

The background of the slide is a grayscale photograph of a road lined with utility poles. The poles are tall and wooden, with multiple cross-arms. The road is paved and has a white dashed line down the center. There are some signs on the left side of the road, including a diamond-shaped sign that says "FLORIDA" and another that says "DIP". The sky is overcast and hazy.

Energex and Ergon Energy 2020-25 Distribution Determination

Consumer
Challenge
Panel

AER Public Forum Consumer Challenge Panel 24 October 2019

CCP14
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Mike Swanston

Our role as a Consumer Challenge Panel...

- We advise the AER on:
 - i. Whether the network businesses' proposals are in the long-term interests of consumers, *and*
 - ii. The effectiveness of network businesses' engagement activities with their customers –
 - i. who, how, when and what issues EQ engaged with its customers on,
 - ii. how this engagement has influenced the revenue proposal,
 - iii. do consumers agree with the revenue proposal, and
 - iv. is there a process for ongoing review of CE/continuous improvement
- We consider this role in the context of the National Electricity Objective (NEO)
- Emphasis on “challenge” to both the network and the AER
- Aim of getting to a proposal that is “capable of acceptance”

The AER is guided by the NEO

National Energy Objective (NEO):

*“to promote efficient **investment** in, and efficient **operation** and use of, energy services for the **long term interests of consumers** of energy with respect to **price, quality, safety, reliability and security** of supply of energy.”*

Therefore, we consider:

- How prudent and efficient is proposed capex/opex expenditure?
- How will costs be allocated to different consumer groups?
- How does the proposal reflect the changing electricity market and long-term issues?

CCP scope in the AER building blocks

The 'in scope' capex/opex items account for ~ 35-40% of Ergon/Energex proposed revenue

In scope	Out of scope
✓ Proposed capex in period	✗ Rate of return – AER binding guideline in December 2018
✓ Proposed opex in period	✗ Opex productivity – AER decision March 2019 for 0.5%/yr
✓ Application of incentive schemes	✗ Taxation allowance – AER decision in December 2018
✓ Tariff Structure Statement	✗ Regulatory depreciation
✓ Consumer engagement	

Consumer Challenge Panel

What we will
cover today

1. Some opening comments on the Draft Decision
2. How the Draft Decision differs from EQ's Reg Proposals
3. The importance of a lower WACC to the outcome
4. Energex and Ergon efficiency over time
5. Ergon opex
6. Ergon and Energex capex
7. Delay, content and engagement re the TSS
8. Our expectations for the revised proposal
9. Broader issues for the future

Some opening comments

1. The EQ proposal targeted reduced prices, but AER found further reductions. We recognise this *may lead EQ to reconsider* some of the matters from the proposal.
2. We are pleased the AER draft decision reflected the *genuine desire to engage* and seek to reflect consumer feedback, although there have been some rocky stages e.g. TSS
3. The significant changes in recent years formation gives some confidence in proposed 20-25 reductions, but *are the savings sustainable* post 2025 given a one-off 'sugar hit' in 20-25 ?
4. EQ showed restraint but is still coming to grips with the way the AER evaluates proposed expenditure especially capex, and now has the challenge to *meet the AER's justification requirements* in its revised proposal.
5. We wonder about *capability to deliver* even the lower capex in the draft decision, including repex and ICT.

Some more opening comments

6. A significant part of the reduction in the draft decision in the current period is driven by a lower WACC. What will EQ do in 2020-25 to prepare it if the **interest rate cycle reverses** for 2025-30?
7. We note that the AER reductions in allowed expenditure in the Draft Decision may lead to EQ reducing/taking off the table their **CESS/EBSS “return”**. If it is then we trust that the amount taken “back off the table” is related to the increased capex EQ is able to support in their revised proposal
8. We note some matters that are outside EQ’s control and the AER review process:
 - i. jurisdictional issues e.g. **solar bonus** post 30 June 2020 and **transitional retail tariffs** post 30 June 2021
 - ii. what the final consumer faces depends on how the retailer passes on the new tariffs

However these are of vital interest to consumers and we trust *EQ will at least consider their possible impact* on customers in future engagement.

Draft Decision compared to the proposal - Energex

Real \$2020	Current 2015-20	Forecast Period 2020-25			Draft Decision % Change	
	Forecast – like for like	Draft Plan Sept 18	Reg Proposal Jan 19	AER Draft Decision	From current period	From Jan 2019 Reg Proposal
Total Revenue	6,704	6,209	6,085	5,428	-19.03%	-10.80%
Capex (inc Capital Contributions)	2,846	2,383	2,327	2,090	-27.06%	-10.77%
Opex (exc Debt Raising Costs)	1,894	1,763	1,775	1,926	+1.66%	+8.50%
RAB (at end of period)	12,917	12,755	12,701	12,474	-3.40%	-1.78%
WACC %	6.01%	5.49%	5.46%	4.87%	-1.14%	-0.59%

Draft Decision compared to the proposal – Ergon Energy

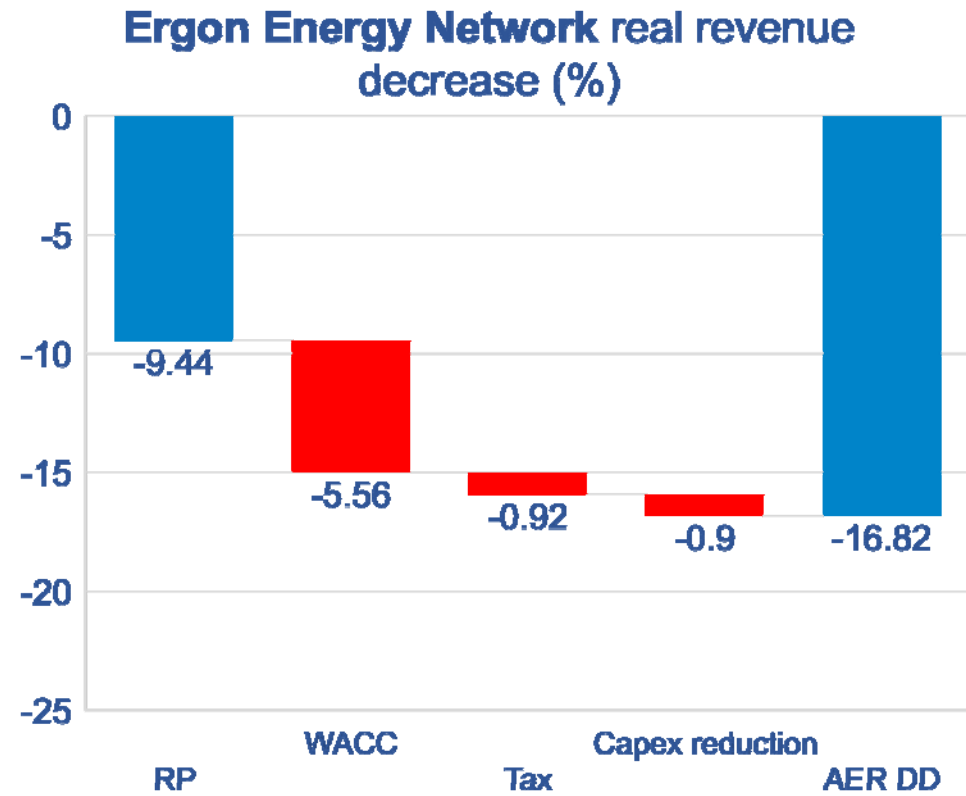
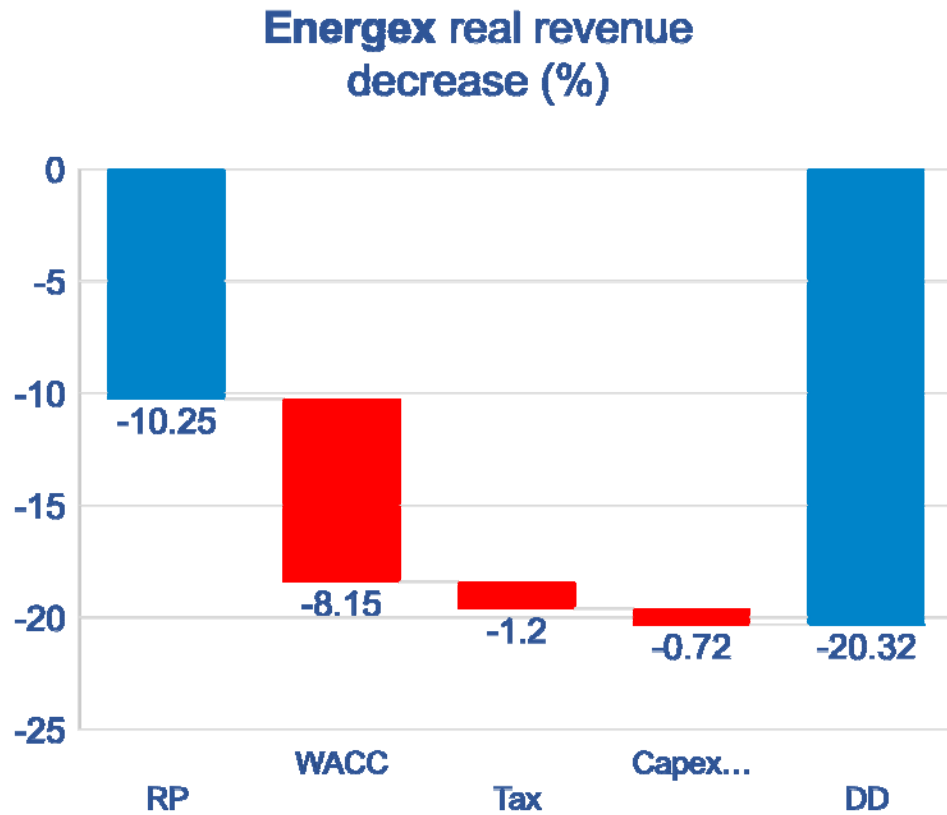
Real \$2020	Current 2015-20	Forecast Period 2020-25			Draft Decision % Change	
	Forecast – like for like	Draft Plan Sept 18	Reg Proposal Jan 19	AER Draft Decision	From current period	From Jan 2019 Reg Proposal
Total Revenue	6,398	6,325	6,061	5,780	-9.96%	-4.64%
Capex (inc Capital Contributions)	2,729	2,540	2,905	2,339	-14.29%	-19.48%
Opex (exc Debt Raising Costs)	2,024	1,761	1,806	1,945	-3.89%	-7.70%
RAB (at end of period)	11,650	11,701	12,077	11,425	-1.93%	-5.00%
WACC %	6.01%	5.49%	5.46%	4.87%	-1.14%	-0.59%

Indicative DUoS Price Reductions 2019/20 versus 2020/21

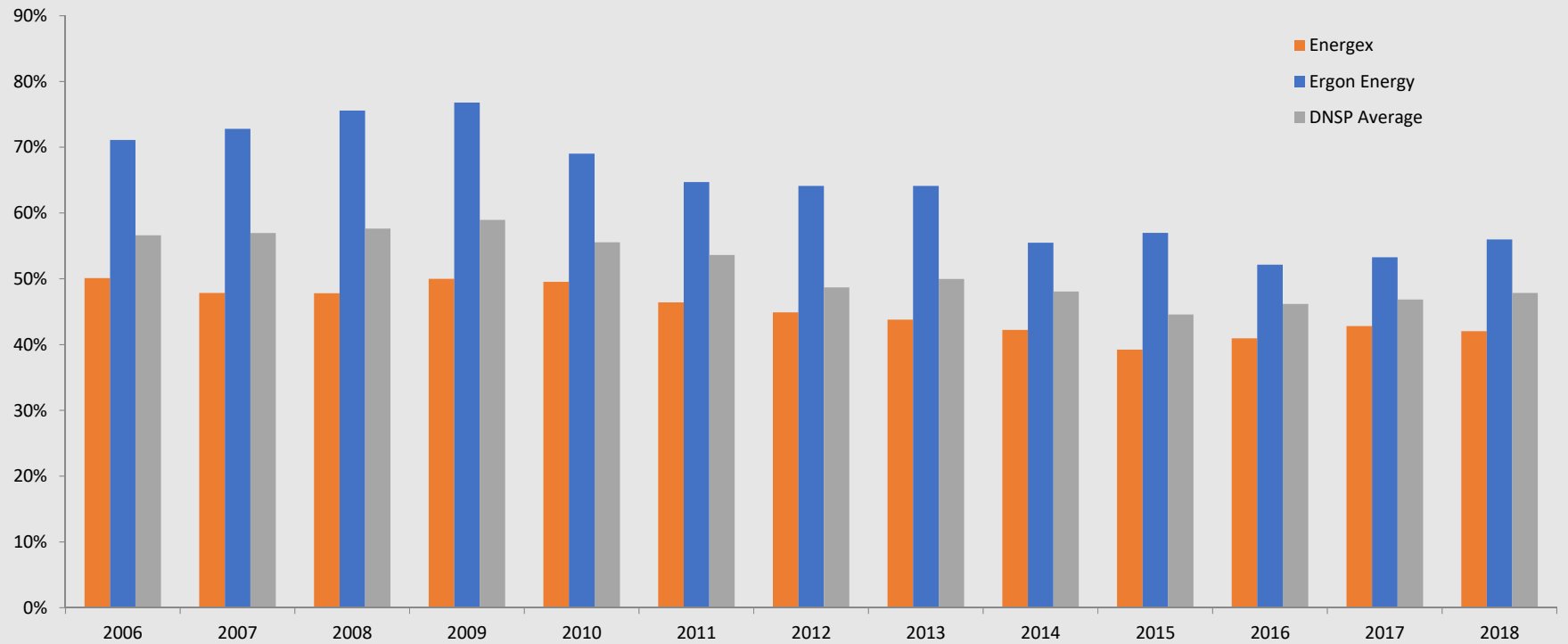
	Residential Customer		Small Business Customer	
	Reg Proposal	Draft Decision	Reg Proposal	Draft Decision
Energex	-10.3%	-17%	-11.4%	-19%
Ergon	-4.5%	-14%	-4.5%	-16%

- Note:
- a) Reductions proposed are once-off real reductions for average residential and average small business customers on legacy default network tariffs in South East Qld.
 - b) The difference in distribution network charges for regional customers compared to customers in South East Qld will continue to be subsidised by the Qld Government via CSO payments.
 - c) The retailer response to network tariff reductions is not able to be forecast.
 - d) External influences such as the possible impact of jurisdictional schemes (eg. solar bonus scheme) are not included.

WACC is driving the lower revenue cap



Asset utilisation remains low



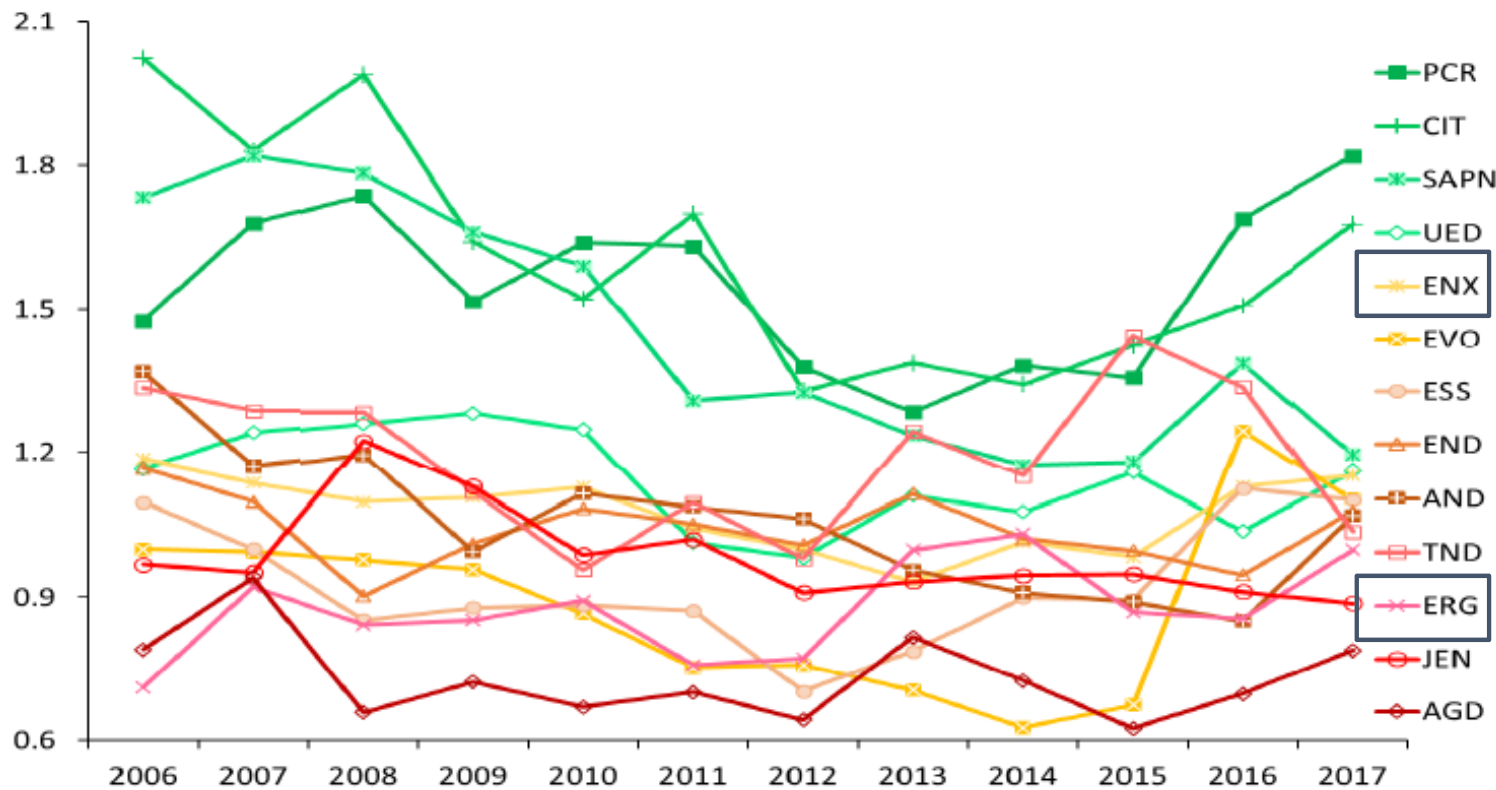
Ergon opex

1. This was an issue we highlighted in the April Forum
2. Historically Ergon has performed poorly even accounting for its rural, low density network
3. AER has accepted Ergon's proposal, although the AER's alternative estimate was higher
 - I. Reduction in recent years with this forecast to continue in base year (17/18)
 - II. Application of latest operating environmental factors
 - III. Gets Ergon across the 0.75 benchmark for "not materially inefficient"
4. But Ergon's position may change

"However, we note that this is a finely balanced assessment. We will review this position after updating our benchmarking analysis, taking into account the actual base year opex included in Ergon Energy's revised proposal and the results of our 2019 Annual Benchmarking Report, which will be published in late November 2019." (p. 6-8)
5. Previous CCP commentary recommending the AER review the current 0.75 benchmark – all networks can get to that, so it loses its relevance. Efficiency measures are relative, not absolute

Improved productivity is expected 20-25 but will the relative position improve - opex?

Figure 4.3 DNSP opex multilateral partial factor productivity indexes, 2006-17



Energex – around the same level as 2006

Ergon – reasonable increase from a very low base, but not as much as some others, so relative position still low

Useful if AER developed forecast productivity based on DD

Capital investment allowances (CAPEX)

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Energex

- Repex -9%, augex -35%, ICT -24%
- 0.3% demand growth

Ergon Energy

- Repex -23%, augex - 31%, ICT – 24%
- 0.3% demand growth

CCP's response to the EQ proposals: CAPEX

- Overall, the case put forward by EQ for reduced capex is supported, but more to be done
- Ergon increase in repex of 25% (\$208M), reflects efficient spending trends ?
- Neutral failure risk / LV safety: the most appropriate use of funds ?
- The case focussing on safety is persuasive, but may not meet the AER's requirements
- ICT: benefits and treatment of past investments, and prudence & efficiency of proposed investment ?
- Concerns regarding the prudence of other non-network expenditure – property, fleet

Capex: Items for the revised proposal

- We acknowledge the 'door is still open' for EQ to provide more supporting information re capex, but will this result in change ?
- We expect EQ will work hard to better justify the asset replacement needs of regional Qld
- ICT response will align with the likely needs of the AER ICT analysis guideline
- Capitalised overheads needs to reflect the broader productivity savings
- Further discussion of the discrepancies between Energex and Ergon regarding public lighting

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TSS needs
more work,
we know EQ
are working
on it

- The draft decision suggests a roadmap to get to an approved TSS
- EQ now well down that pathway
- Are the new tariffs for primary production and industry workable and acceptable to those customers ?
- Look forward to consumer advocates comments – especially vulnerable residential customers, ginners and foundries on transitional tariffs
- Await Government decision on any extension of transitional tariffs beyond 30 June 2021 and Solar Bonus Scheme – outside this AER process

CCP 14 expectations for the revised proposal

- EQ will adequately engage with customers on any proposed changes or challenges to the draft determination – initial indications are good
- EQ establish effective customer / stakeholder oversight of issues such as tariffs and innovation
- EQ revisit the objectives of the primary production and industrial tariffs to seek innovation, new ideas and joint solutions
- EQ articulate their ‘network of the future’ to focus future investment
- That the AER clarify their assessment of capitalised overheads (e.g. Ergon capex -21%, but overheads are only -11%)

Next steps and consumer engagement

- EQ to submit final proposal in December
- Submissions due 15 January 2020
- CCP will be making a submission and we encourage consumer advocates to do likewise

Broader issues for the future

- We look forward to the day when the AER does not have to 'repeat' the significant level of detailed analysis of individual projects
- Invite the AER to consider a review of the contingent project definition
 - developed at a time when issue was how to meet increased demand
 - Now an issue of uncertainty around capex in a falling/flat grid demand world and DER
 - Some alignment with the RiT-T thresholds?
- DER expenditure is moderate, accepted by AER, but the broader *Intelligent Grid Enablement* will require a broader approach by utilities and the AER. We look forward to AER DER paper.
- Determination to provide greater clarity of P0 and network cost reductions
- Review of opex "not materially inefficient" methodology around the 0.75 trigger point



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