Consumer
Challenge
Panel

# CCP10 Response to the Essential Energy Revised Regulatory Proposal 2019-24 and AER Draft Determination

February 2019

Submitted to: NSW2019-24@aer.gov.au.

# SECTION 1

## Observations of the regulatory reset process in New South Wales and the Australian Capital Territory

### OVERVIEW

This section is common to the four submissions that CCP 10 is making in responding to the AER Draft Decisions and subsequent Revised Revenue Proposals from the three New South Wales and the Australian Capital Territory electricity distribution businesses: namely Ausgrid, Endeavour Energy, Essential Energy and Evoenergy. Section 2 and beyond deals specifically with issues relating to each distributor.

The observations in this section relate to our activity during the past two years when we have been engaging with the businesses. We have sought to set out matters relevant to all 4 businesses and the processes that we have observed. It is not our intention to compare the four businesses, rather to derive the common issues. We recognise that while the 4 businesses have many technical issues in common, other aspects of the businesses are quite different - particularly governance and individual business culture.

In this section 1, we address three predominant aspects of the revenue reset process observed by CCP10:

- Firstly, we note the unique circumstances in which CCP10 has operated;
- the second part highlights our observations on emerging best practice in consumer engagement; and
- we then discuss the issues that we believe are emerging NEM wide and that need to be addressed by the AER, the businesses and all stakeholders in the medium term.

### UNIQUE CIRCUMSTANCES

At the outset we acknowledge that the context in which the 2019- 24 regulatory processes have been developed is unique with a number of abnormal factors in play, particularly when compared to previous regulatory processes. We have made this point in all of our previous submissions, but we repeat the observations here because they are significant.

#### Ownership

Changes in ownership have been significant for Endeavour Energy and Ausgrid due to the partial sale of these businesses by the New South Wales government. While Essential Energy has remained under government ownership, it now needs to operate as a separate business just like the other two New South Wales distribution businesses. This means that the New South Wales businesses have dealt with the development of 2019-24 regulatory processes in a very different manner to the approach taken for the 2014-19 regulatory proposals, when the businesses acted as a group under the banner of Networks New South Wales. Evoenergy has changed its name from ActewAGL with this business being separated from other parts of the ActewAGL business group, with retail functions also being separated from network activity.

We recognise that changing ownership and governance arrangements and, in some cases, legislated operational restrictions, coupled with the application of a new ring-fencing guideline (in 2017), have required new processes to be undertaken in developing regulatory proposals for each of the four businesses. This is not to suggest that any of the businesses were unaware of the timing or the rules for development of their 2019-24 proposals, but they provide important context.

**2014-19 regulatory process - remitted decisions**

One of the significant, unique factors is that the 2014-19 revenue determinations had not been resolved before the initial revenue proposals for 2019-24 were to be lodged. This is due to the Limited Merits Reviews (LMR) and subsequent Federal court appeals that followed from the AER's final decisions for 2014-19, which resulted in aspects of the AER's final decisions being remitted to it to be remade. We note that aspects of final decisions were also remitted back to the AER for a fifth business, Jemena Gas Networks (JGN), though the issues in play for JGN were not as closely correlated with the issues for the ACT and New South Wales electricity distribution businesses. The AER's final decisions were also made after the 2014-19 regulatory period commenced due to changes in the rules for network regulation that were finalised by the AEMC late in 2012, which in turn led to the AER developing the "Better Regulation" guidelines to deal with application of the new rules in 2013. This resulted in a placeholder decision for the first year of the 2014-19 period.

The end result was that the total amount of money that customers would need to pay to each of the businesses for its provision of network services during 2014-19 was not fully known at the time of lodgement of the 2019-24 initial revenue proposals. This means that these regulatory proposals were lodged against a backdrop of some price uncertainty for not only customers but also for each of the network businesses.

An important factor in the initial AER final decisions for 2014-19 was the recognition that the ACT and the New South Wales businesses, in particular, needed to transition from businesses that were operationally inefficient to businesses that were more efficient. The introduction of benchmarking of operational expenditure for Australian network businesses coincided with the release of the original final decisions for 2014-19, another important development in regulatory practice in Australia, though the timing may not have been ideal.

The good news for this 2019-24 regulatory proposal is that the 2012 rule changes in the better regulation approaches are now tested and embedded in Australian network regulatory practice. The introduction of benchmarking was a key element of the better regulation process and so was new in the last regulatory period. Increasingly the AER's use of benchmarking is better understood with the benefit of history and greater certainty in the collection of RIN data across the NEM. We have drawn on aspects of the most recent AER benchmarking report in considering aspects of regulatory proposals, believing that benchmarking is an important aspect of regulatory processes and remains a critical cross check tool for the AER. The use of benchmarking as one of a number of informative tools by the AER helps to secure outcomes that are in the long-term interests of consumers.

Since the processes for developing the 2019-24 regulatory proposals were running parallel to and somewhat determined by the outcomes of the remitted decisions for 2014-19, CCP10 in effect became a party involved in the consideration of each of the remitted decisions. We actively discussed the development of remittal proposals with each of the businesses and with other consumer advocates including ECA, PIAC, NCOSS and EUAA as well as consumer representatives on each of the distributor's consumer engagement committees. We recognise that LMR, other legal challenges and remitted decisions have not been easy to deal with for the businesses, the AER nor consumers. What is clear is that consumers were not well served by the actions of the 4 businesses and Networks NSW in challenging the AER's original 2014-19 Final Decisions.

**Restoring Confidence in Energy Regulation (AER 2.0)**

It is worth recalling that on 26 July 2017, at an Energy Networks Association (ENA) conference in Brisbane, AER chair Paula Conboy delivered a presentation entitled "Working together to restore confidence in energy regulation." In this presentation she provided some context to the situation at that time:

> "*We have had a highly adversarial culture around energy regulation in Australia. In fact, I was quite shocked at the intensity of that culture when I arrived here three years ago and it has been a conscious effort of mine to move away from it. This adversarial approach needs to change if we are to achieve mutually acceptable outcomes for investors and consumers; outcomes that are in the long-term interests of consumers. I know that many of you agree that a more constructive working relationship with us is essential if we are to move on from an inefficient and ultimately unsustainable adversarial approach*."
>
> Paula continued: "*we want to engage with you and with consumers earlier in the process. We want to identify key points of disagreement early and we want to work collaboratively to resolve them… It's a new way; and in a post limited merits review world; I would suggest it is the only way… We are essentially kicking off AER 2.0*."

The AER then hosted a Round Table discussion about approaches to resolving the remitted decisions in August 2017. That meeting included the relevant network businesses, AER, CCP10 and selected consumer groups and focussed on the need to resolve the remitted decisions expeditiously.

Recognising the uniqueness of the circumstances leading up to the remits for NSW and ACT network businesses, and observing the significant price impacts on households and businesses of rapidly rising energy costs, CCP10 suggested starting with some principles to help shape the specific aspects of the matters raised in the AER's remittal Issues Paper.

There was no 'roadmap' for resolving the remitted decisions efficiently and effectively nor for the implementation of "AER 2.0." In considering the aspects of the remitted decisions relating to operating costs and debt, both the subject of Issues Papers from the AER, CCP10 proposed the following principles, as a basis for seeking resolution and garnering goodwill:

1. The focus must be on not only the National Energy Objective (NEO), but shorter-term impacts matter too (The short term can impact on the long-term interests of consumers)
2. Recognition of the uniqueness of the current situation
3. Use the best available evidence
4. Apply LMR and Federal Court directives, where they exist
5. The process is of transition from inefficient network businesses, to efficient businesses
6. Objective fairness between businesses
7. Sustainable Opex
8. Dealing with "A New Reality"
9. Trust and goodwill are needed to produce outcomes that work for all parties

CCP10 is relieved that each of the remitted decisions for the 4 electricity distribution businesses have been formally finalised or are near finalisation as of early January 2019. All parties, including the AER, are to be congratulated for the reality that these decisions are practically resolved. By moving on from that unconstructive period of regulatory engagement, the 4 businesses can now shift towards making consumers' interests their focus. It also frees the AER to continue to develop '*a more constructive working relationship'* with the regulated businesses and importantly to focus on systemic issues in the NEM of concern to consumers, some of which we have highlighted in the final part of this section 1 of our submission.

**Extensions**

We also note that the each of the New South Wales electricity distribution businesses sought three-month extensions for the lodgement of their regulatory proposals. In Essential's case it was so that it could resolve the 2014-19 remittal prior to lodging its initial proposal for the subsequent regulatory period. In Endeavour and Ausgrid's case the main reason was to enable the businesses to improve their consumer engagement on their initial proposals before lodging them with the AER.

We believe that all parties have made substantial progress in the (under) 18 months since the initiation of "AER 2.0." The magnitude of this change cannot be underestimated for network businesses, for the AER and its various teams, consumer groups and the CCP. The level of goodwill has grown between all parties and trust is building and was a major factor in the extensions being granted for each of the three NSW businesses, despite some concern by some stakeholders, including the AER, about the capacity of some of the businesses to utilise the time appropriately for improved consumer engagement.

The resolution of the remitted decisions and the goodwill generated in achieving resolution in most cases in an expeditious manner, has been significant in influencing the Revised Revenue Proposals for each business and has led to improved consumer engagement by each of the four businesses. We observe that each business has engaged using different timeframes and methodologies, but the intent for better outcomes has become more evident as each business has finalised its Revised Proposal.

**Ongoing Regulatory Change**

Good regulatory practice, like rust, never sleeps. Over the period in which these regulatory proposals were developed through to lodgement of the Revised Revenue Proposals, there have been a series of revisions to guidelines, rules and legislation that business and consumer interests have needed to take into account:

- legislative change has seen the abolition of LMR during 2017
- legislative change has also resulted in a binding rate of return guideline during 2018. The final rate of return Guideline (the 2018 Guideline) was developed with extensive consultation with a broad range of stakeholder interests and considerable expert input
- rule changes have specifically dealt with ring fencing and a range of proposals have dealt with aspects of distributed energy resources (DER) and access to the grid
- the AER has initiated reviews of aspects of the regulatory framework, which has resulted in changes to rate of return, taxation, treatment of inflation, dynamic productivity for operating costs and tariffs. Separate CCP subpanels have dealt with each of these issues and we refer to submissions on each of these issues from the relevant CCP subpanel. Our advice is intended to be consistent with the CCP views expressed in these processes and
- there has also been clear direction from governments and the AER for network businesses to engage much more directly and transparently with consumer interests.

We recognise that regulation is not an exact science, there will always be aspects of ambiguity and issues upon which regulatory judgement will be required. We also observe that each of these processes have led to improved regulatory process and enhanced certainty for both consumers and network businesses. It is our belief that the result of these various changes to Australian network regulatory processes is starting to shift the asymmetry in network regulation between business and consumer interests to improved alignment with consumer interests and the national electricity (and gas) objective**s.**

**Ongoing Market Change**

In their submission in response to the original 2014-19 proposals from the ACT and NSW businesses, CCP1 contextualised their submission by saying:

> "*We consider that there is a new reality facing distribution businesses (and indeed, others in the energy sector) and yet we see limited evidence that the submissions from the New South Wales distribution businesses reflect this and move beyond "business as usual".*
>
> *The new reality is a result of changes in demand and changes in customer willingness to pay high electricity bills, leading to a need for businesses to adapt to meet these new circumstances*."

The imperatives of this new reality have accelerated since this CCP1 observation, from less than five years ago. Some argue that the role of network businesses for electricity distribution is less clear cut than it was even five years ago with DER meaning that there is considerably more localised generation occurring, while the locations for larger scale renewable energy generation are likely to be different from those for fossil fuel-based generation. The role and functioning of the future grid is a global question and one that was considered by the ENA, on behalf of its network members, with the CSIRO through their network of the future "Roadmap".

The pace of change in their businesses and in the regulatory framework is now a reality for network businesses to a greater degree than has been in the past, however this reflects more the privileged position that network businesses have had in the past compared to most other business endeavours. Rapid and dynamic change remains relatively new for network businesses and provides opportunities for greater efficiency and cost reduction for customers - it does not need to be a driver for higher costs.

**Price, Trust and External Scrutiny**

Energy markets across Australia have been the focus of unprecedented public, political and media attention over the last decade. The cost of electricity has been the major driver of these concerns. During this time electricity costs across the country have risen at a much greater rate than CPI and also incomes for both households and business. This reality is demonstrated in the graph given below in **Figure 1** and produced by the ACCC in its interim report on retail electricity pricing.

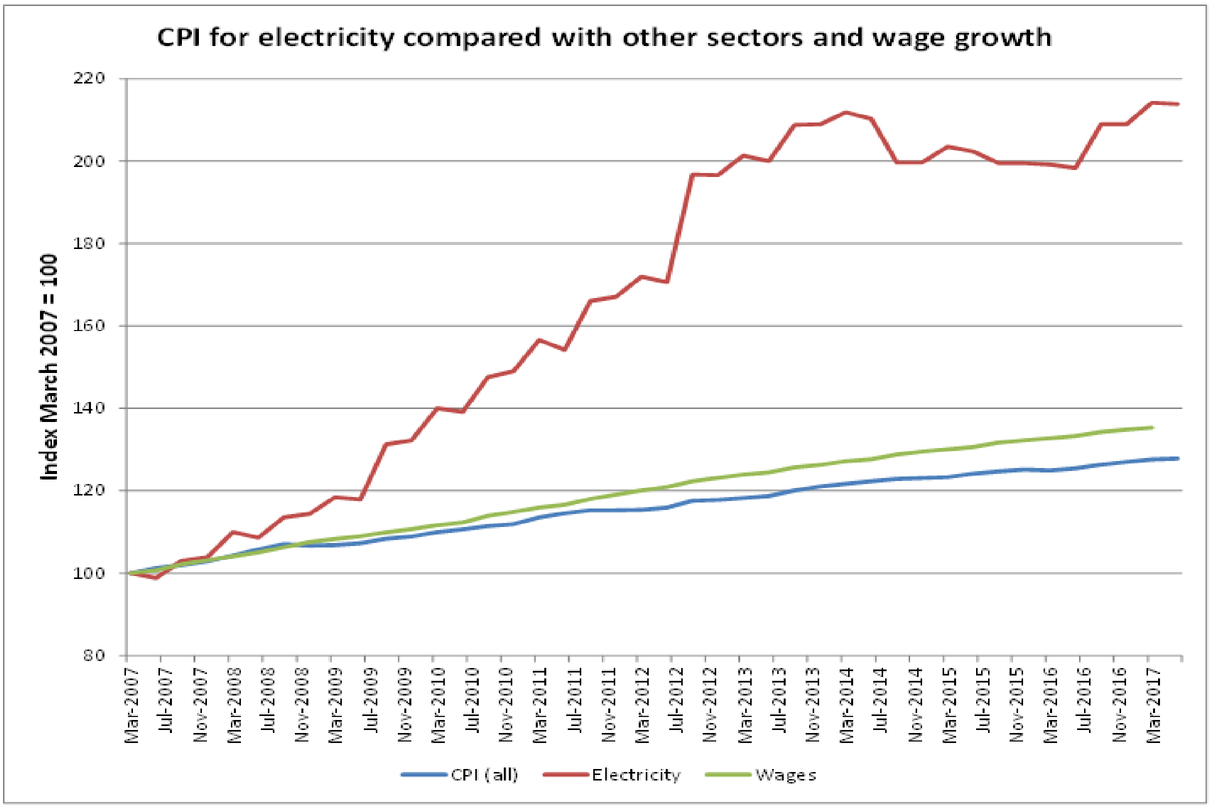


**Figure 1: Cost-Price Index and electricity price growth** (Source ACCC)

High and rising prices have undermined consumer trust in energy markets.

This is demonstrated through the ECA energy consumer sentiment survey with the December 2018 report presenting the following in response to the question "*How confident do you feel that the overall market is working in your long-term interests*?" For New South Wales, 32% of those surveyed responded positively compared to 15% for the ACT. Both of these results were increases on the previous survey six months earlier, up 11% for New South Wales and 4% for the ACT. 28% of people in NSW and 50% in the ACT were negative about the market working in their interests and 40% in New South Wales and 35% in the ACT were neutral. So less than a third of customers feel confident that the market is working for them in the ACT and NSW.

The survey also asked, "*How confident do you feel that the energy market will provide better outcomes for you in five years, in terms of value for money?"* In NSW 34% of people and 19% in the ACT responded positively with 23% in NSW and 38% in the ACT being negative.

We recognise that these survey results refer to energy markets in general and are not specific to network businesses, however the results reflect low levels of trust in all aspects of energy markets, including network businesses and the pressure on every part of the energy supply chain.

Rising prices and low levels of trust in energy markets have attracted sustained political interest with a number of reviews being undertaken including by the Chief Scientist, Prof Alan Finkel and more recently by the ACCC. The ACCC released their report "Restoring electricity affordability and Australia's competitive advantage"[1] in July 2018, this being the final report from their Retail Electricity Pricing Inquiry.

This ACCC final report was published after the initial regulatory proposals from the New South Wales businesses but before their Revised Revenue Proposals. This report also considered areas where consumers could reasonably expect savings in their energy bills, by 2020-21, by jurisdiction. This summary of savings is given in Table 1 below.

1 https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_0.pdf

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

| | | Achievable savings ($ per annum) | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Region | 2017–18 Bill | Networks | Wholesale | Enviro | Retail | Reduction | 2020–21 Bill | % 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 |

For small business customers, similar savings can be made. However, as a larger proportion of small businesses are on standing offers, the recommendation to abolish the standing offer and implement the lower-priced default tariff will have a proportionately greater benefit to small business customers.

The ACCC estimates that small businesses can achieve savings of 24 per cent on 2017-18 prices if ACCC recommendations are adopted (see figure H).[3]

**Table 1: Achievable electricity bill savings by jurisdiction** (source: ACCC, table A)

Of interest is that the AER concluded that the greatest area for savings for New South Wales customers was from further reductions in network charges, this coming on top of the significant improvements in efficiencies that were achieved by all three businesses over the 2014-19 period.

The achievable savings for NSW customers are summarised below in **Figure 2**.

**Figure G: Achievable average residential bill savings in NSW by 2020-21**

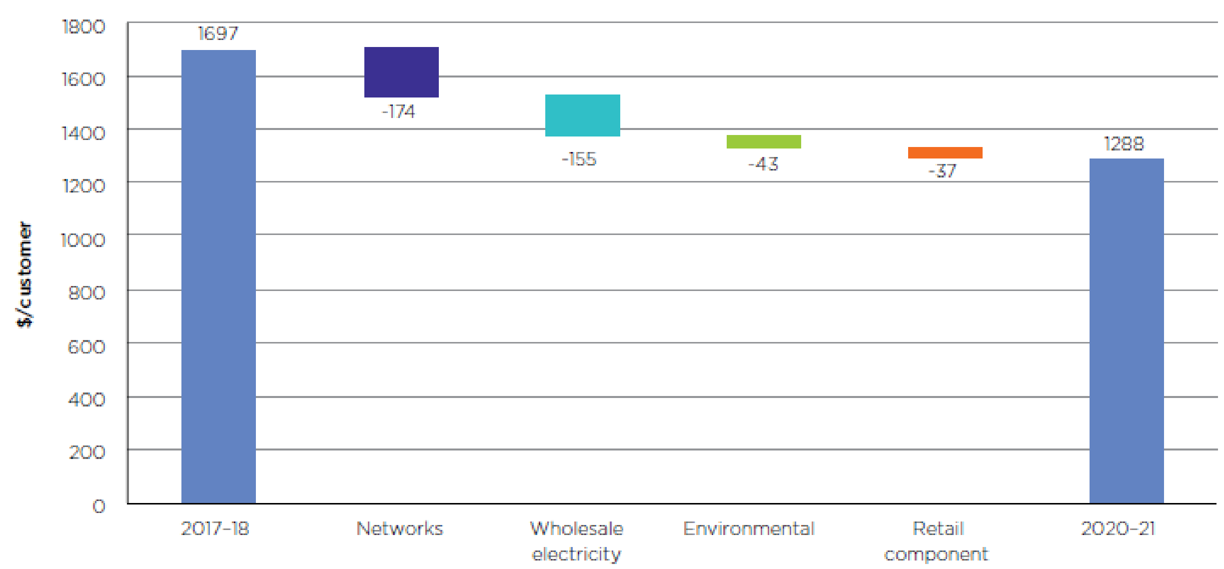


**Figure 2: Components of achievable bill savings – New South Wales** (Source: ACCC)

## OBSERVATIONS OF GOOD ENGAGEMENT

One of the core objectives for the CCP is to provide advice to the AER about the consumer engagement undertaken by network businesses and the effectiveness of this engagement. We were aware of some of the uncertainty that network businesses were reporting about better understanding the expectations and obligations for consumer engagement. So CCP10 met with each of the four businesses as soon as practical after our appointment and highlighted that we would be considering each network's engagement by reference to three broad questions:

- What was tried?
- What was heard?
- What was applied?

In addition, CCP10 encouraged the distributors and the AER to adopt a 'no surprises' approach to engagement and discussion, with the intention of difficult discussions and possibly contentious positions being raised and resolved during the process.

The concept of a proposal that '*is capable of being accepted'* was also generated in our discussions, further reinforcing the approach to resolve key issues as they arise, and have as many issues as possible resolved before the publication and lodgement of the proposals. Such an approach is intended to efficiently reduce the costs for all stakeholders inherent in the preparation and defence of revenue submissions in the propose-respond model, leading to a more understood, engaged and supported outcome for all stakeholders.

We said that we did not expect any particular engagement model to be pursued, rather that the main focus for us would be to consider how consumer views have been applied to regulatory proposals that were lodged.

Each business used different engagement methodologies and worked to very different time frames. Some were infuriatingly tardy in demonstrating what we considered good consumer engagement practice to be. However, we are confident in asserting that all four businesses have dramatically improved their consumer engagement through both the development of their regulatory proposals and in finalising the remitted decisions and we are confident that the expertise acquired and skills applied will have ongoing benefit to the businesses and consumers they serve. Our concern is to ensure that the engagement becomes part of BAU business planning cycles for each business now during the regulatory cycle and that engagement doesn't stop and start up again in 3 years' time.

We congratulate the four businesses for the significant progress they have achieved in developing their consumer engagement practice and in particular the significant internal culture shifts that have been achieved.

At the ENA annual dinner in December 2018 Essential Energy was awarded the ECA/ENA sponsored consumer engagement award, the second year that this award has been offered. CCP10 has been able to observe much of the engagement approaches applied by Essential Energy over the better part of two years and congratulates them on the leadership they have shown in consumer engagement and in being the first business to resolve its remittal process.

Their leadership has operated as a benchmark in NSW with wide ranging impact on the other businesses. We believe that Essential's award win is well deserved.

**Good practice in consumer engagement**

We observe that good consumer engagement practice involves three sets of relationships.

*i. Relationships Internal to the business*

Good practice for consumer engagement starts with the Board and CEO being committed to improving consumer engagement practice including regularly reviewing engagement measures. It involves an internal shift away from primarily relying on engineering plans to a focus that is centred on consumers' needs and a consideration of what consumers are prepared to fund. Essential Energy's CEO along with senior staff demonstrated their commitment through their attendance at a number of regional deliberative forums where it was evident that they were listening closely to their customers.

Staff responsible for consumer engagement need to be closely linked with regulatory staff and other decision-makers so that there is internal consistency in a businesses' commitment to its customers. Another thing we observed was differing levels of feedback from customers being reflected in the Revised Proposals by the businesses. Sometimes, consumer feedback was diligently recorded but led to no changes to the proposal. In other cases the feedback was acknowledged by the business but the inflexible internal processes required to respond to the feedback meant that last minute changes were put to consumer groups who by then had limited resources to respond to the late revisions.

We have seen very clearly over the last two years the importance of businesses being able to be brutally honest with themselves in understanding how they are perceived by customers, consumer groups and stakeholders and to be able to hear the bad news, as well as the good news, and to respond proactively.

Good communication is essential for effective engagement and in particular strategies are needed to inform those consulted about what the business has heard from them and the responses they are making. Consumer engagement is not always about agreeing with a group of customers, it is about taking seriously and looking at all practical measures to address concerns raised.

*ii. Relationships with the regulator*

Old habits die hard and the adversarial relationships that have largely existed between Australian network businesses and the AER needed to change and have changed dramatically over the last couple of years. An important driver is that network businesses and the AER need to be able to talk to each other often and with transparency. Where a problem is identified, it needs to be tested and solutions found to resolve the agreed issues. A recent initiative is the engagement of the AER staff, particularly in the capex team, with the engineers of the 3 NSW businesses. AER staff has engaged prior to the AER making its Draft and Final Decisions and have shared their concerns with proposals and modelling. This has given the businesses an opportunity to respond to those concerns and adapt their proposals. This is also building greater transparency in decision-making and is only possible in an environment where the threat of litigation is largely removed. We congratulate the AER capex team for their responsiveness to our suggestions to be more transparent with their early modelling and any concerns in business cases and for this greater openness. We have specifically encouraged each business to work with the AER repex team to improve the AER's RIN data and repex model as we believe it is critical for consumers and businesses to have confidence in the model as a cross check, given the likely capex investment that will be needed in the future in new technology platforms. We commend Ausgrid, in particular, for embedding this commitment into their Revised Proposal.

*iii. Relationships with consumers*

Emerging better practice for consumer engagement includes network businesses producing a realistic draft revenue proposal (often referred to as a Draft Plan) at least six months before it is due with the AER and for active consultation with consumer groups, consumers and other relevant stakeholders on the Draft Plan. ElectraNet (the winners of the inaugural ECA/ENA consumer engagement award), Australian Gas Networks and TasNetworks initiated this approach. Each of the ACT /NSW businesses were intending to apply this approach. However, we suggest that for a variety of reasons including their historical adversarial relationships with the AER and consumers which had led to a history of ambit claims, they were not able to implement the approach as smoothly as they would have liked. We note that electricity and gas network businesses submitting regulatory proposals after these four businesses are releasing draft / preliminary plans for consultation. We regard the ACT/NSW distribution businesses as being in transition towards widespread application of draft plan approaches.

Engaging about the Draft Plan for about 18 months before it is released and then allowing about six months for more focused engagement in consultation is good practice and warrants ongoing encouragement and development.

The term "deep dive" became inextricably linked with the New South Wales businesses, particularly as they sought to make best use of the extensions they were granted. The efforts in seeking to gain consumer insight through deep dives were significant and commendable. We observe that some of the learning from the various processes called "deep dives" have included the value of keeping deep dive consultations focused on particular, more difficult issues where the network is genuinely seeking consumer and stakeholder input. It is our observation that deep dives work best when they involve a relatively small number of people, including the relevant AER staff and AER technical advisers and consumer groups, who are able to report back to a broader base. Deep dives need to be about seeking solutions rather than seeking to convince. The main issue we observed in the NSW deep dive processes were that they were far too late in the regulatory process. We commend Endeavour for continuing to engage on both its capital contributions policy and capex proposal prior to the AER publishing its Draft Decision and reducing its capex proposal. We also congratulate Ausgrid for the extensive consumer engagement on many aspects of its Revised Revenue Proposal. More recently Evoenergy had discussions about its IT proposals with CCP10 and its Energy Consumer Reference Council (ECRC) after the AER's Draft Decision. We note that the timing in all three cases was not ideal. However, CCP10's firm expectation is that such a late extensive, intense deep dive process with extensive revisions so late in the process would not occur next time. It can partly be explained as a feature of the unique need to reset the NSW and ACT businesses' relationships with the AER and consumer groups.

“Deliberative forums” were also developed through the NSW processes and proved to be a very effective approach. The general model is that groups of 60 to about 80 consumers are brought together for about 4 hours, and spend most of the time working in facilitated groups of 8 to 10 people dealing with a maximum of three significant issues of the period. Returning to groups involved with initial deliberative forums has also proved to be very helpful.

Another feature of emerging consumer engagement involves businesses establishing ongoing consultation committees such as TransGrid’s Powering Sydney’s Future. We commend Ausgrid for initiating its Network Innovation Advisory Committee (NIAC), which embeds consumer input into Ausgrid’s technological transition to the smart grid. We would encourage the other distributors to also think of opportunities, which embed ongoing consumer input as part of their planning and innovation for critical areas. We have previously encouraged Endeavour to consider this approach to manage the development of the second airport.

Other examples of innovative consumer engagement practices that we observed included:

- openness to having difficult conversations
- proposals being presented as a decision as a whole
- readiness to engage on capital expenditure plans, risks, drivers and objectives
- more active engagement with the AER on issues such as repex modelling and risk quantification and allocation
- recognition of the importance of productivity improvements
- challenging thinking on the application of capex / opex trade-offs (e.g. DM)
- review of network risk position, especially for network augmentation and replacement
- much more interactive and conversational relationship with advocates and the AER
- progressive refinement of ideas involving frequent conversation
- cost-effective catering with a broad range of healthy options
- openness to working with other businesses on common issues such as tariff impact modelling and grid innovation
- greater public acceptance (by some of the businesses) of AER decisions on framework changes e.g. WACC, tax review and productivity
- preparedness to establish ongoing consumer / stakeholder oversight framework
- giving up CESS for certain categories of expenditure
- seeking feedback on drafts of Revised Proposals and
- a desire – initially demonstrated by Essential Energy at the initial proposal, then subsequently by Endeavour Energy and Ausgrid in their Revised Proposals – for their proposals to be supported by consumers and capable of acceptance by the AER.

**Further development of good regulatory practice**

The process in developing the New South Wales and ACT regulatory proposals for 2019-24 and resolving the remitted decisions for 2014-19 has been a sometimes-arduous process dealing with significant change across a number of fronts. As indicated above, the periods of pain and frustration have been justified and significant outcomes achieved for consumers and the businesses through the 'journey'. CCP10 has been told by several stakeholders that the process of resolving the remittals has led to greater trust by internal stakeholders, including investors, which in turn has led to greater transparency in engagement by the businesses with the AER, CCP10 and other consumer groups around the subsequent 2019-24 revenue proposals.

There are important next steps that need to be undertaken to embed the processes, relationships and culture improvements that have been achieved. These include:

- regulatory processes to *reward good practice*. In our first submission, CCP10 encouraged the AER to develop 'signals' for network businesses to encourage ever better consumer engagement practice and to develop rewards / incentives for those businesses that do it well. A regulatory proposal that is lodged following extensive engagement and dialogue with relevant AER teams and is capable of or very close to being capable of acceptance, should be encouraged and rewarded. We understand that steps have been taken to this end, but it remains unfinished business.
- Each network business needs to *further embed their consumer engagement* practices and to retain relationships developed with consumers and consumer groups throughout developing the regulatory proposals and to provide feedback to those who have provided input so far.
- *Review the AER's Better Regulation Consumer Engagement* Guideline for Network Service Providers November 2013 to reflect a more sophisticated understanding of the outcomes of consumer engagement and a consideration of best practice.
- *Resourcing for consumer engagement* continues to be a dilemma with no dedicated resourcing currently available to enable consumer groups to maintain relationships with network businesses. It is hoped that the COAG Energy Council will return to the question of resourcing for consumer engagement in network processes early in 2019.
- Increasingly CCP is being asked about the future of network regulatory processes in Australia, and we consider that the time is ripe for discussion about a rolling network regulatory process where the *focus is on ongoing relationships* rather than it being a major focus once every five years.
- For CCP and the AER, an emerging question is about relationships with network businesses beyond the release of a final determination. On current AER practice CCP10 will cease to exist in April 2019 when the AER publishes its final Decisions in the four 2019-24 processes. Network businesses and their consumer reference groups are increasingly asking about *potential for ongoing CCP engagement*. For example, CCP members have been asked to participate in TransGrid's Powering Sydney's Future processes and most recently by Ausgrid in its NIAC and Pricing Working Group.

  CCP members have developed an intimate understanding of the plans and operation of the 4 businesses, and have in many ways grown trusted and informed relationships with senior management of those businesses. Consideration of how ongoing relationships can continue, whilst respecting the fundamental role of consumer challenge, would be helpful.

- Just as a more regular, transparent and cooperative relationship between utilities and their customers is being encouraged and is proving beneficial, CCP10 has observed significant benefit in the *early engagement with the AER* as part of the reset process. Sharing ideas and challenges, understanding the implications of organisational differences and the sharing of common ideas and initiatives has proven valuable and significantly streamlined the processes inherent in the regulatory reset.

We recognise that the AER cannot and should not compromise its 'arms-length' relationship with utilities, nor is the AER the primary channel for information sharing. Resource availability is also a major consideration.

Further development of the interaction with utilities, particularly when approaching revenue resets, will prove valuable in leading to an efficient and transparent process, supporting the submission of proposals that are 'capable of being accepted'.

## CHANGING PRIORITIES FOR NETWORK REGULATION

In the past 12 months, most Australian distribution utilities have undertaken some form of community engagement related to their regulatory revenue resets. CCP10 has been heartened to see a marked change in the nature and content of this engagement by a number of progressive distributors, not only in their collaborative approach to engagement, but importantly as a reflection that these companies are embracing changing customer and community expectations in the modern energy environment, and are prepared to share this journey with their customers.

Leading utilities demonstrate a willingness to reconsider electricity supply risks in light of changing consumer expectations around price and productivity, seeking new and innovative ways to engage communities and use new technologies to meet their obligations and community requirements. Volumes of traditional network planning and investment analysis - whilst still important inside the organisation - gives way to a more conversational, relevant, risk-based and innovative attitude to providing network capacity, meeting system performance obligations and optimising customer interactions.

Such an approach is underpinned by three key issues. Firstly, with Australia's energy customers experiencing remarkably high energy prices, every participant in the energy supply chain has a responsibility to take all reasonable steps to minimise the cost of energy distribution - and therefore customers' energy bills - as much as reasonably possible. CCP and other customer advocates look for a clear commitment by the utility to seek every opportunity to reduce the cost of addressing network constraints, through the mantra '*doing more with less'* and '*not a dollar more than necessary, not a day too soon'.*

Secondly, as the growth of the asset base presents a long - term risk to high energy prices for many years to come, consumers expect that every effort is being made to minimise growth in the total value of long-term assets, especially in this environment of rapidly changing energy use and technology uptake by consumers.

Finally, as changing technologies become more available to customers and utilities, meeting network obligations is much more a collegiate and interactive process. A responsibility exists on customers, distributors and new industry participants to collaborate in the effective utilisation of existing assets, and to seek innovative approaches for the safe, reliable and affordable supply of energy.

Throughout the process of the NSW and ACT 2019-24 regulatory determinations, a number of common matters arose that were of concern to CCP10, energy consumers, utilities or both. Many of these matters represented significant expenditure and therefore impact on consumer bills. We summarised 9 issues in our presentation on the NSW Proposals at the Stakeholder Forum on 13 November 2018[2]. CCP10 is very pleased that the 2018 rate of return Guideline and changes to the PTRM to reflect the issues in the tax review have been resolved in a timely way so that they can be incorporated in each of the NSW and ACT Final Decisions.

We are also pleased that both opex productivity and tariff reform are currently being progressed by the AER in time to be reflected in these 4 2019-24 determinations.

**Opex, Productivity and Benchmarking**

CCP10 argued consistently throughout these revenue resets for the AER to review its zero assumption when forecasting productivity. The issue was given prominence by Essential on 9 February 2018 when Essential launched its draft Proposal, which included a significant opex productivity dividend for consumers. In fact, Essential included forecast declining opex, forecasting savings from its IT initiatives, as its opex forecast gave consumers 100% of the savings from that IT investment rather than sharing those efficiencies through the EBSS.

CCP10 and the CCP as a whole are very supportive of the AER's draft decision to revise its assumption from zero to 1% per annum in its recent Draft decision paper – Forecasting productivity growth for electricity distributors dated November 2018. We see the AER's Draft decision as a positive start.

We strongly support the CCP sub panel's submission dated 21 December 2018 to the AER's review, which concluded:

> "*The objective in forecasting opex for the revenue resets is to establish the* ***best available unbiased estimate of the opex for a prudent and efficient operator***."
>
> And........ "*In the CCP's view the current assumption of zero trend productivity improvement does not meet these requirements and* ***we consider that the data supports an assumption of a trend productivity improvement for the DNSPs of at least 1.5-2.0% pa***."

We commend Essential Energy for its leadership in offering a productivity dividend even before the AER had launched this review.

We also congratulate Ausgrid as the first privately owned DNSP to include a 1% per annum opex productivity improvement from 1 July 2020 for consumers. We commend Ausgrid for listening to its customers' consistent submissions that zero productivity is unacceptable. We

[2] https://www.aer.gov.au/system/files/Consumer%20Challenge%20Panel%20%28CCP10%29%20-%20Presentation%20to%20AER%20public%20forum%20-%20November%202018.pdf at slide 41

will leave it to our CCP colleagues to respond in detail to the various DNSP submissions arguing against the AER's Draft Decision. We note that both Essential Energy and Ausgrid have offered productivity dividends and we urge the AER to also apply its Final Decision from its review to each of the 4 businesses.

As we discussed above, the use by the AER of benchmarking as part of its consideration in the original Final 2014-19 decisions was keenly contested. In our Response dated 30 November 2017 to the AER Issues Paper: *Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure*, CCP10 emphasised that we remain strongly in favour of the AER using benchmarking as an assurance tool to cross check forecasts of the distributors.

We are concerned now the 4 businesses will have transitioned to the efficient base year for 17/18 originally determined by the AER, that the AER may reduce its ongoing investment in and reliance on benchmarking as one tool to promote efficient operating expenditure. In our submission from November 2017 we went to some length to discuss the critical ongoing importance of benchmarking. This was set out in Appendix A to our submission entitled "*Incentive Based Regulation and the role of benchmarking*."

We concluded that CCP10:

- is strongly in favour of the AER using benchmarking as an assurance tool to cross check forecasts of the distributors
- supports the AER's annual benchmark publication and strong incentive-based regulation (IBR) as discussed in the attached "*Incentive Based Regulation and the role of benchmarking*" and
- favours stronger, future incentives than the EBSS and encourages the AER to do an international review to check world's 'best practice' for IBR mechanisms.

We urge the AER to commence a thorough review of all its incentive schemes. We also encourage the businesses to continue to work with the AER on refining RIN data and the benchmarking model as it remains an important cross-check tool.

**Tariff reform**

Evoenergy remains one of the stand out businesses in the NEM on its transition to cost reflective tariffs. By contrast during the current regulatory period and TSS 1 we observed of "*the three New South Wales distribution networks:*

- *to date, reform has been slow and fragmented;*
- *there has been no single consumer perspective; and*
- *there has been remarkably little dialogue between retailers and network businesses about the incidence of tariffs.*

*The CCP view is that retailers should be much more actively involved in network tariff debates and indeed the primary audience for network tariff price signals should be retailers rather than customers. CCP10 has been instrumental in encouraging consumer groups to develop Pricing Directions that have been developed to provide cohesive consumer perspective to assist networks, retailers and AER to accelerate reform*".[3]

Our observation is that the development of a cohesive position by customer stakeholders in the Pricing Directions made it easier for stakeholders to respond. For example, Endeavour responded to customer feedback and the Pricing Directions by introducing a TSS as part of its Initial Proposal that met tariff reform objectives by including a transitional demand tariff. The ACCC favourably referred to the Pricing Directions in its Final Decision in the Electricity Inquiry and recommendation 14 in the ACCC's Final Report on Electricity Pricing endorsed many of our recommendations[4]. The AER has since responded to the progress made in NSW by creating a dedicated CCP subpanel 21 to assist in driving tariff reform. Subject to sufficient resourcing the aim of CCP21 is to:

- engage with retailers on their role in working with consumers. CCP believes that it is critical for all stakeholders to understand how the retailers will flow though network tariffs into retail prices and what products/price structures they will offer
- work with ECA, DNSPs, and the AER on impact analysis at the household level and
- develop complementary measures. CCP intends to work with customer advocates, networks, retailers and AER on these.

The work in tariffs driven by the CCP and the AER TSS team will have greatest impact if it is progressed on a NEM wide basis involving all stakeholders.

The revised Tariff Structure Statements of the three NSW businesses have responded further to consumer feedback about the need to shift more rapidly to cost reflective pricing and CCP10 commends the three distributors for engaging in detail with stakeholders, CCP21 and the AER TSS team to progress tariff reform. This will remain an important focus in the NEM during the next decade.

**A shifting focus in consumer priorities**

In the environment of a more active and engaged revenue reset process, it is clear that the influence of new technologies, customer choice, price awareness and sustainability imperatives is changing the way utilities approach their obligations.

Network augmentation and capacity investment is now much more influenced by new customer technologies and market developments. As asset replacement requirements

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[3] CCP10 Response to AER Issues paper and revenue Proposals for NSW Electricity Distribution Businesses 2019-24: August 2018 at page 77. See https://www.aer.gov.au/system/files/CCP10%20-%20Submission%20-%208%20August%202018_0.pdf

[4] https://www.accc.gov.au/system/files/Retail%20Electricity%20Pricing%20Inquiry%E2%80%94Final%20Report%20June%202018_0.pdf

mature and demand growth slows, the key variables in assessing prudent investment are changing. The focus on demand management is now matched by the importance of utilisation of existing assets. Traditional network control has given way to Distribution System Operation (DSO). Information and data in real time is the cornerstone of optimal network investment. New connections incorporate a wide range of energy and demand control options available to the customer, many of which are not yet understood. The market influence of embedded generation and storage, or more importantly the variable influences on those who seek to control that new equipment is yet to be established and understood.

Significantly, the robustness of traditional engineering planning and network development now incorporates the approach of 'least regrets', where risks inherent in rapidly changing network requirements cannot be quantified with certainty.

As the relationship between CCP10 and both the AER and the network businesses developed over this regulatory period, it has become clear to CCP10 that there are aspects of the engagement and proposals that would benefit from further consideration by the AER to apply on a broader NEM wide basis. The intent is to foster work practices, language and behaviours that will encourage utilities to present information to consumers and the AER in a more effective way, by using common language, more standard definitions and a format that makes the impact and benefit to consumers more obvious and measurable.

The areas that we have identified as highest priority in delivering significant value are listed below.

i. *Consider the prudency of Information and Communication Technology (ICT) investments*

The ICT investment by utilities is growing rapidly as the role of corporate support systems, real-time control systems, data gathering, and data analysis plays a much greater role in delivering business efficiencies; both in the operation of the business itself and the optimal investment, operation and risk management of the distribution network. CCP10 acknowledges that ICT expenditure will genuinely be an item of increasing expenditure over the next twenty years. However, utilities need to be held accountable for these significant and growing-investments in Information and Communication Technologies.

Similarly, consumers need to be more informed of the requirements, benefit, prudency and risk implications of investment in ICT and related assets, as they gain an increasing influence on business performance and efficiency (and hence operating cost), depreciation (again, influencing price to customers), data risk, service delivery, customer choice and network supply risk and performance.

We recognise that each utility is encouraged to seek new and innovative ways to work with customers, the community, the regulator and other stakeholders. However, a number of significant matters are arising in the industry generally that lack transparency and clarity of definition and approach. Unless addressed in a common and effective way, the risk continues that this growing area of investment may not be fully in the interests of consumers.

A number of specific concerns exist regarding ICT spend, both as operating costs and the return of investment in new capability.

1. The quantum and impact of significant ICT expenditure by all utilities affects all customers
2. A single provider, SAP is emerging as almost a monopoly provider of utility enterprise systems, and the accountability and influence this provider has on the cost of ICT operation and regular investment is not at all transparent.
3. The efficiencies that businesses gain through ICT investment, the cost of which is largely recovered from customers, should not be recovered again through the incentive schemes.

In their regulatory proposal, Essential Energy is commended for linking the increased investment in ICT capability with performance improvements that are specific and measurable. Whilst we expect that there will be significant challenges in demonstrating the performance change resulting from the technology investment, Essential's commitment to visible benefits for customers sets a new benchmark for ICT investment in the regulatory proposals.

In response to CCP10's ongoing concerns about IT expenditure we are pleased that Ausgrid has committed in its Revised Revenue Proposal to share further granularity of customer benefits derived from IT expenditure and to support an industry wide review by the AER into IT forecasting to improve expenditure assessment.

CCP10 recommends that the AER and community advocates take a stronger role in the understanding of the prudency of ICT investment by utilities. We support the recent advice by the AER to consider the establishment of greater skills in this area, and encourage the AER to work with utilities to present the value and risks of ICT investment to consumers in the form of transparent, measurable and specific performance improvement.

*ii. Clarify the value of the transition to the Distribution System Operator role*

A combination of high retail electricity prices, falling prices for customer technologies and continued subsidies for embedded generation and energy storage has created a confused, crowded and rapidly-changing environment for utilities to respond to.

Supported by a range of largely independent approaches from the AEMC, AEMO and governments, utilities are attempting to embrace the growth in DER in different ways.

Common to this challenge, utilities are proposing expenditure to expand monitoring and control of distribution networks, enhanced centralised network control systems (ADMS) and speculative capability to work with demand aggregators and AEMO as the need arises referred to as a DSO model. Most of this investment is under the banner of 'least regrets'. It is unclear just whose regrets are being minimised – those of the distributor who remains largely capable of recovering the expenditure; or those of the customer (generally, all customers) who it is suggested Is not in a position to understand just what it is that they are regretting.

There is a significant risk that investment in transmission systems under the ISP will address some of the concerns that are planned to be subject to investment by distributors, leading to stranded assets in the area of data gathering and local network control, as well as restrictive connection requirements affecting customers.

Missing also in this planning is the 'customer view' and where the customer impacts and the expected role of customers in any solution are considered and tested through public and specialised engagement. Issues such as direct and indirect costs to customers to participate, technical requirements, contractual matters and similar are still to be addressed.

At the risk of entering an already crowded space, CCP10 recommends that the AER assist in clarifying the problem statement, range of solutions and form of cost–benefit analyses that are expected from distributors. This information can form the basis of further consumer engagement.

As part of the analysis of the impact of the growth of DER, the wider market of aggregators, retailers and new market service providers should be actively considered to determine what role these market entities can undertake as the uptake of DER continues.

*iii. Support greater pace of the adoption of Advanced Metering*

A number of times throughout the regulatory reset process, the issue of a better understanding of a customer's energy use arose. This came up in a number of contexts, including tariff design and adoption, the optimal integration of DER and improving the assessment of supply risk associated with network development.

At all times, the obstacle was that the AMI rollout is largely set in priority and location by energy retailers who have a different set of priorities and drivers for promoting the growth of smart metering and AMI.

CCP10 believes the AER can investigate the claims by the distributors of missed opportunities for prudent and effective investment in networks arising from the implications of the Power of Choice (metering) framework.

*iv. Explore opportunities for more efficient engagement on network development*

In concert with the work undertaken by CCP20 (Regulatory Investment Test), it is becoming clear that the engagement by the community, customers and potential solution providers in the capital investment process is not effective.

Significant in this situation is the resource commitment by utilities and potential respondents to prepare, consider and implement plans that can assist the reduction in investment in the traditional network assets of poles and wires, cables and substations.

Consumer and industry representatives highlight the disincentive as a result of the large investment in time and resources to consider not only the capital investment plans of each utility, but their voluminous Distribution Annual Planning Reports (DAPR) and required information under the Regulatory Investment Test – Distribution.

As network investment opportunities shift to considering more cost-effective customer options, there is a powerful incentive to improve the application and effectiveness of the intent of demand management and network efficiency through a more coordinated, and seamless process to engage the community on network growth matters.

CCP10 acknowledges the work done by Endeavour Energy in developing an online and interactive DAPR, which is a useful step in enhancing the effectiveness to deliver non-network solutions to demand growth.

*v. Form a common view on the cost to address cybersecurity risk*

CCP10 has observed each distribution business taking a different approach to cybersecurity risk, leading to varying impacts on the cost to consumers through both operating expenses and capital investment.

Against the background of an increasing reliance on technology for the efficient operation of the network and the businesses themselves, the establishment of standards and a measured assessment of the businesses' response to those standards – much in the way other significant investments in assets are considered – will be of value in maintaining a focus on the long-term interest of electricity consumers.

CCP10 recommends further engagement and skill development by the AER in the area of cybersecurity and its cost and risk impact to customers and the wider community.

# SECTION 2

## CCP10's response to Essential Energy's revised regulatory proposal of January 2019

### RECENT DEVELOPMENTS AND OVERVIEW

This section considers responses to the Essential Energy Revised Revenue Proposal dated 21 December 2018 (Revised Proposal) following the AER draft decision dated 1 November 2018 (Draft Decision). The approach we have taken is to only consider those issues that we raised at the public forum on 13 November 2018 about the Draft Decision and matters of particular interest from the Revised Proposal.

Matters that are not covered have either been dealt with previously or we are satisfied with the Essential Energy position.

In submitting its revised revenue Proposal, Essential Energy says:

*"Having accepted the majority of the AER's Draft Determination, the key changes in our Revised Proposal, other than those driven by updates for our 2017–18 actuals and the AER's final Rate of Return guideline, are:*

- *Classification of Services table - to encompass two services we have identified since submitting our Proposal that will improve outcomes for our regional, rural and remote customers;*
- *TSS - to address AER and stakeholder feedback on calculating and assigning distribution network charges;*
- *Ancillary Network Services (ANS) prices - to ensure recovery of our efficient costs; and*
- *Public Lighting prices – following dedicated stakeholder consultation on our model."*

This summary response reflects Essential's ongoing responsiveness to consumer input and their constructive working relationship with the AER which led to an initial revenue proposal that was, effectively, capable of acceptance.

We consider there is value in recapping previous stages, leading up to the lodgement of the Revised Proposal. Essential Energy lodged its Regulatory Proposal on 30th April 2018, supported by their presentation at the Stakeholder Forum on the 3rd of July. At that forum, CCP10 acknowledged the robust and effective consumer engagement approach taken by Essential Energy, particularly with their regional deliberative forums resulting in their very consumer-focussed regulatory proposal.

AER in their Draft Decision of November 2018 has largely accepted Essential Energy's initial proposal. Furthermore, their Revised Proposal makes it clear that Essential Energy agrees with the AER Draft Decision.

The AER in its Draft Decision of November 2018 says:

> *"This draft decision, which largely accepts Essential's revenue proposal, reflects not only the considerable efficiency gains it has achieved over the current period, but also the strategies and initiatives it now proposes to deliver further efficiencies in expenditure and improvements in productivity over 2019–24."*

The main change to the initial proposal by Essential Energy has been the application of the 2018 Rate of Return guideline, leading to a 4.6 per cent reduction in the allowed revenue, to $5292M ($nominal). We note and support the broad acceptance by the AER in their Draft Decision of Essential Energy's opex and capex proposals, these were honed with consumer input.

In our response to the Regulatory Proposal in August 2018, a number of matters were raised as opportunities for Essential Energy to better reflect the issues raised by consumer representatives throughout the engagement, including RAB growth through indexing leading to higher prices; and an aggressive IT programme that had a challenging delivery programme that may impact its effectiveness.

At that time, we concluded that Essential Energy's Regulatory Proposal was capable of being accepted as it was consistent with the long-term interests of consumers. For instance, regarding capital expenditure, we stated:

> *"The Essential Energy 30th April 2018 proposal is capable of acceptance, but will require ongoing discussion about approaches to reduce the carried forward impacts of the RAB.*"

Regarding transparency of their aggressive IT-led change programme, CCP10 said:

> *"We consider the Essential Energy forecasts can be accepted as they have incorporated ongoing productivity gains that anticipate the benefits of the IT spending and business/process re-engineering proposed."*

**CCP10 believes that Essential Energy's Revised Revenue Proposal <u>is capable of acceptance</u> by the AER.** We take this position because there is clear evidence that the proposal is in the long-term interests of consumers, and that the Revised Proposal fairly and meaningfully reflects the outcomes of their intensive and effective engagement with consumer groups.

## CONSUMER ENGAGEMENT

On 28th November 2018, Essential Energy was announced the winner of the Energy Networks Australia and Energy Consumers Australia (ECA) 2018 Consumer Engagement Award for its 2019-24 Regulatory Proposal customer engagement program[5]. The CEO of ECA, Rosemary Sinclair, presented the award, saying that embracing consumers as partners in change to drive down electricity prices was a critical part of building a new culture in the energy sector. She also said *"Rebuilding trust with consumers in the energy sector will take time and must come from the top – the leading businesses are entering into a new dialogue with consumers and taking responsibility for the issues they're raising to deliver more affordable outcomes … The*

[5] We recognise that Mark Henley is a member of CCP10 and was a member of the judging panel for this award, we do not consider that this is any conflict of interest in him being part of both processes.

*winner showed they had proactively engaged with their consumers to better reflect their views and priorities and allow that to shape services."*

CCP10 concurs with the views summarised by Rosemary Sinclair and congratulates Essential Energy on winning the award, which was given primarily for Essential Energy's consumer engagement in all phases of their regulatory proposal development, ultimately leading to the lodgement of their Revised Proposal for 2019-24. We have been fortunate in being able to observe many aspects of Essential Energy's consumer engagement. The genuineness and openness of the engagement is why trust levels have been built to the extent that Essential Energy's RAB situation is understood and their price changes for 2019-24 is acceptable, despite an increase in nominal terms.

There is value in briefly highlighting some aspects of the Essential Energy consumer engagement approach to support our observations about the effectiveness of their engagement and their preparedness to apply advice offered by customers.

In our submission in response to the initial proposals from NSW distribution businesses, we said:

> *"We identify one example of significantly improved consumer engagement as summarised by the following diagram in figure 3 from the Essential Energy revenue proposal. This diagram summarises a breadth of engagement methodologies and a well-developed alignment with key stakeholders."*

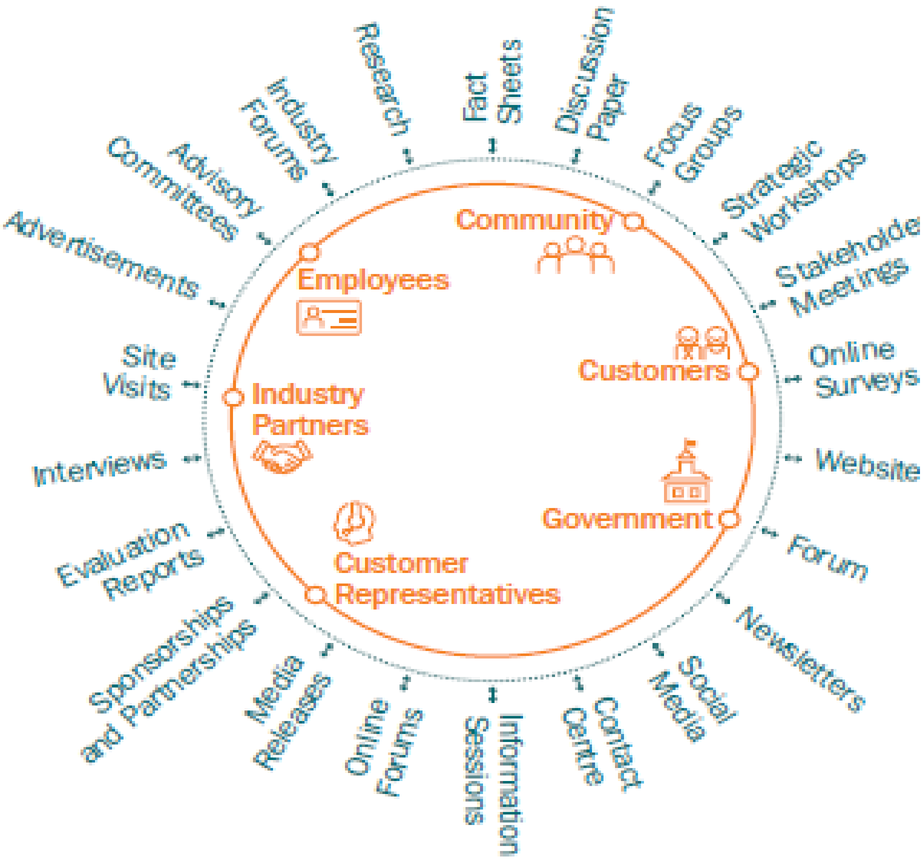


**Figure 3: Essential Energy's Engagement Approach** (Source: Essential Energy regulatory proposal 19-24)

In our opinion, features of Essential Energy's consumer engagement include the following six observations.

1. While Essential Energy has rightly been recognised for their extensive 'deliberative forum' program, there has been a significant range of engagement methodologies applied.
2. A second observation is that the engagement deliberately sought a diversity of views, including an active regional program with forums in locations that spanned the geographical reach of the region they serve.
3. A third observation is that Essential Energy started their engagement early, with formal engagement commencing in June 2016, about a year and a half before they were due to lodge. We note with interest that they still sought an extension of lodgement date, which we actively supported due to the trust already built through progress to that time and mainly due to resolving remittal discussions.
4. Importantly, Essential Energy did not resile from responses that they did not want to hear. We understand that Essential Energy was initially surprised at consumer reaction to their draft proposal, February 2018, when consumers expressed concern that prices would still be increasing, despite their significant reductions in operating and capital expenditure, due to growing RAB. Essential Energy then undertook extra analysis, including engaging consultants, to explore the reasons for their rising RAB and were transparent with customers about the reality of their circumstances. This is an ongoing discussion with all stakeholders.
5. A fifth observation is that Essential Energy have been deliberate in their planning that consumer engagement is a core part of their long-term practice, as well as having a regulatory proposal focus.
6. Above all else, we observe that Essential Energy have been open, respectful and genuine in all of their engagement activities. They have demonstrated this by clearly documenting in regulatory proposals the advice that they have received from customer input and the responses that they are making to that advice.

The Revised Proposal summarises the 4$^{th}$ phase of their engagement, the period November to December 2018 and responded primarily to aspects of the AER's Draft Decision. Essential Energy identified the following activities in their 'phase 4 consultation':

- 3 deliberative customer forums
- Three 'deep dives' with stakeholders
- In depth interviews with large customers and retailers
- Consultation regarding streetlighting
- On-line forum and
- a meeting of their Customer Advisory Group.

**Essential Energy Engagement and IAP2**

The IAP2 (International Association of Public Participation) Public Participation Spectrum[6] provides a useful framework for consideration of the consumer engagement (which we regard as synonymous with the public participation language of IAP2) undertaken by a business or organisation.

In its simplest form, the spectrum summarises increased levels of consumer engagement in moving from left to right:

INFORM – CONSULT – INVOLVE – COLLABORATE – EMPOWER

The IAP2 spectrum also provides "promises to the public" appropriate to each element of the spectrum. The promise to the public / consumers for the "Involve" level of the spectrum is:

> *"We will work with you to ensure that your concerns and aspirations are directly reflected in the alternatives developed and provide feedback on how public input influenced the decision."*

While for the "Collaborate" goal the promise to the public is:

> *"We will look to you for advice and innovation in formulating solutions and incorporate your advice and recommendations into the decisions to the maximum extent possible."*

We observe that during the course of their engagement for the 2019-24 regulatory period, Essential Energy has moved their engagement from a general level of "consulting" to being nearer the "Collaborate" level of the spectrum, with the understanding that Essential Energy will do more in the future to engage consumers in informing innovation. This is significant progress and in our opinion positions Essential Energy as one of the leading utility networks in Australia in commitment to and effectiveness of consumer engagement.

## REVENUE AND REVISED PROPOSALS 2019-24

The AER has largely accepted the initial proposal. The Revised Revenue Proposal makes it clear that Essential Energy agrees with the AER Draft Decision, this is reflected in Figure 4, which shows AER Draft and Revised revenue Proposal revenues, over time.

[6] https://www.iap2.org.au/About-Us/About-IAP2-Australasia-/Spectrum

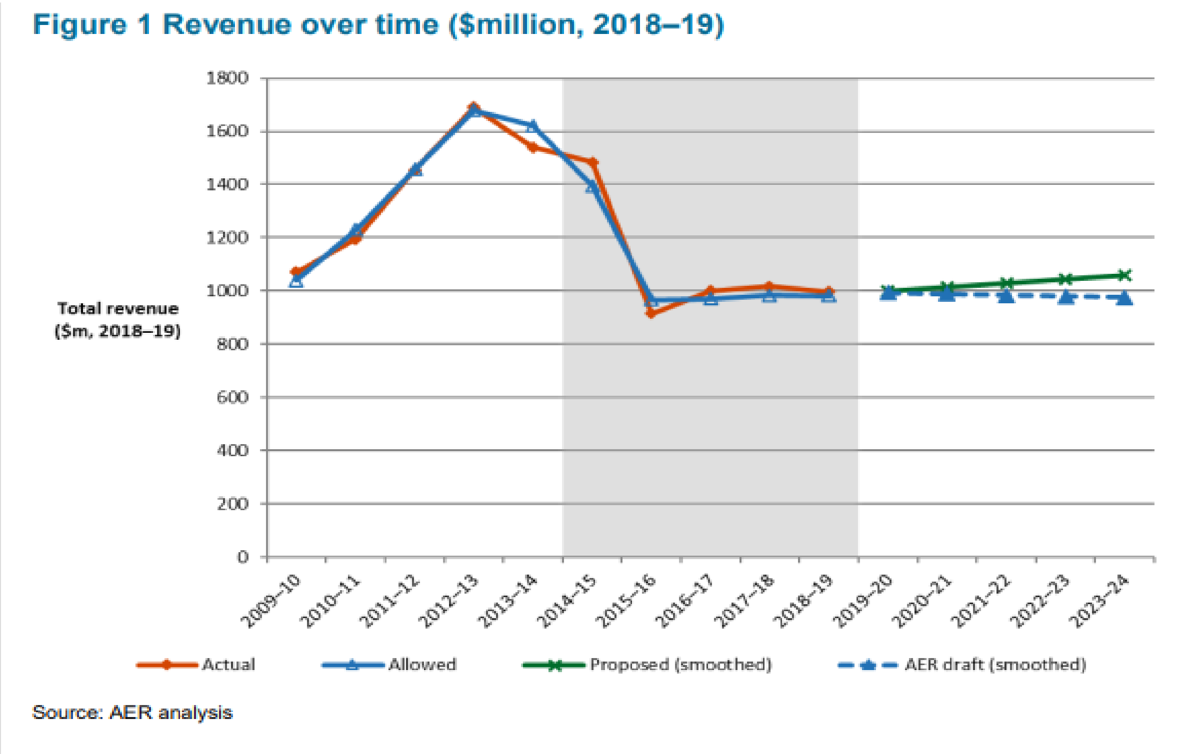


**Figure 4: Annual Revenue Requirement - historic and forecast** (Source: AER DD p11)

From this figure it is evident that the revenue requirement is stable now, noting that the main reason for the gap between the Revised Revenue Proposal and the AER Draft Decision is application of the new rate of return guideline, which has lower returns on capital than the 'placeholder' values in the Draft Decision.

Figure 4 also shows the significant reductions in revenue over the current and next revenue periods, 2014-19 and 2019-21, compared to the very high expenditures of 2009-14.

## REGULATED ASSET BASE GROWTH

Dealing with the ongoing growth in RAB has been one of the major dilemmas for Essential Energy and their customers in developing the 2019-24 revenue requirement. The major expenditure in 2009-14 will live on in the RAB for many years, unless concerted action is undertaken to alleviate consumer burden from the RAB. This is reflected in the AER's comments in the Draft Decision

> *"Essential's allowed revenue for 2009–14 included provision for significant increases in capital investment... Over that period Essential's regulatory asset base (RAB) grew by 38.9 per cent. In a challenging investment environment during the global financial crisis, the rate of return (a forecast of the financing costs Essential would require to attract efficient investment in its network) was set at 10.02 per cent. When applied to the growing RAB this resulted in substantial increased revenues and higher prices for customers."*

The RAB growth over time is shown in Figure 5 below.

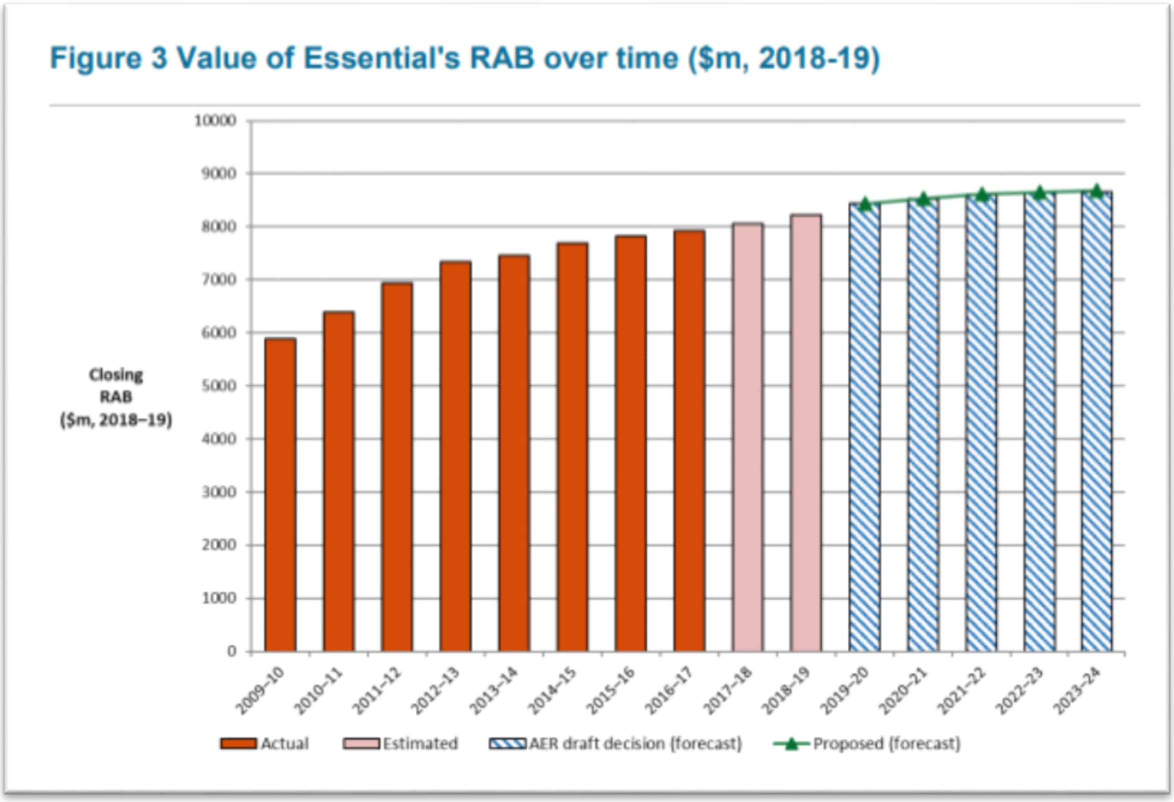


**Figure 5: Growth in the Regulated Asset Base – (Source: AER DD p13)**

The AER also said in their Draft Decision:

> *"While Essential has and continues to seek efficiencies, over 2019–24 the amount of capex that will be added to the RAB is greater than expected depreciation, so that the total value of Essential's RAB will continue to grow. However, as Figure 3 shows, projected RAB growth of 5.5 per cent over the 2019–24 period is significantly below its peak in 2009–14. We are encouraged by Essential's continued commitment to work with consumers on this important issue."*

Consumer Groups and CCP10 have worked closely with Essential Energy over the past year to firstly understand the reasons behind the continued growth in RAB and secondly to explore solutions. Essential Energy says in their Revised Revenue Proposal:

> *"We have engaged Houston Kemp to investigate options for managing our future RAB growth. They have put forward a number of options, including a change to our capitalisation policy, a change to our regulatory depreciation approach or a move to stand-alone power systems.*
>
> *We will consider and possibly look to implement one or a combination of these potential options over the 2019–24 regulatory period."*

We do not believe that there is any more than Essential Energy can do regarding the RAB at this stage, given that we understand that options have been given to the owner, the NSW Government and it is they who will need to decide which option(s) they will choose to manage future RAB growth.

## CAPITAL INVESTMENT (CAPEX)

CCP10 and other consumer advocates have been very clear of their expectation that the distributors in New South Wales strive to capitalise on their enhanced asset base by focussing on maximising utilisation of existing assets and reconsidering risk parameters in future network plans based on the benefits that increased network security can deliver.

In our response of August 2018 to the initial Proposal by Essential Energy dated 30 April 2018, we highlighted:

> *"We are highly supportive of the aggressive approach that Essential Energy is taking in reducing capital expenditure whilst working to maintain service levels, safety and network performance. We recognise that Essential is underpinning these improvements though a significant investment in information technology and data analytics, which, by all indications, is a valid and reasonable approach.*
>
> *We do have concerns about Essential's ability to deliver these reductions in full. Implementing sweeping changes to IT, with the associated data management cultural change and ability to manage core costs such as labour, have been proven elsewhere to be difficult.*
>
> *We commend Essential for the initiative, and trust that Essential has a powerful and sensitive suite of supporting performance measures and monitoring mechanisms to ensure successful change without impacting the safety and quality of the electricity supply to their customers."*

We note the correction to the modelling error picked up in the Draft Decision, leading to a corrected capex forecast of $2081M ($2018-19).

The declining capital expenditure planned for 2019-24 in the Revised Revenue Proposal is significant and shown in Figure 6 below, and clearly the 2019-24 spending levels are low compared to much of the preceding 2 decades.

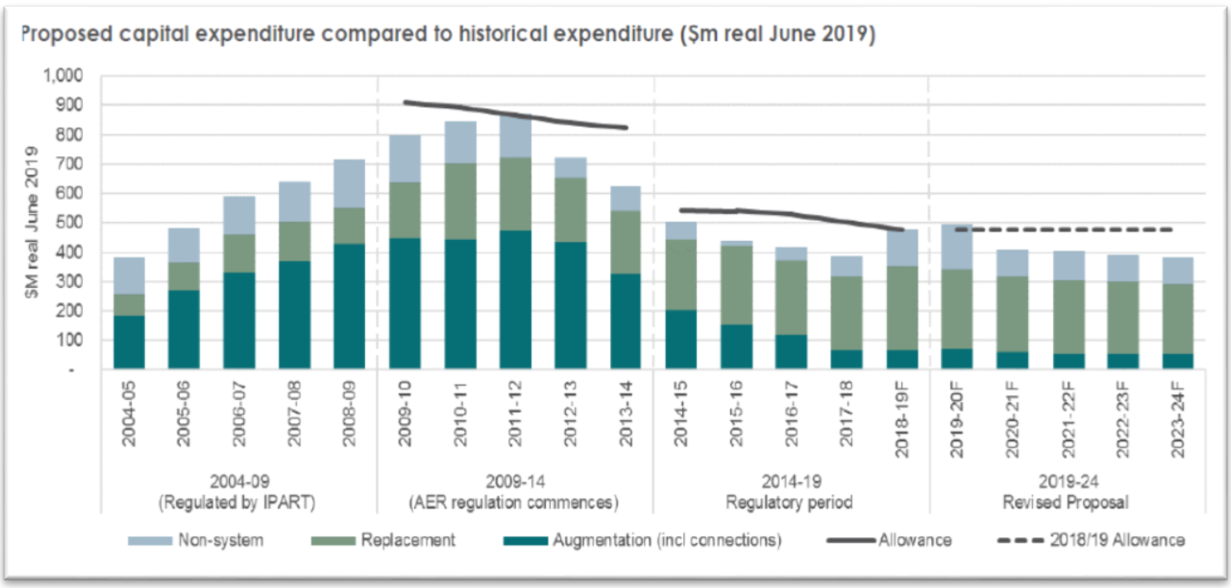


**Figure 6: Capital expenditure trend** (Source: Essential Energy Revised Revenue Proposal)

CCP10 remains fully supportive of Essential Energy's capital investment programme.

We do suggest, however, that Essential consider the application of an extension of their Consumer Advocacy Group to provide a level of oversight and transparency over expenditure associated with Demand Management and network innovation, including better utilisation of the Demand Management Incentive Allowance

Investment areas such as the Strategic Initiative Investments ($130M) and parts of the aggressive ICT programme may also benefit from this approach.

## OPERATING EXPENDITURE (OPEX)

CCP10 is pleased to note that Essential Energy has accepted the AER's Draft Decision on opex of $1718.4M ($2019), which in turn largely reflects Essential Energy's initial proposal. We note and support the AER's comments that:

> *"This draft decision, which largely accepts Essential's revenue proposal, reflects not only the considerable efficiency gains it has achieved over the current period, but also the strategies and initiatives it now proposes to deliver further efficiencies in expenditure and improvements in productivity over 2019–24."*

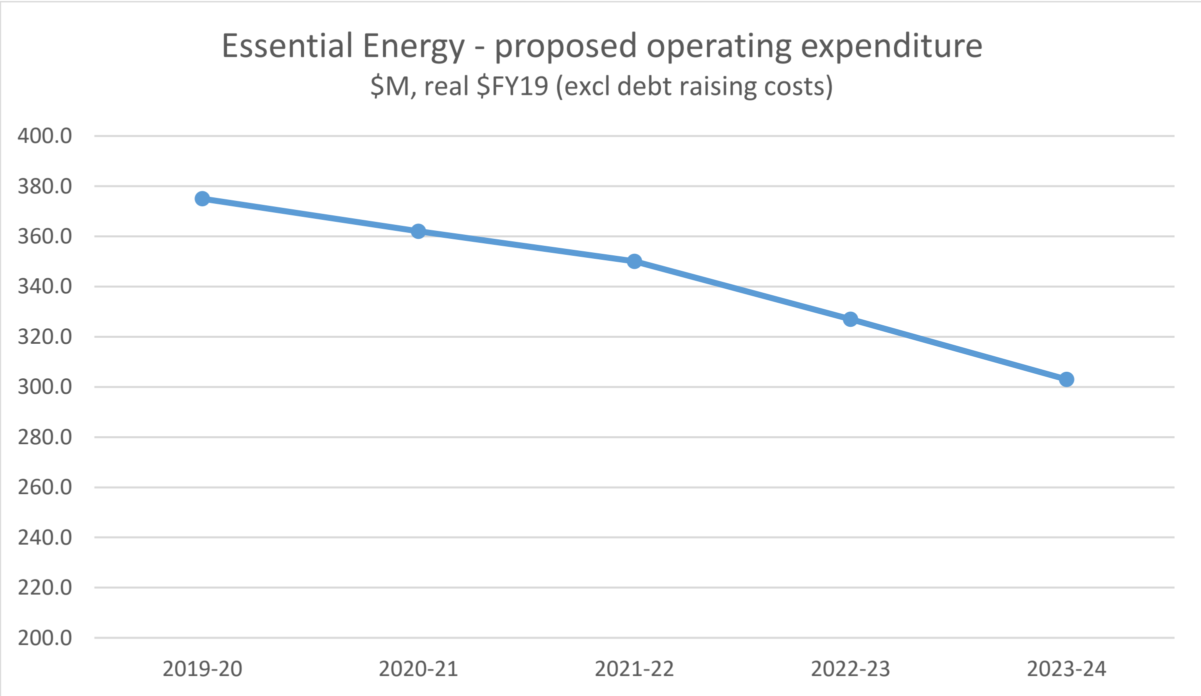


**Figure 7: Proposed Operating Expenditure** (Source: Essential Energy Revised Revenue Proposal)

### Dynamic Opex Productivity

We recognise that Essential Energy has committed to delivering an opex productivity dividend to their consumers by delivering ongoing opex efficiency improvements which is consistent with meeting the long term interests of their consumers. We commend Essential for this initiative and the leadership it showed in NSW in taking this step.

## TAX

Essential Energy discussed the AER review of the regulatory tax allowance in their Revised Revenue Proposal, saying"

> *"The AER is currently undertaking a review of the regulatory tax allowance. Their final report proposes changes to the tax allowance calculation that will be processed through alterations to the PTRM and RFM. The AER will consult on these model changes over the next few months and apply them in its Final Determination on our Revised Proposal. We expect the changes to lower our revenue requirement."*

Regarding Imputation credits (gamma), Essential Energy says:

> *'We accept the value of 0.585 for gamma to align with the AER's final Guideline."*

CCP10 regard the attitudes taken by Essential Energy on both of these tax related matters to be sensible and to be demonstrating "good faith."

## TARIFF STRUCTURE STATEMENT

The key changes in the revised TSS are:

1. adjustment of the demand charge for Residential and Small Business users to exclude the shoulder period;
2. maintenance of the ability for Residential and Small Business customers with a smart meter to opt out to an Anytime (flat rate) distribution network charge; and
3. removal of the mandatory assignment to a demand distribution network charge for customers installing new technologies such as solar photovoltaic (PV), batteries and electric vehicle charging points. These customers will be assigned to distribution network charges in the same manner as other Residential and Small Business customers.

CCP10 supports these changes which align the revised TSS more closely with the Pricing Directions statement developed by PIAC, ECA, TEC and CCP10. While the ability to opt out to a flat tariff may be considered to reduce cost reflectiveness it can help manage the impacts of the reforms in the transition to more cost-reflective tariffs.

We also support Essential Energy's promotion of the adoption of more cost-reflective tariffs by allocating more residual costs to less efficient distribution network charges and charging parameters, and fewer residual costs to the more efficient distribution network charges and charging parameters.

The Pricing Directions supported demand tariffs, but acknowledged the role for better targeted TOU tariffs. While Essential Energy has maintained a TOU tariff as the default tariffs for customers with new smart meters, we note that

- demand + TOU energy is the default tariff for medium – large business users and
- a residential demand +TOU tariff is offered as an opt-in tariff and is structured to encourage customers to move to this tariff as "opt-in demand charges are the most efficient of our cost-reflective distribution network charges".

Taken together this suggests that over the longer term there may be a greater role for demand tariffs at the residential level. If so we would encourage Essential Energy to use this period to prepare for the transition by:

- identifying and working with customers with smart meters who may benefit from moving to a demand tariff and providing information and support for the transition and
- undertaking research on customer impacts at the household level, including analysis by socio-economic characteristics. This will enable the identification of impacts on vulnerable households and design of complementary measures.

## ALTERNATIVE CONTROL SERVICES

Two of the matters raised by the AER in their Draft Decision for review by Essential Energy were aspects of Alternative Control Services, specifically Streetlighting and Ancillary Network Services.

### STREETLIGHTING

After the Draft Decision was presented, Essential Energy provided their model for determining streetlight costs to the Councils in the areas they serve and to other interested stakeholders. Essential heard *"that our model was not easy to navigate and important customer information was difficult to find."*

As they have repeatedly demonstrated, Essential Energy's response was to consult with interested parties and to go through the detail of their model and concerns, resulting in a number of adjustments to the model which has now satisfied Councils and other stakeholders. These adjustments have been factored into the Revised Proposal that CCP10 regards this an a fair and appropriate outcome.

### ANCILLARY NETWORK SERVICES (ANS)

Essential Energy reports that they agreed with the AER on most of the ANS points that were raised in the Draft Determination, however they have adjusted their costs for security lighting, in line with the streetlighting review and have reviewed the staffing rates and labour rates associates with providing ANS services. We understand that both have been adjusted to be more reflective of the actual costs of providing services and are in line with AER guidelines. The ANS adjustments are acceptable to CCP10

## CONCLUSIONS

This submission begins with a quote from Essential Energy identifying 4 areas of further consideration resulting from the Draft Decision, these being: classification of selected services, incorporating feedback into the TSS, and reviewing ANS and public lighting costs to accurately reflect actual costs.

Essential Energy was also well aware of concern about the ongoing impacts of RAB on the prices consumers would pay during the 2019-24 regulatory period. We observe that they have continued to take these concerns very seriously, have consulted widely and have commenced detailed discussion about options with the NSW Government, as business owner. We do not think that Essential Energy could have done much more than they have undertaken on these matters.

Essential Energy has also been pro-active in responding to broader regulatory processes, including prompt application of the Rate of Return Guideline and Tax review as well as delivering an operating costs productivity dividend to their customers.

These outcomes that are good for customers have been achieved with ongoing, open and constructive engagement with consumers and other stakeholders. We commend Essential Energy on delivering a proposal that was capable of acceptance and a Revised Revenue Proposal that responds positively to the handful of relatively minor matters raised in the Draft Determination.

We endorse the following statement from Essential Energy from their Revised Revenue Proposal, under the heading "Beyond 2024:"

*"The business strategy that underpins this Revised Proposal will enable Essential Energy to reduce our costs, prepare for the future and empower our customers to share and use energy for a better tomorrow."*

## GLOSSARY

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| AMI | Advanced metering infrastructure |
| CCP | Consumer Challenge Panel |
| CCP10 | The subpanel of the CCP appointed to consider ACT and NSW electricity distribution business regulatory proposals for 2019-24 |
| DER | Distributed Energy Resource (small scale energy generation or storage devices that are grid connected) |
| DM | Demand Management |
| ECA | Energy Consumers Australia |
| ENA | Energy Networks Australia |
| EUAA | Energy Users Association of Australia |
| EWON | Energy and Water Ombudsman NSW |
| IAP2 | International Association of Public Participation |
| LMR | Limited Merits Review |
| NCOSS | New South Wales Council of Social Services |
| NEM | National Electricity Market |
| PIAC | Public Interest Advocacy Centre (NSW) |
| PTRM | Post-tax revenue model |
| RAB | Regulated Asset Base |
| RIN | Regulatory Information Notice |
| TSS | Tariff Structure Statement |