

5 February 2019  
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## INTRODUCTION AND SUMMARY

The Energy Users Association of Australia (EUAA) is the peak body representing Australian energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing and materials processing industries. Combined they employ over 1 million Australians, pay billions in energy bills every year and are desperate to see all parts of the energy supply chain making their contribution to the National Electricity Objective. Our members are highly exposed to movements in both gas and electricity prices and have been under increasing stress due to escalating energy costs.

These increased costs are either absorbed by the business, making it more difficult to maintain existing levels of employment or passed through to consumers in the form of increases in the prices paid for many everyday items. Many of our members have operations in NSW, including some with operations across all three DNSPs and have borne large rises in network charges over the last decade.

The process to arrive at the allowable revenue for the 2019-24 period for the three NSW DNSPs has been long and arduous for all involved.

The original AER final decisions published in April and June 2015 were extensively disputed through the Australian Competition Tribunal and then the Federal Court. The subsequent remittal process that set the final agreed 2014-19 revenue only finished with the Ausgrid decision in January 2019, five months before the end of the five-year period it applies to. The remittal process led to the networks obtaining an extension to engage in deep dive discussions with stakeholders prior to submitting their Initial Proposals in April 2018 for 2019-24 and then a much-compressed period for engaging on the AER's Draft Decision and the networks' revised proposals.

Alongside all these developments was the privatisation process that brought in new owners for Ausgrid and Endeavour and a requirement on Essential to be a standalone corporate entity. These new shareholders were judged by the market to have paid a significant price for their assets and came expecting a return on those assets.

Finally, the Federal Government abolished LMR in 2017 while the AER instigated network wide reviews of rate of return, expected inflation, taxation allowance, tariffs and opex productivity. We strongly support the conclusions from these completed AER reviews and support the submission made by CCP22 to the AER on this matter supporting an annual factor of at least 1.5-2.0%.<sup>1</sup>

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<sup>1</sup> See the EUAA's submission <https://www.aer.gov.au/system/files/EUAA%20-%20Submission%20to%20the%20AER%20Opex%20Productivity%20Growth%20Forecast%20Review%20Draft%20Decision%20aper%20-%202021%20December%202018.pdf> and CCP22 submission <https://www.aer.gov.au/system/files/CCP%20-%20Submission%20to%20the%20AER%20Opex%20Productivity%20Growth%20Forecast%20Review%20Draft%20Decision%20aper%20-%202020%20December%202018.pdf>

All these (depending on the outcome of the opex review) reduced return expectations that may have been part of their bid assumptions. However, just as our members have to accept both regulatory and market risk, they expect the owners of regulated assets to accept regulatory risk.

In parallel with these events there was a large push from the AER under AER 2.0 and the work of the ENA, ECA and other consumer advocates, including the EUAA, to improve consumer engagement so that the final AER decision did truly reflect the national electricity objective of the long-term interests of consumers.

As we noted in our submission on the networks' initial proposals<sup>2</sup>, our primary criterion for assessment is affordability. This is no different for the vulnerable residential consumer, the vulnerable small or medium business supplying local markets, or the vulnerable large business subject to international competition. With the exception of perhaps some isolated areas, in general we see no justification for spending to achieve improved reliability above the existing level. Rather we look to improved efficiencies to enable the DNSPs to provide the same level of service at a lower real cost.

This submission focusses on the Revised Proposal from Ausgrid. It concludes that, subject the AER accepting the revised capex proposal of \$2.69b and a decision to adopt a trend opex productivity of at least 1% per year for 2021, Ausgrid's Revised Proposal is "capable of acceptance" by the AER. The changes since October 2018 in Ausgrid's approach to consumer engagement and how this is reflected in their revised proposal have been remarkable. We congratulate them on this change to a much more collaborative and constructive approach and look forward to it developing further in the future.

Nevertheless, we note that even with the significant work to reduce opex and capex, the real value of RAB still increases over the reset period. This will pose a significant challenge for pricing in the next 2024-29 regulatory period.

We congratulate Essential on an initial proposal that was substantially accepted by the AER and its receipt of the ENA Energy Network Consumer Engagement Award. We believe their revised proposal is "capable of acceptance". We comment on the challenge Essential has in reducing its regulated asset base and look forward to progress to reduce this over 2019-24.

Our comments on Endeavour are focussed on its strong opposition to the AER applying opex productivity improvements. It is very disappointing that Endeavour is the only one of the three networks to not voluntarily propose opex productivity improvements. Given this, and its pushback on the binding WACC guideline and revised tax allowance calculation methodology both published in December, we wonder how consistent this overall approach is to their signing up to the recently announced Energy Charter.<sup>3</sup>

We believe that their final proposal is only capable of acceptance if they agree to follow the final conclusions of the AER reviews of opex productivity with a minimum of 1% annual productivity factor, calculation of the tax allowance, and the AER is satisfied with its \$1.7b capex proposal.

While the networks have been able to bring consumers varying level of price falls from 1<sup>st</sup> July 2019, it remains to be seen how sustainable these falls will be. Generally, the major factor causing the price fall or limiting the price rise, are factors effectively outside the "control" of the network – particularly the lower WACC from the AER's final

<sup>2</sup> See [https://www.aer.gov.au/system/files/EUAA%20-%20Submission%20-%2010%20August%202018\\_1.pdf](https://www.aer.gov.au/system/files/EUAA%20-%20Submission%20-%2010%20August%202018_1.pdf)

<sup>3</sup> See <https://www.theenergycharter.com.au/participants/>

binding decision last December<sup>4</sup>, but also the changes in tax allowance calculation<sup>5</sup> - rather than networks becoming more efficient in opex and capex expenditure. In the case of Ausgrid, the table shows the impact for the “average” medium and large consumer.

Bill change FY20 vs FY19	Attributable to non-Ausgrid decisions		Attributable to Ausgrid decisions		Total Bill change	
Medium business (160-750MWh/yr.)	-\$1,973	-7.0%	-\$751	-2.7%	-\$2,724	-9.7%
Large business (>750MWh/yr.)	-\$2,051	-1.7%	-\$780	-0.6%	-\$2,831	-2.3%

This shows that nearly three quarters of the price fall is due to factors outside of Ausgrid’s internal decision making – particularly the lower WACC. Ausgrid’s commendable efforts to reduce capex and opex contributed only one quarter of the overall price fall.

The issue for consumers and networks is that this lower WACC is partly driven by the current low interest rates. A change in the interest rate cycle to levels of just 5-7 years ago will require significantly greater cuts in network opex and capex to prevent potentially significant network price rises in the future.

Finally, we comment on the urgent need for the AER to institute a network wide review of ICT and associated cyber security capex and opex spending. This is an increasing component of networks’ revenue that does not have the same rigour applied to it that is applied to other parts of a network’s expenditure. Networks claim that such expenditure is required to improve efficiency, meet customer expectations and comply with legislative obligations. Consumers are seeking much more detailed justifications and AER review rigor around this expenditure.

Kind regards



Andrew Richards  
Chief Executive Officer  
Energy Users Association of Australia

<sup>4</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-guideline-2018/final-decision>

<sup>5</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/regulatory-tax-approach-review-2018/aer-position>

## Ausgrid

Ausgrid as an organisation is going through immense change. The EUAA recognises the transformation that has occurred to achieve the cost reductions in the current period has had a significant impact on the whole organisation. These changes will need to continue for Ausgrid to achieve the improvements it has committed to for 2019-24 and the consequent network price decreases all consumers will continue to enjoy. We look forward to working with, and supporting, Ausgrid as it continues this transformation process over the next five years.

### Consumer engagement

In the past, the EUAA, along with other consumer advocates, has been very critical of Ausgrid – its use of litigation to achieve its desired outcomes, its poor consumer engagement that seemed to be more of a tick the box exercise than a genuine engagement process and its unwillingness to properly evaluate its expenditure proposals. This was reflected in both our submission on the initial proposal and our acceptance of the remittal agreement, both in August 2018.<sup>6</sup>

By contrast, in this submission we were very pleased to report a significant and fundamental change in Ausgrid’s approach in late 2018 in the lead-up to the publication of the AER’s Draft Decision in November 2018. This new approach was built on the following set of engagement principles:<sup>7</sup>

#### Our Engagement Principles

The following principles aim to build customers’ trust and improve decision making:

**Be collaborative:** Don’t be defensive and remain open to possibilities

**Be quantitative:** Provide data from the customer’s perspective

**Be accountable:** Agree a timeframe and deliver

**Be transparent:** Encourage and support our stakeholders in holding us to account on progress, agree timeframes and deliver

**Be adaptable:** Be prepared to change based on feedback from stakeholders

Ausgrid then entered into a period of intense negotiation with a range of consumer representatives – including CCP10, ECA, PIAC and the EUAA, as well as the AER - to develop a package that would potentially be capable of acceptance from consumer advocates.

The EUAA came out of this intense period with a greatly increased respect and trust for Ausgrid. They kept to the principles, they engaged in meaningful and substantive debate on all aspects of their proposal, though at a level of intensity given the limited time available, that restricted our ability to fully examine all aspects. They were prepared to make some hard decisions that consumer advocates had previously sought and Ausgrid had strongly resisted.

This showed the new engagement approach was not simply words but was demonstrated in clear actions across a range of issues important to consumers.

<sup>6</sup> See p.14 <https://www.aer.gov.au/system/files/EUAA%20-%20Letter%20to%20Ausgrid%20on%202014-19%20remittal%20proposal%20-%202014%20August%202018.pdf>

<sup>7</sup> Ausgrid p. 14 <https://www.aer.gov.au/system/files/Ausgrid%20-%20Revised%20Proposal%20-%20Revised%20Regulatory%20Proposal%20-%20January%202019.pdf>

We look forward to this new approach being the basis of continuing Ausgrid engagement and to participating in the specialised committees Ausgrid proposes to establish as part of its Revised Proposal.

*Ausgrid's extensive list of commitments is welcome*

The table summarises these commitments which are extensive and one of the largest and most significant we have seen from an electricity or gas network. We would particularly highlight:

- The final capex of \$2.69b compared with \$3.08m in the initial proposal and a much more robust internal analysis process for assessing capital projects
- The 1% opex productivity factor from year 2 – 2020-21 with a longer-term commitment to sharing productivity gains with their customers
- Acceptance of AER decisions on rate of return and tax
- The commitments around increased consumer engagement:
  - the expanded role for the Customer Consultative Committee
  - establishment of the Technology Review Committee to improve transparency around IT and cyber investments with consumer input into the forecasting and assessment methods for IT expenditure
  - the establishment of a Network Innovation Advisory Committee to review proposed \$42m of innovation projects that are not included in CESS
- Commitment to the recently announced Energy Charter
- Progress on implementing innovative tariffs through the Pricing Working Group

## Review of commitments to customers

<b>CORE VALUE ITEMS</b>		
Capex	\$2.69 billion Breakdown table 5.1 p.69 (changes discussed with AER)	Executive Summary + Chapter 5
Opex	1% FY21 Narrative linked to business specific and ENA legislation	Executive Summary + Chapter 6
Tax	\$44m (SL-DV) + \$26m (Refurb) Narrative on \$44m in Executive Summary, \$44m and mention of \$26m in Chapter 4 p.59	Executive Summary + Chapter 4
Rate of Return	Accepted - Narrative in light of decision and consistent with customer expectations	Executive Summary + Chapter 7
Revenue	Consistent with Draft Determination, although slightly above waterfall given tax note included in building block revenues	Chapter 4
CESS exclusions	Innovation, ADMS and Cyber (total \$123m) Financial amount not defined (option value)	Chapter 9, p168
Innovation	Allocated \$42m to NIAC GHD reviewed CBAs to ensure consistency with NER	Executive Summary, Chapter 2 + 3
Tariffs	Implementing Demand Tariff + continuing Pricing Working Group	Executive Summary, Chapter 10 + TSS
<b>OTHER STATED AND AGREED COMMITMENTS</b>		
<b>DEVELOP</b>  Our business & shared understanding	Develop a Revised Proposal capable of acceptance	See above core financial parameters
	Sharing and improving internal forecasting approach and cost benefit analysis	Customer Consultative Committee, Chapter 2
	Explore option analysis to make long term asset decisions in an uncertain environment	Chapter 5 p. 72
	Share further granularity of customer benefits derived from IT expenditure	Technical Review Committee, Chapter 2
	Support an industry wide review into IT forecasting to improve expenditure assessment	Technical Review Committee, Chapter 2
	Engage with customer representatives on cyber expenditure and maturity levels	Technical Review Committee, Chapter 2
<b>DRIVE</b>  Industry Development	Pricing Working Group – Co-design tariffs, information and complementary measures	Chapter 2 + 10
	Jointly develop policy and regulatory framework submissions	Chapter 2 - All Committees
	Collaboration with AER to improve repex model and drive greater confidence in tool	Chapter 5, p.78
<b>DELIVER</b>  Better outcomes	Sign up to the Energy Charter	Chapter 2, p.23
	Propose productivity in period from FY21 and long term commitment to achieving and sharing future productivity gains with customers	Chapter 6
	Deeper engagement in customer strategy and business planning not just regulatory planning	Chapter 2 - Customer Consultative Committee
	Network Innovation Advisory Committee to drive direction of innovation portfolio	Chapter 2 + 3 - NIAC Governance framework
	Capital Expenditure Sharing Scheme exclusions, innovation portfolio, cyber and expenditure.	Chapter 9, p. 167 + 168
	Greater focus on non-network solutions, including demand management + work with customers on demand response rule change	Chapter 2, 3 + 5
Deliver improvements in every area of our business with our customers help.	All committees and Customer Strategy	

### Capex evaluation rigor improved

While the EUAA does not have the resources to fully evaluate all aspects of the proposed revised capital spend, our involvement in the deep dive discussions in late 2018 gave us confidence that we are willing to support the proposed \$2.69b if this accords with the AER's detailed assessment. This is a significant reduction from the initial

proposal of \$3.08b. As is the case with all other DNSPs, proposed capex is dominated by repex, with augex under 7% of the total:<sup>8</sup>

**Our total capex forecasts compared to the AER’s Draft Decision 2019–24 (\$million, real FY19)**

	AUSGRID ORIGINAL PROPOSAL	AER DRAFT DECISION SUBSTITUTE	AUSGRID REVISED PROPOSAL
Repex	1,673	1,207	1,402
Augex	189	169	182
Connection	52	29	33
ICT	158	134	144
OTI	58	3	77
Property	208	135	152
Motor vehicles and plant	99	73	87
Minor assets	25	0	23
Capital support	621	577	590
<b>Total</b>	<b>3,084</b>	<b>2,327</b>	<b>2,690</b>

Source: Ausgrid analysis

Ausgrid ran a very detailed deep dive process to examine capex during the extension period in early 2018. This had limited effectiveness as the standard justification seemed to be a variant of “if we do not spend the \$ then the lights will go out”.

In assessing the capex proposal, the EUAA particularly focussed on:

- the need for comprehensive business case analysis, and
- the expectation that not all projects that meet the hurdle rate should be automatically put in the revised proposal capex

This is a reflection of both the comments made by the AER in its Draft Decision:

“We found insufficient options analysis and cost-benefit assessment in a number of areas in Ausgrid's forecast non-network capex. A key concern we share with stakeholders is the lack of clear explanation from Ausgrid as to how the ex-ante benefits of the program have been incorporated into the overall expenditure proposal. Our review has found no evidence that this has been undertaken in developing its forecast.”<sup>9</sup>

and the approach our members take to capital. They have a limited capital budget and only those projects that meet strict criteria and fit within the limited capital budget should be approved. We were concerned that the approach taken by networks is that all projects that meet the hurdle rate are included which is not what really happened in a workably competitive market.

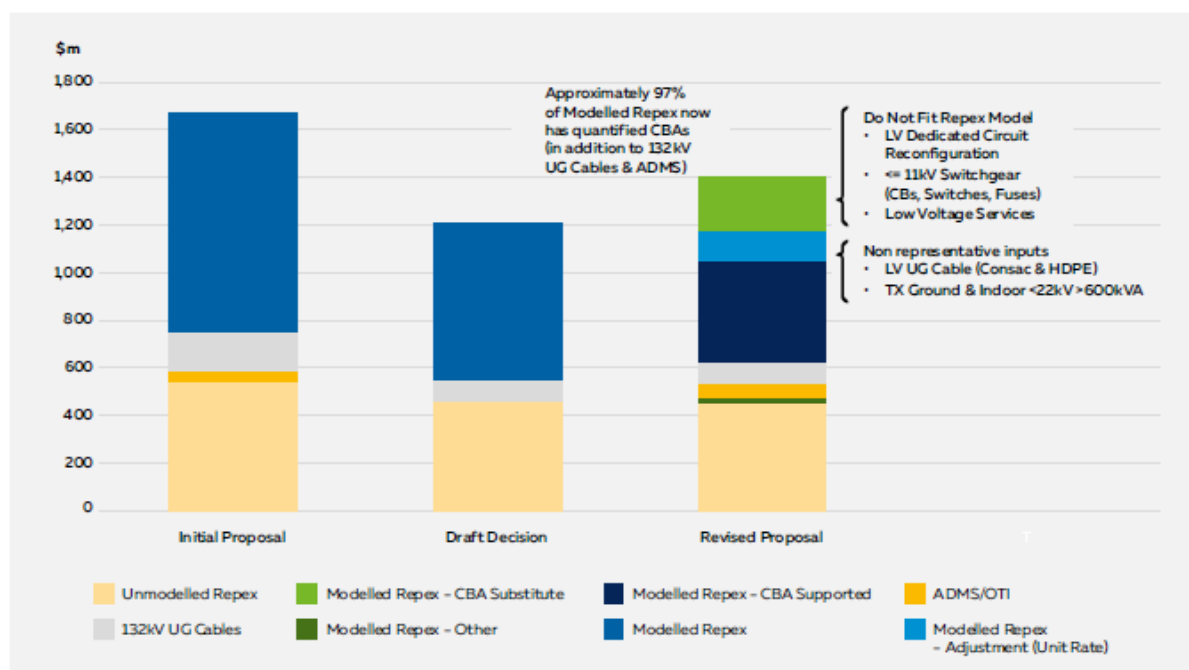
By contrast, the engagement in late 2018 was much more focussed around the specific justification, the level of risk Ausgrid was prepared to bear and the level of analysis in co-operation with the ECA’s consultant. Following the AER’s criticism in the Draft Decision,

<sup>8</sup> Ausgrid p. 58

<sup>9</sup> AER Draft Decision p. 25 <https://www.aer.gov.au/system/files/AER%20-%20Ausgrid%202019-24%20-%20Draft%20decision%20-%20Overview%20-%20November%2020182.pdf>

Ausgrid undertook a substantial revised evaluation process of major components of repex. While we have not had the time to evaluate these CBAs in detail, the approach is welcome and we leave the AER to undertake a more detailed evaluation.<sup>10</sup>

### Proportion of our repex forecast subject to cost-benefit analysis (\$million, real FY19)



In Ausgrid’s Initial Proposal, it modelled all major replacement projects. In the Revised Proposal it expanded modelling to cover all replacement programmes for “modelled capex”. The change is shown in the following table:

**Table 1. CBA modelling Summary (FY19 Real \$m)**

Model	Initial Proposal	Model Outcomes	Revised Proposal (Change from Model Outcomes)*
Poles	\$156	\$144	\$138 ↓
Low Voltage CONSAC / HDPE	\$116	\$104	\$95 ↓
High Voltage Overhead Lines	\$47	\$59	\$51 ↓
Low Voltage Overhead Service Lines	\$55	\$60	\$49 ↓
High Voltage Underground Cable Reactive	\$34	\$46	\$43 ↓
Low Voltage Dedicated Mains	\$45	\$72	\$43 ↓
Circuit Breakers (excludes switchboards)	\$51	\$43	\$43 ↔

<sup>10</sup> Ausgrid p. 65 <https://www.aer.gov.au/system/files/Ausgrid%20-%20Revised%20Proposal%20-%20Revised%20Regulatory%20Proposal%20-%20January%202019.pdf>



Model	Initial Proposal	Model Outcomes	Revised Proposal (Change from Model Outcomes)*	
High Voltage Fuse Switches	\$50	\$46	\$36	↓
Distribution Substations	\$32	\$27	\$24	↓
Low Voltage Underground Cable Reactive	\$26	\$25	\$26	↔
Pole Top Substations	\$20	\$23	\$22	↔
High Voltage Air Break Switches	\$16	\$19	\$15	↓
Major Transformers	\$13	\$21	\$17	↓
Sub-transmission Isolator and Earth Switches	\$7	\$10	\$9	↔
High Voltage Underground to Overhead Connection	\$8	\$15	\$6	↓
High Voltage Drop-out Fuses	\$8	\$26	\$7	↓
Sub-transmission Towers	\$5	\$8	\$8	↔
CBD Distribution Transformers	\$18	\$7	\$4	↓
High Voltage CBD Isolator and Earth Switches	\$16	\$2	\$2	↔
<b>Sub-total</b>	<b>\$723</b>	<b>\$756</b>	<b>\$639</b>	<b>↓</b>
Not Modelled for the Revised Proposal	\$31	-	\$23	↓
<b>Modelled Total</b>	<b>\$754</b>	<b>\$756</b>	<b>\$662</b>	<b>↓</b>
Un-modelled	\$382	-	\$342	↓
<b>Total</b>	<b>\$1,136</b>	<b>-</b>	<b>\$1,004</b>	<b>↓</b>

This revised modelling led to a reduction of \$116m in capex (\$756m less \$662m) - or \$132m if “Un-modelled” repex is included (\$1136 less \$1,004m).

It is welcome to see Ausgrid willing to make these hard decisions, given its historical approach— where it decided to take on more risk to limit price rises. This is particularly seen in the approach to the 132kV fluid filled cables capex.

The initial proposal had \$165m based on the environmental risk of a leak and consistent with undertakings to the NSW EPA. The AER accepted \$93m where projects had a positive CBA or were already committed. Following productive discussions with consumer advocates, Ausgrid decided not to pursue funding for the cables - if monitoring suggests replacement is required, then the capital would be drawn from the approved capex allocation.

While substantial progress has been made in the transparent evaluation of capex, it is from a low base and much more needs to be done. Ausgrid has committed to this and we look forward to monitoring progress through the Customer Consultative Council and the specific programmes to be considered through the:

- Technology Review Committee reviewing IT and cyber security expenditure, and
- Network Innovation Advisory Committee looking at the innovation portfolio for network of the future and ADMS

We support the application of CESS in 2019-24 and welcome Ausgrid’s response to consumer concerns by excluding capex associated with the network innovation programme, the ADMS and additional cyber security from CESS, even though in total the potential spend (~\$100m + cyber) is only a small proportion of total capex.

But the Regulated Asset Base is still increasing in real terms

This table summarises total and per customer RAB. The minor (0.8%) reduction in per customer RAB in the Revised Proposal is certainly welcome hopefully indicating a turning point that will turn a lot further in the 2024-29 period.

\$2019	Opening		Closing	
	\$m	Per customer	\$m	Per customer
Initial			16,174	8,827
Draft			15,390	8,399
Revised	15,302	8,660	15,747	8,594

However, the 3% rise in the absolute level is still of concern. Given the price falls Ausgrid is delivering in 2019-24 have been driven by factors outside of Ausgrid’s control (especially WACC) the need to reduce RAB will be even more important in the future when interest rates start rising from their historic lows. Asset utilisation will need to significantly improve to lower new capex requirements.

There are a number of ways of measuring average network wide asset utilisation. The following graph provides three:

- (i) the AER’s data (blue line) which includes “Cold Spare Tx’s”
- (ii) Ausgrid data that excludes “Cold Spare Tx’s” from the capacity measure which Ausgrid argues is better reflection of actual transformer capacity (grey line), and
- (iii) Ausgrid data on “effective capacity” which it argues is the best measure of utilisation (gold line)



What all three lines show is the significant fall in asset utilisation since 2008. This is a legacy in part of the State Government imposed reliability standards that were in place in the early part of that period. While consumers may have benefitted from the higher reliability levels, the clear message from all consumers in the Ausgrid stakeholder

engagement was that consumers want to see the network prices fall with no change in reliability standards. They want to see a return on their large past investment that they will continue to pay for over many years.

Even with the Ausgrid favoured utilisation measure, utilisation only recovers to ~55% by 2024. In the AER measure it stagnates in the mid 30s. The DNSP average for the AER measure in 2017 was 47%. This has ominous implications for prices for the 2024-29 period if interest rates rise and capex/opex are not further significantly reduced.

Operating costs have been reduced by a productivity factor

The revised opex of \$2.29b is slightly lower than the AER Draft Decision of \$2.31b (prior to the application of the opex productivity factor) and the initial proposal of \$2.40b (all \$2019).

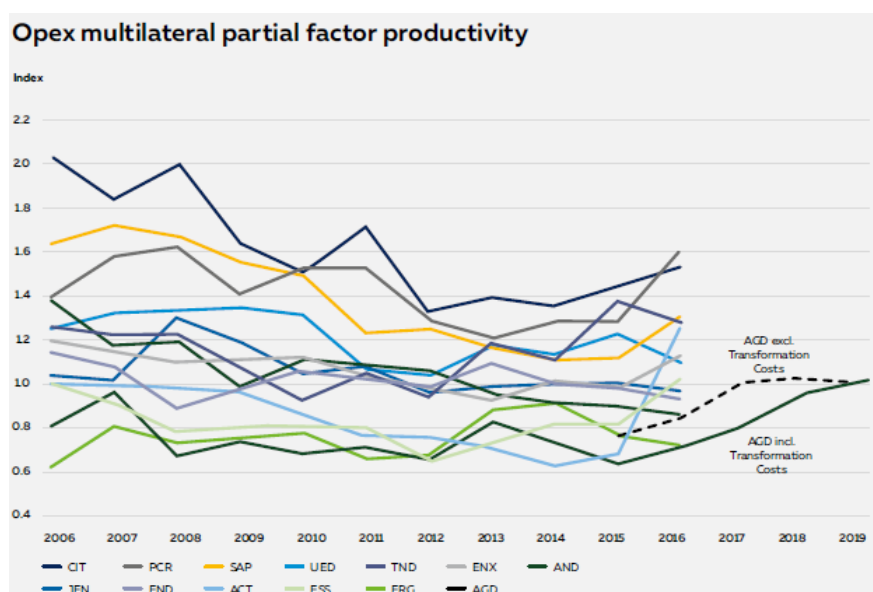
Firstly, we want to acknowledge the significant progress that Ausgrid has made in reducing operating costs over the current period – with reduction in opex of over \$100m/yr. This has set a much lower starting base for the 2019-24 period. However we believe that there is still significant room for further improvement that would see Ausgrid much closer to the efficiency frontier.

Then, for 2019-24 we welcome:

- the agreement to adopt the draft AER productivity factor of 1% per year and accept some of the reasons for it to apply from year 2 – 2020-21, and
- the acceptance of the AER Draft Decision on step changes

We consider there is still considerable scope for further improvement:

- while the data indicates that Ausgrid’s opex productivity has increased significantly over recent years due to their transformation programme, much of this is about “catching-up” given that Ausgrid was generally in the bottom two DNSPs.<sup>11</sup>



Those above Ausgrid have also improved and we think that the frontier has moved out. While Ausgrid has adopted the draft AER position of 1.0% per year, above we noted our support for the analysis by CCP22 that suggests an annual movement of 1.5-2.0%.

<sup>11</sup> Ausgrid p. 116

- Ausgrid advance four reasons for a delay to 2020/21 - we accept the reasons related to the ongoing costs of the transformation e.g. transformation costs of a lower capex spend and privatisation rules around employment, but do not accept the arguments around additional cost items e.g. land tax. These types of cost increases – as well as cost decreases which are not mentioned by Ausgrid - occur in the normal course of every business. They are nothing special and do not warrant special consideration.

Fundamental changes to the Tariff Structure Statement were welcome

The EUAA has participated in the development of tariffs through the Pricing Working Group. To Ausgrid’s credit following their change in engagement approach in late 2018, they made a fundamental change in pricing for residential and small business - from higher fixed charges to demand tariffs for new customers and those with a smart-meters with a 12-month transition.

Given that medium and large business are generally already on cost reflective tariffs, our members focus on the impact of reductions in opex/capex (as well as external factors such as the WACC and tax allowance) on prices. The table shows the reductions in 2020/21 will be greater for medium sized consumers.<sup>12</sup>

**Medium and large business customer bill impacts – typical customer**

TARIFF	TYPICAL USAGE MWH PA	NETWORK COMPONENT OF BILL IN FY20	PERCENTAGE AND \$ CHANGE FROM FY19
Existing: EA302 40-160 MWh pa	70	\$6,795	-13% (-\$1,047)
Existing: EA305 160-750 MWh pa	300	\$25,376	-10% (-\$2,717)
Existing: EA310 > 750 MWh pa	1,000	\$61,646	-4% (-\$2,270)

Note: Excludes GST. Usage is for a 'typical' customer on each tariff.

While the reductions are welcome, around three quarters of the price fall has been due to factors outside of Ausgrid’s control – particularly the AER’s revised binding WACC.

Bill change FY20 vs FY19	Attributable to non-Ausgrid decisions		Attributable to Ausgrid decisions		Total Bill change	
	\$	%	\$	%	\$	%
Medium business (160-750MWh/yr.)	-\$1,973	-7.0%	-\$751	-2.7%	-\$2,724	-9.7%
Large business (>750MWh/yr.)	-\$2,051	-1.7%	-\$780	-0.6%	-\$2,831	-2.3%

Ausgrid’s commendable efforts to reduce capex and opex contributed only one quarter of the overall price fall. The issue for consumers and networks is that this lower WACC is partly driven by the current low interest rates. A change in the interest rate cycle to level of just 5-7 years ago will require significantly greater cuts in network opex and capex to prevent potentially significant network price rises in the future.

<sup>12</sup> See p. 171

## Essential Energy

### Consumer engagement was very good

Essential has been the standout for consumer engagement and this was reflected in it receiving the ENA/ECA Energy Network Consumer Engagement Award in December 2018. It was the first to settle its remittal of 2014-19 with the AER and its initial 2019-24 proposal was substantially accepted by the AER in its Draft Decision. Essential's leadership in consumer engagement has been significant not just for the other NSW DNSPs, but for networks throughout the NEM. The EUAA saw this first hand as a member of its Customer Advocacy Group.

### RAB is still an enduring issue

We appreciate the openness with which Essential has considered the issue of rising RAB's. The following table shows the rise in RAB over the current reset period:<sup>13</sup>

Indicative opening RAB value as at 1 July 2019 (\$m nominal)					
\$m nominal	2014-15	2015-16	2016-17	2017-18	2018-19F
Opening RAB	6,774	7,157	7,388	7,577	7,798
Add: actual and estimated capital expenditure	479	417	411	388	494
Less: regulatory depreciation	96	186	222	167	141
Less: adjustments for 2013-14 actual capital expenditure					5
Closing RAB	7,157	7,388	7,577	7,798	8,146

and this table shows the forecast RAB at 30 June 2024:<sup>14</sup>

Forecast RAB roll-forward values for 2019-24 regulatory period (\$m nominal)					
\$m nominal	2019-20	2020-21	2021-22	2022-23	2023-24
Opening RAB	8,146	8,573	8,887	9,185	9,452
Add: actual and estimated capital expenditure	517	435	443	439	436
Less: regulatory depreciation	90	121	145	171	172
Closing RAB	8,573	8,887	9,185	9,452	9,717

They show nominal rises of 14% in the current period and 13% for 2019-24.

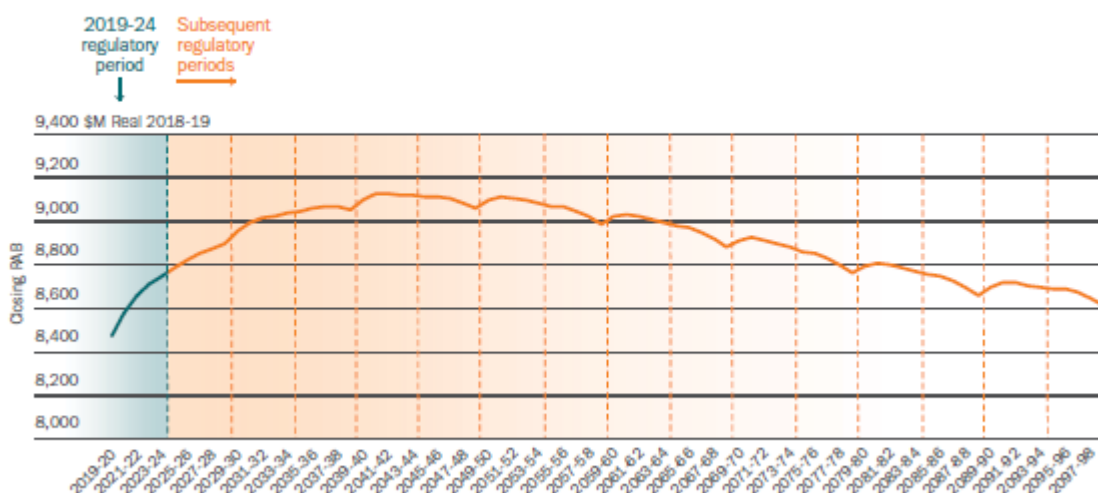
Assuming a continuation of 2023/24 capex (which is materially lower than historical levels) into the future, Essential estimates that the RAB continues to grow for at least 20 years as new capex exceeds depreciation.<sup>15</sup>

<sup>13</sup> See p.54 <https://www.aer.gov.au/system/files/Essential%20Energy%20-%20Revised%20Proposal%20-%20December%202018.pdf>

<sup>14</sup> Op cit p. 55

<sup>15</sup> See p. 33 <https://www.aer.gov.au/system/files/Essential%20Energy%20-%202019-24%20Regulatory%20Proposal%20-%2020180430%20-%20Public%20%28reduced%20size%29.pdf>

### RAB trajectory



Essential has clearly recognised this issue and communicated it well to consumers. It is driving the relatively small price fall over 2019-24 despite Essential proposing significant decreases in capex and opex.

Essential has done an excellent job of bringing consumers along with it in the difficulties it faces. They have commissioned consultants to provide options to address the problem.<sup>16</sup> We look forward to seeing Essential, and its shareholder the NSW Government, taking further action to reduce the RAB during the 2019-24 and subsequent periods.

### Endeavour Energy

#### Disappointing approach on opex

The EUAA has consistently argued that, given AER’s network regulation is designed to replicate what should be the outcome in a “workably competitive” market, then a positive opex productivity factor should be applied by the AER in its assessment of the prudent and efficient level of opex.

Our members find it difficult to believe that continuation of the AER’s current zero productivity factor assumption is an accurate reflection of what occurs in a competitive market. Our members operate in these competitive markets outside the protection of a virtually guaranteed rate of return and are expected to continuously improve their productivity and cost performance. If not, they could quickly go out of business.

In order to achieve this, they expect that their suppliers also show the same focus on productivity and cost reduction. We are continually told by networks that they are putting the “customer at the centre” and we do see some positive signs as shown by some networks. But not from all.

The fact that Tasnetworks, Essential and Energy Queensland have all voluntarily proposed opex productivity improvements in the last 12 months (with the first two offering it prior to the announcement of the AER review) for their next revenue reset period may have been dismissed by privately owned networks with “they can do that because they are Government owned and are less concerned about their rate of return”.

However, that argument dissolved when Ausgrid submitted its Revised Proposal for a 1% annual improvement from 2021 that was discussed above.

<sup>16</sup> See pp 18-19 <https://www.aer.gov.au/system/files/Essential%20Energy%20-%20Revised%20Proposal%20-%20December%202018.pdf>

As Endeavour acknowledges, efficiency is a dynamic concept – what might be efficient today may not be in the future. In its submission to the AER review of opex productivity, which is included in its Revised Proposal, it argues that EBSS, as part of an incentive based regulatory framework provides the required incentive for a network to be dynamically efficient.<sup>17</sup> It also distinguishes between:

- Movements in the efficiency frontier, and
- “catch-up” efficiency improvements – where a network “catches-up” to the level the AER regards as “not materially efficient”

The current opex productivity review is only concerned with the former. The EUAA supports the AER completing a review of the latter when the current review is complete – more particularly the current 0.75 benchmark position that is regarded as “not materially inefficient” and above which the network can have the benefit of EBSS.

Endeavour has followed the current AER approach of a zero-productivity factor. In its Final Proposal it notes that:

“Customer advocate groups raised the issue of requiring productivity improvements to be built into the forecast opex allowance at the AER’s public forum and subsequently in their submissions. The issue was also noted in submissions from retailers.

and responds;

“Unlike the issues outstanding at the end of the deep dive process, Endeavour Energy is not proposing to amend its proposal, which is materially lower than our 2014-19 opex spend, in light of these submissions.”<sup>18</sup>

So, it retains the zero-productivity factor in its proposal. Yet in its submission to the AER’s Opex review, included as part of the Final Proposal for 2019-24, Endeavour argues (in its opex submission) for a trend productivity factor of -0.7%. This is even with, for example, the supposed benefits of its large IT expenditure. In the last 10 years it has spent ~\$(2019)215m and propose to spend another \$91m for 2019-24. The latter is justified on the basis that:

“We are currently replacing our ICT systems which will improve the information we have about our network and improving our asset management practices in response to the feedback we have received from the AER and EMCa. These improvements should enable us to deliver the outcomes we have committed to at a lower cost and without increasing risk.”<sup>19</sup>

Endeavour also seems to argue that the network should keep all the benefits of any move in the frontier. The EUAA thinks that in a workably competitive market that these efficiencies flow to consumers. It is improvements beyond this level of productivity that the EBSS should apply to.

Further, Endeavour is running the same line of argument that it did in its Initial Proposal:<sup>20</sup>

“We also note that at the time of our initial proposal we identified step changes totalling up to \$10 million p.a. Since the lodgement of our initial proposal we have experienced further cost pressures, specifically our

<sup>17</sup> See discussion on pp 4-5 <https://www.aer.gov.au/system/files/Endeavour%20Energy%20-%20Submission%20to%20the%20AER%20Opex%20Productivity%20Growth%20Forecast%20Review%20Draft%20Decision%20aper%20-%202021%20December%202018.pdf>

<sup>18</sup> See p. 13 <https://www.aer.gov.au/system/files/Endeavour%20Energy%20-%20Revised%20Proposal%20-%200.01%20Revised%20Proposal%20-%20January%202019.pdf>

<sup>19</sup> Endeavour p. 20

<sup>20</sup> See p. 22 <https://www.aer.gov.au/system/files/Endeavour%20Energy%20-%20Revised%20Proposal%20-%200.01%20Revised%20Proposal%20-%20January%202019.pdf>

insurance premiums have increased following the 2017 Californian bushfires and these are expected to further increase with the 2018 Californian bushfires and the withdrawal of some insurers from providing bushfire coverage. On the basis of the AER’s draft decision and our revised opex proposal we have not sought to pass on these step changes and have maintained our position of absorbing them within our opex allowance.

In our view, Endeavour uses the term “step changes” for cost increases that would never meet the AER’s criteria. These are cost increases that are the normal course of business. As we noted above it is fair to assume that there will also be offsetting external cost decreases but these don’t seem to be discussed. These increases and decreases are part and parcel of the normal course of operations – there is nothing “special” about them. Our members experience these sorts of cost pressures all the time. They simply have to absorb them and seek offsetting cost decreases, just like any of their competitors. Absorbing them is not indicative of productivity improvements.

Even if Endeavour disagreed with the AER’s view on the quantum of the productivity factor, it could have indicated that it was willing to accept the application of the AER review, but did not. Because of Endeavour’s approach on opex, the EUAA does not believe that their proposal is “capable of acceptance”.

The EUAA supports the AER applying the outcome of its opex productivity review to NSW DNSPs.

#### Disappointing approach on other matters

It is disappointing to see Endeavour still objecting to the AER’s binding WACC Guideline published last December.<sup>21</sup> This is a settled matter following extensive debate and consultation.

It is also disappointing to see Endeavour’s failure to accept the final AER position in its review of the tax depreciation calculation also published last December.<sup>22</sup> We do not accept the argument made by Endeavour around the need to align depreciation methods for regulatory and tax depreciation. Intergenerational issues are best address through regulatory depreciation, not tax depreciation.

#### Final proposal not capable of acceptance

We believe that Endeavour’s Final Proposal is only capable of acceptance if they agree to follow the final conclusions of the AER reviews of opex productivity with a minimum of 1% annual productivity factor, calculation of the tax allowance, and the AER is satisfied with its \$1.7b capex proposal.

#### **System Wide ICT and Cyber Risk Issues for the AER to consider**

This has been an expanding category of capex across all networks in recent years and the so-called “cyber security” risks have expanded the call for increased expenditure.

There seemed to be an acceptance that IT expenditure was “good” because it “improved productivity”<sup>23</sup> or provided an “improved customer experience” even if it wasn’t clear what consumer support there was for this. In a time of greater control of “long life” capex, ICT with its relatively short depreciation schedule had an attractive “fast money” return to the network owners.

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<sup>21</sup> Ibid p. 22

<sup>22</sup> Ibid p. 18 and 31

<sup>23</sup> Perhaps Endeavour thinks that without the \$215m ICT expenditure over the last decade, trend productivity would have been less than the -0.7% it suggests the AER uses?



The level of scrutiny - by both networks and the AER - has generally not matched the expansion in expenditure. Consumers are not well qualified to understand the ICT value proposition networks are presenting them. Our experience is that networks generally put the justification in qualitative terms. For example, Ausgrid says:

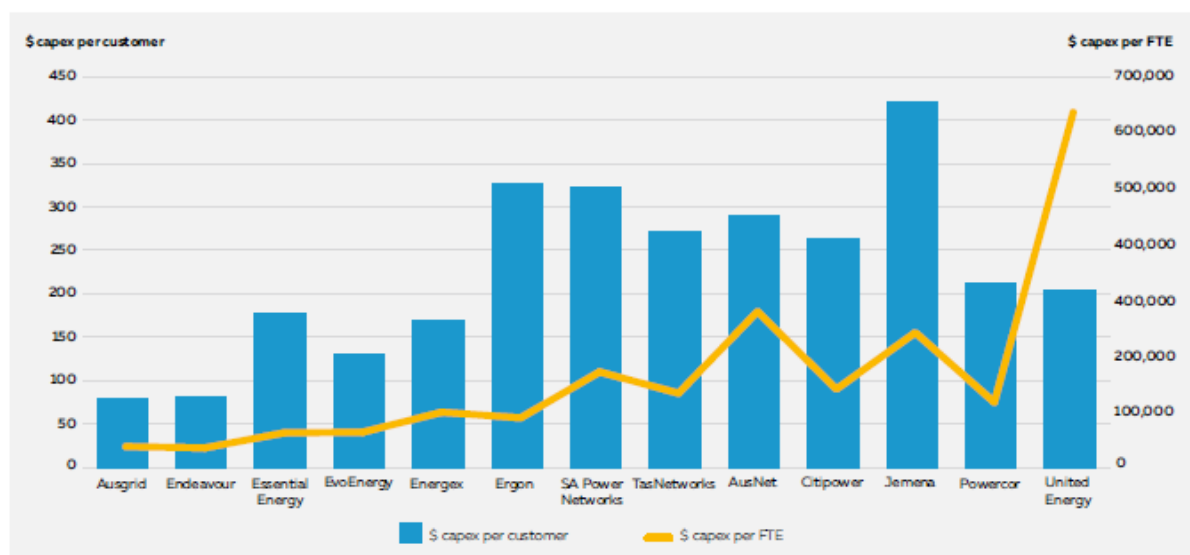
“Our ICT capabilities support the safe and reliable delivery of network services to our customers. In the 2019–24 regulatory period, we need to invest in maintaining these capabilities and also respond to a changing technological landscape, emerging risks and developing customer expectations.”<sup>24</sup>

and:

“... a number of our ICT capex programs are aimed at delivering capabilities (e.g. automation of manual processes) to help us achieve the productivity savings we are challenging ourselves to achieve and offset ICT opex increases that are expected to be incurred over the 2019-24 regulatory period.”<sup>25</sup>

But did make some advances in the way it sought to benchmark its proposed spend e.g. \$ spend per customer and FTE.<sup>26</sup>

**Figure 5.20**  
**Benchmarking of Ausgrid’s non-network ICT (\$million, real FY19)**



And historical spend:<sup>27</sup>

<sup>24</sup> Ausgrid p. 87

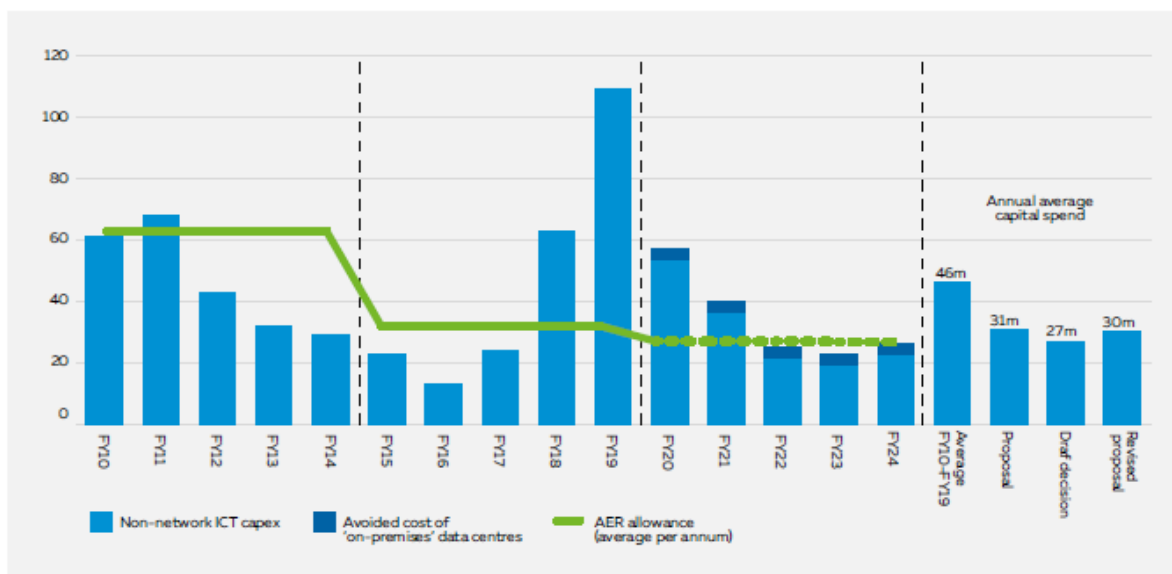
<sup>25</sup> Ausgrid p.117

<sup>26</sup> See p. 88 <https://www.aer.gov.au/system/files/Ausgrid%20-%20Revised%20Proposal%20-%20Revised%20Regulatory%20Proposal%20-%20January%202019.pdf>

<sup>27</sup> Op cit p. 89

**Figure 5.21**

**Ausgrid's non-network ICT capex (\$million, real FY19)**



Endeavour mounts a similar argument:

“Our forecast ICT capex as a percentage of total capex is 4.2 percent compared to the 2016 industry average of 7.2 percent, our ICT totex per employee has been consistently below the industry average, and our ICT totex per customer in 2016 was equal to the industry average.”<sup>28</sup>

Favourable comparisons among the DNSP cohort could simply be an indication of too high a spend across all networks.

Then it suggests another justification:

“...our forecast ICT capex was below both 2009-14 and 2014-19 levels providing prima facie evidence of its efficiency under a revealed cost incentive based regulatory framework.”<sup>29</sup>

It might provide prima facie evidence but it does not provide substantive evidence. Endeavour’s forecast ICT expenditure in the current period of ~\$120m is substantially above its allowance of \$91m. It that prima facie evidence that Endeavour are poor managers of IT spend (cost overruns?) or prima facie evidence of Endeavour finding new ways to improve capex and opex productivity? It appears not to be the latter given their views on the opex productivity factor.

Endeavour understandably highlights the need to spend ICT:

“...in order to comply with our critical infrastructure licence conditions...”<sup>30</sup>

But where is the independent analysis to substantiate what is a “prudent and efficient” level of spend to meet those conditions?

<sup>28</sup> Endeavour p. 21 <https://www.aer.gov.au/system/files/Endeavour%20Energy%20-%20Revised%20Proposal%20-%2001%20Revised%20Proposal%20-%20January%202019.pdf>

<sup>29</sup> Op cit p.20

<sup>30</sup> ibid

We recognise that it is difficult for networks to justify this expenditure, particular when there are legislative requirements to meet. Ausgrid commissioned a study on their cyber investment and preparedness that indicated there is a likelihood of additional regulations being imposed in the future. Ausgrid is proposing an additional \$20m, without any clearly laid out plan of what it will be used for. We support this amount being included given that it will be subject to review by the Technology Review Committee.

Essential is perhaps the most advanced network we have seen in terms of seeking to more directly measure the benefits of ICT spend. It sees its ICT expenditure as a key enabler of improved opex and capex efficiency – which allowed it to commit to opex productivity improvement and propose a capex spend that was accepted by the AER in its Draft Decision. For example:<sup>31</sup>

“During the 2019-24 regulatory period, Essential Energy will leverage ICT as the primary enabler for business transformation. The efficiencies underpinned by our ICT strategy directly link with the service affordability that our customers value. During Phase 3 of our engagement program, customers who attended our forums strongly supported our investment in technology to improve efficiency and lower operating and capital costs. This strategy involves adopting modern alternatives to traditional, longer-term ICT capital investments and rationalising existing legacy applications and infrastructure. The outcomes we seek include:

- transformed core asset management practices;
- transformed back office operations;
- efficiently-bundled and scheduled work tasks;
- advanced technology that provides asset health and asset management insights; and
- better ways of communicating with customers and other distributors.”

The spend in ICT and associate cybersecurity is a large part of networks’ capex proposals but the AER tends to use a relative benchmarking approach. While the AER has tools such as the repex model and independent analysis of major capex cost benefit analyses, it does not have a robust framework to evaluate ICT. We look forward to the AER developing this more robust network wide evaluation process that more clearly requires the linkage of expenditure to specific consumer benefits.

This review should include:

- provisions to ensure the network does not get a “double” benefit – recovery of the initial ICT capex and then 30% of the reduction in opex through EBSS. It should only get the former.
- Review of the range of suppliers available to provide various IT services, particularly around cyber security, to see if there might be risks of there are a limited number of suppliers

EUAA  
5 February 2018

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<sup>31</sup> Essential Proposal p. 69 <https://www.aer.gov.au/system/files/Essential%20Energy%20-%202019-24%20Regulatory%20Proposal%20-%202020180430%20-%20Public%20%28reduced%20size%29.pdf>