**C**onsumer

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12 December 2017

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Dear Sebastian

**Endeavour Energy - Request for extension of lodgement of 2019-24 revenue allowance proposal**

On 10 November 2017, CCP 10 and Slavko Jovanoski attended meetings with each of the NSW electricity distribution businesses as part of CCP10’s general process relating to development of regulatory proposals for the 2019-24 period. We met with ActewAGL for the same purpose on 30 November 2017. The purpose of the pre-lodgement discussions was to ensure that the NSW and ACT businesses would not be ‘surprised’ by CCP advice to the AER in response to their draft 2019-24 regulatory proposal. We agreed with the AER and the businesses that we would provide an individual ‘progress report’ to the AER for each business. The AER intends to make our progress reports public. We anticipate that pre-lodgement discussions with businesses and progress reports by the CCP is likely to become standard CCP practice.

As part of this process, CCP 10 met with Endeavour Energy (Endeavour) at the AER’s Sydney offices on 10 November to discuss Endeavour’s consumer engagement on its draft 2019-24 revenue allowance proposal. At that meeting, CCP10 expressed some concerns about Endeavour’s draft proposal and about its consumer engagement to date.

We will be providing the AER with a separate written ‘progress report’ about the views we expressed in that meeting in the near future.

In the course of the meeting with Endeavour CCP 10 and Endeavour discussed the possibility of Endeavour requesting the AER to agree to an extension of the date for lodgement of its draft 2019-24 proposal beyond 30 January 2018. We indicated that if Endeavour made such a request to the AER, CCP 10’s advice to the AER about the request could only be supportive if Endeavour presented a proposal that was, as far as possible, consistent with the AER’s framework (including WACC) and the reasonable expectations of consumers.

The rationale behind our suggestion was, if granted, an extension would give Endeavour time to undertake detailed consumer engagement on a revised draft revenue proposal. Consumers would also benefit from greater certainty on future prices, a reduction in the risk of adverse outcomes, and a less contentious process. We expressed the opinion that if the AER was involved in the engagement it need not be disadvantaged by the reduced time between lodgement of the draft proposal and the publication by the AER of its draft decision, the timing of which is determined by the rules.

Through our involvement with Endeavour’s consumer engagement to date, it has become clear that a major issue for Endeavour to consider in its 2019-24 and subsequent regulatory proposals will be the forecasting of demand and planning growth for Western Sydney. Our particular focus consequently was on a capital expenditure deep dive engagement process.

On 16 November, you asked us to provide our preliminary view to you on how any extension would affect the interests of consumers and we provided that advice to you on 26 November. Since that letter Endeavour has been engaging with each of CCP 10, ECA and PIAC about its request for an extension and has sought to address the concerns expressed by CCP 10 in our 26 November letter.

On 8 December 2017, you sought our views on the letter and consumer engagement program from Andrew Schille sent to you dated 8 December 2017 (the extension request). The views in this letter are informed by our discussions between Endeavour and CCP 10 members between 17 November and 11 December, statements made by Endeavour management to its Customer Consultative Committee (CCC) meeting on 22 November 2017, our interactions with Endeavour on the development of the consumer engagement plan which underpins the extension and the extension request. Our observations expressed in the 10 November meeting about Endeavour’s consumer engagement to date underpin the views in this letter.

**CCP support for an extension to submit the 19-24 proposal**

CCP 10 supports Endeavour’s request for an extension because:

1. we believe it is in consumers’ interests. Consumers best interests are specifically understood in the current context to be sustainable price reductions in real terms, (assuming safety and reliability of supply)
2. we have considerable confidence from the collaborative approach in which Endeavour has engaged with consumer representative groups, including CCP10, in the development of the consumer engagement program underpinning the extension request. We observe an understanding that consumer engagement is a two-way process that involves actively listening to consumer input and responding to such input
3. Endeavour has expressed a longer-term commitment to the critical importance of consumer engagement as part of its business planning - specifically its commitment to the development of a customer forum moving towards the Scottish Water model and
4. the commitment by Endeavour to the AER’s building blocks combined with the extensive engagement program means the AER should not be disadvantaged by the reduced time between lodgement of the draft proposal and the publication by the AER of its draft decision.

**Key issues**

**Price**

In the consumer engagement Endeavour has conducted on its 2019-24 proposal to date, CCP 10 has observed that consumers have reinforced that affordability is their key concern. This focus on price stability and affordability is reflected in the final advice given to Endeavour by its consultant Newgate and was highlighted by Endeavour to CCP 10 in our meeting on 10 November 2017: “*Affordability is the key issue for* ***all customers*** *and* ***stakeholders****.*” And “***Customers*** *want Endeavour Energy to keep its share of charges as low as possible so as to assist all customers, including the vulnerable*.”

Delivering continued efficiencies in capital investment and operating expenditure to maintain downward pressure on network pricing is also consistent with public statements by Endeavour executives: “*We remain committed to keeping downward pressure on network charges while delivering the safe and reliable electricity supply expected by customers*.” Rod Howard 25 May 2017. This statement was made after the Federal Court decision.

We rely on Endeavour’s commitment in its extension request to achieving pricing stability and affordability for customers in 2019-24 consistent with pricing outcomes for its customers since 2009.

**Capital requirements**

In our letter of 26 November, we expressed concern about the variations in Endeavour’s capex projections and the fact that there has been a lack of clear explanation and justification of the changing forecast. This concern is exacerbated by Endeavour currently having underspent its allocated capex in 2014-19, whilst at the same time discussing possible increases for the next period as high as $2.25B. On data provided to the CCC on 22 November, system capital is planned to grow from $1.561B forecast to be invested in 2014-19 (on the assumption that the current 30% underspend can be recovered in the last two years of the period) to $2.075B proposed for 2019-24.

At the CCC meeting Endeavour indicated that it will increase its capex expenditure rate and intends to spend the full 2014-19 allocation. Whilst this is a partial answer to one of our concerns, it gives rise to a different concern about efficient and prudent capital investment and the increasing size of Endeavour’s Regulated Asset Base.

The CCC was also advised that the proposed increase to $2.250B for 2019-24 was based on:

1. non-system capital of $175M, a slight increase from the $171M last determination;
2. a 33% increase in system capital requirements from 2014-19 to 2019-24;
3. a 16% increase in asset replacement capital over the same period; and
4. a significant increase in connection costs, from $150M to $310M – largely by an upward step-change in growth in property development and a change to their capital contributions policy to meet industry ‘standard practice’.

It is noted that the proposal for contingent projects includes not only the proposed new airport for Sydney ($65M), but also asset replacement work including building and aged cable replacement ($120M). The application of the contingent project framework for asset replacement projects will need further exploration.

We expressed these concerns to Endeavour and note that Endeavour has agreed in its extension request to an initial target total capex expenditure of $2.25B and a detailed collaborative consultation ‘deep dive’ on the capital requirement in conjunction with the AER, consumers and other stakeholders to address our concerns.

**Conclusion**

We believe that as a result of the proposed consumer engagement consumers will have greater visibility and understanding of the benefits they will receive as a result of Endeavour’s opex and capex proposals. The engagement also has the potential to lead to greater certainty of future price outcomes and an assurance that consumers are paying no more than is necessary in network charges. In our view, a key outcome of Endeavour’s extension request is the potential for greater transparency and confidence in growth forecasts for Western Sydney, which is expected to experience continuing growth for the foreseeable future. Accordingly, we believe there is the potential for long-term consumer benefit in the 19-24 reset and in future reset periods from the proposed consumer engagement program. We commend Endeavour for their commitment to developing a long-term consumer engagement strategy and their exploration of engagement approaches from their Australian peers and overseas businesses.

We are aware that the AER will give a copy of this letter to Endeavour.

Yours sincerely

Mark Henley, Louise Benjamin, Eric Groom and Mike Swanston