



5 April 2018

Paula Conboy
Chair
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3000

Dear Paula

PROPOSAL FOR THE REMITTAL OF THE ENDEAVOUR ENERGY 2014-19 DETERMINATION

Following the release of the April 2015 Determination for Endeavour Energy, participants in the regulatory process had sought review of aspects of the AER decision and the subsequent decision of the Australian Competition Tribunal. These external processes were completed in July last year and since that time the AER and Endeavour Energy have undertaken a number of consultation processes to consider the remittal and the regulatory proposals for the 2019-24 regulatory control period.

This proposal reflects these consultations and our published commitments to delivering an affordable, safe and reliable network, investing for customer and economic growth, and enabling customers' choices.

Acknowledging pricing pressures on customers

Throughout our engagement processes Endeavour Energy has acknowledged that energy affordability is the primary concern of the customers we serve. We understand that customers expect us to deliver a safe and reliable electricity supply through the constraints of affordability, and that affordability must be an outcome of our long-term plans.

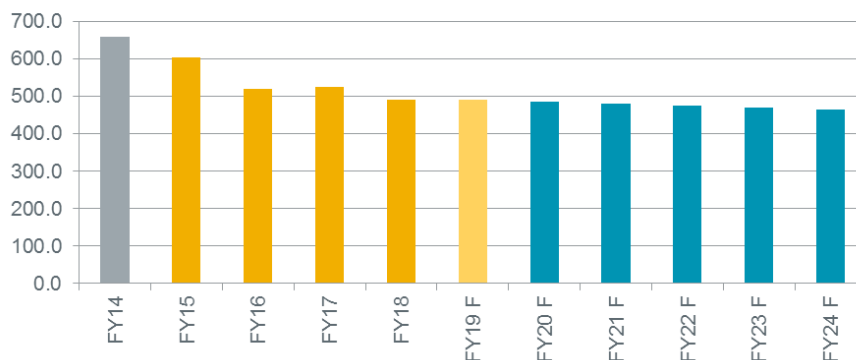
We are conscious that there are price pressures from multiple components of the industry that we cannot influence, however Endeavour Energy has committed over several years to doing our part to constrain price increases in the final bill that customers pay.

As a result Endeavour Energy's customers have been the beneficiaries of the lowest network charges in NSW for over five years.

The chart below set outs how our charges have fallen, and are forecast to move, year on year for an average residential customer over the current regulatory period and into the next regulatory period. It highlights that if this proposal is accepted we are forecasting no real price increases to customers between now and the end of the next regulatory period.

In other words our price movements to customers will be at or below actual CPI.

Average Annual Residential DUOS Bill (Real FY18)



However, we understand that cost pressures in other segments of the energy chain mean that our efforts may not be immediately apparent. Over the five-year period between 2012/13 and 2017/18, Endeavour Energy's average network charges decreased by \$75 in nominal terms, while the other components of customers' electricity bill increased by \$267 in nominal terms over this same five year period.

History of Delivering Efficiencies

Over the last decade Endeavour Energy has implemented a number of initiatives to address affordability. Our primary focus has been to reduce our expenditure. These initiatives recognise that efficiency improvements can be derived in a variety of ways and have engaged the organisation as a whole to rise up to the challenges put to it.

To live up to commitments given to reduce our opex by 2%p.a. over the 2009-14 period, Endeavour Energy utilised "grass roots" programs where staff identified a large number of small scale efficiencies that in aggregate achieved substantial savings that have been sustained and exceeded the targets we set ourselves.

With the sale of our retail business to Origin Energy in 2011 our business support costs were reduced to avoid network bill impacts. The targeted efficiency programs outperformed our expectations, ensuring our customers were insulated from the significant price impact we identified in transitioning to a network only business.

With the formation of Networks NSW in July 2012 we worked with the other NSW DNSPs to drive efficiencies across the state that could only be achieved through standardisation and the purchasing power of the combined industry segment.

Our corporate-wide efficiency program has involved many tough decisions. Since 2012, we have cut our workforce by almost 1,000 FTEs without compromising safety or reliability, and generated total savings of \$891m (real FY18) through to February 2018. Endeavour Energy continues to build on its history of focused reform and measurable, sustained efficiency improvements. Our final year opex in 2018/19 represents a reduction in our annual opex of 20% in real 2018/19 dollar terms over the current regulatory period. This is a commitment that was given publicly some months ago.

Our history and commitment to delivering customer outcomes is not new. The savings in opex that we have achieved over the past decade is reflected in the assessment of our efficiency relative to our peers.

Our consistent responsiveness to the regulatory incentives and our organisation wide focus on efficiency were the key drivers that lead the AER to continue to apply the opex efficiency scheme.

Endeavour Energy is the only NSW network subject to the remittal process to have the EBSS applying in the current regulatory period.

Details of our Proposal

We are proposing to adopt the April 2015 Determination as published by the AER, and updating for actual data, where appropriate, for the cost of debt and CPI on the basis that we retain no more than \$110m of revenues over-recovered as a result of the enforceable undertakings during this regulatory period. Consequently, we would return the majority of over-recovered revenue to customers over the next regulatory period through reduced prices in accordance with the principles of the revenue smoothing participant derogation we lodged with the AEMC.

Specifically, the key aspects of Endeavour Energy's proposal for the remittal are:

- Adopt the April 2015 Determination opex and application of the EBSS based on that opex for the 2014-2019 regulatory control period;
- Commit to the application of the revealed cost opex forecasting methodology so that the opex for the 2019-24 regulatory control period will be determined using the AER's opex forecasting model based on our 2017/18 actual opex. The reported actual opex for 2017/18 will be at or below the forecast included in the AER's April 2015 Determination;
- Continued application of the EBSS for the 2019-24 regulatory control period;
- Continued adoption of the capex allowances contained in the April 2015 Determination and continued support for the application of the CESS for the 2014-19 and 2019-24 regulatory control periods;
- Adoption of the AER's 2013 Rate of Return Guideline, including the application of a transition to the trailing average for the 2014-19 and 2019-24 regulatory control periods;
- Retain no more than \$110m of revenues over-recovered under the undertakings in 2018/19 dollar terms;
- Return the balance of the revenues over-recovered under the undertakings; forecast to be \$239.6m in financial year 2018/19 dollar terms on the basis that Endeavour Energy enters into an enforceable undertaking with the AER to set prices for 2018/19 based on the 2017/18 revenues, escalated for CPI. This amount also includes adjustments to reflect an updated CPI forecast as per corrections provided by the AER and in accordance with the findings of the Australian Competition Tribunal of \$12.2m; and
- The amount above to be returned to customers has not considered the outcomes of the STPIS over the current regulatory period. Once the revenue target has been determined by the AER, the outcomes will be incorporated into the balance to be returned in the regulatory proposal for the 2019-24 regulatory control period.

What this Proposal means for our Customers

- Acceptance of this proposal will resolve the appeals and dispute between Endeavour Energy and the AER in full thereby providing certainty to customers regarding their current and future prices.

- Guaranteed lower prices for customers. Matters relating to the cost of debt and opex were sent back to the AER by the Australian Competition Tribunal and the Federal Court due to issues with the original decision. We claim that a reasonable valuation of those matters is \$543.8m in \$2018/19, \$176.5m for unfunded actual opex and \$367.3m for debt based on actual market data.
- If this proposal is accepted the net benefit to customers could be considered to be as high as \$433.8m in \$2018/19 after the retention of \$110m of revenues is deducted.
- This proposal locks in our public commitment to ensuring that savings in annual opex of 20% are passed on to customers. In our Directions Paper released in August last year we committed to achieving opex outcomes in line with the AER's April 2015 Determination by the 2017/18 financial year.
- Our proposal reinforces our commitment to an incentive based regulatory regime that provides financial disciplines and rewards to drive further improvements in operating costs and capital investments that will ultimately be passed on to consumers.
- Adoption of the 2013 Rate of Return Guideline as applied by the AER, including adoption of a gamma of 0.4, provides certainty for customers and ensures that the trailing average cost of debt approach is applied, helping insulate customers from the short-term price impacts of debt cost movements compared to the rate on the day approach.
- This proposal removes all anticipated contention regarding the cost of capital and the opex allowance for the next regulatory period, leaving only the issue of the necessary capital expenditure to support efficient customer outcomes to be agreed. This is expected to provide customers with confidence of stable and efficient regulatory outcomes.
- The proposed CPI adjusted undertaking and the reduction in revenues for the next regulatory period of \$239.6m in \$2018/19 to account for the undertaking in place over this current regulatory period will ensure price stability to customers in line with the revenue smoothing participant derogations lodged by Endeavour Energy.
- Retention of a portion of the over-recovery reduces the benefit of the other matters within the proposal by \$110m in \$2018/19 and will allow Endeavour Energy to resolve the outstanding matters without further points of dispute and provide certainty for customers for the remainder of this and the next regulatory period. The annualised customer impact of our proposed retained over-recovery is less than \$25 per billed customer over the current regulatory period.

Commitment to delivering efficient outcomes

In our 2017 Directions Paper, which set out key aspects of our 2019-24 regulatory proposal, we committed to locking in opex savings arising from achieving at least the AER allowed opex for the 2017/18 financial year. Endeavour Energy reiterates this commitment.


Further, in our application to extend the time to lodge our regulatory 2019-24 proposal we committed to undertaking further engagement on our capex plan with a view to testing our thinking with key stakeholders and taking on their feedback. We pioneered a series of 'deep dive' workshops which brought together representatives from the AER's technical and pricing teams, members of the AER's Consumer Challenge Panel and consumer advocates and key stakeholders.

These workshops were well received and led to greater understandings of key areas of agreement and areas where we still need to do some more work. Importantly, we have adjusted our plans as a result of the feedback we received.

We set ourselves an aspirational target for this consultation to result in a capital program that is agreed and supported by customers as delivering value for money while meeting their growing energy needs. We believe we are on track to achieve this.

Please contact me if you have any questions or wish to discuss our proposal further. Alternatively, your staff may wish to contact our General Manager Regulation and Corporate Affairs, Andrew Schille on 0404 028 250.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tony Narvaez', written over a light blue rectangular background.

Tony Narvaez
Chief Executive Officer