational restrictions, coupled with the application of a new ring-fencing guideline (in 2017), have required new processes to be undertaken in developing regulatory proposals for each of the four businesses. This is not to suggest that any of the businesses were unaware of the timing or the rules for development of their 2019-24 proposals, but they provide important context.

2014-19 regulatory process - remitted decisions

One of the significant, unique factors is that the 2014-19 revenue determinations had not been resolved before the initial revenue proposals for 2019-24 were to be lodged. This is due to the Limited Merits Reviews (LMR) and subsequent Federal court appeals that followed from the AER's final decisions for 2014-19, which resulted in aspects of the AER's final decisions being remitted to it to be remade. We note that aspects of final decisions were also remitted back to the AER for a fifth business, Jemena Gas Networks (JGN), though the issues in play for JGN were not as closely correlated with the issues for the ACT and New South Wales electricity distribution businesses. The AER's final decisions were also made after the 2014-19 regulatory period commenced due to changes in the rules for network regulation that were finalised by the AEMC late in 2012, which in turn led to the AER developing the "Better Regulation" guidelines to deal with application of the new rules in 2013. This resulted in a placeholder decision for the first year of the 2014-19 period.

The end result was that the total amount of money that customers would need to pay to each of the businesses for its provision of network services during 2014-19 was not fully known at the time of lodgement of the 2019-24 initial revenue proposals. This means that these regulatory proposals were lodged against a backdrop of some price uncertainty for not only customers but also for each of the network businesses.

An important factor in the initial AER final decisions for 2014-19 was the recognition that the ACT and the New South Wales businesses, in particular, needed to transition from businesses that were operationally inefficient to businesses that were more efficient. The introduction of benchmarking of operational expenditure for Australian network businesses coincided with the release of the original final decisions for 2014-19, another important development in regulatory practice in Australia, though the timing may not have been ideal.

The good news for this 2019-24 regulatory proposal is that the 2012 rule changes in the better regulation approaches are now tested and embedded in Australian network regulatory practice. The introduction of benchmarking was a key element of the better regulation process and so was new in the last regulatory period. Increasingly the AER's use of benchmarking is better understood with the benefit of history and greater certainty in the collection of RIN data across the NEM. We have drawn on aspects of the most recent AER benchmarking report in considering aspects of regulatory proposals, believing that benchmarking is an important aspect of regulatory processes and remains a critical cross check tool for the AER. The use of benchmarking as one of a number of informative tools by the AER helps to secure outcomes that are in the long-term interests of consumers.

Since the processes for developing the 2019-24 regulatory proposals were running parallel to and somewhat determined by the outcomes of the remitted decisions for 2014-19, CCP10 in effect became a party involved in the consideration of each of the remitted decisions. We actively discussed the development of remittal proposals with each of the businesses and with other consumer advocates including ECA, PIAC, NCOSS and EUAA as well as consumer representatives on each of the distributor's consumer engagement committees. We recognise that LMR, other legal challenges and remitted decisions have not been easy to deal with for the businesses, the AER nor consumers. What is clear is that consumers were not well served by the actions of the 4 businesses and Networks NSW in challenging the AER's original 2014-19 Final Decisions.

Restoring Confidence in Energy Regulation (AER 2.0)

It is worth recalling that on 26 July 2017, at an Energy Networks Association (ENA) conference in Brisbane, AER chair Paula Conboy delivered a presentation entitled "Working together to restore confidence in energy regulation." In this presentation she provided some context to the situation at that time:

> "*We have had a highly adversarial culture around energy regulation in Australia. In fact, I was quite shocked at the intensity of that culture when I arrived here three years ago and it has been a conscious effort of mine to move away from it. This adversarial approach needs to change if we are to achieve mutually acceptable outcomes for investors and consumers; outcomes that are in the long-term interests of consumers. I know that many of you agree that a more constructive working relationship with us is essential if we are to move on from an inefficient and ultimately unsustainable adversarial approach*."
>
> Paula continued: "*we want to engage with you and with consumers earlier in the process. We want to identify key points of disagreement early and we want to work collaboratively to resolve them… It's a new way; and in a post limited merits review world; I would suggest it is the only way… We are essentially kicking off AER 2.0*."

The AER then hosted a Round Table discussion about approaches to resolving the remitted decisions in August 2017. That meeting included the relevant network businesses, AER, CCP10 and selected consumer groups and focussed on the need to resolve the remitted decisions expeditiously.

Recognising the uniqueness of the circumstances leading up to the remits for NSW and ACT network businesses, and observing the significant price impacts on households and businesses of rapidly rising energy costs, CCP10 suggested starting with some principles to help shape the specific aspects of the matters raised in the AER's remittal Issues Paper.

There was no 'roadmap' for resolving the remitted decisions efficiently and effectively nor for the implementation of "AER 2.0." In considering the aspects of the remitted decisions relating to operating costs and debt, both the subject of Issues Papers from the AER, CCP10 proposed the following principles, as a basis for seeking resolution and garnering goodwill:

1. The focus must be on not only the National Energy Objective (NEO), but shorter-term impacts matter too (The short term can impact on the long-term interests of consumers)
2. Recognition of the uniqueness of the current situation
3. Use the best available evidence
4. Apply LMR and Federal Court directives, where they exist
5. The process is of transition from inefficient network businesses, to efficient businesses
6. Objective fairness between businesses
7. Sustainable Opex
8. Dealing with "A New Reality"
9. Trust and goodwill are needed to produce outcomes that work for all parties

CCP10 is relieved that each of the remitted decisions for the 4 electricity distribution businesses have been formally finalised or are near finalisation as of early January 2019. All parties, including the AER, are to be congratulated for the reality that these decisions are practically resolved. By moving on from that unconstructive period of regulatory engagement, the 4 businesses can now shift towards making consumers' interests their focus. It also frees the AER to continue to develop '*a more constructive working relationship'* with the regulated businesses and importantly to focus on systemic issues in the NEM of concern to consumers, some of which we have highlighted in the final part of this section 1 of our submission.

Extensions

We also note that the each of the New South Wales electricity distribution businesses sought three-month extensions for the lodgement of their regulatory proposals. In Essential's case it was so that it could resolve the 2014-19 remittal prior to lodging its initial proposal for the subsequent regulatory period. In Endeavour and Ausgrid's case the main reason was to enable the businesses to improve their consumer engagement on their initial proposals before lodging them with the AER.

We believe that all parties have made substantial progress in the (under) 18 months since the initiation of "AER 2.0." The magnitude of this change cannot be underestimated for network businesses, for the AER and its various teams, consumer groups and the CCP. The level of goodwill has grown between all parties and trust is building and was a major factor in the extensions being granted for each of the three NSW businesses, despite some concern by some stakeholders, including the AER, about the capacity of some of the businesses to utilise the time appropriately for improved consumer engagement.

The resolution of the remitted decisions and the goodwill generated in achieving resolution in most cases in an expeditious manner, has been significant in influencing the Revised Revenue Proposals for each business and has led to improved consumer engagement by each of the four businesses. We observe that each business has engaged using different timeframes and methodologies, but the intent for better outcomes has become more evident as each business has finalised its Revised Proposal.

Ongoing Regulatory Change

Good regulatory practice, like rust, never sleeps. Over the period in which these regulatory proposals were developed through to lodgement of the Revised Revenue Proposals, there have been a series of revisions to guidelines, rules and legislation that business and consumer interests have needed to take into account:

- legislative change has seen the abolition of LMR during 2017
- legislative change has also resulted in a binding rate of return guideline during 2018. The final rate of return Guideline (the 2018 Guideline) was developed with extensive consultation with a broad range of stakeholder interests and considerable expert input
- rule changes have specifically dealt with ring fencing and a range of proposals have dealt with aspects of distributed energy resources (DER) and access to the grid
- the AER has initiated reviews of aspects of the regulatory framework, which has resulted in changes to rate of return, taxation, treatment of inflation, dynamic productivity for operating costs and tariffs. Separate CCP subpanels have dealt with each of these issues and we refer to submissions on each of these issues from the relevant CCP subpanel. Our advice is intended to be consistent with the CCP views expressed in these processes and
- there has also been clear direction from governments and the AER for network businesses to engage much more directly and transparently with consumer interests.

We recognise that regulation is not an exact science, there will always be aspects of ambiguity and issues upon which regulatory judgement will be required. We also observe that each of these processes have led to improved regulatory process and enhanced certainty for both consumers and network businesses. It is our belief that the result of these various changes to Australian network regulatory processes is starting to shift the asymmetry in network regulation between business and consumer interests to improved alignment with consumer interests and the national electricity (and gas) objective**s.**

Ongoing Market Change

In their submission in response to the original 2014-19 proposals from the ACT and NSW businesses, CCP1 contextualised their submission by saying:

> "*We consider that there is a new reality facing distribution businesses (and indeed, others in the energy sector) and yet we see limited evidence that the submissions from the New South Wales distribution businesses reflect this and move beyond "business as usual".*
>
> *The new reality is a result of changes in demand and changes in customer willingness to pay high electricity bills, leading to a need for businesses to adapt to meet these new circumstances*."

The imperatives of this new reality have accelerated since this CCP1 observation, from less than five years ago. Some argue that the role of network businesses for electricity distribution is less clear cut than it was even five years ago with DER meaning that there is considerably more localised generation occurring, while the locations for larger scale renewable energy generation are likely to be different from those for fossil fuel-based generation. The role and functioning of the future grid is a global question and one that was considered by the ENA, on behalf of its network members, with the CSIRO through their network of the future "Roadmap".

The pace of change in their businesses and in the regulatory framework is now a reality for network businesses to a greater degree than has been in the past, however this reflects more the privileged position that network businesses have had in the past compared to most other business endeavours. Rapid and dynamic change remains relatively new for network businesses and provides opportunities for greater efficiency and cost reduction for customers - it does not need to be a driver for higher costs.

Price, Trust and External Scrutiny

Energy markets across Australia have been the focus of unprecedented public, political and media attention over the last decade. The cost of electricity has been the major driver of these concerns. During this time electricity costs across the country have risen at a much greater rate than CPI and also incomes for both households and business. This reality is demonstrated in the graph given below in **Figure 1** and produced by the ACCC in its interim report on retail electricity pricing.

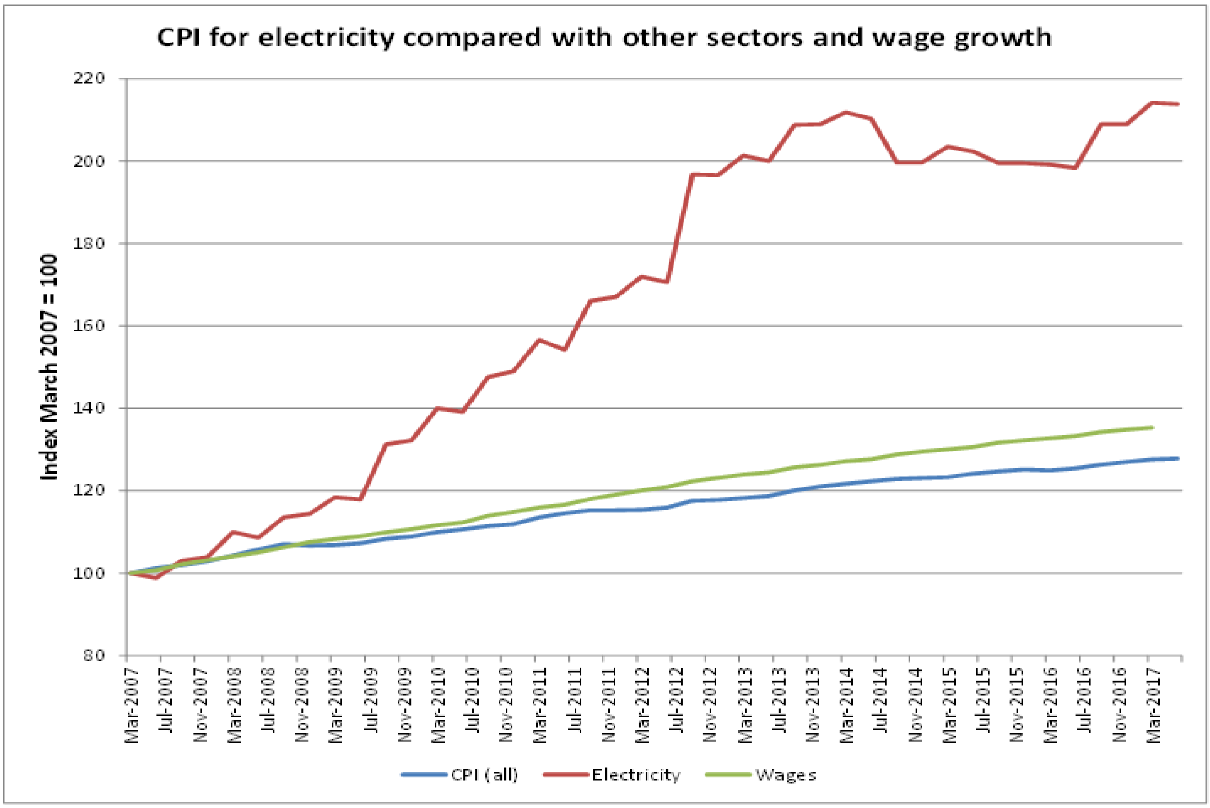

Figure 1: Cost-Price Index and electricity price growth (Source ACCC)

High and rising prices have undermined consumer trust in energy markets.

This is demonstrated through the ECA energy consumer sentiment survey with the December 2018 report presenting the following in response to the question "*How confident do you feel that the overall market is working in your long-term interests*?" For New South Wales, 32% of those surveyed responded positively compared to 15% for the ACT. Both of these results were increases on the previous survey six months earlier, up 11% for New South Wales and 4% for the ACT. 28% of people in NSW and 50% in the ACT were negative about the market working in their interests and 40% in New South Wales and 35% in the ACT were neutral. So less than a third of customers feel confident that the market is working for them in the ACT and NSW.

The survey also asked, "*How confident do you feel that the energy market will provide better outcomes for you in five years, in terms of value for money?"* In NSW 34% of people and 19% in the ACT responded positively with 23% in NSW and 38% in the ACT being negative.

We recognise that these survey results refer to energy markets in general and are not specific to network businesses, however the results reflect low levels of trust in all aspects of energy markets, including network businesses and the pressure on every part of the energy supply chain.

Rising prices and low levels of trust in energy markets have attracted sustained political interest with a number of reviews being undertaken including by the Chief Scientist, Prof Alan Finkel and more recently by the ACCC. The ACCC released their report "Restoring electricity affordability and Australia's competitive advantage"[1] in July 2018, this being the final report from their Retail Electricity Pricing Inquiry.

This ACCC final report was published after the initial regulatory proposals from the New South Wales businesses but before their Revised Revenue Proposals. This report also considered areas where consumers could reasonably expect savings in their energy bills, by 2020-21, by jurisdiction. This summary of savings is given in Table 1 below.

[1] https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_0.pdf

Table A: Achievable average annual residential bill savings by 2020–21

		Achievable savings ($ per annum)						
Region	2017–18 Bill	Networks	Wholesale	Enviro	Retail	Reduction	2020–21 Bill	% Reduction
Victoria	1457	39	192	34	26	291	1166	20
NSW	1697	174	155	43	37	409	1288	24
South east Queensland	1703	147	192	18	62	419	1284	25
South Australia	1727	13	227	89	42	371	1356	21
Tasmania	1979	113	226	75	–	414	1490	21

For small business customers, similar savings can be made. However, as a larger proportion of small businesses are on standing offers, the recommendation to abolish the standing offer and implement the lower-priced default tariff will have a proportionately greater benefit to small business customers.

The ACCC estimates that small businesses can achieve savings of 24 per cent on 2017-18 prices if ACCC recommendations are adopted (see figure H).[3]

Table 1: Achievable electricity bill savings by jurisdiction (source: ACCC, table A)

Of interest is that the AER concluded that the greatest area for savings for New South Wales customers was from further reductions in network charges, this coming on top of the significant improvements in efficiencies that were achieved by all three businesses over the 2014-19 period.

The achievable savings for NSW customers are summarised below in **Figure 2**.

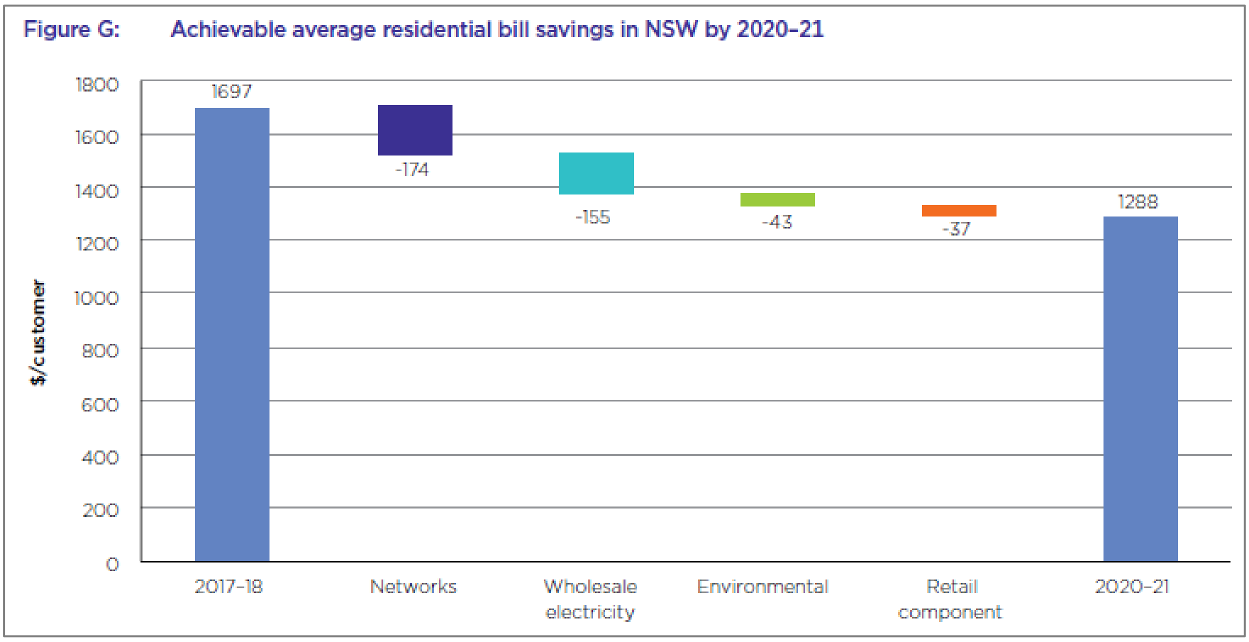

Figure 2: Components of achievable bill savings – New South Wales (Source: ACCC)

OBSERVATIONS OF GOOD ENGAGEMENT

One of the core objectives for the CCP is to provide advice to the AER about the consumer engagement undertaken by network businesses and the effectiveness of this engagement. We were aware of some of the uncertainty that network businesses were reporting about better understanding the expectations and obligations for consumer engagement. So CCP10 met with each of the four businesses as soon as practical after our appointment and highlighted that we would be considering each network's engagement by reference to three broad questions:

- What was tried?
- What was heard?
- What was applied?

In addition, CCP10 encouraged the distributors and the AER to adopt a 'no surprises' approach to engagement and discussion, with the intention of difficult discussions and possibly contentious positions being raised and resolved during the process.

The concept of a proposal that '*is capable of being accepted'* was also generated in our discussions, further reinforcing the approach to resolve key issues as they arise, and have as many issues as possible resolved before the publication and lodgement of the proposals. Such an approach is intended to efficiently reduce the costs for all stakeholders inherent in the preparation and defence of revenue submissions in the propose-respond model, leading to a more understood, engaged and supported outcome for all stakeholders.

We said that we did not expect any particular engagement model to be pursued, rather that the main focus for us would be to consider how consumer views have been applied to regulatory proposals that were lodged.

Each business used different engagement methodologies and worked to very different time frames. Some were infuriatingly tardy in demonstrating what we considered good consumer engagement practice to be. However, we are confident in asserting that all four businesses have dramatically improved their consumer engagement through both the development of their regulatory proposals and in finalising the remitted decisions and we are confident that the expertise acquired and skills applied will have ongoing benefit to the businesses and consumers they serve. Our concern is to ensure that the engagement becomes part of BAU business planning cycles for each business now during the regulatory cycle and that engagement doesn't stop and start up again in 3 years' time.

We congratulate the four businesses for the significant progress they have achieved in developing their consumer engagement practice and in particular the significant internal culture shifts that have been achieved.

At the ENA annual dinner in December 2018 Essential Energy was awarded the ECA/ENA sponsored consumer engagement award, the second year that this award has been offered. CCP10 has been able to observe much of the engagement approaches applied by Essential Energy over the better part of two years and congratulates them on the leadership they have shown in consumer engagement and in being the first business to resolve its remittal process. Their leadership has operated as a benchmark in NSW with wide ranging impact on the other businesses. We believe that Essential's award win is well deserved.

Good practice in consumer engagement

We observe that good consumer engagement practice involves three sets of relationships.

i. *Relationships Internal to the business*

Good practice for consumer engagement starts with the Board and CEO being committed to improving consumer engagement practice including regularly reviewing engagement measures. It involves an internal shift away from primarily relying on engineering plans to a focus that is centred on consumers' needs and a consideration of what consumers are prepared to fund. Essential Energy's CEO along with senior staff demonstrated their commitment through their attendance at a number of regional deliberative forums where it was evident that they were listening closely to their customers.

Staff responsible for consumer engagement need to be closely linked with regulatory staff and other decision-makers so that there is internal consistency in a businesses' commitment to its customers. Another thing we observed was differing levels of feedback from customers being reflected in the Revised Proposals by the businesses. Sometimes, consumer feedback was diligently recorded but led to no changes to the proposal. In other cases the feedback was acknowledged by the business but the inflexible internal processes required to respond to the feedback meant that last minute changes were put to consumer groups who by then had limited resources to respond to the late revisions.

We have seen very clearly over the last two years the importance of businesses being able to be brutally honest with themselves in understanding how they are perceived by customers, consumer groups and stakeholders and to be able to hear the bad news, as well as the good news, and to respond proactively.

Good communication is essential for effective engagement and in particular strategies are needed to inform those consulted about what the business has heard from them and the responses they are making. Consumer engagement is not always about agreeing with a group of customers, it is about taking seriously and looking at all practical measures to address concerns raised.

ii. *Relationships with the regulator*

Old habits die hard and the adversarial relationships that have largely existed between Australian network businesses and the AER needed to change and have changed dramatically over the last couple of years. An important driver is that network businesses and the AER need to be able to talk to each other often and with transparency. Where a problem is identified, it needs to be tested and solutions found to resolve the agreed issues. A recent initiative is the engagement of the AER staff, particularly in the capex team, with the engineers of the 3 NSW businesses. AER staff has engaged prior to the AER making its Draft and Final Decisions and have shared their concerns with proposals and modelling. This has given the businesses an opportunity to respond to those concerns and adapt their proposals. This is also building greater transparency in decision-making and is only possible in an environment where the threat of litigation is largely removed. We congratulate the

AER capex team for their responsiveness to our suggestions to be more transparent with their early modelling and any concerns in business cases and for this greater openness. We have specifically encouraged each business to work with the AER repex team to improve the AER's RIN data and repex model as we believe it is critical for consumers and businesses to have confidence in the model as a cross check, given the likely capex investment that will be needed in the future in new technology platforms. We commend Ausgrid, in particular, for embedding this commitment into their Revised Proposal.

iii. Relationships with consumers

Emerging better practice for consumer engagement includes network businesses producing a realistic draft revenue proposal (often referred to as a Draft Plan) at least six months before it is due with the AER and for active consultation with consumer groups, consumers and other relevant stakeholders on the Draft Plan. ElectraNet (the winners of the inaugural ECA/ENA consumer engagement award), Australian Gas Networks and TasNetworks initiated this approach. Each of the ACT /NSW businesses were intending to apply this approach. However, we suggest that for a variety of reasons including their historical adversarial relationships with the AER and consumers which had led to a history of ambit claims, they were not able to implement the approach as smoothly as they would have liked. We note that electricity and gas network businesses submitting regulatory proposals after these four businesses are releasing draft / preliminary plans for consultation. We regard the ACT/NSW distribution businesses as being in transition towards widespread application of draft plan approaches.

Engaging about the Draft Plan for about 18 months before it is released and then allowing about six months for more focused engagement in consultation is good practice and warrants ongoing encouragement and development.

The term "deep dive" became inextricably linked with the New South Wales businesses, particularly as they sought to make best use of the extensions they were granted. The efforts in seeking to gain consumer insight through deep dives were significant and commendable. We observe that some of the learning from the various processes called "deep dives" have included the value of keeping deep dive consultations focused on particular, more difficult issues where the network is genuinely seeking consumer and stakeholder input. It is our observation that deep dives work best when they involve a relatively small number of people, including the relevant AER staff and AER technical advisers and consumer groups, who are able to report back to a broader base. Deep dives need to be about seeking solutions rather than seeking to convince. The main issue we observed in the NSW deep dive processes were that they were far too late in the regulatory process. We commend Endeavour for continuing to engage on both its capital contributions policy and capex proposal prior to the AER publishing its Draft Decision and reducing its capex proposal. We also congratulate Ausgrid for the extensive consumer engagement on many aspects of its Revised Revenue Proposal. More recently Evoenergy had discussions about its IT proposals with CCP10 and its Energy Consumer Reference Council (ECRC) after the AER's Draft Decision. We note that the timing in all three cases was not ideal. However, CCP10's firm expectation is that such a late extensive, intense deep dive process with extensive revisions so late in the process would not occur next time. It can partly be explained as a feature of the unique need to reset the NSW and ACT businesses' relationships with the AER and consumer groups.

"Deliberative forums" were also developed through the NSW processes and proved to be a very effective approach. The general model is that groups of 60 to about 80 consumers are brought together for about 4 hours, and spend most of the time working in facilitated groups of 8 to 10 people dealing with a maximum of three significant issues of the period. Returning to groups involved with initial deliberative forums has also proved to be very helpful.

Another feature of emerging consumer engagement involves businesses establishing ongoing consultation committees such as TransGrid's Powering Sydney's Future. We commend Ausgrid for initiating its Network Innovation Advisory Committee (NIAC), which embeds consumer input into Ausgrid's technological transition to the smart grid. We would encourage the other distributors to also think of opportunities, which embed ongoing consumer input as part of their planning and innovation for critical areas. We have previously encouraged Endeavour to consider this approach to manage the development of the second airport.

Other examples of innovative consumer engagement practices that we observed included:

- openness to having difficult conversations
- proposals being presented as a decision as a whole
- readiness to engage on capital expenditure plans, risks, drivers and objectives
- more active engagement with the AER on issues such as repex modelling and risk quantification and allocation
- recognition of the importance of productivity improvements
- challenging thinking on the application of capex / opex trade-offs (e.g. DM)
- review of network risk position, especially for network augmentation and replacement
- much more interactive and conversational relationship with advocates and the AER
- progressive refinement of ideas involving frequent conversation
- cost-effective catering with a broad range of healthy options
- openness to working with other businesses on common issues such as tariff impact modelling and grid innovation
- greater public acceptance (by some of the businesses) of AER decisions on framework changes e.g. WACC, tax review and productivity
- preparedness to establish ongoing consumer / stakeholder oversight framework
- giving up CESS for certain categories of expenditure
- seeking feedback on drafts of Revised Proposals and

- a desire – initially demonstrated by Essential Energy at the initial proposal, then subsequently by Endeavour Energy and Ausgrid in their Revised Proposals – for their proposals to be supported by consumers and capable of acceptance by the AER.

Further development of good regulatory practice

The process in developing the New South Wales and ACT regulatory proposals for 2019-24 and resolving the remitted decisions for 2014-19 has been a sometimes-arduous process dealing with significant change across a number of fronts. As indicated above, the periods of pain and frustration have been justified and significant outcomes achieved for consumers and the businesses through the 'journey'. CCP10 has been told by several stakeholders that the process of resolving the remittals has led to greater trust by internal stakeholders, including investors, which in turn has led to greater transparency in engagement by the businesses with the AER, CCP10 and other consumer groups around the subsequent 2019-24 revenue proposals.

There are important next steps that need to be undertaken to embed the processes, relationships and culture improvements that have been achieved. These include:

- regulatory processes to *reward good practice*. In our first submission, CCP10 encouraged the AER to develop 'signals' for network businesses to encourage ever better consumer engagement practice and to develop rewards / incentives for those businesses that do it well. A regulatory proposal that is lodged following extensive engagement and dialogue with relevant AER teams and is capable of or very close to being capable of acceptance, should be encouraged and rewarded. We understand that steps have been taken to this end, but it remains unfinished business.
- Each network business needs to *further embed their consumer engagement* practices and to retain relationships developed with consumers and consumer groups throughout developing the regulatory proposals and to provide feedback to those who have provided input so far.
- *Review the AER's Better Regulation Consumer Engagement* Guideline for Network Service Providers November 2013 to reflect a more sophisticated understanding of the outcomes of consumer engagement and a consideration of best practice.
- *Resourcing for consumer engagement* continues to be a dilemma with no dedicated resourcing currently available to enable consumer groups to maintain relationships with network businesses. It is hoped that the COAG Energy Council will return to the question of resourcing for consumer engagement in network processes early in 2019.
- Increasingly CCP is being asked about the future of network regulatory processes in Australia, and we consider that the time is ripe for discussion about a rolling network regulatory process where the *focus is on ongoing relationships* rather than it being a major focus once every five years.
- For CCP and the AER, an emerging question is about relationships with network businesses beyond the release of a final determination. On current AER practice CCP10 will cease to exist in April 2019 when the AER publishes its final Decisions in the four 2019-24 processes. Network businesses and their consumer reference groups are increasingly asking about *potential for ongoing CCP engagement*. For

example, CCP members have been asked to participate in TransGrid's Powering Sydney's Future processes and most recently by Ausgrid in its NIAC and Pricing Working Group.

CCP members have developed an intimate understanding of the plans and operation of the 4 businesses, and have in many ways grown trusted and informed relationships with senior management of those businesses. Consideration of how ongoing relationships can continue, whilst respecting the fundamental role of consumer challenge, would be helpful.

- Just as a more regular, transparent and cooperative relationship between utilities and their customers is being encouraged and is proving beneficial, CCP10 has observed significant benefit in the *early engagement with the AER* as part of the reset process. Sharing ideas and challenges, understanding the implications of organisational differences and the sharing of common ideas and initiatives has proven valuable and significantly streamlined the processes inherent in the regulatory reset.

We recognise that the AER cannot and should not compromise its 'arms-length' relationship with utilities, nor is the AER the primary channel for information sharing. Resource availability is also a major consideration.

Further development of the interaction with utilities, particularly when approaching revenue resets, will prove valuable in leading to an efficient and transparent process, supporting the submission of proposals that are 'capable of being accepted'.

CHANGING PRIORITIES FOR NETWORK REGULATION

In the past 12 months, most Australian distribution utilities have undertaken some form of community engagement related to their regulatory revenue resets. CCP10 has been heartened to see a marked change in the nature and content of this engagement by a number of progressive distributors, not only in their collaborative approach to engagement, but importantly as a reflection that these companies are embracing changing customer and community expectations in the modern energy environment, and are prepared to share this journey with their customers.

Leading utilities demonstrate a willingness to reconsider electricity supply risks in light of changing consumer expectations around price and productivity, seeking new and innovative ways to engage communities and use new technologies to meet their obligations and community requirements. Volumes of traditional network planning and investment analysis - whilst still important inside the organisation - gives way to a more conversational, relevant, risk-based and innovative attitude to providing network capacity, meeting system performance obligations and optimising customer interactions.

Such an approach is underpinned by three key issues. Firstly, with Australia's energy customers experiencing remarkably high energy prices, every participant in the energy supply chain has a responsibility to take all reasonable steps to minimise the cost of energy distribution - and therefore customers' energy bills - as much as reasonably possible. CCP and other customer advocates look for a clear commitment by the utility to seek every opportunity to reduce the cost of addressing network constraints, through the mantra '*doing more with less'* and '*not a dollar more than necessary, not a day too soon'.*

Secondly, as the growth of the asset base presents a long - term risk to high energy prices for many years to come, consumers expect that every effort is being made to minimise growth in the total value of long-term assets, especially in this environment of rapidly changing energy use and technology uptake by consumers.

Finally, as changing technologies become more available to customers and utilities, meeting network obligations is much more a collegiate and interactive process. A responsibility exists on customers, distributors and new industry participants to collaborate in the effective utilisation of existing assets, and to seek innovative approaches for the safe, reliable and affordable supply of energy.

Throughout the process of the NSW and ACT 2019-24 regulatory determinations, a number of common matters arose that were of concern to CCP10, energy consumers, utilities or both. Many of these matters represented significant expenditure and therefore impact on consumer bills. We summarised 9 issues in our presentation on the NSW Proposals at the Stakeholder Forum on 13 November 2018[2]. CCP10 is very pleased that the 2018 rate of return Guideline and changes to the PTRM to reflect the issues in the tax review have been resolved in a timely way so that they can be incorporated in each of the NSW and ACT Final Decisions.

We are also pleased that both opex productivity and tariff reform are currently being progressed by the AER in time to be reflected in these 4 2019-24 determinations.

Opex, Productivity and Benchmarking

CCP10 argued consistently throughout these revenue resets for the AER to review its zero assumption when forecasting productivity. The issue was given prominence by Essential on 9 February 2018 when Essential launched its draft Proposal, which included a significant opex productivity dividend for consumers. In fact, Essential included forecast declining opex, forecasting savings from its IT initiatives, as its opex forecast gave consumers 100% of the savings from that IT investment rather than sharing those efficiencies through the EBSS.

CCP10 and the CCP as a whole are very supportive of the AER's draft decision to revise its assumption from zero to 1% per annum in its recent Draft decision paper – Forecasting productivity growth for electricity distributors dated November 2018. We see the AER's Draft decision as a positive start.

We strongly support the CCP sub panel's submission dated 21 December 2018 to the AER's review, which concluded:

> "*The objective in forecasting opex for the revenue resets is to establish the* ***best available unbiased estimate of the opex for a prudent and efficient operator***."

[2] https://www.aer.gov.au/system/files/Consumer%20Challenge%20Panel%20%28CCP10%29%20-%20Presentation%20to%20AER%20public%20forum%20-%20November%202018.pdf at slide 41

> And........ *"In the CCP's view the current assumption of zero trend productivity improvement does not meet these requirements and* ***we consider that the data supports an assumption of a trend productivity improvement for the DNSPs of at least 1.5-2.0% pa****."*

We commend Essential Energy for its leadership in offering a productivity dividend even before the AER had launched this review.

We also congratulate Ausgrid as the first privately owned DNSP to include a 1% per annum opex productivity improvement from 1 July 2020 for consumers. We commend Ausgrid for listening to its customers' consistent submissions that zero productivity is unacceptable. We will leave it to our CCP colleagues to respond in detail to the various DNSP submissions arguing against the AER's Draft Decision. We note that both Essential Energy and Ausgrid have offered productivity dividends and we urge the AER to also apply its Final Decision from its review to each of the 4 businesses.

As we discussed above, the use by the AER of benchmarking as part of its consideration in the original Final 2014-19 decisions was keenly contested. In our Response dated 30 November 2017 to the AER Issues Paper: *Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure*, CCP10 emphasised that we remain strongly in favour of the AER using benchmarking as an assurance tool to cross check forecasts of the distributors.

We are concerned now the 4 businesses will have transitioned to the efficient base year for 17/18 originally determined by the AER, that the AER may reduce its ongoing investment in and reliance on benchmarking as one tool to promote efficient operating expenditure. In our submission from November 2017 we went to some length to discuss the critical ongoing importance of benchmarking. This was set out in Appendix A to our submission entitled "*Incentive Based Regulation and the role of benchmarking*."

We concluded that CCP10:

- is strongly in favour of the AER using benchmarking as an assurance tool to cross check forecasts of the distributors
- supports the AER's annual benchmark publication and strong incentive-based regulation (IBR) as discussed in the attached "*Incentive Based Regulation and the role of benchmarking*" and
- favours stronger, future incentives than the EBSS and encourages the AER to do an international review to check world's 'best practice' for IBR mechanisms.

We urge the AER to commence a thorough review of all its incentive schemes. We also encourage the businesses to continue to work with the AER on refining RIN data and the benchmarking model as it remains an important cross-check tool.

Tariff reform

Evoenergy remains one of the stand out businesses in the NEM on its transition to cost reflective tariffs. By contrast during the current regulatory period and TSS 1 we observed of "*the three New South Wales distribution networks:*

- *to date, reform has been slow and fragmented;*
- *there has been no single consumer perspective; and*
- *there has been remarkably little dialogue between retailers and network businesses about the incidence of tariffs.*

> *The CCP view is that retailers should be much more actively involved in network tariff debates and indeed the primary audience for network tariff price signals should be retailers rather than customers. CCP10 has been instrumental in encouraging consumer groups to develop Pricing Directions that have been developed to provide cohesive consumer perspective to assist networks, retailers and AER to accelerate reform*".[3]

Our observation is that the development of a cohesive position by customer stakeholders in the Pricing Directions made it easier for stakeholders to respond. For example, Endeavour responded to customer feedback and the Pricing Directions by introducing a TSS as part of its Initial Proposal that met tariff reform objectives by including a transitional demand tariff. The ACCC favourably referred to the Pricing Directions in its Final Decision in the Electricity Inquiry and recommendation 14 in the ACCC's Final Report on Electricity Pricing endorsed many of our recommendations[4]. The AER has since responded to the progress made in NSW by creating a dedicated CCP subpanel 21 to assist in driving tariff reform. Subject to sufficient resourcing the aim of CCP21 is to:

- engage with retailers on their role in working with consumers. CCP believes that it is critical for all stakeholders to understand how the retailers will flow though network tariffs into retail prices and what products/price structures they will offer
- work with ECA, DNSPs, and the AER on impact analysis at the household level and
- develop complementary measures. CCP intends to work with customer advocates, networks, retailers and AER on these.

The work in tariffs driven by the CCP and the AER TSS team will have greatest impact if it is progressed on a NEM wide basis involving all stakeholders.

The revised Tariff Structure Statements of the three NSW businesses have responded further to consumer feedback about the need to shift more rapidly to cost reflective pricing

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[3] CCP10 Response to AER Issues paper and revenue Proposals for NSW Electricity Distribution Businesses 2019-24: August 2018 at page 77. See https://www.aer.gov.au/system/files/CCP10%20-%20Submission%20-%208%20August%202018_0.pdf

[4] https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_0.pdf

and CCP10 commends the three distributors for engaging in detail with stakeholders, CCP21 and the AER TSS team to progress tariff reform. This will remain an important focus in the NEM during the next decade.

A shifting focus in consumer priorities

In the environment of a more active and engaged revenue reset process, it is clear that the influence of new technologies, customer choice, price awareness and sustainability imperatives is changing the way utilities approach their obligations.

Network augmentation and capacity investment is now much more influenced by new customer technologies and market developments. As asset replacement requirements mature and demand growth slows, the key variables in assessing prudent investment are changing. The focus on demand management is now matched by the importance of utilisation of existing assets. Traditional network control has given way to Distribution System Operation (DSO). Information and data in real time is the cornerstone of optimal network investment. New connections incorporate a wide range of energy and demand control options available to the customer, many of which are not yet understood. The market influence of embedded generation and storage, or more importantly the variable influences on those who seek to control that new equipment is yet to be established and understood.

Significantly, the robustness of traditional engineering planning and network development now incorporates the approach of 'least regrets', where risks inherent in rapidly changing network requirements cannot be quantified with certainty.

As the relationship between CCP10 and both the AER and the network businesses developed over this regulatory period, it has become clear to CCP10 that there are aspects of the engagement and proposals that would benefit from further consideration by the AER to apply on a broader NEM wide basis. The intent is to foster work practices, language and behaviours that will encourage utilities to present information to consumers and the AER in a more effective way, by using common language, more standard definitions and a format that makes the impact and benefit to consumers more obvious and measurable.

The areas that we have identified as highest priority in delivering significant value are listed below.

i. *Consider the prudency of Information and Communication Technology (ICT) investments*

The ICT investment by utilities is growing rapidly as the role of corporate support systems, real-time control systems, data gathering, and data analysis plays a much greater role in delivering business efficiencies; both in the operation of the business itself and the optimal investment, operation and risk management of the distribution network. CCP10 acknowledges that ICT expenditure will genuinely be an item of increasing expenditure over the next twenty years. However, utilities need to be held accountable for these significant and growing-investments in Information and Communication Technologies.

Similarly, consumers need to be more informed of the requirements, benefit, prudency and risk implications of investment in ICT and related assets, as they gain an increasing influence on business performance and efficiency (and hence operating cost), depreciation (again, influencing price to customers), data risk, service delivery, customer choice and network supply risk and performance.

We recognise that each utility is encouraged to seek new and innovative ways to work with customers, the community, the regulator and other stakeholders. However, a number of significant matters are arising in the industry generally that lack transparency and clarity of definition and approach. Unless addressed in a common and effective way, the risk continues that this growing area of investment may not be fully in the interests of consumers.

A number of specific concerns exist regarding ICT spend, both as operating costs and the return of investment in new capability.

1. The quantum and impact of significant ICT expenditure by all utilities affects all customers
2. A single provider, SAP is emerging as almost a monopoly provider of utility enterprise systems, and the accountability and influence this provider has on the cost of ICT operation and regular investment is not at all transparent.
3. The efficiencies that businesses gain through ICT investment, the cost of which is largely recovered from customers, should not be recovered again through the incentive schemes.

In their regulatory proposal, Essential Energy is commended for linking the increased investment in ICT capability with performance improvements that are specific and measurable. Whilst we expect that there will be significant challenges in demonstrating the performance change resulting from the technology investment, Essential's commitment to visible benefits for customers sets a new benchmark for ICT investment in the regulatory proposals.

In response to CCP10's ongoing concerns about IT expenditure we are pleased that Ausgrid has committed in its Revised Revenue Proposal to share further granularity of customer benefits derived from IT expenditure and to support an industry wide review by the AER into IT forecasting to improve expenditure assessment.

CCP10 recommends that the AER and community advocates take a stronger role in the understanding of the prudency of ICT investment by utilities. We support the recent advice by the AER to consider the establishment of greater skills in this area, and encourage the AER to work with utilities to present the value and risks of ICT investment to consumers in the form of transparent, measurable and specific performance improvement.

ii. Clarify the value of the transition to the Distribution System Operator role

A combination of high retail electricity prices, falling prices for customer technologies and continued subsidies for embedded generation and energy storage has created a confused, crowded and rapidly-changing environment for utilities to respond to.

Supported by a range of largely independent approaches from the AEMC, AEMO and governments, utilities are attempting to embrace the growth in DER in different ways.

Common to this challenge, utilities are proposing expenditure to expand monitoring and control of distribution networks, enhanced centralised network control systems (ADMS) and speculative capability to work with demand aggregators and AEMO as the need arises referred to as a DSO model. Most of this investment is under the banner of 'least regrets'. It is unclear just whose regrets are being minimised – those of the distributor who remains largely capable of recovering the expenditure; or those of the customer (generally, all customers) who it is suggested Is not in a position to understand just what it is that they are regretting.

There is a significant risk that investment in transmission systems under the ISP will address some of the concerns that are planned to be subject to investment by distributors, leading to stranded assets in the area of data gathering and local network control, as well as restrictive connection requirements affecting customers.

Missing also in this planning is the 'customer view' and where the customer impacts and the expected role of customers in any solution are considered and tested through public and specialised engagement. Issues such as direct and indirect costs to customers to participate, technical requirements, contractual matters and similar are still to be addressed.

At the risk of entering an already crowded space, CCP10 recommends that the AER assist in clarifying the problem statement, range of solutions and form of cost–benefit analyses that are expected from distributors. This information can form the basis of further consumer engagement.

As part of the analysis of the impact of the growth of DER, the wider market of aggregators, retailers and new market service providers should be actively considered to determine what role these market entities can undertake as the uptake of DER continues.

iii. Support greater pace of the adoption of Advanced Metering

A number of times throughout the regulatory reset process, the issue of a better understanding of a customer's energy use arose. This came up in a number of contexts, including tariff design and adoption, the optimal integration of DER and improving the assessment of supply risk associated with network development.

At all times, the obstacle was that the AMI rollout is largely set in priority and location by energy retailers who have a different set of priorities and drivers for promoting the growth of smart metering and AMI.

CCP10 believes the AER can investigate the claims by the distributors of missed opportunities for prudent and effective investment in networks arising from the implications of the Power of Choice (metering) framework.

iv. Explore opportunities for more efficient engagement on network development

In concert with the work undertaken by CCP20 (Regulatory Investment Test), it is becoming clear that the engagement by the community, customers and potential solution providers in the capital investment process is not effective.

Significant in this situation is the resource commitment by utilities and potential respondents to prepare, consider and implement plans that can assist the reduction in investment in the traditional network assets of poles and wires, cables and substations.

Consumer and industry representatives highlight the disincentive as a result of the large investment in time and resources to consider not only the capital investment plans of each utility, but their voluminous Distribution Annual Planning Reports (DAPR) and required information under the Regulatory Investment Test – Distribution.

As network investment opportunities shift to considering more cost-effective customer options, there is a powerful incentive to improve the application and effectiveness of the intent of demand management and network efficiency through a more coordinated, and seamless process to engage the community on network growth matters.

CCP10 acknowledges the work done by Endeavour Energy in developing an online and interactive DAPR, which is a useful step in enhancing the effectiveness to deliver non-network solutions to demand growth.

v. Form a common view on the cost to address cybersecurity risk

CCP10 has observed each distribution business taking a different approach to cybersecurity risk, leading to varying impacts on the cost to consumers through both operating expenses and capital investment.

Against the background of an increasing reliance on technology for the efficient operation of the network and the businesses themselves, the establishment of standards and a measured assessment of the businesses' response to those standards – much in the way other significant investments in assets are considered – will be of value in maintaining a focus on the long-term interest of electricity consumers.

CCP10 recommends further engagement and skill development by the AER in the area of cybersecurity and its cost and risk impact to customers and the wider community.

SECTION 2

CCP10's response to Endeavour Energy's revised regulatory proposal of January 2019

INTRODUCTION

This section 2 considers responses to the Endeavour Energy revised revenue proposal dated 8 January 2019 (Revised Proposal) following the AER draft decision dated 1 November 2018 (Draft Decision). The approach we have taken is to only consider those issues that we raised at the public forum on 13 November 2018 about the Draft Decision and matters of particular interest from the Revised Proposal.

Matters that are not covered have either been dealt with previously or we are satisfied with the Endeavour Energy position.

CCP10 is pleased that Endeavour Energy has accepted a large proportion of the matters raised in the AER Draft Decision. Similarly, the revision of the capital expenditure requirements undertaken by Endeavour in their initial proposal reflected a significant commitment to address the concerns raised by consumer groups. Endeavour Energy's commitment to no real price increases is consistent with the long-term objectives of consumer groups and advocates.

Consumer groups are generally wary of the often - overstated claims by network businesses about how different they are from other businesses and so need to be treated differently. CCP10 acknowledges that there is some substance to such claims for Endeavour Energy. We recognise that Endeavour's network services are required to meet the needs of one of the fastest growing regions of Australia, with significant increases in population expected over the coming decade and beyond. Endeavour Energy also serves the location of the long awaited second airport for Sydney, which also provides something of a point of difference from other network providers.

As noted in our response to the initial Regulatory proposal, these new developments provide significant opportunities for Endeavour Energy.

The Revised Revenue Proposal from Endeavour Energy is for a total of \$3,687M (real 2-18-19), which is a small reduction of \$45M (1%) when compared to the AER's Draft Decision of \$3,732M and 5% less than the initial proposal. This change is shown in Figure 1 below. When the influence of the 2014-19 remitted decision and the change to the taxation allowance is factored in, the revenue requirement is largely unchanged from the AER Draft Determination.

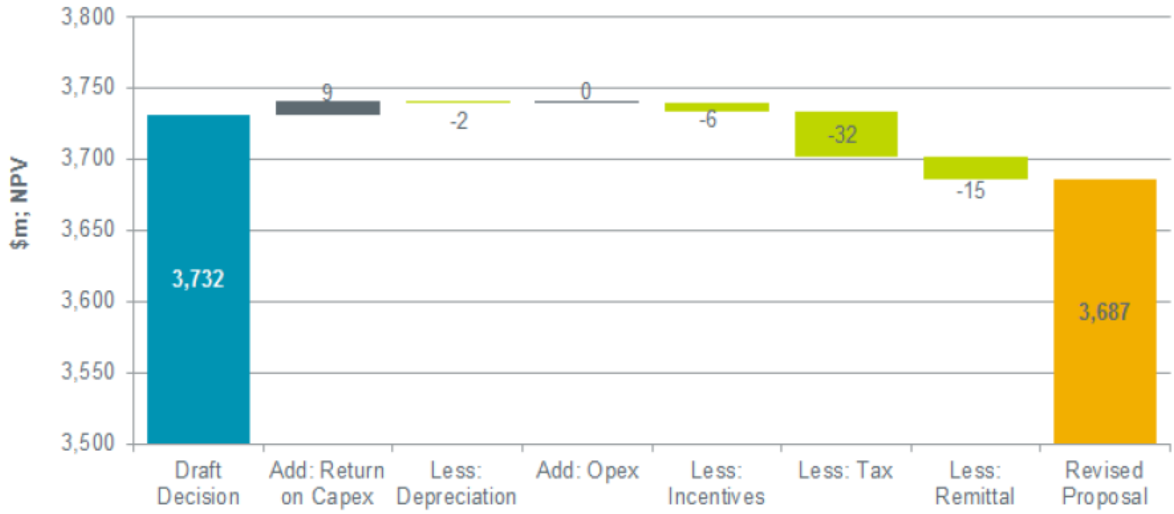


Figure 3: Revised revenue requirement (nominal, NPV) compared to the AER Draft

(Source Endeavour Energy Revised Revenue Proposal, figure 5)

Three matters remain unresolved in Endeavour Energy's Revised Proposal from a consumer point of view. Each are discussed in detail further in this response.

Firstly, we note the significant effort Endeavour Energy has invested in taking a contrary position on **operating productivity**. CCP10 sees this position as being a significant departure from the strong views expressed in related work by consumer advocates in the wider revenue reset environment as well as at odds with other DNSPs such as Ausgrid, Energy Queensland and Essential.

Secondly, Endeavour Energy has not fully supported the AER's **return on capital** in its final Rate of Return Guideline, which we note is binding, nor has it expressly committed to adopting the changes from the AER's recent **tax review**. Again, we view this as inconsistent with the long-term interests of consumers and at odds with the position taken by other DNSPs.

Thirdly, our position on the additional funding for the establishment of new electricity supply to the **greenfield Western Sydney Airport** area is one of tacit support. We believe that Endeavour Energy has responded reasonably to community concerns by scaling back the scope of the project and has provided further information regarding the likely need for the work. Our concerns remain around whether the project justifies the additional funding beyond that agreed in the Draft Decision.

CCP10 believes Endeavour Energy's Revised Proposal is capable of acceptance, subject to:

a) **the AER's review of the revised capex proposal of $1739.6M, and**

b) **a decision by the AER to adopt a trend productivity adjustment of at least 1% per annum and the inclusion of the changes to the PTRM from the Tax Review.**

Without these conditions, it cannot be said that the Revised Proposal fairly and meaningfully reflects the outcomes of Endeavour's intensive and otherwise effective engagement with consumer groups.

CONSUMER ENGAGEMENT AND RECENT DEVELOPMENTS

Consumer engagement has been a significant journey for the consumer groups and Endeavour Energy during the phases leading to the presentation of this Revised Proposal. We commence our consideration of the consumer engagement undertaken by Endeavour Energy by acknowledging a quote from their Revised Proposal:

> *"Our goal over the past two years has been to substantially improve engagement and build on the extensive engagement we have undertaken since 2012.*
>
> *We have spent more time consulting and listening and less time informing. We agreed on a principle of 'no surprises' and focused conversations on tough issues in our expenditure proposals, explaining risks and trade-offs and teasing out realistic alternatives where possible. This helped to build genuine respect and understanding, and narrow the gap where opinions differed. We also sought expert advice, broadened the involvement of our executive team and increased resources.*
>
> *Finally, we tried some new engagement processes that had not been used by network businesses before. We responded to feedback from the AER's Consumer Challenge Panel and ran a series of 'deep dive workshops' which were co-designed to examine expenditure plans in greater detail with our regulator, shareholders, customer representatives, retailers, state and local government representatives, developer associations and Endeavour Energy's senior management team.*
>
> *We have listened harder and adjusted our plans based on what we heard. Our executive team has played the lead role in engaging with both customers and stakeholders which has led to an increased sense of trust in the decision-making process."*

That this statement occurs early in the first section of their Revised Proposal and under a section headed *"1.1 Our New Approach*," is particularly laudable. We have no reason to doubt the sincerity of these comments, their desire to engender trust nor the application of learnings by Endeavour Energy over recent years.

We commend Endeavour Energy on their willingness to spend "*more time consulting and listening and less time informing."*

We understand this comment as being based on the IAP2 (International Association of Public Participation) Public Participation Spectrum.[5]

In its simplest form, the spectrum summarises increased public participation, consumer engagement in this instance, as moving from left to right:

INFORM – CONSULT – INVOLVE – COLLABORATE – EMPOWER

For Endeavour Energy to move their engagement from "informing" to "consulting" is significant progress. The IAP2 spectrum also signals opportunities for further engagement development.

[5] https://www.iap2.org.au/About-Us/About-IAP2-Australasia-/Spectrum

The IAP2 spectrum also provides "promises to the public" (consumers in this case) appropriate to each element of the spectrum. The promise to the public / consumers for the "consult" level of the spectrum is:

> *"We will keep you informed, listen to and acknowledge concerns and aspirations, and provide feedback on how public input influenced the decision."*

The public promise associated with the opportunities of moving to the "Involve" level of the spectrum is:

> *"We will work with you to ensure that your concerns and aspirations are directly reflected in the alternatives developed and provide feedback on how public input influenced the decision."*

We suggest that the next challenge for Endeavour Energy is to move their engagement, in general, to the "involve" level of the IAP2 spectrum.

Endeavour Energy says that they responded to CCP comments by conducting a series of 'deep dives.' As we observed in section 1 above, while CCP10 did not specify any methodology to be applied to accelerate consumer engagement, we were happy to observe the efforts made to develop and implement what Endeavour Energy called "deep dives" and consider that Endeavour has played a useful role in developing this approach and in gaining significant consumer input using the approach. At the Stakeholder Forum on 3rd July 2018 acknowledged the pioneering approach taken by Endeavour Energy with their sequence of 'deep dives' and forums that played a major part in Endeavour Energy 's consumer engagement related to the contents of their regulatory proposal.

In the rest of this section 2, we reflect on the evolution of Endeavour's engagement and the issues that were the focus of debate.

Endeavour Energy lodged its Regulatory Proposal on 30th April 2018, supported by their presentation at the Stakeholder Forum on the 3rd of July.

In our written response to the original Regulatory Proposal in August 2018, a number of matters were raised as opportunities for Endeavour Energy to better reflect the issues raised by consumer representatives throughout the engagement. Those issues included:

- concerns that the revenue requirement that resulted in an annual CPI+1% price rise throughout the regulatory period did not reflect the broad request by consumers for lower energy prices;
- the need for opex productivity;
- despite a continued rapid growth in customer numbers, the increase in capital requirements in the proposal compared to the previous period appeared disproportionate and was not well explained nor justified;
- a proposed change to the capital contributions policy increased the proportion of the customer connections costs borne by all customers through the revenue recovery; and

- an opportunity existed to better explain the proposed expenditure on information technology – both for business support and network operation – in terms of improvements in terms that were meaningful and directly applicable to consumers, such as network performance, increased penetration of Distributed Energy Resources (DER), improved customer service outcomes or, most importantly, reduced costs.

We concluded that Endeavour Energy's Regulatory Proposal was not capable of being accepted as it was not consistent with the long-term interests of consumers. For instance, regarding capital expenditure, we stated:

> *"Despite the strong case for investment to meet the energy demands of new residential and commercial development in the Endeavour area, CCP10 is strongly of the opinion that Endeavour Energy has not made a reasonable case in justifying this significant increase in expenditure above that required for the current period. We believe there is a strong case for significantly reduced investment … as a result of addressing the opportunities noted in this report."*

To their credit, Endeavour Energy in September 2018 chose to take unprecedented action to revise their capital forecast before the AER had released their Draft Decision. CCP10 commends Endeavour Energy for recognising the issues raised by consumer advocates. In our letter to the AER of 21 September 2018, we stated:

> *"CCP10 commends Endeavour for its attempts to resolve the issues raised by customers about its capex proposal. We agree with Endeavour that it is preferable to progress these issues now and not to leave them unresolved until after the AER's Draft decision, consequently we support the reduction in capex proposed by Endeavour Energy for 2019-21, while noting that it is at the 'upper end' of our cost expectations.*
>
> *Whilst the timing has not been ideal, CCP10 commends Endeavour for the revision of its proposal and its openness to constructively consider consumer feedback, some of which has been 'robust."*

In that letter, we discussed that the revised expenditure on asset replacement (Repex) and Network Augmentation, whilst not providing detail on the changes intended by Endeavour Energy, by implication addressed the cost elements of the issues raised in our earlier engagement. We also recognise the decision made by Endeavour Energy to reinstate the previous capital contributions policy, a matter that we appreciate required some difficult conversations with developers and other interested parties.

CCP10 supports the statement by the AER in their Draft Decision regarding Essential Energy's capital investment, where:

> *"Endeavour's reduced forecast has now formed the basis of the total forecast capex we have adopted for the purpose of this draft decision, which better reflects the efficiency gains achieved in the current period.[6]"*

[6] AER Draft Decision, p4

Whilst acknowledging the actions by Endeavour Energy leading to acceptance of the majority of issues raised by the community, we would hope that such an action will not take place again. Whilst by a commercial measure the concerns, other than opex productivity and the new issue of calculation of tax, have largely been addressed, there is little or no transparency into the way Endeavour Energy has approached the revised capital requirement.

Endeavour Energy has largely left it to the AER's analysis to explain the way the new capex target will be delivered, as the Revised Proposal says little publicly about the way the changes to the underlying capital needs were determined, and what impact those changes may have. Consumer groups and stakeholders are largely unable to consider the changes to the network risks, project proposals and efficiency commitments that Endeavour Energy will undertake to meet the new network capital expenditure. The way Endeavour Energy plans to meet the challenges through effective use of demand management (DM), for example, is unclear. Similarly, the matters raised early in the engagement process relating to non-system capital investment remain unaddressed by Endeavour Energy.

Overall though, when considering Endeavour Energy's revised proposal, we commend Endeavour Energy for their action in responding to the concerns of consumers. We note the positive outcomes in the decline in the Regulated Asset Base (RAB) per customer that is now evident across the period (from $6,380 to $6,083), and the real price reductions. We believe that in the face of significant continued customer growth and the pressures such demand puts on the business, Endeavour Energy is demonstrating a reasonable and progressive approach to network investment (and operational efficiency).

We also acknowledged the good work done by Endeavour Energy to include a default transitional demand tariff for new connections and an opt-in cost reflective demand tariff in their Initial Proposal. CCP10 agreed with PIAC in considering the Endeavour Energy draft TSS proposal to be the best of those of the three NSW DNSPs, reflecting the requirements expressed by its customers and consumer representatives. We discuss the revised TSS further below.

REVENUE AND REVISED PROPOSALS 2019-24

Drawing from information from the Endeavour Energy proposals and CCP10 analysis, Figure 4, Figure 5 and Figure 6 below summarise the revenue proposals for Endeavour Energy's activity showing the original Endeavour Energy proposal, the AER Draft Decision and the Endeavour Energy Revised Proposal.

Figure 4 below highlights the significant reduction in the building block revenue from the initial revenue proposal, largely due to the reduction in the proposed rate of return and return on capital from 6.11% originally proposed by Endeavour Energy to 5.74%, consistent with the recent AER Rate of Return instrument.

The fall in the overall revenue requirement and the reduction in the proposed revenue, particularly in the early years of the period, reflect the views expressed by consumer groups.

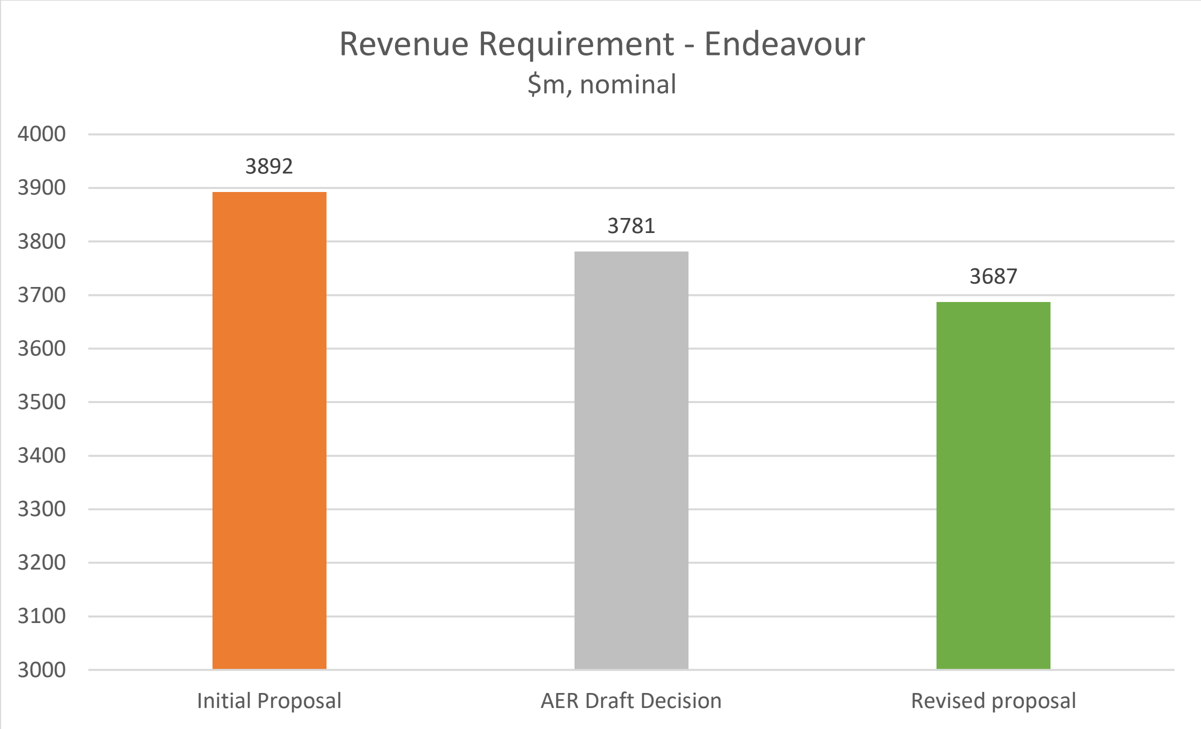
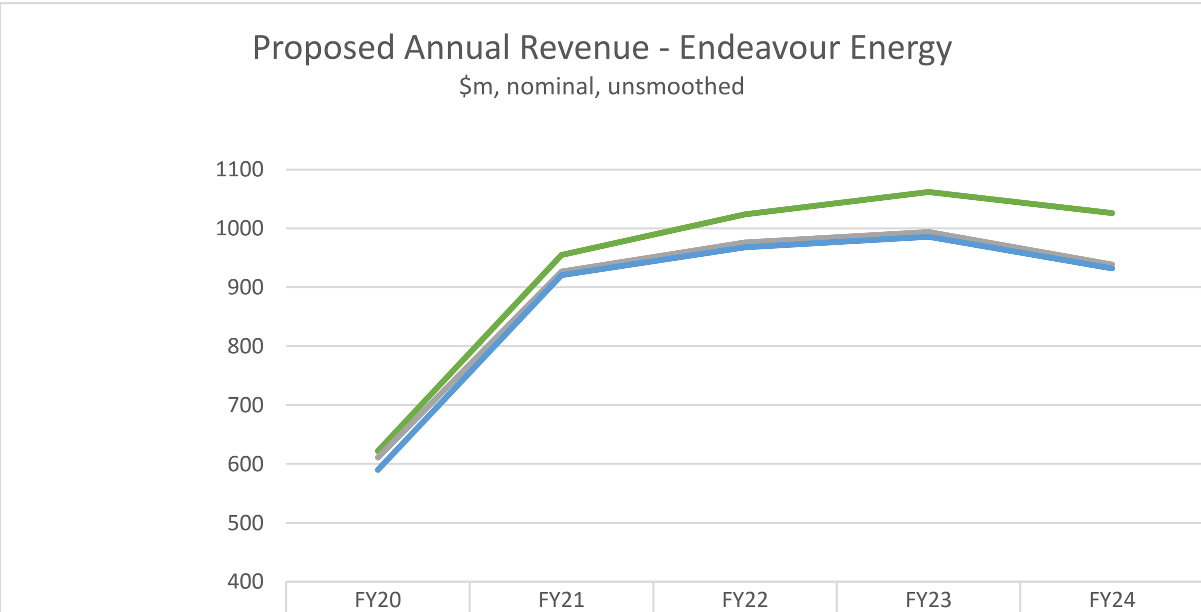


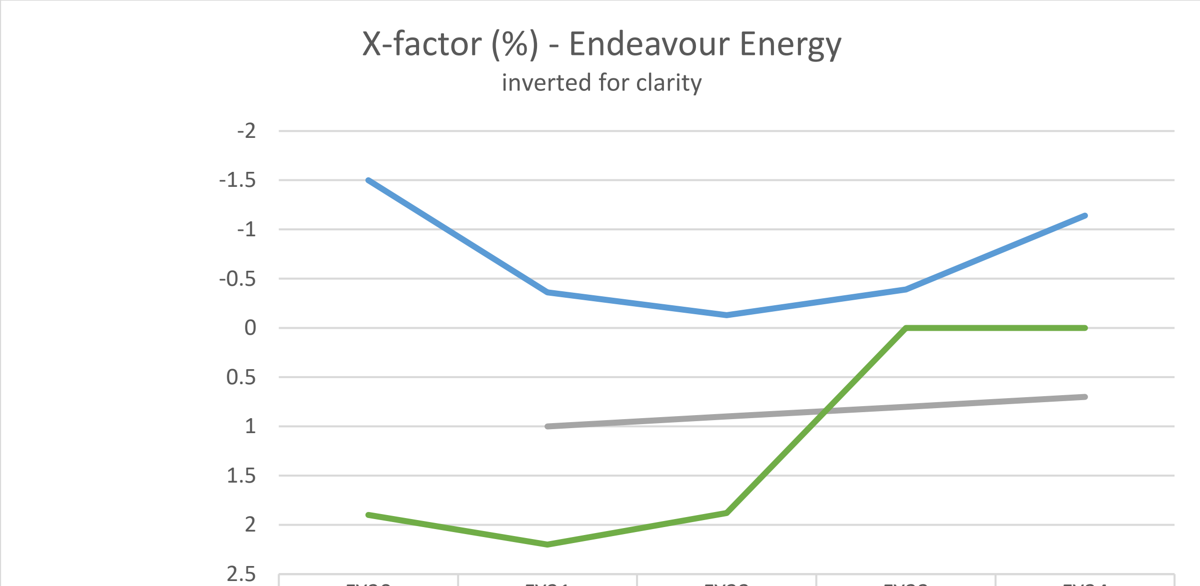
Figure 4: Annual Revenue Requirement - (Source: Endeavour Energy, CCP)

We also note reductions in operating expenditure, consistent with the preference that was evident in much of the consumer engagement.



	FY20	FY21	FY22	FY23	FY24
Intial proposal	622	955	1024	1062	1026
AER Draft Decision	611	927	976	994	939
revised proposal	590	921	968	986	932

Figure 5: Annual Revenue Requirement – Endeavour Energy (Source: AER, Endeavour Energy)



	FY20	FY21	FY22	FY23	FY24
Intial proposal	-1.5	-0.36	-0.13	-0.39	-1.14
draft decision		1	0.9	0.8	0.7
revised proposal	1.9	2.2	1.88	0	0

Figure 6: CPI -X-factor for Endeavour Energy (Source: AER, Endeavour Energy)

REGULATED ASSET BASE GROWTH

Endeavour Energy has for some years - and clearly continues to - meet strong growth in customer numbers. This growth is reflected in the network augmentation investment planned. A reduction in the value of the RAB per customer is a key component of our assessment that capex investment is in the long-term interests of consumers.

Pleasingly, we commend the outcome of Endeavour Energy's revised capex forecast, noting:

> *"This revised capex forecast results in RAB per customer reducing from $6,326 at the end of 2018-19 to $6,053 in 2023-24 (in today's dollars)* [7]*."*

[7] Endeavour Energy Revised proposal, p8

CAPITAL INVESTMENT (CAPEX)

Introduction

CCP10 and other consumer advocates have been very clear of their expectation that the distributors in New South Wales strive to capitalise on their enhanced asset base by focussing on maximising utilisation of existing assets and reconsidering risk parameters in future network plans based on the benefits that increased network security can deliver.

In our response of August 2018 to the initial Proposal by Endeavour Energy dated 30 April 2018, we highlighted:

> *"Despite the strong case for investment to meet the energy demands of new residential and commercial development in the Endeavour area, CCP10 is strongly of the opinion that Endeavour Energy has not made a reasonable case in justifying this significant increase in expenditure above that required for the current period. We believe there is a strong case for significantly reduced investment, even to the order of 20%, as a result of addressing the opportunities noted in this report."*

Specifically, our concerns related to:

a) the case for the decrease in the developers' contribution (capital contribution), estimated at $180M, to new subdivisions had not been made and was therefore not supported;

b) the ICT plan did not support transparent, validated and efficient investment and did not relate to clear productivity or performance benefits that were returned to consumers;

c) benefits from the significant investment in asset growth and replacement in the 2009-14 period were not evident in Endeavour's approach to meeting growth;

d) the significant increase in the network capacity augmentation cost over the current period (63%, $161M) had not been well-justified;

e) the programme and high unit costs to replace network assets (lines and substations) did not appear to reflect an aggressive approach to cost reductions or a contemporary view to network risk management; and

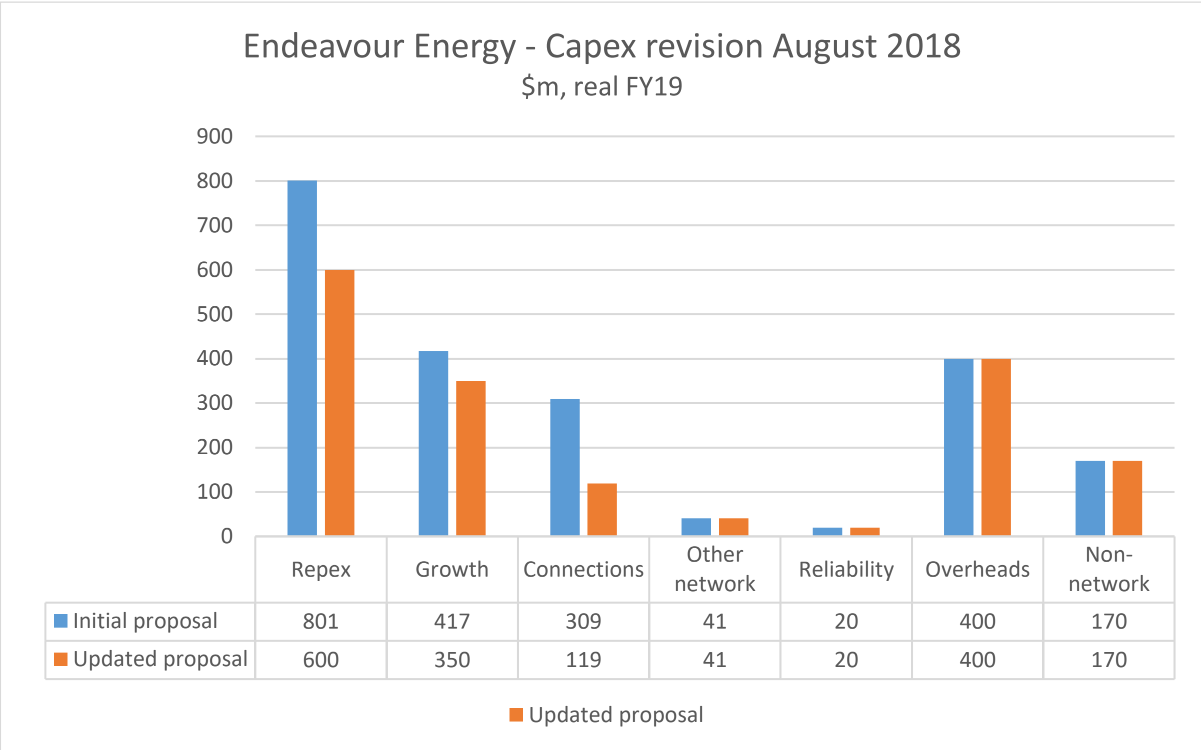
f) With significant customer growth, CCP10 would expect Endeavour Energy to be at the forefront nationally on initiatives related to DM, efficient new connections and tariff incentives.

Consumer engagement on capex

Endeavour Energy undertook a very intense approach to 'deep dives' in 2017 and again in early 2018. These sessions were well facilitated, however they largely served as information sessions to provide customer advocates with significant detail regarding their initial regulatory proposal. We have previously expressed our disappointment that despite this extensive deep dive program, the capex proposal in Endeavour's Initial Proposal did not materially respond to the extensive feedback that customers gave to Endeavour Energy during the deep dive process.

On 22 August 2018, at their Customer Consultative Committee (CCC) meeting, Endeavour Energy finally responded to a number of the concerns expressed by the community groups after the initial proposal. This was followed by a letter to the AER on 30 August revising Endeavour Energy's capital investment proposal from $2,158M to $1,700M. CCP10 was supportive of the revision. We acknowledge the conciliatory and interactive way this revision was prepared. Placing the 'late timing' to one side, we see the consideration by Endeavour Energy of the matters raised by consumers and the commitment to a capex proposal that can be accepted as a highlight of the Endeavour Energy proposal process, and credit to the management of the business.

The changes proposed in their letter of 30 August are summarised in Figure 7 below.



	Repex	Growth	Connections	Other network	Reliability	Overheads	Non-network
Initial proposal	801	417	309	41	20	400	170
Updated proposal	600	350	119	41	20	400	170

Figure 7: Endeavour Energy Capex revision (source: CCC meeting notes August 2018)

Key changes were:

- a reduction of $200M (-25%) in asset replacement capital;
- a reduction of 67M (-16%) in network augmentation (Growth); and
- $190M of capital contributions being transferred back to the original level of 'causer pays'; in a reversion of the capital contributions policy.

Other categories remained unchanged.

CCP10 notes the revised estimate of $1,700M capital expenditure was accepted in the AER Draft Decision.

CCP10 assessment

The regulatory community considered the action by Endeavour Energy to revise the capital investment component of their initial Proposal before the AER Draft Decision as unusual. As we noted above, CCP10 acknowledges the action by Endeavour Energy to revise their capex forecasts as an important step in reflecting the extensive feedback provided by community stakeholders.

Unfortunately, however, other than in some brief discussion of the changes in their letter of 30 August, the revision of the capital proposal did not include much information on how these new targets would be met and what implications the change had on the key areas of network risk, project delivery or customer service that would directly impact customers. In contrast, Endeavour Energy put significant time and effort through their deep dives into informing consumer groups on the many parameters that led to their initial capex proposal. Other than the changed 'bottom line' for augmentation and replacement investment and the AER analysis in the Draft Decision, consumer stakeholders are very much in the dark as to just how Endeavour Energy will deliver these changes to the planned expenditure and what impact to customers these changes may have.

It is unfortunate that Endeavour Energy chose not to clarify or discuss these changes in their Revised Proposal, and we trust that further information will be conveyed to their CCC in the future to build confidence among stakeholders about Endeavour's investment forecasting capability.

CCP10 also notes that the changed expenditure is not without implications, as expressed by Endeavour Energy:

> *"As noted in our August 2018 submission revising our capex forecast, these reductions are material and increase risk of asset failure or delaying growth in our network area. Capex reductions will put upward pressure on our opex spend given the increased maintenance and non-network costs that will be required to achieve these outcomes. However, we have committed to achieving these reductions without compromising the service and reliability outcomes promised in our initial proposal[8]."*

CCP10 supports the reasonable steps taken by Endeavour Energy such as community engagement campaigns and investment in short-to-medium term supply risk-mitigation measures in order to address any short-term adverse impacts that may arise as a result of their transition to a reduced capital investment profile. We also expect that this position will not in any way diminish Endeavour Energy (or any other distributor's, for that matter) responsibility to continue to pursue world-class workplace and community safety initiatives.

We still have some concerns, if not material, surrounding the capital investment proposed by Endeavour Energy. These concerns are:

- appropriate treatment of the additional costs related to the power supply to the Western Sydney Airport;
- a coordinated approach to Advanced Distribution Management Systems (ADMS) and cybersecurity;
- efficient IT expenditure and its clear link to benefits to consumers; and
- further reductions in the 'back office' capitalised overheads costs.

[8] Endeavour Energy Revised Proposal, p20

Overall, CCP10 is supportive of the revised capital investment proposed by Endeavour Energy for 2019-24.

Endeavour Energy's Proposal

The revised capex proposal by Endeavour Energy is almost $40M more than that accepted in the Draft Decision. That difference is the inclusion of the cost to develop initial supply to the emerging load centre of the Western Sydney Airport and surrounds.

That increase can be seen in Figure 6 below.

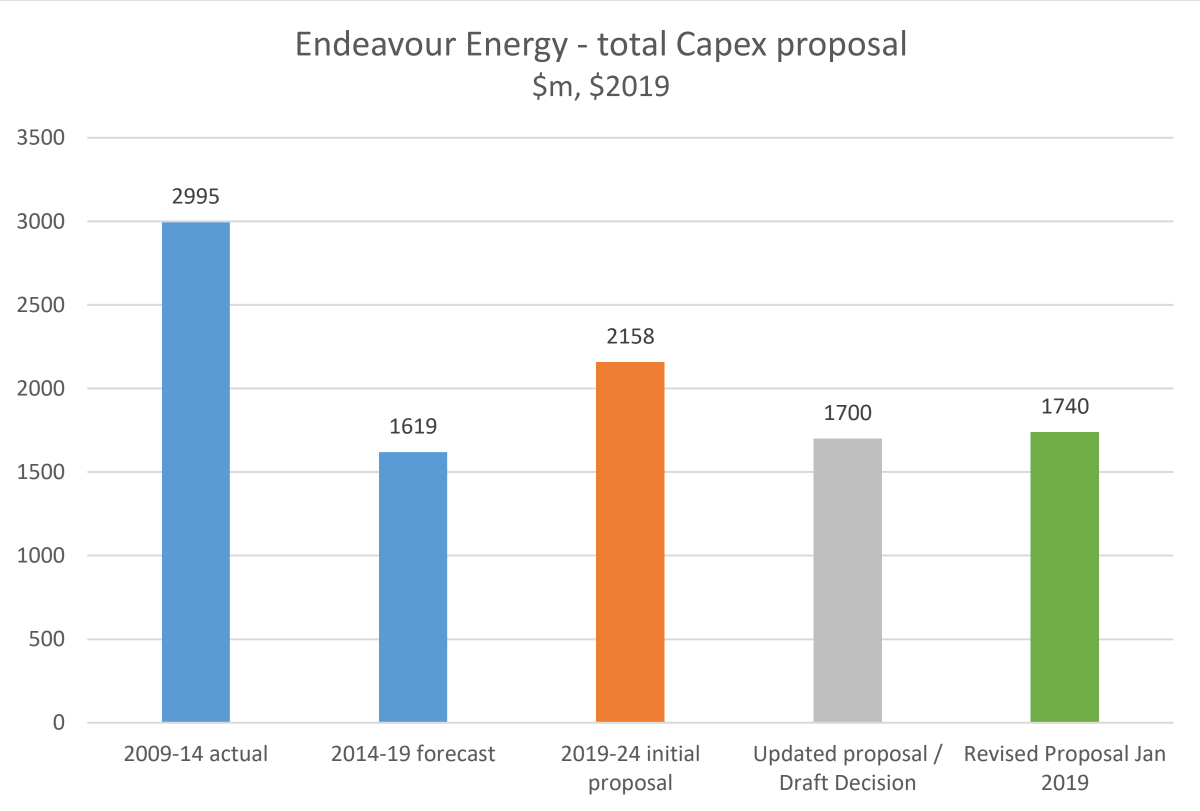


Figure 8: Proposed Capital Investment by Endeavour Energy (source: Endeavour Energy)

Western Sydney Airport (Aerotropolis)

The AER rejected the Western Sydney Airport (Aerotropolis) project as a contingent project on the basis that some investment will most likely be required in 2019-24 and a lower cost alternative may be available through 'staging 'the solution. This position was consistent with that of community stakeholders. We asked Endeavour Energy to undertake more consultation and assessment and requested they explore whether the supply to the development could be undertaken in increments over successive regulatory periods.

Endeavour Energy has provided a revised project plan that replaces the original contingent project of $61.2m with a plan for initial supply costing $39.3m (real, 2018-19). In addition, Endeavour Energy has provided additional information from organisations associated with the Airport project. Accordingly, CCP10 now agrees with the cost, timing and scope of the proposal by Endeavour Energy, recognising the changed project as addressing the concerns of customer representatives.

However, we note that in its Draft Decision, the AER formed an initial estimate of capex of $1.674B, and accepted the Endeavour Energy proposal of $1.7B as the substitute forecast. We ask the AER to consider the $26M 'gap' as being part of the allowed cost of the Western Sydney Airport region supply proposal.

We also note some discussions with Endeavour regarding the requirement of a capital contribution by the Aerotropolis developers towards this capital requirement. We support the AER's consideration of the appropriate level of capital contribution by the developers that relate to the airport-related projects, consistent with the 'causer pays' approach supported by consumer groups.

In addition, recent initiatives by other utilities have seen the establishment of oversight committees that comprise representatives from the business and community stakeholders. These committees have significant input into the timing, scope and quantum of investment into projects that have a high level of community significance. We discussed this development in section 1. Such an approach fosters transparency, trust and community 'ownership' of such investment.

We suggest such an approach for consideration by Endeavour Energy in relation to the development of the Western Sydney airport.

Operational technology, ICT and innovation

The ability for customer and community advocates to assess the prudency and efficiency of *ICT investment* is remarkably poor, and the subject of our specific recommendation to the AER in section 1. Ongoing investment in ICT can nowadays be only judged by trend, or some form of superficial relative benchmarking. Available alternatives such as life extension, functional trade-offs or resistance to the market power of a small number of system providers are not discussed or presented to consumers in any meaningful way. We reiterate our statement from our response to the initial Proposal:

> *"It is an understatement to say that CCP10 are very uncomfortable with the level of IT spend being undertaken by … many network businesses".*

We are pleased to point out that, relatively speaking, Endeavour Energy appears to have one of the lowest levels of planned ICT capital investment in 2019-24. The principles of better transparency of efficient and prudent expenditure and correlation of the investment to benefits for consumers however remain valid.

In the Draft Decision the AER noted that its trend analysis found that Endeavour's forecast was lower than historical rates of expenditure. The AER went on to observe that the degree of cost benefit analysis supporting the IT expenditure was inadequate:

> "*Our review has found insufficient supporting information for individual projects. For example, with the exception of the Enterprise Resource Planning (ERP) and billing upgrade program, Endeavour did not provide quantitative cost-benefit assessment for any project. We note that the lack of sufficient cost-benefit analysis is indicative of the concerns that EMCa raised throughout its detailed review of Endeavour's*

governance framework, risk management processes and expenditure forecasting methodologies....”[9]

As we consistently observed during the reset processes for the NSW and ACT businesses, with the exception of Essential Energy, none of the other networks properly detailed the benefits from these investments nor included the efficiency of those benefits in their Initial Proposals. We note that the Endeavour Energy Revised Proposal accepts the AER Draft Decision regarding ICT and other non-network expenditure. We still remain unclear about the benefits to consumers of these additional costs, as the Revised Proposal does not link them to measurable benefits to customers such as reliability improvement or reduced operating costs. We assume, however, that this is the case.

We remain very concerned that in this area of non-network investment the AER’s recent determinations have used the level of expenditure of a previous regulatory period as a sufficient basis for overcoming this lack of cost benefit analysis. CCP10 trusts that the AER will be in a position to take a much more reasoned and active assessment of ICT expenditure in future revenue resets following its review. We encourage Endeavour Energy to fully support the AER’s forthcoming work in this area.

Expenditure on cybersecurity requirements continues to be difficult to assess. In section 1 CCP10 has raised this as one of the matters that would benefit from a whole-of-industry approach in funding proposals, as the issue is almost by definition opaque to consumers and driven largely by national requirements. There are few if any indicators that assist consumers to assess the prudency and efficiency of cybersecurity investment.

Despite the misgivings we have expressed, CCP10 raises no objection to Endeavour Energy’s proposal regarding ICT investment and Cybersecurity in their Revised Proposal for this regulatory period. We reiterate our suggestion that, similar to that of the Western Sydney Airport network augmentation, Endeavour Energy consider the establishment of a Technology Review Committee as a subcommittee of its CCC to encourage transparency and a commitment to positive customer outcomes.

Capitalised Overheads

In the Revised Proposal, Endeavour Energy has provided further information regarding their forecast capitalised overheads. We appreciate this information and accept the position.

We expect some efficiencies in data management as a result of improved ICT facilities, and would like to see clearly presented in future determinations how that formula and hence costs change as businesses invest in productivity tools such as IT.

Whilst we continue to encourage the AER and the network businesses to maintain a strong focus on reducing back-office costs and passing those benefits on to customers, we acknowledge the information provided by Endeavour Energy in their Revised Proposal is reasonable evidence of an efficient level of capitalised overheads.

[9] https://www.aer.gov.au/system/files/AER%20-%20Endeavour%20Energy%202019-24%20-%20Draft%20decision%20-%20Attachment%205%20-%20Capital%20expenditure%20-%20November%202018.pdf at 5-85

OPERATING EXPENDITURE (OPEX)

Dynamic Opex Productivity

On 9 November 2018, the AER published a draft decision paper on forecasting productivity growth for electricity distributors. In the Draft Decision, the AER indicates its intention to apply the productivity growth forecast it arrives at through this consultation process to the opex estimates of electricity distribution businesses, including Endeavour Energy, for whom the AER will publish a final distribution determination in April 2019. The AER also foreshadowed this position in its Draft Decision on Endeavour's initial revenue Proposal.

CCP members, separate from CCP10 (the opex CCP) have engaged in this process and said in the opex CCP submission to the review of opex productivity:

> *"Opex productivity is important because opex is important. Table 1, drawn from the AER DNSP data base 3, shows that, on average, opex accounts for around a third of total network charges paid by consumers over the last decade. It is a cost that is immediately paid by consumers and not, like capex, spread over current and future generations. Today's consumers' wallets feel the impact of inefficiency immediately."*

Reporting that for Endeavour Energy, opex costs as a percentage of total revenue were 31% of total costs through the period 2006-17. This being in line with opex: total revenue ratios for other network businesses. This level of opex expenditure also highlights its significance in impacting bills paid by customers.

The opex CCP submission concluded:

> *"Opex is a key component of the overall revenue requirements. Consumers expect that, like businesses facing competition, the regulated business should continually seek to improve their efficiency and that consumers should benefit from this. Consumers also expect the regulator to deliver this outcome. Indeed, this is a necessary requirement for the regulatory framework and individual decisions if they are to meet the requirements of the NEO/NGO and be consistent with long-term interests of consumers (LTIC). ...*
>
> *The objective in forecasting opex for the revenue resets is to establish the best available unbiased estimate of the opex for a prudent and efficient operator. The estimate for trend productivity must be consistent with this overall objective and the framework used for the determination of the efficient opex. To be consistent with the base-step-trend approach, the allowance for trend productivity should exclude the effect of past significant step changes and 'catch-up' efficiency gains as these are separately included in the estimation of the efficient opex.*
>
> ***In the CCP's view the current assumption of zero trend productivity improvement does not meet these requirements and we consider that the data supports an assumption of a trend productivity improvement for the DNSPs of at least 1.5-2.0% pa."***

CCP10 supports the views presented by our opex CCP colleagues, that it is reasonable for customers to expect improving efficiency over time. We also acknowledge that Endeavour Energy has delivered significant productivity improvement during the 2009-19 period, particularly during the earlier years of this period. This is reflected in Endeavour Energy being the only one of the four NSW and ACT businesses to have the EBSS incentive scheme applied to its opex in 2014-19.

The opex productivity measures being proposed by the opex CCP are dynamic, meaning that productivity cannot be considered as a one-off action, no matter how significant the one-off improvement. We strongly believe that an opex productivity improvement for all DNSPs, including those under the EBSS, is both reasonable and prudent during the 2019-24 regulatory period.

Endeavour Energy has been an active participant in the AER's productivity review. Endeavour was represented at the AER's public stakeholder forum on 30 November 2018 and presented a number of issues from the AER to consider as part of its review. The opex CCP submission canvassed these arguments in detail.

Endeavour Energy has subsequently prepared a submission to the opex productivity review supported by a report from Houston Kemp, which in the face of customer concerns actually argues for a negative productivity factor. In its cover letter for its submission Endeavour Energy states:

> "*Our concern is that a poorly specified, unrealistic and/or inaccurate productivity factor carries significant regulatory risk and the available evidence does not support a positive productivity factor. The averaging period selected is opportunistic as it produces the highest possible productivity factor and there are a number of methodological errors and inconsistencies. A productivity factor of -0.7% is calculated when correcting for these issues and updating for the latest available information.*" [10]

In contrast to Endeavour Energy's assertions, the AER's proposal reflects a balanced consideration of a broader range of relevant information having regard to the quality of that information. This generates an assumption for productivity forecasts that businesses operating in workably competitive markets would consider more realistic. The AER has not been opportunistic: as the opex CCP submission to the opex review demonstrates, the AER's proposed factor of 1.0% is below that which can be supported by the relevant available data. Endeavour's proposed -0.7% does not correct the AER estimates or update it for the latest information. It simply ignores the issues validly raised by the AER.

Endeavour Energy also states that in some way a productivity factor of +1% rather than zero will reduce the incentives for the utilities to pursue productivity improvements:

> "*It creates perverse incentives to achieve mandated productivity gains at the cost of service outcomes and/or dis-incentivises outperformance of the productivity factor*."

This statement is not supported by quantitative or substantive analysis in either the Endeavour Energy submission or the accompanying report by Houston Kemp. In contrast,

[10] Endeavour Energy, Submission to Opex Productivity Review, p1

the opex CCP submission to the opex review demonstrates quantitatively using the AER's models that this assertion is false.[11]

One of the key issues in this review is the relevance of the 2006-12 data. There is no disagreement that for data of equal quality, a longer time series is preferred to a shorter data series, but it does not follow that any longer data series is better than a shorter one.[12] AER, its consultants and the opex CCP have argued that the data in that period is so distorted by the impact of one-off step changes in costs that it distorts trend estimates of productivity. Endeavour Energy presents partial information on the impact of these changes on the opex by citing pass-throughs allowed up to 2009. However, the larger impact was in the period after 2009. Endeavour Energy data indicates pass-throughs of additional opex of \$127m for Essential Energy and \$60.4m for Ausgrid due to the increased reliability standards. However, Endeavour Energy has not included the further increases of \$135m and \$116m, respectively that AER allowed in the regulatory period 2009-14.

Endeavour Energy is clearly aware that the increased reliability standards continued to increase opex in the 2009-14 because their submission notes that the businesses were required to achieve the standards by 2014. Hence it argues that this would have impacted costs beyond 2012. However, as the AEMC has shown – and is a common view among close observers of the NSW energy sector – the NSW DNSPs largely achieved the reliability standards well before 2014.[13]

In regard to the impact of the bushfire-related and other cost changes for the Victorian DNSPs, Endeavour Energy limit the estimated impact to allowed step change for the VBRC recommendations for two DNSP's (Powercor and SP Ausnet). This discounts the Victorian DNSP's own estimates of the additional costs. For the regulatory period the Victorian DNSPs proposed step changes of \$584m (\$2010) over the period 2011-16, which accounted for almost 20% of the proposed expenditure of \$3.131m (\$2010). The expenditure on these step changes was front-end loaded so that the primary impact was in 2001-12 and continued in subsequent years – see estimate by SP Ausnet in Figure 9 below.[14]

[11] CEPA endorsed this conclusion in its report prepared for other DNSPs. "As the CCP note, the opex benchmark does not affect the incentives on the DNSPs to make productivity improvements." CEPA, Analysis supporting Ausgrid's, Evoenergy's and Jemena's submission to the Australian Energy Regulator's review of its approach to forecasting operating expenditure", p13.
[12] Taken to extremes such an argument is akin to the drunk looking for his keys under the lamppost, rather than where he lost his keys, because that is where the light is.
[13] Endeavour Energy AEMC, Review of Distribution Reliability Outcomes and Standards 31 August 2012, p4. https://www.aemc.gov.au/markets-reviews-advice/review-of-distribution-reliability-outcomes-and-st. Cited in CCP Submission to Opex Review, p21-22.
[14] See CCP Submission to Opex Review, p20-21.

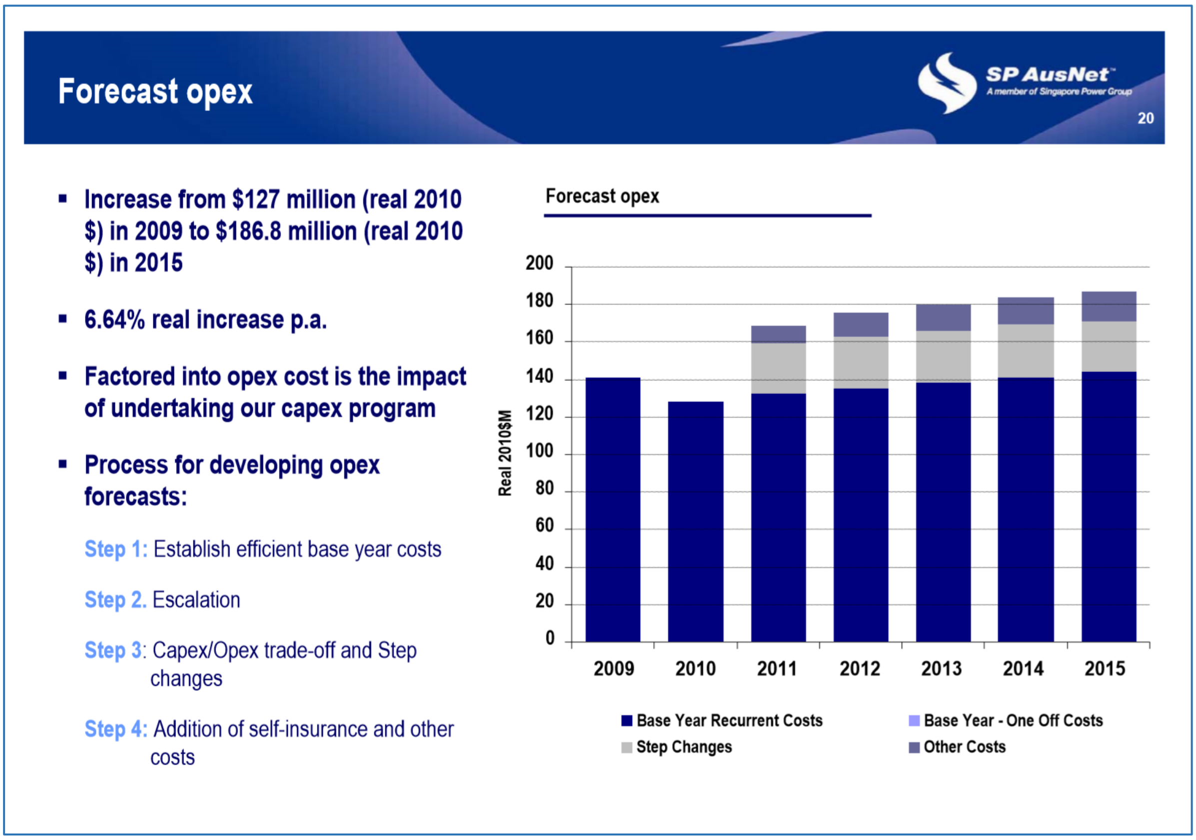


Figure 9: SP Ausnet- Opex impacts of bushfire- related costs (Source: SP Ausnet)

Subsequently, in its 2015 submission to the AER, United Energy stated that:

> *"The analysis indicates that our Opex PFP declined slightly since 2006, however we had a much smaller decline than other frontier businesses. We note that this decline does not take into account exogenous operating environment factors that affected our operations, including Opex step changes that occurred during this period, including those arising out of new regulatory obligations;"*[15]

In summary, there is clear and strong quantitative evidence that the impact of these one-off changes on opex in the period to 2012 was substantial. Data in the period is so distorted by these costs that it distorts the estimate for productivity change over the longer period of 2006-17. These concerns could be reduced – as all acknowledge – if data was available for a much longer period. Unfortunately, the AER's data set only goes back to 2006, but the Productivity Commission has estimated total productivity improvements for the broader energy sector. This shows an average improvement of around 1.3% over the 34 years to 2008-09.

Endeavour Energy emphasises the need to separate frontier shift from catch-up efficiency. The practical means of doing this is to estimate the trend productivity movements based on data from the frontier firms only. This is the approach taken by the AER. The opex CCP undertook extensive sensitivity analysis for varying definitions on the Frontier firms that demonstrated that the AER analysis erred on the cautious side.

[15] United Energy, Operating Expenditure Overview, Submission to AER, 2015, p14,

It should be noted that the discussion by Endeavour Energy and Houston Kemp on the challenges facing transforming firms is most directly relevant to firms trying to bridge the gap to the best performing firms – i.e. it tends to muddy this distinction between frontier shift and catch-up efficiency.

Another issue that Endeavour Energy and Houston Kemp seek to introduce is a concern that the analysis does not consider the costs and risks of achieving productivity change. To the extent that a DNSP may need to spend money (opex) up front to save money (opex) that is embedded in the trend estimates. The opex CCP also recognises that capex may be required to achieve opex savings. But our concern is quite the opposite of Endeavour Energy and Houston Kemp. We observe proposals for continuing growth in capex, particularly in IT, with, except for Essential Energy, no apparent allowance for the productivity improvements from the capex spending.

Other network businesses, including Essential and Ausgrid, have accepted the concept of opex productivity improvement as imminent, announcing their agreement to accept any productivity improvement determined by the AER after appropriate consultation. Endeavour Energy could have also taken this approach.

RATE OF RETURN

We note that Endeavour Energy has applied the 2018 Final Rate of Return Guideline in its Revised Proposal. However, it has not publicly accepted the basis for the AER's Final Guideline. By contrast Endeavour Energy has made the following observations in its Revised Proposal about the 2018 Guideline:

> "*In adopting this instrument, we repeat the concerns raised during the consultation process by the ENA, investors and other networks.*
>
> *We consider the rate of return is below international comparisons and it poses a significant risk to our ability to raise the capital required to manage the network in a safe and reliable manner over the longer term. We recently commissioned a report (Attachment 0.06) by Deloitte Access Economics (Deloitte or DAE), which outlines the benefits associated with the 'future grid' and the investment environment required to unlock its full potential.*
>
> *As noted by the ENA, the final rate of return instrument fails to provide the balance required to realise the benefits of grid modernisation*"[16]

We have acknowledged in section 1 that investment in the new grid and in IT to transform networks is inevitable. We expect significant capital investment to be supported by customers and approved by the AER to fund this transformation. However, CCP10 has several concerns about the foundation that Endeavour is laying in this Revised Proposal.

[16] https://www.aer.gov.au/system/files/Endeavour%20Energy%20-%20Revised%20Proposal%20-%200.01%20Revised%20Proposal%20-%20January%202019.pdf at page 18

At the moment CCP10 does not have the same confidence in Endeavour's approach and capability as we have for Essential and Ausgrid in its capital forecasting capability and its ability to provide cost benefit analysis to support the future investment needed. As we noted above in capex the process for arriving at the revised $1.7M capex proposal is not yet supported by detailed cost benefit analysis.

More broadly, the case by some network business that underinvestment in network development will lead to an increase in retail energy prices of up to 4% by 2029, such as that suggested in the Deloitte report quoted by Endeavour Energy, considers a wide range of variables that will be very sensitive to policy and external actions, such as the Government's approach to closing coal power stations and the impact of a more rapid uptake if demand and capacity tariffs. Such a scenario is yet to be socialised and tested in the consumer arena; and therefore, we place little weight on Endeavour Energy's argument.

TAX

Corporate Income tax

The value of gamma was one of the matters considered by the review of the Rate of Return guideline during 2018, resulting in a binding guideline being developed.

In their revised revenue proposal, Endeavour Energy said:

> *"The final 2018 rate of return instrument includes a gamma estimate of 0.585. We have applied this estimate in our revised proposal. We have also updated the corporate income tax allowance as a consequence to changes to the other building block components."*

We understand this to mean that Endeavour energy accepts that the guideline is binding and so will apply the value of gamma of 0.585

Tax Review

On 16 December 2018 the AER published its Final Report in the Review of regulatory tax approach. We note that the AER's Final report is not recommending rule changes rather it is focussed on the introduction of changes to the PTRM.

The AER's Final Report recommends three depreciation related changes. In order for two of the three recommended changes (immediate expensing and diminishing value) to be implemented the AER requires a formal model change process. The third recommendation around depreciation (capping gas asset lives) does not require a model change to implement.

The AER has set out in the Report the process it intends to follow to implement the changes. Briefly it will produce an explanatory statement that includes the proposed model changes and the reasons for those changes in late January 2019 and consult with stakeholders. Consistent with the AER's initial report and discussion paper, its intention is to apply the model changes to the group of revenue determinations with final reset decisions due in April 2019 which includes Endeavour Energy.

In discussions since they lodged their Revised Proposal, Endeavour Energy has advised CCP10 that they accept the policy position from the tax review and recognise the need to work with the AER to determine how the policy will be implemented in practice. We understand that Endeavour Energy have been engaged in the process, working with the relevant AER staff on data and fine-tuning model application. At the time of writing this submission, Endeavour advised CCP10 that their modelling and that of the AER were coalescing. There are some technical details still unresolved, but we understand that these quite technical matters are not substantial.

Regarding the treatment of depreciation, which is part of the PTRM, Endeavour Energy said

> *2.3.2 Regulatory depreciation*
>
> *The AER accepted our proposed approach to regulatory depreciation. The allowance in the draft decision differs from our initial proposal due to adjustments made to our capex forecast and the lower expected inflation rate.*
>
> *We accept the AER's draft decision methodology and have updated it to incorporate the impacts of the changes to the opening RAB and the capex revisions. We note that it will be further updated to reflect the most recent inflation data at the time of the AER's final decision.*
>
> *Following the AER's adoption of the diminishing value method for tax depreciation we suggest the AER review whether a straight-line method remains appropriate for regulatory depreciation purposes. The depreciation methods have been aligned to date and our submission to the Tax Review identified inter-generational and long-term pricing benefits from applying the diminishing value method to both regulatory and tax depreciation.*

Endeavour are suggesting a review of aspects of regulatory depreciation to shift it to diminishing value on the basis of inter-generational equity and alignment with tax depreciation. This is a separate proposal that should not delay implementation of the AER's recommendations on the estimation of tax expense. Furthermore, we believe both arguments are dubious. The CCP tax submission noted that regulatory depreciation is the prime means of achieving intergenerational equity but it is not obvious that switching to diminishing value improves intergenerational equity. The current approach means that the depreciation charge is constant in real terms over the life of the assets. That is, today's consumers pay the same amount in depreciation as future consumers.

Diminishing value front-end loads depreciation and means that today's consumers pay more in depreciation than future consumers. This has benefits for the utility but seems to create intergenerational inequity. If the system is not growing a constant depreciation charge (in real terms) is equitable between users in different periods. Where the system is growing and additional capacity is provided now for the benefit of future consumers, it would seem more equitable to back-end load depreciation (the opposite of diminishing value),

The CCP submission to the Tax Review argued that the objectives in the estimating the building block allowance for regulation and estimating tax expense are different and alignment of the depreciation profiles is not necessary. The regulatory depreciation allowance needs to provide for a recovery of capital costs consistent with inter-generational equity, the tax expense needs to be the best unbiased estimate of actual tax paid by the benchmark entity. Hence there is no a priori reason to expect the assumptions to align. Nor is it realistic to expect that the tax depreciation and regulatory depreciation can be aligned since the regulatory and tax asset bases are different, primarily because the former is indexed for inflation and the latter is not.

We welcome the AER's Final Decision on its approach to tax. We support the submission from the specialist CCP subpanel on tax that agreed with the AER that model changes should apply to the ACT and NSW regulatory Determinations to be decided in April 2019. We encourage Endeavour to engage constructively with the AER to make the changes to the PTRM between January and April and not to resist the changes in the AER's tax decision.

TARIFF STRUCTURE STATEMENT

CCP10, and customer stakeholders such as PIAC and ECA, supported the adoption of the TSS proposed by Endeavour Energy in its original Proposal. Endeavour's proposal was the most responsive to the Pricing Directions statement prepared by PIAC, ECA, TEC and CCP10 and provided a sensible transition to more cost-reflective tariffs.

In response to the AER's Draft TSS Decision and ongoing consultation with stakeholders Endeavour Energy has revised its proposal to:

- re-calculate its residential and small business demand tariffs to improve their attractiveness; and
- introduce an optional seasonal time of use (STOU) energy tariff for residential and small business customers.

However, Endeavour has not agreed to several aspects of the AER Draft Decision:

- removal of the flat energy tariff as an opt-out option for customers on cost-reflective tariffs;
- the inclusion of meter replacement as a trigger for cost-reflective tariff assignment - subsequently they also will not adopt the 12-month waiting period associated with the AER's Draft Decision: and
- the default assignment of customers to the demand tariff rather than the transitional demand tariff.

CCP10 supports the decision of Endeavour Energy to retain the transitional demand tariff as the default opt-out option for all new customers and existing customers with the required metering who upgrade their network connection and install smart meters. This is an important means of managing the move to cost reflective network tariffs. We also understand Endeavour's concern to maintain an ability to opt-out to a flat energy tariff to manage customer impacts and improve acceptance of the reform. But, like Essential Energy, the approach to the allocation of residual costs can be used to enhance the attractiveness of the cost-reflective tariffs.

CCP10 considers that moving customers who replace their metering with a smart meter to the opt-out transitional demand tariff can support the move to cost-reflective tariffs if supported by enhanced protection mechanisms. Data sampling and targeted information programs can play an important role in this. However, the effectiveness may well depend on the involvement of retailers and a pro-active approach to providing information and support on how the consumer can respond to reduce their bills.

CONCLUSIONS

In our concluding comments on 13th November 2018 at the Stakeholder Forum, CCP10 compared Endeavour Energy's recent journey to that of a maxi-yacht racing in Sydney Harbour. We observed that the yacht started very strongly. They were then 'becalmed' and subsequently we observed signs that the yacht was heading off-course. Even though the yacht undertook a significant reset of its navigation and is now more strongly on course, it has not fully taken advantage of its position.

Endeavour Energy displayed leadership in establishing a focused and at times almost overwhelming programme of information for consumers. In so doing, Endeavour Energy paved the way for the new form of industry engagement. Despite a missed opportunity to better explain the implications of the revised capital requirement in the Revised Proposal, the change taken by Endeavour Energy reflected their acceptance of the feedback provided by consumers and advocacy groups. We acknowledge the fact that the change has 'changed the landscape' of Endeavour Energy's augmentation and asset replacement plans - but we believe for the better.

We acknowledge the leadership taken by key members of Endeavour Energy, in particular their regulatory team, in reviewing the proposal early and embedding changes from which the long-term interests of Endeavour Energy's consumers will benefit.

However, CCP10 regrets that between November 2018 and the end of January 2019 Endeavour chose not to capitalise on the growing goodwill and evolving trust with consumers and its stakeholders. The decision to oppose the AER's Draft decision for a positive opex productivity forecast and instead to argue for a negative one has not been well received by consumers. We believe this is against the both the short and long-term interests of customers. Similarly, ongoing opposition to the binding Rate of Return and the lack of express support for the outcomes from the Tax Review is counterproductive. It cannot be ignored that parts of this Revised Proposal have been made with a degree of resistance. We look forward to Endeavour Energy and the AER being able to resolve these issues for the benefit of energy consumers.

Finally, we acknowledge the commitment by Endeavour Energy that:

> *"Following the lodgement of this revised proposal, we will continue to work with the AER, customers and stakeholders to help inform the AER's decision-making to deliver a final revenue determination that is in the long-term interests of the 2.4 million people across the one million households and businesses we serve …"*

This section commenced with a recognition of the opportunities that Endeavour Energy has generated to further build trust with consumers and other stakeholders, particularly by working collaboratively to develop forward-looking solutions to the growth of Western Sydney, including the Western Sydney airport, (Aerotropolis). The residential growth anticipated for Western Sydney provides substantial opportunities for Endeavour energy to work collaboratively and proactively to apply demand management, energy efficiency and DER opportunities. In this context we continue to encourage Endeavour Energy to utilise the DMIA (Demand Management Incentive Allowance) more fully than they have in the past. We are pleased that early proposals for DMIA projects have been submitted for the current period.

We encourage Endeavour Energy to consider how it can progress its consumer engagement 'to the next level' by seeking to apply IAP2 'Involve' level strategies, and to do so on a consistent and ongoing basis. We have raised several issues at the end of section 1 that have NEM-wide significance, and we encourage Endeavour to work with the AER and its peers on these issues. We strongly believe that this will be an important key to the transformation of the network.

We look forward to Endeavour Energy building on the evolving trust between it and its stakeholders, as it meets the critical and challenging task to provide a safe, reliable and affordable network throughout its rapidly growing customer base.

Glossary

AMI	Advanced metering infrastructure
CCP	Consumer Challenge Panel
CCP10	The subpanel of the CCP appointed to consider ACT and NSW electricity distribution business regulatory proposals for 2019-24
DER	Distributed Energy Resource (small scale energy generation or storage devices that are grid connected)
DM	Demand Management
ECA	Energy Consumers Australia
ENA	Energy Networks Australia
EUAA	Energy Users Association of Australia
EWON	Energy and Water Ombudsman NSW
IAP2	International Association of Public Participation
LMR	Limited Merits Review
NCOSS	New South Wales Council of Social Services
NEM	National Electricity Market
PIAC	Public Interest Advocacy Centre (NSW)
PTRM	Post-tax revenue model
RIN	Regulatory Information Notice
TSS	Tariff Structure Statement