Consumer
Challenge
Panel

# NSW Electricity Distribution Regulatory Proposals 2019-24

## CCP10 response to Draft Decisions

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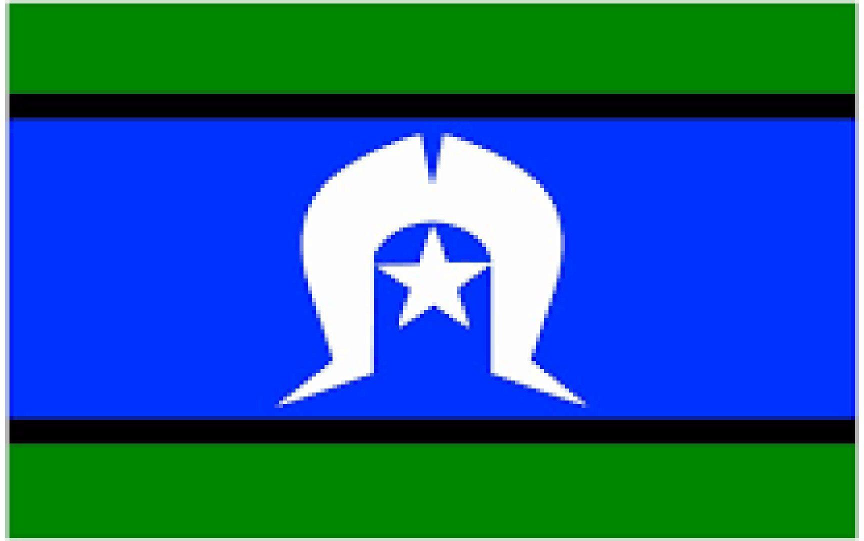
Sydney, 9th November 2018

We recognise the traditional owners of the land we meet on: The Gadigal people of the Eora Nation.



# Context of these proposals is significant

- 2014-19 determination not resolved before the 2019-24 was lodged
- REMITTED Proposals (and some decisions) finalised – Well done all !
- Rapid environmental changes: open networks, price awareness
- Immense community mindfulness : energy a regular media headline
- 2012 rule changes and Better Regulation no longer brand new
- New ownership for Ausgrid and Endeavour
- NSW businesses on transition from inefficient to efficient
- New binding Rate of Return guideline being developed by the AER
- Benchmarking now better established, compared to 2015
- Major developments in Consumer Engagement intent and approach
- And the politics ….

# Context of these proposals is significant

Tale of 3 Reg Periods …

2009-14: RAB to the Max

2014-19: the painful adjustments

2019-24: Consumer Centred / age of uncertainty

ACCC

*Restoring electricity affordability and Australia's competitive advantage*

**43% of achievable savings for NSW customers**

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 | $\boxed{174}$ | 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: ACCC

# Draft determination in summary

## Ausgrid

**Positives (for Ausgrid and their customers)**

- ✓ Consumer Engagement was solid, but could have been more effective
- ✓ Consumer engagement is ongoing
- ✓ Reductions in capex, opex, but we are looking for more and better justification
- ✓ TSS

**Elsewhere**

- Rate of Return (MRP = 6%, beta = .6, gamma = .5 - and still prices up)
- Productivity Review

**Further Work**

- Capex – CBA and justification
- Non network and capitalised overheads, including IT
- Innovation and Demand Management Incentive Scheme
- Tariffs and Pricing

# Draft determination in summary

# Essential Energy

**Positives (for Essential and their customers)**

- ✓ Proposal capable of being accepted
- ✓ Consumer Engagement
- ✓ capex /opex
- ✓ Openness to discuss all round

**Elsewhere**

- Rate of Return (MRP = 6%, beta = .6, gamma = .5 - and still prices up)
- Productivity Review

**Further Work**

- Change Monitoring
- RAB
- Demand Management Incentive Scheme
- Future Network

# Draft determination in summary

# Endeavour Energy

**Positives (for Endeavour and their customers)**

- ✓ Consumer Engagement
- ✓ revised proposal for capex
- ✓ RAB / capex /opex
- ✓ TSS
- ✓ Openness to discuss all round

**Elsewhere**

- Rate of Return (MRP = 6%, beta = .6, gamma = .5 - and still prices up)
- Productivity Review

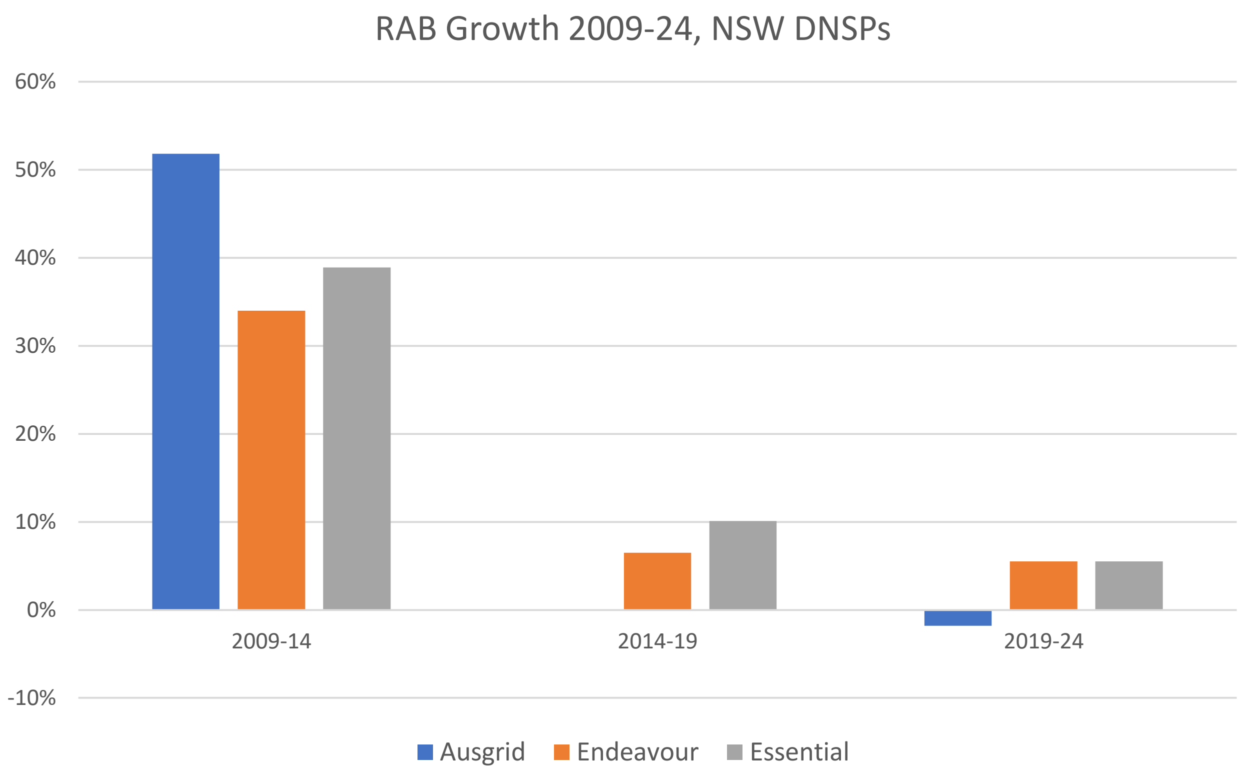
**Further Work**

- Non network and capitalised overheads, including IT
- Demand Management Incentive Scheme
- 2nd Airport

# RAB changes 2009-24

| RAB Growth | 2009-14 | 2014-19 | 2019-24 |
|---|---|---|---|
| Ausgrid | 51.8% | 0% | -1.8% |
| Endeavour | 34% | 6.5% | 5.5% |
| Essential | 38.9% | 10.1% | 5.5% |

Source: AER



# A note on RAB - Essential Energy

Given the proposed reduction in Essential's expenditure across opex and capex - and the lower WACC- Essential's RAB growth of 5.5% highlights the need for the shareholder to take action to reduce the RAB.

The customer bill impact is +$70 network charge for residential and +$314 for small business

CCP10 supports Essential Energy as it continues to engage with stakeholders on the issue of the growth in the value of the RAB.

# Nominal impact of network charges on retail bills from the Draft Decisions

(Much of reduction from WACC rather than network action)

| Impact on network charges | Residential | Small Business |
|---|---|---|
| Ausgrid | $44 ⬇ | $104 ⬇ |
| Endeavour | $6 ⬆ | $14 ⬆ |
| Essential | $70 ⬆ | $314 ⬆ |

# Operating Expenditure

# Opex. Let’s pause and reflect

- Customers were not well served by the dispute over expected opex efficiency in the 2014-19 resets
- Excellent that the scope of disagreement has been reduced with the AER and with NSW customers through the recent remittal processes
- We acknowledge the cuts that the NSW businesses have done to meet the 4$^{th}$ year base year
- This is not enough as the goal needs to be not one dollar more than necessary
- Under incentive regulation
  - the AER sets a ‘tough but fair’ price path
  - The DNSP has incentive to improve efficiency
  - EBSS was intended to equalise incentives over time – not create a bonus
  - “Soft” assumptions on productivity mean that the expected value is positive and inconsistent with LTIC

# Opex specific issues

**Essential:**

We commend Essential's leadership in using forecast opex including productivity dividends from ICT and other productivity initiatives and giving full benefits to customers.

**Endeavour:**

Note that Endeavour was first business in NSW to have the EBSS. However all businesses need to continue to strive for efficiency

**Ausgrid:**

We support the AER's approach to step changes.

AER rejected some of the DM projects. We support all DM projects that can be shown to have benefits for customers. Ausgrid has started to engage with us about the formation of an Innovation Working Group to explore DM projects, which we will support

# Opex - trend

- AER draft Decision Paper in the opex productivity review recommends an industry wide 1% per annum productivity growth in the trend component of forecasting opex
- CCP10 supports the AER using the final opex productivity growth forecast from the review for all future determinations including for Endeavour and Ausgrid
- Essential has offered more than 1% productivity in opex. The AER has indicated in the Draft Decision that it will accept Essential's greater opex productivity forecast
- CCP will be making a full submission to the AER review

# Opex productivity review

- Welcome the review as CCP has submitted in all recent resets that zero productivity is not reasonable
- 1% per annum is a start however we will be arguing for 2-2.5% per annum for every DNSP
- The AER says industry average opex MPFP growth shows 1.6% per annum. We agree with the AER putting greater weight on the MPFP measures as part of a holistic approach.
- As part of the review process we need to better understand how the AER estimated 1.6% as we think a higher productivity growth can be justified
- Labour productivity growth is .9%. This represents 60% of inputs and it may be reasonable to expect productivity in the remaining inputs. This would be around 1.5% if all inputs such as materials and inventory are taken into account
- Both these indicators support a starting productivity of 1.5%-1.6% before considering any productivity from ICT investments

# ICT & the Opex productivity review

- We are calling for a full review by the AER of ICT expenditure. Until this review is complete we believe ICT efficiency should be added to the productivity growth. We conservatively estimate this at .5-1% per annum for opex alone. When added to the 1.5%-1.6% this would be 2-2.5%.
- There are efficiencies and productivity gains from ICT investment. This is a major reason for the greater opex and capex productivity being proposed by Essential in its proposal.
- The AER acknowledges the potential for ICT efficiency in its discussion on non network capex in each of Endeavour and Ausgrid's proposals

# Capital Expenditure

# Capex
## Key themes for consumers from the DD

Repex is the big issue – risk, efficiency, innovation, modelling. It's time to discuss the long game.

Augex is down, but remains significant for customers in efficiency and policy

Capital connections policy varies, relatively inconsistent

Looking for efficiencies in overheads

IT needs vastly greater transparency in spend & impact

# Capex overview

# Ausgrid

Ausgrid

> *"We expect that the (considerable) level of prior expenditure, along with the efficiencies becoming available to Ausgrid, present a significant opportunity to reduce the level of investment required to maintain a safe and reliable network in times of changing customer requirements"*

Our issues were:

- Risk approach seemed conservative = high repex
- Aggressive approach to cost reduction in design not evident
- Dividend from previous investment not clearly realised
- Opportunities for innovation, DM
- Non-system cost reductions ?
- Looking for the impact of PSF in the capex ($240M)

# Ausgrid – CCP10 response

**CCP10 supports the AER draft decision of $2,210M for the Ausgrid capital investment.**

$2,966M > $2,210 (-25%)

Reflecting:

- A review of REPEX unit costs & asset lives
- Concerns with options analysis and CBA for both network and non-network areas
- Opportunities to temper connection costs
- Revised connections gross capex is efficient
- Lack of clarity of non-network investment benefits
- Opportunity to review investment governance

**We commend the further work committed to by the AER and Ausgrid to resolve areas of ongoing concern such as:**

Justification of asset replacement projects

CBA for non-network projects, including assessment of alternatives

Focus on the reduction of unit costs for work and design

Impact of PSF on CBD planning

Aged cable replacement risk and priority

Justification of the ADMS project

Timely submission of appropriate information

**We acknowledge the ongoing work by Ausgrid in reducing annual growth and replacement investment, including:**

Capex governance external review and peer review

Innovation fund proposal

# Ausgrid – next

Overheads - We note Ausgrid's assessment as currently 4th. That's good, but there is no reason why it could not be #1, with the benefits shared with customers.

Property – we are looking for transparent payback on the investment, reflecting corporate changes (headcount down 44%)

ADMS needs to be discussed in plain language, consistent with the national trend of Open Networks

We note that Ausgrid may still be keen to engage with customers. We are not skilled engineering consultants, but it's important to rebuild trust in the costs and value of the network

# Capex overview

# Endeavour Energy

> *"Overall, whilst being at the 'upper end' of our expectations, we believe END in their revised proposal has presented an acceptable case for capital investment."*

Our issues were:

- Low confidence in the forecast high expenditure in the out-years
- Headworks cost per new customer increased significantly
- Change to the capital contributions policy was unsupported
- We saw little productivity change in capitalised overheads
- END has every opportunity and incentive to be a leader in DM

# Endeavour Energy – CCP10 response

**CCP10 supports the AER draft decision of $1,700M as a maximum expenditure allowance.**

Reflecting:

- More realistic augmentation forecasts
- Demonstrated ability to meet high growth currently
- More efficient augmentation costs
- Addressed Capital Connections concerns
- Revised REPEX forecasts of volume and costs

# Endeavour Energy – CCP10 response

**Our agreement is as a maximum capital allowance.**
**We seek further work on the following:**

1. Further opportunities to draw benefit from previous network augmentation & security

2. The Western Sydney Airport, if similar to other major airport infrastructure, will be a large operator with their own significant investments in tri-generation and energy projects. It may be a single (franchise) operator of the precinct, and as such appear to Endeavour as a single large customer connection, subject to capital contribution requirements. We don't believe increasing the allowance beyond $1.7B is necessary to accommodate this connection.

3. With recent over-budget investment in IT and a growing customer base, we seek further economy of scale and productivity improvement in Endeavour's capitalised overheads.

# Capex overview

# Essential Energy

*"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 believe Essential Energy's proposal is capable of being accepted by the AER."*

Our issues were:

- Essential's ability to deliver these reductions in full, and implementing sweeping changes to IT.
- Essential having 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.

# Essential Energy – CCP10 response

**CCP10 supports the AER draft decision of $2081M capital investment (as proposed).**

Reflecting:

- A proposal that includes a reduction in forecast augmentation and capitalised overheads
- Forecast asset replacement and connection capex lower than the current period.
- A focus on risk assessment and new processes supported by an investment in new technology

# Essential Energy – CCP10 response

**We agree with the AER's capital allowance.**

**Our caveat regarding risks, capability and contingency planning remain.**

CCP10 notes that Essential is the NSW DNSP most at risk of localised impacts of the 'solar curve', and we commend Essential to articulate its position regarding the development of the Open Networks approach.

# Overview - key capex issues - ICT

IT spend – operating costs and payback of investment are key issues

We acknowledge that ICT expenditure will genuinely be an item of increasing expenditure over the next 20 years. We support the use of technology to upgrade the networks.
However consumers need to see the benefits of the investment they are making.

- The quantum and impact of significant IT spend NEM-wide is a concern
- SAP emerging as a standard – efficiencies ? Critical mass ? Monopoly ?
- Need clear differentiation between ongoing and 'growth' IT, with an obligation on DNSPs to identify the customer benefits and to pass them on to customers.
- CESS and EBSS are not sufficient, as customers pay for business efficiency
- Counterfactuals for replacement are weak and needs more rigour
- 'Same as last period' is not a valid assessment in itself
- Hold NSPs to account for efficiency deliveries
- Need a national view of the open networks trend

# Overview – capex issues for consideration

- Working relationship with AER is significantly improving, and can be further improved in some areas
- Continual refinement of the repex model as one of a number of inputs
- IT spend – operating costs and payback of investment are key issues
- AMI rollout needs to be viewed as an critical enabler
- Innovation and DM spend needs a more flexible approach
- CE for the future – clarify the links between RIT, DAPR, Capex reg proposal

# Tariff Structure and Pricing Direction

# Pricing Directions impact

- Development of Pricing Directions between CCP10, PIAC, ECA and TEC led to combined stakeholder view
- Endeavour responded during CE with introduction of a demand tariff
- AER formed CCP21 to work with ECA and AER
- ACCC report endorsed Pricing Directions
- AER tariff reform roundtable today with AEMC, AEC, Arena, ECA and CCP21
- Ausgrid now responding to stakeholder rejection of its draft TSS
- Next step development of national customer impact modelling

# Smart meter as (re)assignment trigger

- The trigger for assignment determines the rate of transition and pace of reform.
- ACCC supports mandatory assignment. CCP Pricing Directions supported default assignment with opt out to another cost reflective tariff
- AER supports:
  - New customer – assigned to cost reflective tariff
  - Customer initiates change to connection (e.g. solar PV, three-phase) – assigned to cost reflective tariff
  - Customer receives smart meter due to replacement of faulty meter – assigned after a 12-month sampling period so customer can access more information to make informed decisions about changing behaviour and selecting retail offers

# Specific tariff issues

**Essential:**

- All customers with a smart meter should be allocated to the same demand tariff– agree with AER no need to look behind the meter. Agree there should be no opt out to flat tariff
- Alternative to adding the 12 month data sampling period to manage customer impact might be strong customer impact analysis

**Endeavour:**

- Most cost reflective. Agree with AER that default assignment should be to maximum cost reflective tariff with opt out to transitional cost reflective tariff. No opt out to a flat tariff

**Ausgrid:**

- No consumer stakeholder supported the draft TSS. AER could have been much stronger in its rejection.
- Commend Ausgrid for working with its Pricing Working Group towards a new TSS including a demand tariff for customers with a smart meter more closely aligned to Endeavour's demand tariff

# Consumer Engagement

- Boat 1 hit the start line at full speed and maintained their course and momentum throughout. They had the slowest boat, with considerable RAB drag and long distances to travel, but managed to sail in clear air, except for the potential to go off course due to the RAB squall. They quickly righted the course and retained confidence.

- Boat 2 Started well, though a little becalmed early. Picked up the pace later in the race and were heading for line honours, but misreading the signs they missed the final buoy (turn). Rebooted the GPS, got back on track and came home with a wet sail.

- Boat 3 had an OK start, but observers could tell that the personnel shifted roles, slowing clear progress. Spent parts of the race on course and with good speed, but prone to becoming becalmed at times, losing speed and spent some time discussing the orientation of the map. Current location, under full sail, heading rapidly to the finish line, must stay on course.

Photograph: D Ramey Logan

# Consumer Engagement

- This really was the ‘first test’ of intense early engagement
- Wont be an extension again – this was a ‘one off’
- Leading businesses see CE as whole of business responsibility.
- We now expect utilities to engage early – in fact, don’t stop engaging
- Energy is a long game – we need to see strategic business plans that includes customer, community and regulatory engagement
- Energy is a long game – regulatory proposals reflect a long-term asset management vision

# Next Steps

# Issues for immediate consideration

- Keep engaging, but keep it focussed – Goodwill can't be assumed
- Price paths: are they the best that consumers could expect?
- Productivity: give the benefits to customers early, and don't wait for EBSS
- Tariffs – reform depends on a national view, keep it real.
- IT expenses are large, do they constitute good value for money for consumers? Opex / capex trade-offs?
- Capital Contributions
- Lack of DM and constant investment in capex for network solutions
- Capex, are some capex proposals larger than necessary?

# Overview - key issues for consideration

Working relationship with AER is significantly improving, and can be further improved in some areas, (AER 2.0)

Continual refinement of  the repex model as one of a number of inputs

IT spend – operating costs and payback of investment are key issues

AMI rollout needs to be viewed as an critical enabler

Innovation and DM spend needs a more flexible approach

CE for the future – clarify the links between RIT, DAPR, Capex reg proposal

OPEX and productivity benefits should be fast-tracked to consumers

Tariff reform will only be fully successful with a national approach

Just being good is generally not good enough for customers – keep engaging

# And finally …

# It’s now about the narrative …

- FANTASY ? X … Might be, if we are not careful
- FICTION ? X … Not any more. That’s the bad old days !
- WHO DUNNIT ? X … Take accountability !
- ROMANCE ? X … Not there yet – and so long as Barbara Cartland is not in the reg team.
- AUTOBIOGRAPHY ? No, its about the informed future.

# A big thank you

We know this was the first run of intensive, early engagement on the regulatory proposals.

The businesses made a huge investment – in time, money, and "blood, sweat and (sometimes too often) tears)" - in engagement.

CCP10 thanks the teams, in particular Natalie, Selina and Kate, for your good grace, understanding, tolerance, long hours, short turnarounds and unqualified support we received from your businesses.

It was often not easy, but definitely worth it.

Of course, this is not the end of the journey…

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# NSW Electricity Distribution Regulatory Proposals 2019-24

## CCP10 response to Draft Decisions