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Submitted via email: AERresets2024-29@aer.gov.au

Dear Arek

Issues Paper – Essential Energy Electricity Distribution Determination 1 July 2024 to 30 June 2029

Essential Energy appreciates the opportunity to respond to the Australian Energy Regulator (AER) on its Issues Paper – Essential Energy Electricity Distribution Determination 1 July 2024 to 30 June 2029 ("Issues Paper"). We acknowledge the commitment made by the AER to consult in a transparent and focussed manner with consumers and stakeholders and welcome feedback provided through the Issues Paper. We have set out below our responses to the Issues Paper and also take this opportunity to highlight some potential areas of change between the 2024–29 Regulatory Proposal ("Proposal") submitted in January 2023 and the Revised Proposal expected to be submitted in December 2023

Consumer engagement

Essential Energy is pleased to note the AER's recognition of the comprehensive and high-quality program of consumer engagement we undertook to develop our Proposal, as well as the reference to the Comacon independent report, which rated it as outstanding. We appreciate the commitment and contribution of the Consumer Challenge Panel to this process.

We intend to continue our engagement journey unabated, and will develop and refine plans in conjunction with our Stakeholder Collaboration Collective (SCC) and Pricing Collaboration Collective (PCC) to ensure we engage in the right manner, on all the necessary topics with the relevant customers and stakeholders. There will be regular SCC and PCC touch points, ongoing engagement with councils and their representatives in relation to public lighting, as well as targeted stakeholder sessions and a further round of customer forums. We also intend to consult specifically on changes to tariffs with our low-voltage large business customers. One key change we are making to our engagement approach, is moving to dedicated one-on-one sessions with retailers and aggregators, rather than using Zoom forums. This more intimate approach will help us achieve better insights and have more engaging discussions than we obtained last year using virtual meeting platforms.

Recognising that the 2024–29 regulatory determination does not represent a final destination for consumer engagement and following the success of our deep-dive pricing session held in Sydney last year, we are establishing our new Peoples Panel. This pricing session demonstrated that if customers are given enough information and time to deliberate, the solutions they provide will add significant value to our business. Although we already engage regularly with our Customer Advisory Group (CAG), the Peoples Panel will enable us to have direct contact with our everyday customers. We are planning three meetings with them this year and several of the topics for the group discussion and debate will impact the Revised Proposal, such as:

- Their appetite for Essential Energy to continue with the proposed investments in the face of increasing cost of living pressures.
- Whether a 12-month grace period should apply before moving customers to our new Sun Soaker two-way default tariff.
- What is a fair way to recover NSW Roadmap and Green Hydrogen costs from our customers.

Capital expenditure

The AER has indicated that it will undertake a targeted review of about 50 percent of our capital expenditure ("capex"), with a focus on resilience, Future Network, cyber security, non-recurrent ICT spend, fleet and connections.

Repex (including resilience spend and Future Network)

Our underlying level of repex is consistent with 2019–24 regulatory period, however, it appears for the purposes of comparison, that the AER has included resilience in this category, and this is inconsistent with other distributors participating in this reset. We specifically engaged on resilience investment options, and in particular the desired outcomes of these investments with customers, and all the projects put forward in our Regulatory Proposal have the support of customers. Although we are proposing increased expenditure related to resilience, we have ensured that all these investments stack up on a cost-benefit basis, achieve the desired outcomes requested by customers, and benefit our customers in the long term. To provide some perspective, our proposed proactive pole replacements in high-risk areas represent less than one percent of our total pole population.

Whilst we did finalise our climate change modelling and Future Network business case after publishing our Draft Proposal, we engaged with consumers and stakeholders on the impacts of these changes to ensure they were still supported ahead of submitting our Proposal to the AER. As part of our final engagement session with customers before finalising the Proposal, we outlined the external factors placing upward pressure on prices along the entire electricity supply chain, as well as rising interest rates and inflation placing cost of living pressures on households and businesses. After a table discussion, we then asked customers whether they supported continuing with the proposed investments given the now higher costs and in the face of further expected interest rate and inflation rises. There was more than 80 percent support to continue with the proposed options at every one of the seven forums and a total of 86 percent overall.

Non-recurrent ICT spend (including Cyber Security)

Due to the inherently lumpy one-off type of expenditure, the AER has advised that they will be undertaking a targeted review of this spend. They also noted that our forecast recurrent ICT spend was higher than recent expenditure. ICT expenditure categories have been impacted by the accounting change for cloud computing, as well as the AER's 2019 Guidance note on how they will assess non-network ICT capex. Rather than focusing on the last few years expenditure by category, reviewing the overall long term ICT expenditure, shows a consistency in trend.

In the Proposal, Essential Energy provided business cases for all of the expenditure in the non-recurrent ICT category, as well as Post Implementation Reviews for completed projects.

Fleet

We identified a modelling error ahead of submitting our Proposal; we had mistakenly applied some fleet capex to the ICT asset category in the Draft Proposal – when corrected, this resulted in our fleet capex showing as increasing in the Proposal. Whilst we did not engage directly with customers on this correction, it was highlighted as one of the corrections between the Draft and Regulatory Proposal with our SCC. The change actually resulted in lower bill impacts for customers, given fleet assets have a longer asset life than ICT assets.

Connections

The increase in our Connections capex has resulted from revising our approach to funding shared network costs. Re-interpreting our current Connection Policy will see us fund an appropriate share of augmentation when the increased capacity can demonstrate benefit to the wider customer base. This change in interpretation will encourage growth in load and new connections, help reduce the existing cost barriers that first movers face, and allow us to deliver more efficient outcomes where multiple large proponents are looking to connect in an area of the network. Importantly, this change in

approach will deliver an increase in network load and reduce the per unit cost to customers, that our SCC identified as the preferred means to help manage the size of our Regulatory Asset Base (RAB).

Operating Expenditure

In relation to operating expenditure (opex), the AER has indicated that it will target the Future Network step change as well as our forecasting approach for opex and its interaction with the efficiency benefit sharing scheme (EBSS).

As noted above, we engaged with customers on the increase to Future Network spend following publication of the Draft Proposal – they supported continuing with the investment, even with the higher bill impacts caused by inflation and interest rates.

In terms of the base step trend, we accepted all of the AER's recommended changes at the early signal pathway (ESP) check-in, other than the final year adjustment. This was on the basis that applying the downward trend in our current 2019–24 opex allowance for the final year would not result in the best estimate of actual opex in FY24. The resulting reduction is simply not achievable given the impacts of COVID-19 and extreme weather events on opex during this current regulatory period. We consider that our alternative final year adjustment produces an opex forecast that better meets the operating expenditures objectives under the National Electricity Rules.

When compared to other NSW business', the level of opex proposed by Essential Energy for 2024–29 is largely consistent with current levels of opex in 2019–24. A lower level than this will present significant challenges for the business and is unsustainable.

For the Revised Proposal, Essential Energy intends to adjust the level of proposed opex for:

- Updates to the base year FY23 for actuals
- New adjustments to the base year FY23 – to reflect deferred work due to severe flooding and wet weather
- Updates to proposed step changes where appropriate, for example, using updated insurance premium forecasts and more refined modelling of expenditures

We are also considering introducing some new step changes, such as:

- a reclassification of bushfire risk areas reflecting updated bushfire simulation modelling, meaning that vegetation costs will be higher
- reduced network maintenance costs following the introduction of SAPS
- the potential for a cyber security step change given recent developments in cyber threats
- the potential for an unplanned maintenance step change due to increasing weather related asset failures
- the potential for a labour step change to reflect changes in our plans; such as for apprentice intakes, and future eTech requirements

The above changes will enable our Revised Proposal to reflect the most up to date opex information for 2024–29, for review by the AER. We intend to engage further with customers and stakeholders on our opex approach and step changes.

EBSS

Essential Energy acknowledges that there was an inadvertent inconsistency between the estimate of the final year opex for the current regulatory period used to forecast opex, and the value included for EBSS purposes. We appreciate the guidance provided in the Issues Paper on two options to address this inconsistency and would welcome further consultation with the AER on this area to inform our Revised Proposal. However, the resulting further increase in EBSS penalties noted by the AER in the Issues Paper, emphasises the concerns that Essential Energy had previously raised with the AER (mid-2020) about the impact of unforeseen external events, and the potential for limiting or suspending the EBSS for 2019–24.

The EBSS is premised on incremental improvements each year compared to the approved opex allowance. In Essential Energy's case, the opex allowance for 2019–24 was ambitious and downward trends reflected plans for reductions in opex that did not eventuate. In addition, bushfires, continuing wet weather extremes and COVID-19 have meant that the business will still be in catch-up mode during 2023–24. This contrasts with the allowance trend. Essential Energy is absorbing the additional opex costs above the allowance. The application of further disproportionate penalties due to external

events outside of Essential Energy's control appears unreasonable and does not reflect the underlying efficiency improvements of the business.

The EBSS version used is also relevant to the size of the penalties. The EBSS was applied to Essential Energy's opex for the first time during the 2019–24 regulatory period. As part of its 2019–24 final decision, the AER stated that it would apply version 2 of the EBSS . However, the AER subsequently indicated that further judgement may be required as to whether the previous version 1 of the EBSS would be applied. In the interests of customer affordability and in the context of the Proposal package, we applied version 1 of the EBSS to the 2019–24 opex. Applying version 2 of the EBSS adopts the approach identified by the AER in Essential Energy's 2019–24 final decision.

We intend to engage further with customers and stakeholders on the EBSS. We encourage the AER to look pragmatically at the opex requested (which is not inconsistent with that of 2019–24) and at the application of the EBSS in light of the external events that Essential Energy has been exposed to during 2019–24.

Depreciation

Overall, the expectations of the AER have been met in terms of depreciation. However, it has raised concerns in regard to how we have calculated the standard life of a new asset class for distributed energy resources (DER). We proposed calculating a standard asset life based on the weighted average cost of the categories of assets contained within the DER asset class – solar panels, batteries, generators, distribution lines and cables. Given the AER's concerns around the longevity of our proposed weighted average asset life, we consider that a preferential approach would be to disaggregate these assets into three separate asset classes for our Revised Proposal. This will better reflect the asset lives for depreciation purposes.

Tariff Structure Statement

The Issues Paper notes that our Tariff Structure Statement (TSS) is broadly in line with the AER's expectations, although more customer impact modelling could have been undertaken. It also highlighted that we have not proposed a transitional tariff or grace period for moving customers to the new Sun Soaker two-way tariff, which may be useful for managing any adverse customer impacts. We have since provided the AER with more detailed customer impact analysis and will use this to engage with customers and stakeholders as to whether they think a grace period should apply, ahead of submitting our Revised TSS.

Alternative Control Services

Public lighting

We carried out four phases of comprehensive engagement with local councils, which identified their key priorities and highlighted their concerns, especially in relation to costs. We adjusted our service offering to reflect the feedback from councils, changes to the Public Lighting Code and the benefits generated from bulk replacement of traditional lighting technology with LEDs. As a result of our bulk LED program our technology mix has altered, resulting in some price increases in lighting categories. However, the overall total cost to provide Public Lighting services in 2024–29 has decreased in real terms, compared to the current regulatory period. We acknowledge that there are items in the Public Lighting model that require further review, explanation and decision-making over the coming months and will undertake a fifth phase of engagement to inform our Revised Proposal.

Metering Services

The main focus of the AER for metering services is around cost recovery for legacy meters and it has suggested potentially bringing metering costs into standard control services by revising the service classifications (spreading costs across all customers) and the potential for accelerated depreciation of legacy meters. The Australian Energy Market Commission (AEMC) is currently undertaking a review of the regulatory framework for metering services which includes an indicative timeline to retire legacy meters by 2030. It will be difficult for the AER to reflect the outcomes of the final AEMC report in its draft determination, however, the implications of the final AEMC report on networks currently in the determination process are complex and extensive. As such, we urge the AER to proactively work with impacted networks over the coming months to agree how to reflect the likely outcomes of the AEMC review in their Revised Proposals.

We note that changing service classification of legacy metering services means that the cost of the program would be shared across all customers, with a consequent uplift in the annual revenue requirement, but a lowering of the costs paid by legacy metering customers. Without a change to the service classification, it is likely that legacy metering customers will experience significant price increases under an accelerated rollout of smart meters.

Therefore, we are supportive of the AER's initial position to adjust the service classification for legacy metering services. In the interests of simplicity, this reclassification should take place at the start of the regulatory period – 1 July 2024. While we support the proposal for accelerated depreciation of the legacy metering asset base, we also note that it will result in higher customer prices in the short term.

Ancillary Network Services

We developed our proposed Ancillary Network Services (ANS) charges in accordance with the AER's price cap formula and utilised its Standardised Model. The increases in rates reflect updated inputs for the 2024–29 period. In our Revised Proposal, we will make structural changes to several fees so they better reflect the cost of the service. Changes are expected in areas such as testing and commissioning, access permits, security lighting and connection fees.

Early Signals Pathway

Essential Energy participated in the inaugural ESP which allowed for early assessment by the AER of our proposed investments and customer engagement, complemented by a more targeted review post Proposal submission. We look forward to continuing the engagement process and hope to realise the benefits anticipated under the ESP.

We will continue to work collaboratively with the AER on the 2024–29 regulatory reset to ensure that the revenue approved for Essential Energy is sufficient to support the acceleration of the energy transition, and that investments undertaken are in the long term interests of our customers. If you have any queries regarding this submission, please contact Natalie Lindsay, Head of Regulatory Affairs on [redacted] or [redacted]

Yours sincerely

[redacted]

John Cleland
Chief Executive Officer