Consumer
Challenge
Panel

5th October 2018

Sebastian Roberts

General Manager, Transmission & Gas

Australian Energy Regulator

(Via email: ActewAGLremittal2014-19@aer.gov.au)

Evoenergy 2014-19 revenue allowance remittal Draft Decision

The AER's draft decision for this remitted decision is summarised by the following extract:

> "Our remade draft decision is to accept Evoenergy's proposal to recover total revenues of $815.6 million ($, nominal) from consumers over the five-year 2014-19 regulatory control period. If this remade draft decision becomes our final decision, the decision will provide consumers with tariff stability and predictability and will maintain distribution network charges at current levels."

Summary Response

The Consumer Challenge Panel, subpanel 10 (CCP10) endorses this decision as being in the best, long term interests of consumers and an appropriate resolution for the remitted decision and in the "novel" circumstances associated with making the remitted decision.

Recent Background

On 24th July 2018 Michael Costello, the CEO of Evoenergy wrote to Paula Conboy, Chair of the AER, with a proposal to finalise the revenue allowance for 2014-19. This decision had been delayed by appeal processes that had resulted in aspects of the original decision being remitted back to the AER to be remade.

Aspects of the proposal from Evoenergy included:

- a total revenue proposal of $815.6 million (nominal) for the 2014-19 period being a revenue allowance in accordance with the AER's set aside 2015 determination;
- being $26 million more than the 2015 final decision, adjusted for actual demand and other ex post factors;
- being $98 million less than the total amount under consideration;
- a reduced STPIS penalty of $1.2m; and

- a return of about $1 million of "over-recovery" to consumers in the 2019-24 regulatory period.

On 18th June 2018, the AER requested CCP10 to provide advice on a draft of a letter from Evoenergy to the AER, outlining a proposal for the remittal of Evoenergy's 2014-19 determination. The proposal comprised a 6-page letter to the AER and a one-page infographic. Our response to this Draft Decision is wholly consistent with the initial advice that we provided to the AER, in response to that 18th June letter.

In that response we observed Evoenergy had engaged with consumer groups about their proposal and that the proposal had been disclosed by Evoenergy to and discussed with consumer groups in the following meetings:

Stakeholder Group	Dates
Bilateral discussions CCP10 and ECA	7th June 2018
Evoenergy's Energy Consumer Reference Council (ECRC)	7th June 2018, with Chair of ECRC 13th June, with full ECRC – 7 community / stakeholder representatives with ECA and CCP10 also in attendance
ACTCOSS CEO, Susan Helyar and CCP10	7th June 2018
ACT Energy Consumers Policy Consortium (ECPC), comprising ACTCOSS, ACT Business Chamber, Care Financial Counselling, SEE-Change and Conservation Council	13th June 2018

We also observed that between the ECRC (Energy Consumer Reference Council) and ECPC (Energy Consumers Policy Consortium – coordinated by ACTCOSS) there is a significant representation of consumer views from across the ACT.

We also summarised the CCP10 involvement during this engagement process:

- we gave feedback to Evoenergy on the draft proposal as it was being developed between December 2017 and June 2018;
- we gave feedback on the draft proposal letter on 7th June 2018;
- we participated in bilateral discussions involving ACTCOSS and ECA during June 2018, also proving some background briefing to these organisations; and
- we participated in the ECRC meeting of 13th June 2018. We observed that Evoenergy uses its ECRC as a significant focus for consumer engagement, and it includes a good range of ACT consumer and stakeholder interests.

We reiterate our earlier comment from our letter stating that:

> "CCP10 confirms that Evoenergy was very receptive to comments from consumer groups and that it has taken steps to incorporate that feedback in the final proposal and the infographic.

> In meetings with the ECRC and Energy Policy Consortium, there was appreciation of the willingness of Evoenergy to consult and recognition of both the rapidly changing nature of energy markets and of the efforts of ActewAGL, now trading as Evoenergy, to improve its efficiency over recent years, including significant cost reductions for operating expenditure. This perspective is discussed in our earlier letter to the AER which references Evoenergy's improving opex multilateral partial factor productivity (MPFP) from the AER's most recent benchmarking report."

Our engagement with Evoenergy since we wrote this letter has been with regard to the 2019-24 regulatory control period and our views about Evoenergy's receptiveness to consumer input remain positive.

Uniqueness of Remitted Decisions

There have been a number of processes undertaken over the past year to both remake the five remitted decisions as promptly as possible and to build on more cooperative processes between network businesses, consumer interests and the regulator, in line with the ideas of AER 2.0 that was outlined by the AER Chair, Paula Conboy, to an ENA conference in late July 2017. CCP10 was part of an AER initiated roundtable that was held on 16th August 2017 to develop a respectful and pragmatic approach to resolving the remitted decisions for the 5 businesses involved; Evoenergy, Ausgrid, Endeavour Energy, Essential Energy and Jemena Gas Networks.

We have made submissions to the AER on both opex issues, 30th November 2017, and debt, 23rd February 2018, relating to the remitted decisions, as well as engaging with each of the businesses, consumer groups and the AER regarding finalising the remitted decisions.

The views expressed in our previous submissions remain relevant to this submission and we refer to both our opex and debt submissions for more detail behind the summary views expressed in this response.

<u>Context of remittals</u>

The context in which this remitted decision is finalised is significant, in particular because it is very difficult to imagine a similar set of circumstances occurring again. Consequently it is important that this and the other 4 remitted decisions are understood to be unique decisions for a unique set of circumstances, or as the AER describes them, "novel" circumstances. It would be inappropriate to regard this and related remitted decisions as creating precedents for future determinations.

The following is an extract from our previous submissions, outlining aspects of the unique/novel circumstances of this decision.

> "The context in which this Issues Paper has been released is significant, as the last decade has seen several critical shifts in the regulatory environment in NSW/ACT. We have summarised some of the key elements of these shifts to highlight aspects of this context. We believe this is relevant to factors that the AER should take into account in remaking the remitted decisions.
>
> The global financial crisis of 2007-08 (GFC) had the impact of significantly increasing the cost of capital, globally. Energy network businesses are capital intensive. This means that the cost of capital significantly impacts on their cost of business and

ultimately the price charged to consumers, in this case for distribution use of system charges, known as DUoS. Consequently, the regulated price for the NSW/ACT distribution businesses for 2009-14 included a much higher allowance for the cost of capital than the prevailing rate up to the GFC.

….Significant changes to network regulation rules were made in 2012 and separate decisions were made to focus any Limited Merits Review appeals on AER decisions to meet a consumer benefit test. In mid-2013 the Productivity Commission emphasised the loss of centrality of consumers in network regulation and also discussed the value of benchmarking in regulation. Meanwhile the AER undertook a comprehensive development of guidelines under the banner of 'better regulation' during 2013 to consider application of the new network regulation rules.

When the AER came to make the 2014-19 regulatory determinations, the three NSW Government owned distribution network businesses and ACT's ActewAGL were the first businesses to which the 2012 rule changes would be applied. Since the regulatory process could not be commenced until the guidelines were established, a placeholder decision was made for the first year of the regulatory period, with a 'true up' to occur once regulatory determinations were made for the full 5-year period, 2014-19.

The final determinations were for reductions in allowable revenue from the regulatory proposals of 33%, 28%, 31% and 31.5% percent for Ausgrid, Endeavour, Essential and ActewAGL respectively. The main component of the reductions being to apply rates of return to capital that reflected much lower post GFC rates and a reduction in operating expenditure (opex).

The network businesses all appealed the AER's decisions to the Australian Competition Tribunal (the Tribunal) by seeking limited merits review (LMR), a process which itself had also been subjected to changes.

The Tribunal upheld the network businesses' appeals regarding return on debt, operating expense allowance and the rate for imputation credits relating to tax allowance. The Tribunal set aside the AER's original decisions and directed the AER to remake the 2014-19 decisions, taking into account the Tribunal's reasons.

The AER appealed the Tribunal decisions to the Federal Court. During 2017 the Federal Court decisions have been made, reinforcing the Tribunal's decisions that the original decisions should be re-made by the AER, though with regard to a smaller number of issues. It is the remaking of the 2014-19 decisions that the AER is now undertaking, with limited direction on some aspects from the Tribunal and Court.

The time taken with the various appeal processes means that in remaking these decisions:

a) the AER and businesses have access to the actual expenditure of each of the businesses for the first 3 years of the regulatory period. It is very rare that a regulator's decision can be made with considerable actual, revealed costs data to draw upon, and

b) the regulatory proposals for the next period, 2019-24 are due to be lodged with the AER before the remitted decisions will be made, using standard regulated price determining processes.

A core implication of the background for remaking the 2104-19 decision is the uniqueness of the situation. In practice, there is no handbook or rules to follow that deal with this combination of unique circumstances, including the historically turbulent financial circumstances of the past decade that have been a significant factor in driving at least some aspects of the unprecedented regulatory situation of the last decade, and the last 4 years in particular."

Principles

In our opex and debt submissions we proposed the following 10 principles to assist in guiding the development of the remitted decisions:

1. The AER's focus must be on the National Electricity Objective (NEO) without ignoring shorter-term impacts as well;
2. A recognition of the uniqueness of the current situation;
3. The AER should use the best available evidence;
4. The AER must apply the Tribunal and Federal Court directives, where they exist;
5. There is a process to transition from an inefficient network business to an efficient business;
6. There should be objective fairness between businesses;
7. Levels of opex must be sustainable;
8. The AER (and other stakeholders too) is dealing with 'a new reality';
9. Making remit decisions as a whole; and
10. Trust and goodwill are needed to produce outcomes that work for all parties.

We consider that these principles have been met in both the development of the Evoenergy proposal and the AER's draft decision.

Opex

The Draft Decision sets out the following table to summarise opex allowances for the 2014-19 regulatory control period.

Table 5-1 AER 2014-19 remade draft decision opex forecast ($million, 2013–14)

	2014-15	2015–16	2016–17	2017–18	2018–19	Total
Opex forecast	61.52	46.60	48.41	48.90	50.30	255.72

CCP10 supports these proposed expenditure allowances. We are also pleased that to our understanding the rare situation exists in this instance whereby more costs are revealed rather than forecast, meaning that Evoenergy and the AER are able to agree on this opex decision. We look forward to Network businesses, the AER and consumer interests reaching more agreement, from now on.

We recognise that Evoenergy's proposal as accepted in this Draft Decision represents a reduction in its opex of around 31 per cent relative to its January 2015 revised regulatory proposal. We also recognise that this reflects a considerable amount of internal review and change by Evoenergy in the 3½ years since they lodged their revised revenue proposal for 2014-19. It is our observation that Evoenergy has accepted that there were inefficiencies in their operations and have subsequently worked diligently to reduce costs, ultimately borne by consumers, to become much more efficient. Evoenergy state that the efficiencies have been improved by:

- an extensive restructuring of the workforce including redundancies;
- re-engineering and asset optimisation to reduce the program of works;
- savings on vegetation management using new light detection and ranging (LiDAR) technology and improved contractual arrangements;
- investment in systems technology to drive smarter operation of the network, including improvements in automation and asset management practices; and
- a reduction in overtime and staff training.

We observe that significant effort was made to reduce labour costs in the first year of the 2014-19 regulatory control period, leaving the benefits to consumers to flow through the remaining years of the period and beyond. We also recognise that the Draft Decision poses the question as to whether the quantum of redundancy programs was efficient. Evoenergy claims that they have been efficient, we have no reason to disagree, for this "one off" redundancy program that was primarily implemented in 2014/15.

Evoenergy staff and management are to be congratulated for their efforts. In recognising the considerable increase in opex efficiency achieved since 2015, we also observe that efforts to improve opex productivity need to be ongoing.

<u>Benchmarking</u>

CCP10 is acutely aware that aspects of the AER's benchmarking analysis that helped to inform its original decision for 2014-19 were controversial. CCP1, the CCP subpanel overviewing the 2014-19 regulatory process for ActewAGL and NSW DNSP's, actively supported the AER's efforts to introduce benchmarking analysis. CCP10 continues to support the development and application of benchmarking as an important element of the regulator's repertoire and in providing clear and transparent data to network businesses.

The Draft Decision states:

> "At our stakeholder roundtable meeting in August 2017, a number of stakeholders agreed there is a significant role for benchmarking in network regulation and

> supported its further development. At the meeting, stakeholders also expressed a clear preference for us to remake our decisions in a timely manner and recognised that revisiting our benchmarking would not be possible without further delaying the remaking of our opex decisions."

It is accepted that we are one of the stakeholders supporting the significant role for benchmarking, and we continue to have this attitude. We also recognise that the AER has made considerable effort to improve the quality of their benchmarking analysis since the first benchmarking report. This means that businesses and other stakeholders can have confidence in the legitimacy of contemporary benchmarking reports published by the AER.

Debt

CCP10 said in our submission dealing with debt issues for the remitted decisions:

> "CCP10 supports the AER proposal to adopt the trailing average with a transition as it is:
> 1. consistent with the NEO and ARORO
> 2. consistent with efficient debt costs and efficient pricing and
> 3. avoids the creation of windfall losses or gains for either the NSP or the consumers.
>
> At this time the alternative proposed by some – but not all – NSPs of adopting the trailing average without a transition would see consumers pay twice for the high interest rates during the GFC. This creates a windfall gain for the NSPs and results in prices that exceed economically efficient prices.
>
> As the AER notes, the alternative to adopting the trailing average with a transition that is consistent with the NEO and ARORO is to continue setting debt costs using the on-the-day rate. Adoption of the trailing average with a transition better meets the long-term interest of consumers because it provides greater price stability."

The Draft Decision includes the following regarding applicable data:

> "The consultation process on Evoenergy's proposal occurred in good faith, based on the best available information at the time. We note that the most recent RBA data update released on 5 June 2018 occurred after a period in which substantial pre-lodgement engagement on the key financial parameters of Evoenergy's proposal had already taken place with its key stakeholders, including consumer groups and our officers.
>
> In summary, given the novel circumstances, the late timing of the 5 June 2018 RBA data update, the good faith in which parties have sought resolution of the remittal, and the broad stakeholder support for Evoenergy's proposal, on balance, we consider that not applying the most up to date RBA data (as updated on 5 June 2018) to this remade draft decision is the outcome that contributes to the NEO to the greatest degree. We will consider all stakeholder submissions received on this issue, and other issues more generally, before publishing our final decision later this year."

CCP10's view is to support the proposal to not apply the 5th June 2018 RBA data, as this information was not available to Evoenergy prior to their negotiations and lodgement of their proposal. We concur with the AER's observation that applying the most recent data available

at the time of proposal development reflects "good faith" by the AER and Evoenergy in developing the remittal proposal.

The AER's Draft Decision regarding debt is:

> "(in) our remitted debt decisions … we consider a revenue neutral transition to a trailing average debt estimation methodology will lead to an allowed rate of return that will achieve the ARORO and contribute to the achievement of the NEO to the greatest degree. This rate of return will both reflect ex ante efficient financing costs and result in an approximately zero NPV investment outcome which is important to achieving efficient investment incentives. A revenue neutral transition will also substantially eliminate any wealth impact on Evoenergy from changing the debt estimation methodology."

This approach is supported by CCP10, and our rationale is given in our submission to the 2017/18 paper dealing with debt for the remitted decisions.

STPIS

The AER's Draft Decision regarding application of the Service Target Performance Incentive Scheme (STPIS) is given as:

> "Our draft decision is to accept Evoenergy's proposed changes to its STPIS performance targets. That is, we have applied a 5 per cent adjustment to all of Evoenergy's STPIS performance targets for 2015-16 and 2016-17 only, but have maintained the STPIS performance targets for 2017-18 and 2018-19 as determined in our 2015 final decision."

CCP10 supports the Draft Decision regarding STPIS.

Best interests of Consumers

CCP10 believes that the Evoenergy proposal is in the long-term interests of Evoenergy's customers. The Draft Decision involves Evoenergy retaining up to $26m in revenue that could notionally otherwise be returned to consumers, but this needs to be considered in the context of the overall proposal. Consumers will benefit from:

- the certainty provided by the resolution of the proposed price path;
- the removal of the risk for consumers from the re-opening of the contentious issues from the Federal Court decision, particularly in regard to debt costs;
- the reductions in operating expenditure that Evoenergy has achieved on an ongoing basis;
- the return of approximately $1m to consumers over the 2019-24 regulatory period;
- Evoenergy's commitment that there will be no real increase in prices for standard control services during 2019-24 as a result of this proposal; and
- enhanced focus on ongoing consumer engagement.

A feature of the Evoenergy remittal proposal is that the revenue effects will be smoothed over the 2019-24 period, contributing to price stability for Evoenergy's consumers. In order

to achieve this proposal, Evoenergy has chosen not to re-open contentious matters following the Federal Court decision.

It is our opinion that the benefits outweigh the costs, in aggregate, for consumers from this proposal.

Control Mechanism

We note that the Draft Decision results in about $1m being returned to customers during the 2019-24 period. We also recognise that the AER has said:

> "To ensure Evoenergy does not recover any additional revenue above the $26 million, we consider a true-up will be required in the 2019–24 regulatory control period. This is because we will not know what Evoenergy's actual standard control services revenue for the 2014-19 regulatory control period will be until after this regulatory control period expires."

CCP10 is comfortable with this approach.

Final Comment

CCP10 commends Evoenergy for taking this opportunity to resolve the 2014-19 revenue determinations. Consumers were not well served by the regulatory impasse between the AER and the NSW/ACT businesses around the 2014-19 determinations.

We also commend the consumer groups on their willingness to engage with Evoenergy for this remittal process and the 'good faith' that they have demonstrated, and which has been responded to very constructively by Evoenergy. CCP10 notes that the consumer groups continue to raise affordability as a key issue in the ongoing engagement about Evoenergy's 2019-24 determination. CCP10 encourages Evoenergy to continue to look for ways to respond in good faith to these concerns as part of its engagement on its 2019-24 determination.

Confidential Material

CCP10 confirms that to the best of our knowledge, this submission does not contain any confidential material nor reference to confidential material

Louise Benjamin, Mark Henley, Mike Swanston

CCP10