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Dear Ms Conboy

Proposal for the remake of Ausgrid's 2014-19 distribution determination (Proposal)

I am pleased to submit this Proposal to the Australian Energy Regulator (**AER**) in regard to the aspects of Ausgrid's 2014-19 determination that were remitted back to the AER to reconsider (**2014-19 Remittal**). This letter provides an overview of our proposal, how it benefits our customers, and how it aligns with the National Electricity Objectives (NEO) and Revenue and Pricing Principles (RRP).

Overview of our proposal

Ausgrid has undertaken extensive customer and stakeholder consultation which has clearly highlighted three common customer priorities; electricity has to be *affordable*, *reliable* and *sustainable*.

The development of this Proposal was informed by the above priorities – focusing particularly on the affordable supply of electricity. Throughout consultation on the 2014-19 Remittal, we have strived to reach agreement with stakeholders which is in the long term interests of customers, while still providing Ausgrid with an opportunity to recover efficient costs, as we transform our business and pursue long-term efficiencies.

Consistent with these objectives, Ausgrid is proposing to retain \$519 million (\$real, FY19) and forego \$677 million (\$real, FY19) of our estimated \$1,196 million (\$real FY19) potential revenue recovery. This represents a \$2.85 billion (\$real, FY19) reduction on the revised proposal Ausgrid submitted on 20 January 2015.

In accordance with the undertakings agreed to and supported by key stakeholders and the AER for the FY17 to FY19 period, Ausgrid expects to collect \$807 million (\$real FY19) above the set aside 2015 Determination. This proposal will result in \$288 million (\$real FY19) being returned to customers via price reductions over the 5 years from FY20 to FY24.

Benefits for customers

We recognise that high energy prices are negatively impacting households and businesses alike. By putting forward further price reductions in our proposal, on top of those already included in our 2019-24 regulatory submission, we are aiming to do our part in delivering energy price relief to customers.

This Proposal will lead to a 3.2% reduction, in real terms (i.e. excluding the impact of inflation), in our share of electricity bills from 1 July 2019. This is in addition to the 5.7% decrease, in real terms, already included in our 2019-24 regulatory submission, bringing the total reduction in our network prices from 1 July 2019 to 8.9%, or \$51 on an average across residential customers, in real terms.

In addition to the price reductions this Proposal delivers further benefits to customers including:

- Locking in \$100 million (\$real, FY19) p.a. savings achieved over the last five years as a result of our transformation program, involving headcount reductions of almost 3,000 people, which translates to a \$76 p.a. reduction on a per customer basis
- Ausgrid and its shareholders absorbing \$250 million (\$real, FY19) of the transformation costs incurred while shifting to a lower cost base
- Maintaining Ausgrid's commitment to the incentive framework needed to invest in cost reduction programs in the future, allowing further cost reductions to be passed on to customers in future regulatory periods
- Ausgrid accepting the AER's proposed approach to the return on debt from the 2015 determination
- Bringing to an end a long running matter giving customers ongoing price certainty

Details of our proposal

Interim arrangements

In the absence of a final 2014-19 determination, for the financial years 2016/17, 2017/18 and 2018/19 Ausgrid's revenue has been set according to enforceable undertakings we established with the AER under section 59A of the National Electricity Law (NEL). These undertakings were supported by key stakeholders and approved by the AER on the basis that our prices/revenues would not increase by any more than CPI. The clear intent was to ensure that customer prices were not subject to significant volatility once the decision was remade.

In 2016/17 and 2017/18 our prices and revenues were escalated by no more than CPI. For 2018/19 our revenues will be kept at the same level in nominal terms – that is, a revenue decrease in real terms.

Through the interim arrangements agreed with the AER (whilst the amount in dispute was determined) we expect to collect \$807 million above the revenues contained in the set aside 2015 Determination. This amount is reflected in our notional unders and overs account and includes \$84 million of notional interest, consistent with the normal workings of the AER framework. These interim arrangements were supported by stakeholders.

Benefits and impact of transformation

Over the 2014-19 regulatory period, while our revenues were set according to AER enforceable undertakings, Ausgrid embarked on a transformation program that is on track to deliver substantial, recurrent savings for our customers.

As a result of this transformation program, our annual opex cost base is today around \$100 million p.a. (\$real, FY19) lower than it was five years ago. This is equal to a \$76 p.a. reduction on a per customer basis.

The transformation program we have undertaken has been multifaceted, spanning cultural change, process improvements and a re-alignment of our structure and capabilities required to deliver lower prices for customers without impacting the reliability of our service.

Part of this program has also included improving the productivity of our workforce, whilst ensuring there is no compromise in safety or reliability, and actively supporting staff impacted by this change. Since the peak in 2010/11, we have reduced our number of full-time equivalent employees by almost 3000 people.

The transformation program will continue to pay dividends for our customers for many years to come. We have invested heavily in streamlining our business, involving a careful assessment of business needs and the appropriate treatment of affected staff.

The program has been delivered within the statutory and regulatory constraints that specifically apply to Ausgrid, namely:

- The *Electricity Network Assets (Authorised Transactions) Act 2015 (ENA Act)*; and
- Ausgrid's *Enterprise Bargaining Agreement (EBA)* made in 2012 under the *Fair Work Act (Cth)*.

The ENA Act, among other things, establishes an 'employment guarantee' for Ausgrid staff. The guarantee period runs for a period of five years until 30 June 2020 and gives effect to statutory obligations that limit the changes that Ausgrid may make to staffing levels, remuneration, and other employee entitlements. In terms of staffing levels, the ENA Act expressly provides that Ausgrid is unable to implement forced redundancies until the guarantee period expires.

Our 2012 EBA defines the decisions we can make about our labour force. It also contains an 'Ausgrid Redundancy and Redeployment Policy 17 May 2013' which has been found to have the same legal status or 'legislative standing' as the 2012 EBA itself. This policy establishes specific processes relating to redundancies and redeployment, as well as requirements for retraining, which we have strictly followed.

These statutory and regulatory obligations governing our labour force, together with our commitment to safety and maintaining reliability have significantly influenced the transformation decisions we have made in recent years, as we have transitioned our business to a higher level of efficiency. We have also been mindful of the dignity and welfare of affected employees during a time of significant hardship, brought about by the need for change.

Opex – recovering the cost of transformation

We are proposing to retain \$374 million (\$nominal), which is the equivalent of \$438 million in real terms (\$real FY19) in relation to the opex component of the 2014-19 Remittal. This will cover 64% of the \$688 million¹ (\$real FY19) of costs we've incurred during the process of transforming our business.

This expenditure outlay has proven to pay significant dividends to consumers with a sustainable and enduring opex reduction. We wish to reinforce the following further points about this aspect of our Proposal:

- Ausgrid has achieved substantial reductions in opex over the 2014-19 period. We have achieved a \$100 million reduction in opex compared to the level we proposed in our revised 2014-19 regulatory submission. The transformation in our cost structure has been difficult for the business and affected employees.
- Ausgrid had no certainty that it would be able to recover the transformation costs incurred. This uncertainty provided strong incentives to deliver the transformation at the lowest possible cost.
- There were considerable constraints on the speed at which we could reduce our workforce. These constraints were imposed by the EBA and the ENA Act. We have worked within these requirements to meet our obligations to our employees and, at the same time, deliver enduring savings to customers.

We are not proposing to recover the residual costs of about \$250 million (\$real, FY19) that we have incurred while shifting to a lower cost base.

Cost of debt – consistent with other NSW businesses

As part of an overall proposal to resolve the remittal Ausgrid is prepared to accept the AER's preferred cost of debt approach as outlined in its 2015 determination. This approach is consistent with the overall proposals that the other NSW businesses have put forward to consumers and the AER as part of their 2014-19 remittals.

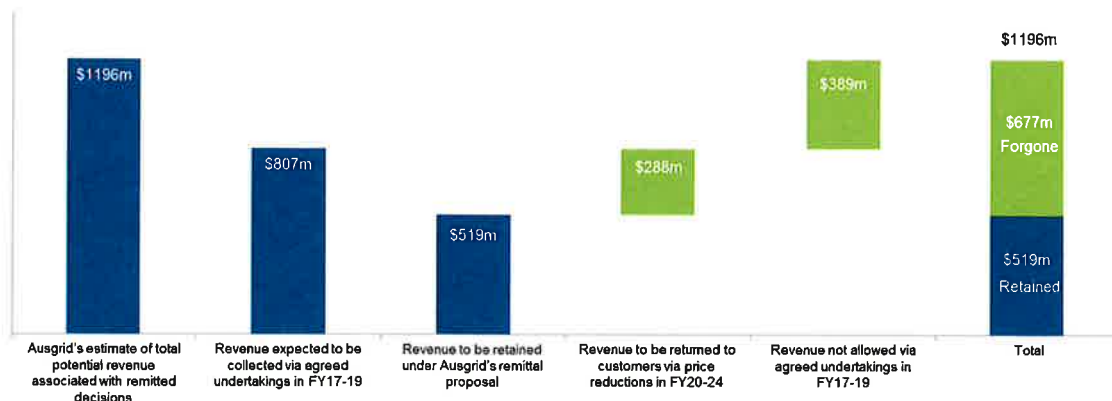
Ausgrid submits this in the interests of re-setting relationships with our customers and the AER. We wish to demonstrate our commitment to delivering on our customers' desire for affordable, reliable and sustainable electricity network services.

Overall revenue impact

In addition to our proposed approach to opex and cost of debt outlined above, we are proposing to retain \$81 million (\$real FY19) as part of an overall proposal to resolve the 2014-19 Remittal. This approach is consistent with the overall proposals that the other NSW businesses have put forward to consumers and the AER as part of their 2014-19 remittals, taking into account the respective opex and costs debt positions of the businesses.

Hence we are proposing to recover a total of \$519 million (\$real, FY19) to conclude the 2014-19 Remittal process. This will result in \$288 million (\$real, FY19) being returned to customers in the form of lower bills over five years, taking effect from 1 July 2019.

¹ This includes the time value of money on costs incurred using the regulated WACC, which is consistent with how other components of this proposal are expressed.



Alignment with NEO and RPP

Our Proposal aligns with the National Electricity Objective (NEO) and the Revenue and Pricing Principles (RPP) in the National Electricity Law (NEL).

The focal point of the NEO is the long term interests of consumers. We consider this to be evident from the outcomes of our transformation program which we have undertaken to substantially reduce the cost of operating our network, while still maintaining reliability and service quality which our customers value.

We also consider that the manner in which Ausgrid has undertaken this transition has been efficient and in the best interests of consumers. The costs incurred in transforming our business are expected to pay for themselves in 5 years or less, and reduced our opex per customer \$76 on average from FY13 (base year for 2014-19 opex allowances) to FY18 (base year for 2019-24 opex allowances).

In these circumstances, we consider both the NEO and the RPP support Ausgrid being provided with a reasonable opportunity to recover the cost of transitioning to a lower level of opex. Providing such an opportunity would also establish the incentives needed to invest in cost reduction programs in the future, that are in the long-term interests of consumers.

Attached are letters from Energy Consumers Association and Energy Users Association Australia supporting our proposal.

Ausgrid recognises that the 2014-19 regulatory determination has a long legal history. We consider it to be in the long term interests of customers and the business that this determination is finalised and consider it an opportunity for Ausgrid and its new management to reset the relationship with the AER, stakeholders and our customers.

Please contact me if you have any questions or wish to discuss our Proposal further. Alternatively, your staff may wish to contact Rob Amphlett Lewis, Executive General Manager Strategy & Regulation, rob.amphlettlewis@ausgrid.com.au, (02) 9269 4501.

Yours sincerely,

Richard Gross
Chief Executive Officer
Ausgrid