Attachment A: Endeavour Energy's preliminary views on F&A matters and reasons for requesting an updated F&A paper

1. Service Classification

There have been several rule changes in recent years as part of the AEMC's Power of Choice reform program that are designed to promote customer choice in emergent technologies and energy services.

We consider these emergent markets, associated rule changes and new market participants will necessitate changes to our existing service listing and classifications. The level and/or prospect for competition in existing services, like metering for instance, will have to be re-assessed, new services will have to be added whilst others removed and some existing service definitions will need alteration.

In conjunction with these rule changes, the AER is currently in the process of developing a nationally consistent ring-fencing guideline. Based on the draft ring-fencing guideline, the F&A service classification decision is a key determinant in what ring-fencing obligations will apply. The existing service listing and classifications should therefore be re-assessed in this new context to ensure the ring-fencing guideline is appropriately applied.

Furthermore, the ring-fencing guideline applies NEM wide. We consider its practical application should be consistent outside of any jurisdictional differences. There have been several F&A decisions for other jurisdictions since the Stage 1 F&A paper was published for the NSW DNSPs. This existing listing should therefore be reviewed to ensure it aligns with other jurisdictions F&A papers to the greatest practical extent.

We also consider that there is currently a gap within the classification of public lighting services being driven by emergent public lighting technologies. Currently this issue is managed through bespoke price agreements between Endeavour Energy and our public lighting customers for each new technology variant that is available. It may therefore be appropriate to classify these new technology services as negotiated services to reflect current practice and provide procedural clarity.

2. Dual Function Assets

The AER confirmed its decision from the 2009-14 F&A paper that distribution pricing would continue to apply to Endeavour Energy's dual function assets in its Stage 1 2014-19 F&A paper. This was due to our dual function assets being an immaterial proportion of our overall regulated asset base. Further, these assets are dedicated to our distribution network meaning that separately pricing them as transmission assets would not have any material impact on our distribution prices. This is because these transmission charges would be wholly allocated to Endeavour Energy, which they currently are as part of our distribution network.

We have updated the analysis provided to the AER in support of its decision in the 2014-19 F&A and attached it to this response. The updated analysis confirms that the relevant assets would remain an immaterial proportion of the overall asset base and be classified as exit equipment. Therefore, we consider there is no need to amend or replace the existing F&A in respect of this matter.

3. Form of Control

We do not consider this matter requires review as part of an amended or replacement F&A. The existing forms of control are operating effectively and we do not consider changes at this time would lead to significantly improved pricing outcomes.

This is particularly the case for standard control services which is currently subject to a revenue cap. We are embarking on a significant tariff reform process through the Tariff Structure Statement mechanism. It would be inappropriate to change the form of control during a period of potential uncertainty and volatility in pricing outcomes.

4. Formulae to give effect to the form of control

We consider minor amendments are required to the formulae that give effect to both the revenue cap form of control for standard control services and side constraint.

This change is required to bring both the form of control and side constraint formulae into alignment with more recent AER decisions.

5. Incentive Schemes

Overall we consider incentive regulation is best practice and should continue to apply. In addition to our specific comments on the schemes below we note there is still a substantial period of time between this date and the start of the next regulatory control period. It may be appropriate for a future version of these incentives schemes to be applied. Alternatively, any substantive changes may necessitate a review of their applicability as part of the determination process. Endeavour Energy proposes this be considered by the AER in consultation with Endeavour Energy, subject to the timing of any updates and the feasibility of implementing any new arrangements.

5.1 Efficiency Benefit Sharing Scheme (EBSS)

Endeavour Energy expects the AER will continue to apply version 2 of the EBSS as currently reflected in our Stage 2 2014-19 F&A paper. For Endeavour Energy, we consider this scheme has operated effectively and delivered payments to Endeavour Energy and customers in accordance with the sharing required by the rules.

However, during our engagement with customers to date, several stakeholders have raised concerns with the operation of the EBSS. To respond to these concerns we recommend the AER provide analysis supporting the effectiveness of the EBSS and the economic rationale that underpins the scheme.

We also recommend that should the AER decide to review this matter as part of an updated or replacement F&A paper it clarifies the interaction between the EBSS and benchmarking. We consider the EBSS should only be applied in conjunction with forecast opex being set using the revealed cost method (i.e. base-step-trend). This is in accordance with the AER’s decision to suspend the EBSS for Ausgrid and Essential Energy as part of its NSW/ACT 2014-19 determination.

5.2 CESS

We support the continued application of version 1 of the CESS as per the Stage 2 2014-19 F&A paper.

Should the AER decide to review this matter we consider it would be prudent to develop a second version of the CESS to apply to the 2019-24 period. An updated CESS guideline should incorporate the clarification provided by the AER in its recent final F&A paper for TransGrid in response to a submission by WesternPower. Our expectation is that the CESS will continue to apply in accordance with the clarification provided by the AER in the TransGrid F&A paper.

5.3 DMIS

Endeavour Energy supports the application of a DMIS, including the continued application of the Demand Management Innovation Allowance (DMIA) as per the Stage 2 F&A paper. Through our engagement activities to date stakeholders have emphasised the importance of demand management and non-network alternatives. We support this view and therefore consider the AER should amend or update its 2014-19 F&A paper to apply a DMIS.

However, we note that a DMIS is currently being developed by the AER as required by the rules. We understand it will not be completed by December 2016. Our preliminary position is that this DMIS should apply to Endeavour Energy for the 2019-24 period. We will make further comment on the application of this scheme, as part of the F&A or determination process depending on the timing, when the final version of the new DMIS is published.

5.4 STPIS

Endeavour Energy supports the continued application of the STPIS as per the Stage 2 2014-19 F&A paper.

Despite this, the AER may wish to review the application of the STPIS in response to concerns raised by stakeholders. Several customer representative groups have suggested the customer service measure (telephone calls answered within 30 seconds) is an antiquated and flawed metric. We understand and appreciate these views and consider a measure more reflective of customer service levels could be developed.

However, it is unclear whether this can be done as part of an amended or replacement F&A, or whether the STPIS can only be revised through a separate consultation process. We note that any alternative would need to be measureable and most likely subject to an information gathering period before a benchmark target could be set.

5.5 Small Scale Incentive Scheme

The rules provide the AER the ability to develop small scale incentive schemes to test innovative approaches to incentives. The AER have not yet developed any such schemes and we do not request that any small scale schemes are developed. However, should the AER decide to implement a scheme we ask that its intended approach be set out in an amended or replacement F&A paper.

6 Expenditure Forecast Assessment Guidelines

Endeavour Energy's current F&A paper applies the current version of the Expenditure Forecast Assessment Guideline, which was published 29 November 2013.

We consider this guideline should be amended to clarify the AER's intended approach for assessing forecast expenditure. We have concerns with the AER's benchmarking methodology and forecasting methodology for both capex and opex. Our concerns with the AER's benchmarking tools and reliance on them are well documented and remain unresolved.

We urge the AER to reconsider its position and engage further with DNSPs and stakeholders to improve its approach. Alternate models, model specifications, pre and/or post modelling adjustments and data improvements all require serious consideration to ensure that the benchmarking tools are fit for purpose and produce reasonable outcomes.

Endeavour Energy supports the use of benchmarking as an investigative tool which may be able to highlight areas for further exploration and assessment. We would welcome any opportunity to engage with the AER with a view to improve the AER's methodology. If the AER decides against updating the guideline we recognise that it would be procedurally appropriate for the AER to apply the existing guideline to the next regulatory control period.

7 Depreciation Approach

Endeavour Energy supports the application of forecast depreciation to establish the opening regulated asset base commencing 1 July 2019. This is consistent with the application of the CESS applied to Endeavour Energy in the current regulatory control period.

8 Cost Allocation Methodology

Whilst not required as part of the F&A process, the Cost Allocation Methodology (CAM) is another aspect of a determination process that needs to be finalised prior to the submission of a regulatory proposal (and the accompanying Regulatory Information Notice). Endeavour Energy therefore wishes to confirm that it does not intend to propose any changes to its existing CAM at this stage.