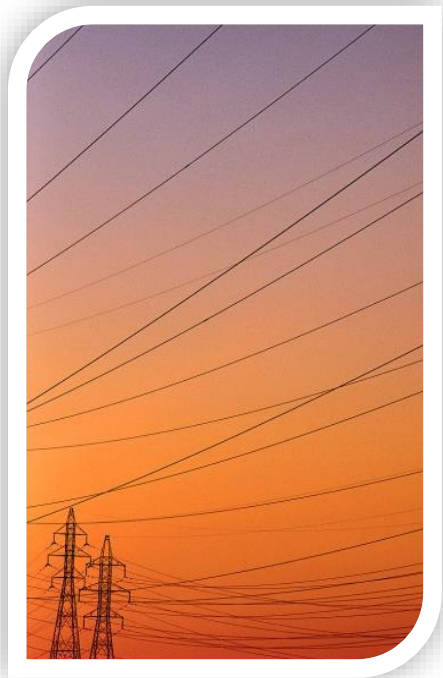


**EQ 2020-25 – AER Public Forum
Consumer Challenge Panel
9 April 2019**



CCP14
Mark Grenning (Chair)
Louise Benjamin
Mike Swanston

Consumer
Challenge
Panel

Our role as a Consumer Challenge Panel...

- We advise the AER on:
 - i. Whether the network businesses' proposals are in the long-term interests of consumers, *and*
 - ii. The effectiveness of network businesses' engagement activities with their customers –
 - i. who, how, when and what issues EQ engaged with its customers on,
 - ii. how this engagement has influenced the revenue proposal,
 - iii. do consumers agree with the revenue proposal, and
 - iv. is there a process for ongoing review of CE/continuous improvement
- We consider this role in the context of the National Electricity Objective (NEO)
- Emphasis on “challenge” to both the network and the AER
- Aim of getting to a proposal that is “capable of acceptance”

The AER is guided by the NEO

NEO:

*“to promote efficient **investment** in, and efficient **operation** and use of, energy services for the **long term interests of consumers** of energy with respect to **price, quality, safety, reliability and security** of supply of energy.”*

Therefore, we consider:

- How prudent and efficient is proposed capex/opex expenditure?
- How will costs be allocated to different consumer groups?
- How does the proposal reflect the changing electricity market and long-term issues?

CCP scope in the AER Building blocks

In scope	Out of scope
✓ Proposed capex in period	✗ Rate of return – AER binding guideline in December 2018
✓ Proposed opex in period	✗ Opex productivity – AER decision March 2019 for 0.5%/yr
✓ Application of incentive schemes	✗ Taxation allowance – AER decision in December 2018
✓ Tariff Structure Statement	✗ Regulatory depreciation
✓ Consumer engagement	

The 'in scope' items account for ~ 35-40% of Ergon/Energex proposed revenue

What we will cover today

1. Changes in the Reg Proposal vs Draft Plan
2. Energex and Ergon efficiency over time
3. Energex and Ergon opex
4. Ergon repex
5. Ergon and Energex Information and Communication Technology (ICT)
6. SPARQ
7. Asset utilisation
8. Tariffs
9. Community and stakeholder engagement so far
10. Proposed stakeholder engagement up to the AER Draft Decision
 - Explore further improvements that are in the LTIC – not a zero sum game

What we said about the Draft Plans

- A quality document where the narrative enabled the reader to:
 - understand the key objectives
 - make effective and informed comment
 - but information gaps that we looked forward to seeing explained in the Reg Proposal
- Significant changes underway in EQ to improve efficiency and reduce costs
 - seen in the proposed 8% reduction in residential and small business prices
 - but not seen in the virtually unchanged prices for larger users
- Noted that a significant part of this reduction was driven by changes in WACC, rather than improved EQ efficiencies
- Saw a genuine desire by EQ to engage with consumers on the Draft Plan as they prepared their Initial Proposal.

Overall, while we welcomed the improvement proposed, our key question was – **why were the price reductions not greater?** The price reduction would have been quite different had interest rates not been falling and the revised WACC guideline not applied.

Many changes over time reflecting consumer engagement + internal EQ analysis - Energex

ENERGEX Real \$2020M	Current Period 2015-2020	Forecast Period 2020-2025			Regulatory Proposal % Change from		
Component	Forecast - like for like	June 2018 Customer Forum	September 2018 Our Draft Plans	31 January 2019 Regulatory Proposal	Current Period 2015- 2020	June 2018 Customer Forum	Septembe r 2018 Our Draft Plans
Total Revenue	6,704	6,479	6,209	6,085	-9.2%	-6.1%	-2.0%
Capex (inc Capital Contributions)	2,846	2,337	2,383	2,327	-18.2%	-0.4%	-2.4%
Opex (exc Debt Raising Costs)	1,894	1,631	1,763	1,775	-6.3%	8.8%	0.7%
RAB (at end of period)	12,917	12,751	12,755	12,701	-1.7%	-0.4%	-0.4%

Major changes around forgoing CESS and EBSS benefits from 2015-20

Many changes over time reflecting consumer engagement + internal EQ analysis - Ergon

ERGON ENERGY Real \$2020M	Current Period 2015-2020	Forecast Period 2020-2025			Regulatory Proposal % Change from		
Component	Forecast - like for like	June 2018 Customer Forum	September 2018 Our Draft Plans	31 January 2019 Regulatory Proposal	Current Period 2015- 2020	June 2018 Customer Forum	September 2018 Our Draft Plans
Total Revenue	6,398	6,645	6,385	6,061	-5.3%	-8.8%	-5.1%
Capex (inc Capital Contributions)	2,729	2,490	2,540	2,905	6.5%	16.7%	14.4%
Opex (exc Debt Raising Costs)	2,024	1,732	1,761	1,806	-10.8%	4.3%	2.6%
RAB (at end of period)	11,650	11,719	11,701	12,027	3.2%	2.6%	2.%

Major changes around forgoing CESS and EBSS benefits form 2015-20 and \$250m increase in repex

Which have resulted in larger P0 price reductions

\$2020	Average Residential Customer		Average Small Business Customer	
	Draft Plan	Reg Proposal	Draft Plan	Reg Proposal
Energex	-10%	-10.3%	-9%	-11.45%
Ergon	-3%	-4.5%	-2%	- 4.5%

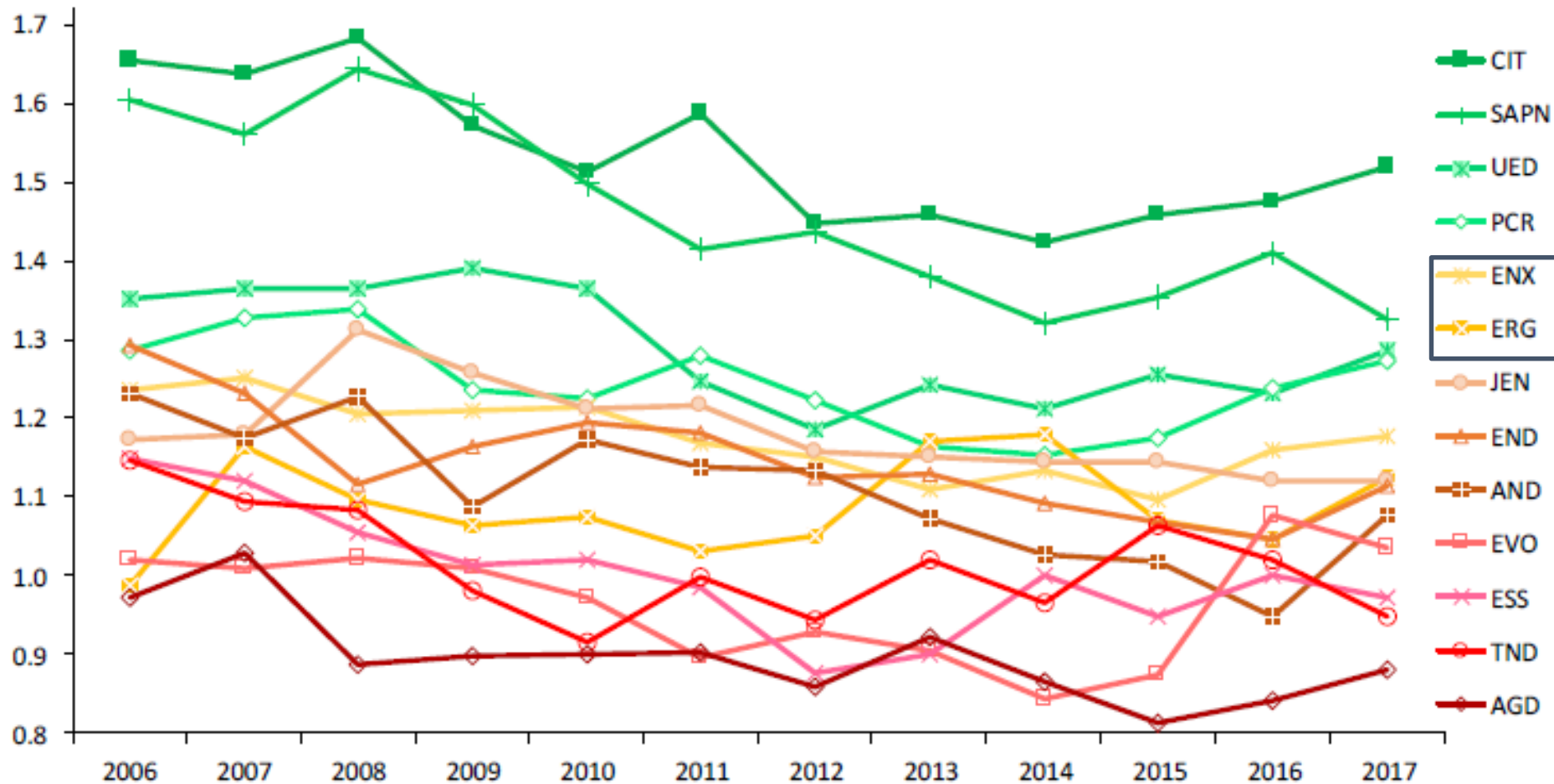
While these reductions are welcome we ask a similar question to what we asked in our Draft Plan submission – Is there further scope for price reductions?

We think there is and that will be the focus of our further engagement leading up to the AER's Draft Decision

Where are Ergon and Energex now?

Middle of the pack in overall DNSP productivity

Figure 4.2 MTFP indexes by individual DNSP, 2006–17

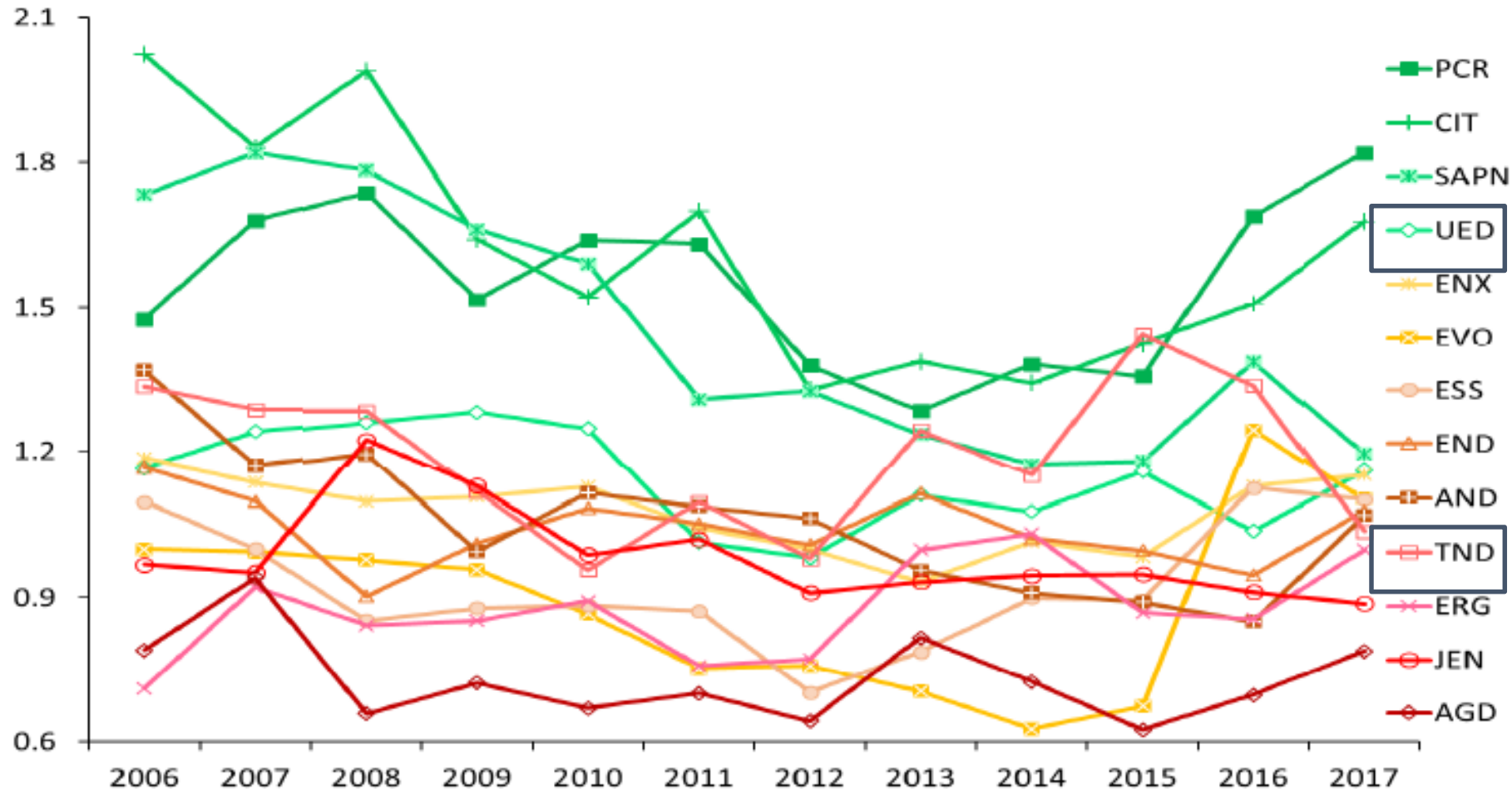


Energex – slight downward trend over time

Ergon – variable performance with a slight increase from a very low base

Ergon is near the bottom on opex productivity; Energex middle of the pack

Figure 4.3 DNSP opex multilateral partial factor productivity indexes, 2006–17

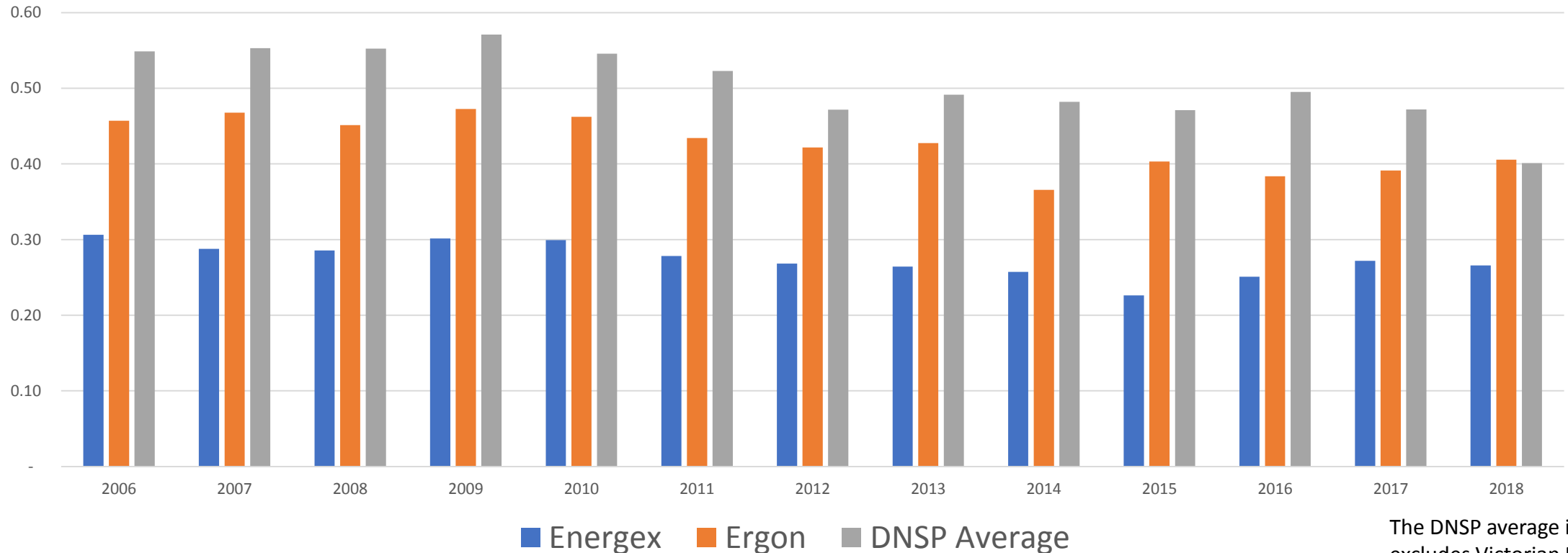


Energex – around the same level as 2006

Ergon – reasonable increase from a very low base, but not as much as some others, so relative position still low

Both with relatively low (esp Ergon) capacity utilisation

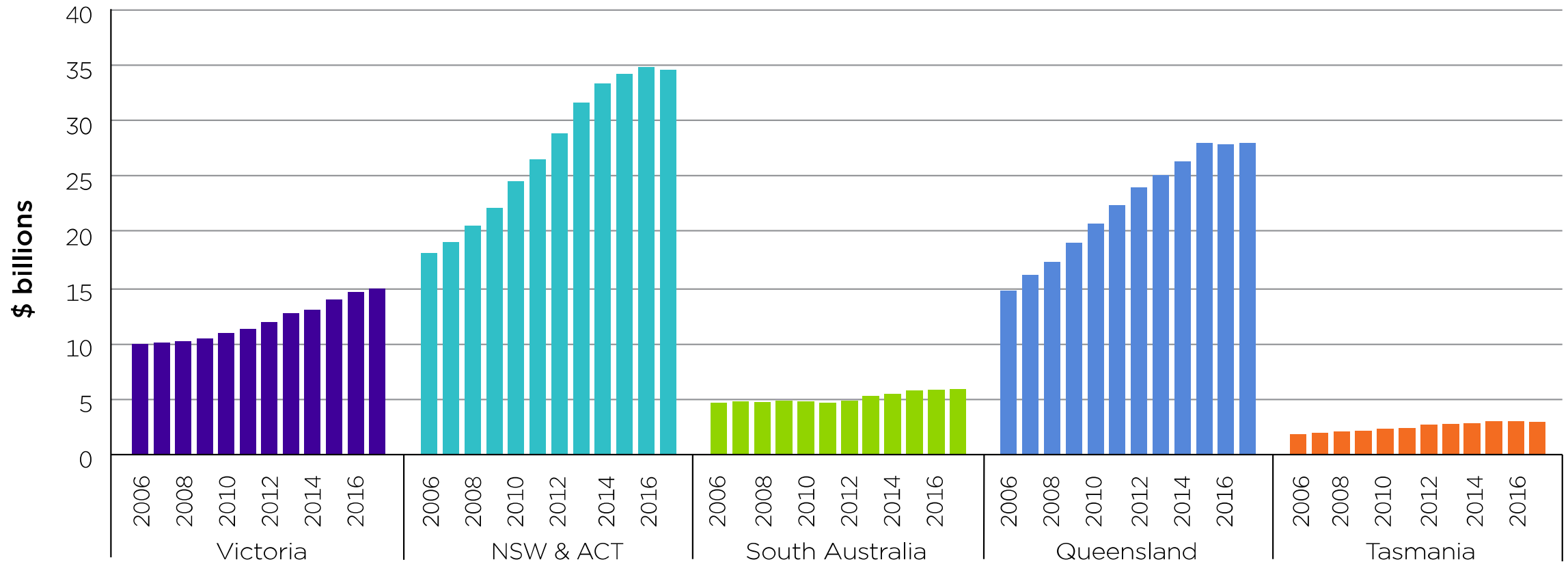
Network Capacity Utilisation



The DNSP average in 2018 excludes Victorian DNSPs which decreases the average.

RAB and previous over investment

Figure D: Regulatory asset base from 2006 to 2017, by NEM region, real \$2016-17



Source: ACCC Retail Electricity Pricing Inquiry Final Report p.ix

https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_Exec%20summary.pdf

ACCC – Achievable Savings

Table A: Achievable average annual residential bill savings by 2020–21

Region	Achievable savings (\$ per annum)						2020-21 Bill	% Reduction
	2017-18 Bill	Networks	Wholesale	Enviro	Retail	Reduction		
Victoria	1457	39	192	34	26	291	1166	20
NSW	1697	174	155	43	37	409	1288	24
South east Queensland	1703	147	192	18	62	419	1284	25
South Australia	1727	13	227	89	42	371	1356	21
Tasmania	1979	113	226	75	—	414	1490	21

Source: ibid p. xv

Observations – what we like

- The headline price reductions are very welcome, but they are concentrated in residential consumers - business consumers will see little improvement
- The reductions in Energex repex and productivity improvement in both Energex and Ergon opex are also very welcome
 - the continued commitment to these changes even though the AER opex productivity review landed on 0.5%/hr
 - the use of market based real wage forecasts rather than those in the EBA
 - no step changes
- The willingness of EQ to engage with stakeholders and make changes as a result of that engagement and to continue that engagement in the period up to the AER Draft Decision
 - we look forward to working with EQ and stakeholders to develop a strategy to address the major issues collaboratively

Observations – what we have concerns about - 1

- Demand forecasts
- Ergon opex base year – is it really “not materially inefficient” or is there still “catch-up” required
- Ergon repex – increased ~\$250m from Draft Plan to \$1b
- Capacity utilisation seems to flatline
- Ergon and Energex ICT – total of \$1.3b with close analysis required of justification – recognise its role in supporting the proposed productivity improvements
- The treatment of SPARQ
- Ability of the organisation to make the scale of the proposed changes especially around the major IT upgrades
- The delay in developing the TSS

Observations – what we have concerns about - 2

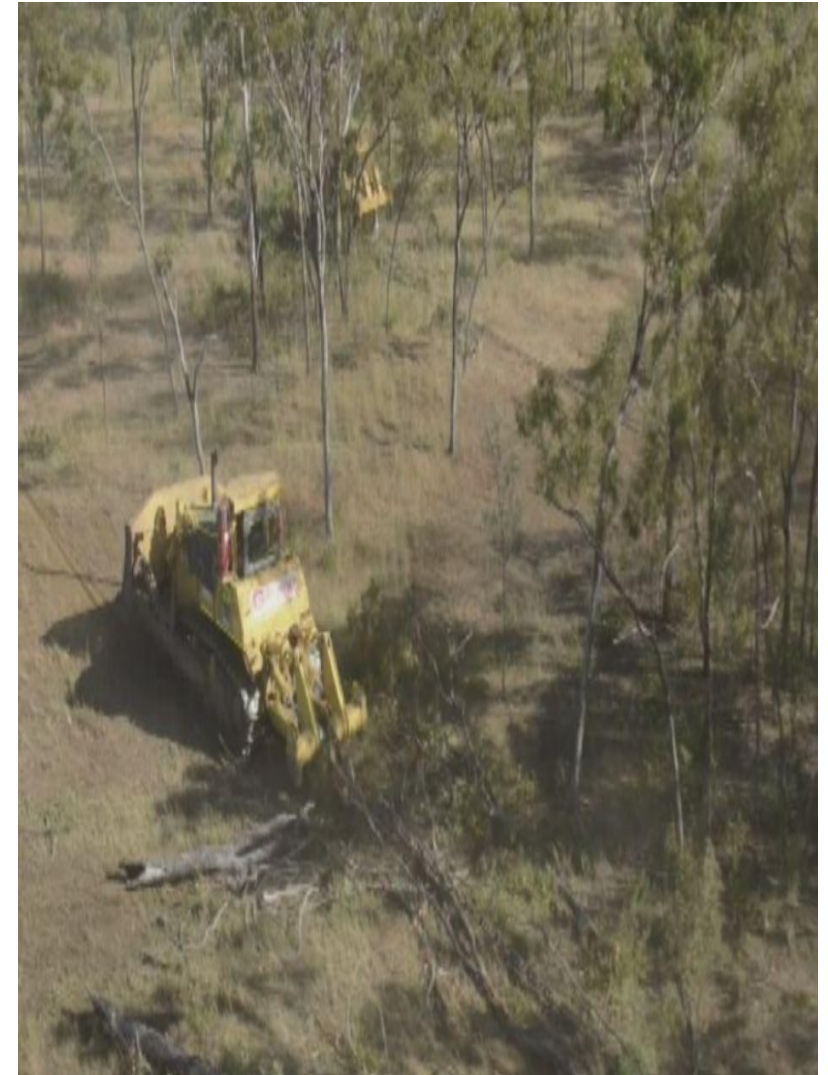
- At a more strategic level we are concerned about the likely price path for 2025-30 given the “sugar hit” in 2020-25
 - Changes in WACC (AER Binding Guideline + lower interest rates) account for ~50% of the reduction in revenue for both Ergon and Energex ie only half is due to EQ’s actions
 - But then a substantial part of EQ’s actions that reduce prices are its one-off(?) foregoing of CESS (total of \$146m) and EBSS (total of \$426m) benefits from 2015-20
- How does what EQ will do in 2020-25 set it up to sustain productivity improvements and further price falls for 2025-30?
 - What happens if interest rate cycle changes and turns up by 2025?

Demand forecasts

- Considerable improvement in recent years following external reviews
 - This will continue with the development of the AER Forecasting Guideline as part of the AEMO RRO forecasting process
- Look forward to reviewing the Energia “road map” being developed in 2019 to implement ACiL Allen recommendations
- Concern is around the DER assumptions and impact of this on the load profile through the day – GWh, not peak MW
 - ACiL Allen highlighting the need for much more sophisticated approach to rooftop PV
 - Also need to review approach to C&I behind the meter solar PV if large rise in tariffs post 1 July 2020 end to transitional tariffs
- As we have seen in recent annual price adjustments with SAPN – consumers bearing demand risk in revenue cap regulation with considerable increases due to falling grid demand
 - Need to consider approach to revenue smoothing so large P0 reductions are not reversed over the course of the 5 years



**Ergon
Opex**



Key Issue is the base year efficiency

- Ergon's long term opex productivity has been poor so we welcome the proposed 9.6% reduction in forecast 2015-20 opex driven by:
 - Average annual productivity growth of 2.6% (vs AER decision of 0.5%)
 - Lack of step changes – when other networks are putting in step changes for functions EQ will need to address
- We agree with the arguments for using 2018/19 as the base year
- The key issue is whether the proposed base year is “not materially inefficient”
 - Yes Ergon is improving and “catching up” to the more efficient group, but so are most other inefficient networks and one year improvement in 2017 can be due to many one-off factors (eg SAPN's large reduction in 2017)
 - But the average of the 4 econometric models still puts Ergon below 0.6 vs the 0.75 benchmark – how does this go on the “pub test”?
 - Every network says that it is unique and hence has unique OEFs so we look forward to how the AER applies the Sapere-Merz OEFs to the benchmarking data
- This is apart from the overall CCP view that 0.75 is too low a benchmark
 - We do not accept the concept that all DNSPs can be “not materially inefficient” given the efficiency measure is a relative, not absolute, measure



EQ Capex



Observations – capex overall

- Network performance and other key performance indicators (safety, environmental) appear stable or improving, against a background of capex underspend. This suggests a very strong case for any *increased* capital is needed.
- There are some non-network proposals, such as property, that we believe could be justified better (such as Brisbane property) and the alternatives explained. The move from Newstead needs to be discussed.
- Overall, we generally support the Energex network capex proposal.

Observations – specific capex (1)

Ergon repex:

- Is the change in asset management approach demonstrated to be in the LTIC ?
- Is the Energex pro-active asset management approach what is needed in regional Queensland?
- Is that the correct level of risk in rural and regional networks?
- What is the evidence to support the new investment: eg greater plant failure, number of substations with access restrictions and other indicators. AER to benchmark risk against other rural and regional DNSPs.
 - If the current approach is not correct then some of the pro-active asset management needed in Ergon should be brought forward in the next 15 months to reduce the capex underspend from 2015-20

CESS:

- Are the CESS claims based on efficient deferral of capex esp. for Ergon?

Observations – specific capex (2)

DER

“Queensland is leading the world in the integration of solar, with one of the highest penetration of residential solar, and our strategy is to remain leaders in this space.” CCP14 acknowledges leading use of inverter technology and load control tariffs. EQ could support its proposal with a wide-scoped DER position, that includes:

- Tariff approach to managing solar exports through load control and time of use, and
- A total cost view of DER integration expenditure.

LV safety monitoring

- We understand the problem and support action, but are there other approaches that may deliver wider benefits (eg smart meters to be considered)?

ICT and the need for an ICT review

Ergon ICT 2015-20 \$364m

Energex ICT 2015-20 \$307

Ergon ICT 2020-25 \$367m

Energex ICT 2020-25 \$294

Ergon ICT 2015-25 **\$731m**

Energex ICT 2015-25 **\$601m**



That is \$1.3b in 10 years

- There needs to be much stronger justifications and counterfactuals. ICT must be tied to the efficiencies. EQ: *“Our commitments to improve our program of works delivery by 3% and reduce EQ’s overheads by 10% across 2020-25 will be achieved through business process improvement. This will be underpinned by digital transformation of the business and network operations through the introduction of technology and a corporate approach to people and change.”*
- Where is the evidence that these efficiencies will disappear if the ICT program is curtailed?
- AER should look at ICT on a totex basis – but the BST approach to opex means we are unable to separate out opex
- AER to review historical benefits, justifications and counterfactuals in the ICT review

Where did the SPARQ go?

- Although SPARQ was re-incorporated into EQ in 2016, EQ continues to represent its costs as part of opex
- Are customers paying for SPARQ assets twice? In 2020-25 EQ proposes to add \$154m into Ergon's RAB and \$147m into Energex's RAB with 10 year asset lives
 - Yes the AER told EQ in 2015-20 to take ICT out of opex and bring the assets onto the RAB balance sheet
 - Good that EQ listened and changed the SPARQ asset lives from 5 years to 10
 - Yes the rules permit EQ to bring the \$300m into the RAB from dismantling SPARQ and to claim depreciation over 10 years but should you?

Is capacity utilisation flat lining?

Ergon

Region	Total Feeder Numbers (2017/18)	2017/18	2020/21	2024/25
Northern	572	24	26	23
Southern	563	51	50	49
Total	1135	75	76	72

*Capacity constraint against the Security Criteria loading (75% for Urban Feeders and 90% for all feeder categories).

**Note dedicated customer connection assets are excluded from the analysis.

Energex

Region	2017/18	2019/20	2024/25
Constrained Feeders*	53	57	53
Total Feeders	2035	2037	2078

• *Capacity constraint against the Security Criteria loading.

“Note that the number of constraints is remaining relatively constant which reflects Energex’s customers expressed need to maintain and not improve network performance during the regulatory control period 2020-25.” Energex 7.091 p. 12; same words in Ergon 7.092 p. 12

Ergon/Energex TSS



TSS needs major work that EQ are focused on

- All stakeholders very concerned about lack of clarity of TSS due to EQ's last minute change of direction
- Concerns extend to design and assignment and impact as no financial information available
- Not clear what problem EQ is trying to solve?
 - Not peak
 - Not duck curve and solar trough
- New strategy is described as *“high level strategy to align with a capacity future or signal to a customer how much network asset it takes to deliver electricity to the customer”*
- Long term aim is capacity with no time of use component. What signal is being sent by an any time capacity tariff that is not correlated to a coincident peak?
- Stakeholders raised issue of vulnerable customers and complexity of the demand tariff

Business customers are particularly concerned

- Business customers are caught in a pincer movement:
 - QCA mandated end of transitional tariffs on 20th June 2020
 - AER requirement for cost reflective tariffs
 - Without a change from 1 July 2020, the current default tariffs will increase annual bills for some customers by >200% which the business cannot sustain
 - EQ working with those businesses and we look forward to continuing to observe this consultation

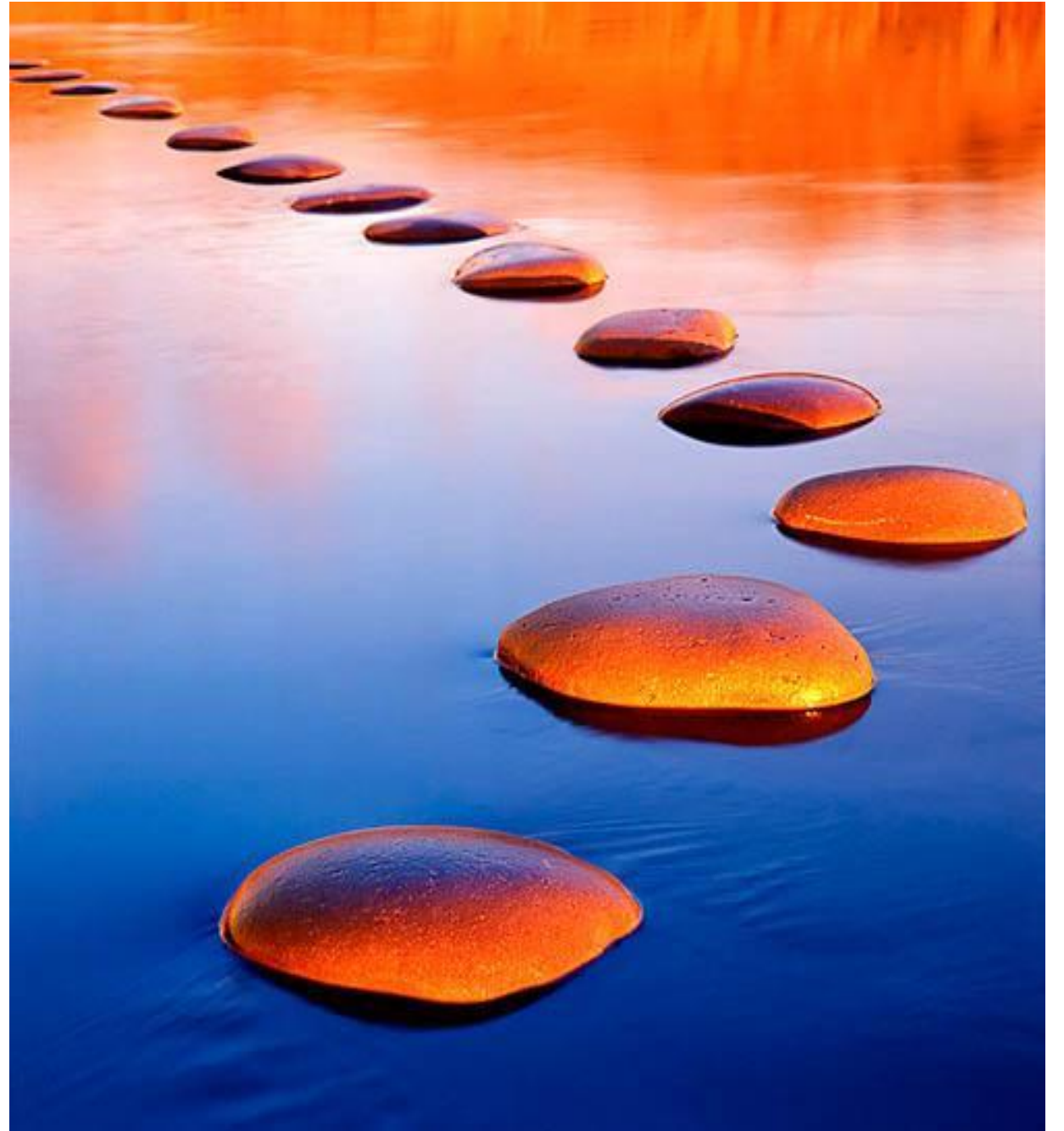
Ergon/Energex Consumer Engagement



What was the benefit for customers?

- EQ started its engagement late
 - Initially it was focussed on merger and integration and staffing issues
- Ambitious catch up plan with strong regional focus
- Active Customer Council
 - We welcome the formation of the Digital Strategy Working Group 2030
- EQ trialled different approaches in RWG meetings including market stalls
- Critical measure of consumer engagement is to apply what was heard and we observed EQ responding to feedback:
 - Change to treatment of leases
 - SPARQ asset lives extended to 10 years
 - Reduction in ICT program
 - Greater price reduction now 10.3% residential and 11.4% small business
- CCP14 not convinced the proposal lays the foundation for maximum efficiency to deliver long-term sustainable price reductions. There is still a gap and some areas to respond to for the proposal to be capable of acceptance

**Next
steps**



CCP 14 focus between now and the Draft Decision

- Focus of our work will be to work with EQ, the AER and stakeholders to develop revisions to the Initial Proposal that could inform the AER's Draft Decision
- We welcome EQ's willingness to be involved
- First step is to develop the engagement plan – scope, participants and timetable
 - What is the gap? What do the AER's technical experts say about the gap?
What are the options to narrow the gap?
 - Propose that this plan be agreed by end of May
- We start from the assumption that it is not a zero sum process ie reductions in one area are not offset by increases in other areas to maintain the current overall revenue position
- Initial discussions suggest the gap is: Ergon repex; Ergon opex base year; ICT for Ergon and Energex (including the rollover legacy ICT RAB from SPARQ) and TSS
- We very much look forward to working with EQ, the AER and stakeholders