SUBMISSION

AUSNET SERVICES EDPR 2021-26 | JUNE 2020

EUAA
Energy Users Association of Australia

INTRODUCTION AND SUMMARY

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing and materials processing industries. Combined they employ over 1 million Australians, pay billions in energy bills every year and expect to see all parts of the energy supply chain making their contribution to the National Electricity Objective. Our members are highly exposed to movements in both gas and electricity prices and have been under increasing stress due to escalating energy costs.

The EDPR proposal provides a clear pathway for significant improvement across a range of measures to help AusNet move away from being one of the least efficient DNSPs with a relatively poor customer service record, to one that hopefully:

- Moves up the absolute and relative productivity league table,
- Lays the basis for lower prices in the longer term with the reduction in RAB, and
- Embeds a major cultural change in its customer relations

Our main response is – could it have done more? We think the answer is yes – particularly around lower accelerated depreciation, a change in the opex base year to 2019 and lower DER capex.

This submission comments on the AusNet Services (AusNet) submission to the AER in January 2020. As the AER has indicated in its recent decisions on SAPN and EQ, substantial COVID-19 impacts can be considered through a rule change process to re-open existing revenue determinations. AusNet's timetable for a December 2020 submission of its revised proposal will provide some additional time to incorporate these impacts and lessen the need for any rule change to apply. This makes customer engagement over the period to submission of the revised proposal in December even more important.

AusNet is to be congratulated for taking on the New Reg trial. It was prepared to take on the risks associated with a major change from conventional consumer engagement and lay itself open to the extensive scrutiny that came with the trial. AusNet recognised that it needed significant change in its approach to customer engagement and the Forum has provided the mechanism for that paradigm change. The Forum's negotiations resulted in some important changes from the Draft Plan to the Proposal that we believe are in the long-term interests of EUAA members.

It is important to see the AusNet proposal and the Customer Forum negotiations in the wider context of external factors of falling WACC and falling tax allowance. In AusNet's case, ceteris paribus, forecast revenue would be $344m or 11% lower than the current period, which if fully flowing through to customers, would have resulted in a significant fall in prices from July 2021. This has been the same context for all revenue resets over recent years. Therefore, the debate has been around how much of the revenue fall should be clawed back by the network whether it be increased capex (e.g. aging assets need replacing), increased opex (step changes) or accelerated depreciation (think about intergenerational equity and take advantage of lower WACCs) and how much should be passed through in lower prices.

While there is debate around how much the short-term interests of consumers over a revenue reset period should drive consideration of the National Electricity Objective's 'long term interests of consumers', our members facing COVID-19 impacts are very focussed on maximising the price reductions in the short term. The long-term interests of our members are more assured when you look after their short-term interests to survive.

In AusNet's case the major clawbacks are the proposed accelerated depreciation ($232m) and opex ($51m). Combined they cancel out 82% of the WACC and tax benefit. Unfortuantly, accelerated depreciation was outside the Customer Forum's scope and there was no consumer engagement on it. The EUAA does not support the proposal as presented. The focus on opex are step changes where we look forward to the AER's detailed analysis to see if they do satisfy step change requirements in the Rules.

Theses outside influences of WACC and tax also provided a somewhat benign context for the Customer Forum negotiations. It is much easier to negotiate and achieve savings when the network has a $344m bucket to divide up. Nevertheless, the Forum achieved some notable successes in its scope and these are welcomed by our members. We would have appreciated more interaction with the Customer Forum as they developed their negotiation parameters. The EUAA had two meetings with the Forum, the last in October 2018.

In the Issues Paper the AER asked for views on whether, given the Customer Forum process, it should conduct a less extensive assessment of the AusNet proposal. In our Public Forum presentation, we asked the AER for more detail to help us come to a view. The AER's response was very high level and therefore not entirely helpful. In the absence of further detailed information from the AER, our initial view is that there may be a case for a lighter AER touch for those agreed matters in the "In-scope (AER assisted)" category. Matters that were not agreed with that scope and all other matters should have the same AER focus as out of scope matters. How else can stakeholders judge the effectiveness of the Forum if it does not have some knowledge on what the Draft Decision would have been independent of the Forum?

We look forward to the AER focus on both capex and opex spend given the significant underspend in both in the current period resulting in carryover EBSS ($92m) and CESS ($47.5m) to the next period.   That may suggest overly generous AER allowances in the current period which lessens the efficiency of the efficiency schemes. We look forward to the AER focussing on the cost benefit analysis for DER capital, especially given the "confidential" nature of these agreements do not allow stakeholder scruitiny.

Finally, perhaps the most surprising aspect of AusNet's submission was the significant confidentiality claims made by AusNet [1]. A total of 1,226 pages or 18% of the total number of pages included information subject to a claim of confidentiality. This compares with 4% for Jemena, 6% for CitiPower and Powercorp, and 11% for United. Major parts of significant documents e.g. around incorporation of DER into the grid were deleted as commercial-in-confidence that prevented proper evaluation of key parts of the proposal.

REVENUE BUILDING BLOCKS

Like all other networks in the current low interest environment, changes in external factors around WACC and tax allowance have, in theory, opened up the possibility of significant price falls to all AusNet customers. Like all other networks, AusNet has seen these reductions as an opportunity to use that headspace to 'catch-up' with expenditure in other areas. In AusNet's case it is the proposed accelerated depreciation and increased opex. Without the fall in WACC and tax allowance total revenue would have increased by 8%, with these factors, total revenue decreases by 1%.

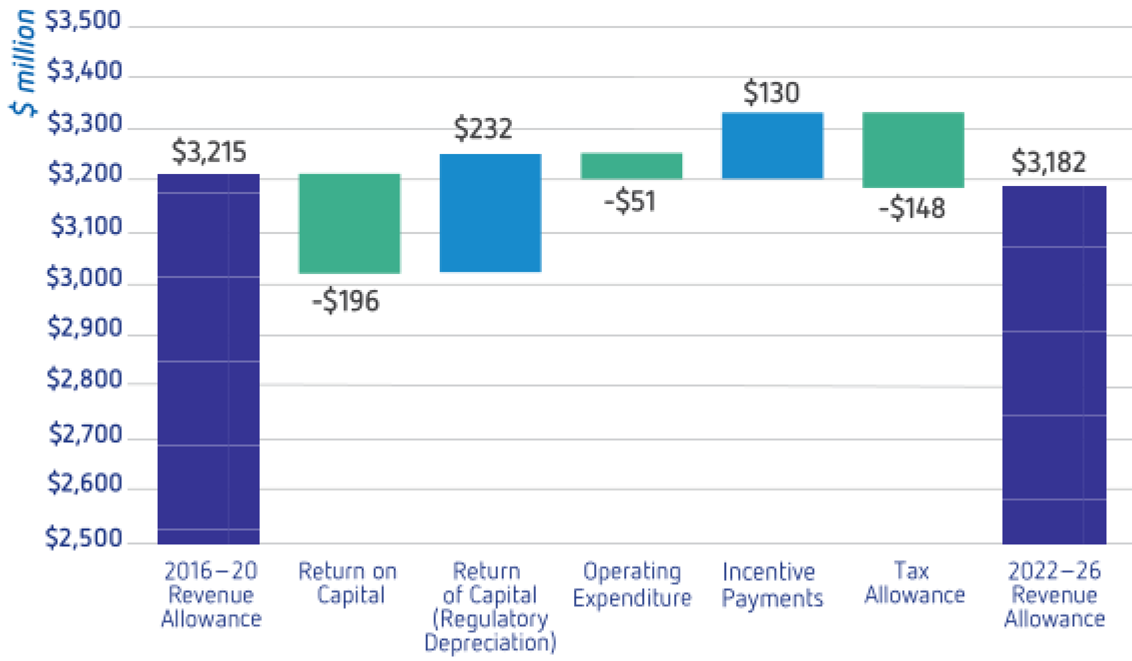
AusNet's proposal offers price reductions of $627 ($2021) for non-residential customers, from an average bill in 2020 of $4,798. In the absence of the WACC and the tax changes, and the lower expenditures proposed by AusNet, there would be an increase of $669, resulting in an average bill of $5,467. The total price reduction resulting from both lower expenditures and the WACC and the tax changes is $1,296 for non-residential customers. Of this, the WACC and tax changes account for $835, or approximately two thirds of the decline.

While for many other networks the WACC/tax factors seem to have provided an opportunity to lessen the focus on efficiency improvements in capex and opex, this is less the case for AusNet given its proposed opex productivity improvements and capex reductions.

[1] See https://www.aer.gov.au/system/files/AER%20-%20Comparative%20Table%20of%20Confidentiality%20Claims%20-%20January%202020.pdf

Nevertheless, a turn in the interest rate cycle over the next 5 years will leave AusNet customers very exposed to a significant increase in price in the next revenue period, despite the fall in RAB over 2022-26. Every 1% increase in the risk-free rate increases the average residential customer bill by 3%.

Figure 5: Changes in the revenue building blocks ($2021)

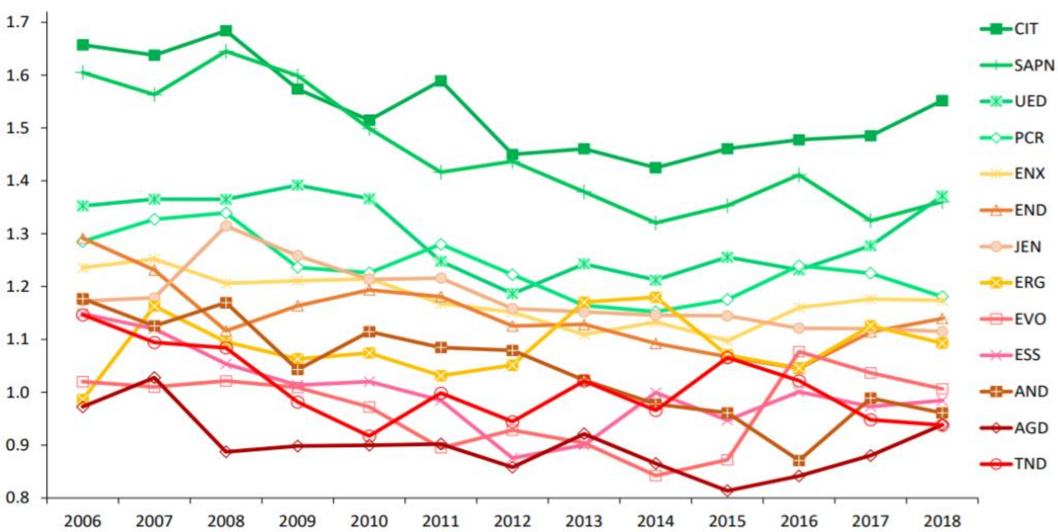


AusNet is the only Victorian network proposing a declining real RAB per customer and this is welcome. While this is partly due to the decline in new capex, it is also contributed by the large accelerated depreciation. Consumers pay for capex – it's is just a matter of when. The greater the rate of accelerated depreciation, ceteris paribus, the lower the future RAB.

WE LOOK FORWARD TO AUSNET'S RELATIVE AND ABSOLUTE PRODUCTIVITY IMPROVING

While the improvements are very welcome, questions include "Can AusNet do even more?" and "How does this proposal lay the basis for similar improvements in the next regulatory period?". The most recent AER benchmarking data shows that AusNet is in the bottom quartile for overall MTFP dropping from 10th in 2017 to 11th in 2018. Its productivity for 2012-18 fell on average 2% per year, the worst of any DNSP. It is in the bottom quartile for capex and second bottom for opex productivity.

Figure 4.2 MTFP indexes by individual DNSP, 2006–18



So, it was surprising to see in the Proposal (Part III p. 129)

> "The AER's 2019 benchmarking report confirms that we are a reasonably efficient DNSP."

We note AusNet, like many DNSPs, argue that there are particular circumstances (e.g. treatment of bushfire risk and historical differences in capitalisation policies) that distort the AER results but, as the Customer Forum argues[2], the AER data is the only evidence consumers have. In response to a question at the Public Forum, AusNet declined to forecast how its relative position might change over the next revenue period. Its argument around opex - that they have the lowest opex per customer of all rural distributors is not a particularly robust indicator given varying customer densities[3]. While there are opex and capex improvements that should improve their absolute efficiency there is still a long way to go to get back to levels of 10 years ago.

Other networks in the bottom quartile are working hard to improve their efficiency (e.g. Ausgrid), so significant improvement is probably required to just tread water in the relative position stakes.

Like AusNet, we look forward to the AER reviewing its approach to different capitalisation policies and how to include bushfire risk as an operating environment factor. Both will provide greater transparency on networks' absolute and relative efficiency.

CONSUMER ENGAGEMENT

AusNet's trial of the New Reg process through the Customer Forum brought a significant and welcome improvement in AusNet's consumer engagement and we look forward to that improvement being sustained as part of BAU activities in the future. For example, our members welcome the appointment of customer relationship managers for large customers. During the development of the EDPR, it was the Customer Forum, supported by the AER, that was the main consumer engagement forum with the BAU Customer Consultative Forum taking a back seat, focusing on other matters and only being kept informed of the Customer Forum's work.

The Customer Forum negotiations achieved a number of positive outcomes, though the scope of the negotiations was somewhat overstated at times. For example, while "Opex was within the scope agreed to by the AER and AusNet Services" it was limited to selection of base year, step changes and trend, not the actual opex in the base year where it is the AER which assesses whether it is 'not materially inefficient'.

AusNet conducted quality deep dives that the EUAA, along with other consumer advocates and the Customer Forum, participated in over the first half of 2019. These helped us to come to a better understanding of those aspects of their proposal. We expected to then participate in discussions with the Customer Forum as they developed their negotiation position. However, that was not the case. We only had two meetings with the Forum – August and October 2018 - well before the negotiations began. Meetings were more 'consult' with no 'involve' or 'collaborate' as we see on the IAP2 spectrum.

The Final Engagement Report shows the Forum had a strong focus on residential and small business customers with little focus on larger C&I customers. This is shown in the list of meetings with business customers in the Final Engagement Report[4]. Our members have many operating sites in the AusNet region, but none had meetings with the Forum.

We note the recent publication of the Farrierswire Stage 3 Monitoring Report and the CEPA Insights Report 3. It was surprising to read in the Monitoring Report:

> "The Customer Forum would have benefited from greater feedback from customer advocates. The message that "prices are too high" was clearly received, but only limited feedback was received on how AusNet

[2] See Final Engagement Report p.16
[3] We agree with the comments of the Customer Forum Final Engagement Report pp 15-16; also see the discussion on cost category PPIs on pp 36-40 in the latest AER DNSP Annual Benchmarking Report November 2019
[4] See Appendix C1 pp 69-71.

Services could reduce prices. Similarly, apart from the AER's Consumer Challenge Panel, there was little response to the Customer Forum's Interim Engagement Report, despite making direct contact with advocates to provide copies of the report.

> The Customer Forum is concerned that community and welfare advocates have limited ability to engage with the EDPR process due to their lack of resources." (p.18)

The EUAA provided a comprehensive submission on both the Draft Plan and the Forum's Interim Engagement Report[5] but, as noted above, no contact was made by the Customer Forum subsequent to AusNet receiving that submission.

We comment on two issues around Forum scope discussed in the Monitoring Report:

- Whether accelerated depreciation should have been in scope (we think so)
- The difficulties the limited scope created for the Forum's task to comment on the 'overall reasonableness' of the proposal

Given the large impact of the proposed accelerated depreciation in the proposal and its exclusion from the Forum's scope, we expected that it would a key issue for separate AusNet Services consultation. But this did not occur.

This raises an important issue that was considered by both external reports – how does the Forum balance the interests of current and future consumers when it is considering a 5 year period in the context of the National Electricity Objective. It also influences the discussion around the price path consumers favour. In our extensive involvement with network resets over many years, the clear message we receive, not just from our members, but also from other consumers sectors, is that they prefer price falls now, rather than what is perceived as a vague promise of price falls in the future (what happens of WACC increases?) by sacrificing price falls now.

Particularly in a disrupted COVID-19 world, our members want the maximum price fall now to help them to be still in business in the long term. The fall in WACC and tax allowance provides the ideal window for that fall. AusNet proposes to claw back ~ 82% of that windfall through accelerated depreciation and opex increases.

The falls in WACC and tax provided a unique context for the negotiations. They would have been quite different – and a lot harder with probably a lot of use of the formal escalation process - in a world of constant or rising WACC and no change in the tax allowance methodology.

Given the Forum's limited scope we find it difficult to understand how it could come to a view on the 'overall reasonableness' of the proposal. The criteria used in the Final Engagement Report to make this assessment were a combination of the annual bill reduction from the in scope negotiations together with measures around reliability and customer engagement. While we consider these measures are certainly relevant, we do not consider them to be sufficient to make the requested assessment. This assessment would have considered out of scope matters like accelerated depreciation and how much of the fall in WACC and tax allowance has been passed on.

Given the large expenditure by AusNet/AER/ECA/ENA on the New Reg trial, we look forward to participating in the third-party ex post review of the process under the New Reg Process step 12.

Finally, we look forward to more detail on the form of the consumer engagement from now until AusNet submits its revised proposal in December. AusNet's response to our question in the Public Forum on future engagement was relatively high level – use of the CCC plus one-on-one meetings. We look forward to more detail being provided on an overall engagement strategy to cover matters such as:

- Matters that were outside of the Forum's scope e.g. accelerated depreciation

[5] See https://www.ausnetservices.com.au/-/media/Files/AusNet/About-Us/Determining-Revenues/Distribution-Network/EDPR-2021_25/Submissions-on-Draft-Proposal/EUAA_SUBMISSION-AUSNET-Draft-Plan-18-April-19.ashx?la=en

- The AER Draft Decision in September
- COVD-19 changes that will be incorporated in the final proposal in December

We support the Customer Satisfaction Incentive Scheme and several customer experience improvement schemes and look forward to the annual public Customer Interactions and Monitoring Report.

THE ROLE THE AER PROPOSES FOR ITSELF UNDER NEW REG IN UNCLEAR

Steps 10-11 in the New Reg process allow the AER to take account of the Engagement Report and consider expediting and/or streamlining the revenue determination process. The Issues Paper (p.29) notes that:

> "Our analysis indicates that AusNet Services' proposal opex and capex compares well to their peers, historical allowances and historical expenditure levels. The Consumer Forum and AusNet Services have reached agreed positions on some aspects of the proposal, including on some aspects of capex and opex.
>
> … our preliminary view is that compared to other Victorian DNSPs' proposals, we may focus our assessment on total opex and capex, and conduct less extensive assessment of components of capex and opex forecasts in AusNet Services' proposal, compared to other Victorian DNSPs' proposals. That said, AusNet Services is proposing a significant increase in depreciation which warrants further analysis."

As we noted above, the EUAA had no engagement with the Customer Forum beyond its meeting in October 2018 and so we had no input to the Forum's development and implementation of its negotiating strategy. In our Public Forum presentation we sought more information from the AER on what this 'less extensive assessment' might specifically involve e.g.:

- Which particular matters that it proposes to bring less scrutiny to? Are these only the matters where there was agreement between the CF and AusNet or does it include all matters that were in the AER/CF agreed scope or the wider AusNet Services/CF agreed scope e.g. there were a number of matters not agreed to such as opex base year and RFCL step change.
- Can the AER provide an example of how this reduced scrutiny might apply in practice?

The AER's response was high level:

> "The AER is still considering all information before it including comments from stakeholders. It will use its various assessment tools – for example, trend analysis, modelling, assessment of bottom up builds, review of top-down challenges – to determine whether further scrutiny on particular matters is warranted."

The AER has those tools at its disposal for all Victorian DNSPs in its standard approach to considering revenue determinations. We look forward to more clarity from the AER on how differently it proposes to use those tools in the case of AusNet compared to the other Victorian DNSPS. Given the three categories in the Forum scope:

(i) In-scope (AER assisted)
(ii) In-scope (AusNet Services and Customer Forum)
(iii) Out of Scope

we can see some case for a lighter AER approach to matters agreed in (i), but not for (ii) or (iii). For example, the cyber security opex step change was in scope (i) but not agreed with the Forum commenting in their Final Engagement Report:

> "Given the highly technical and sensitive nature of the subject matter, along with the uncertainty of the emerging regulatory requirements, the Customer Forum believes this issue should be resolved directly with the AER as part of the later stages of the EDPR process." (p. 17)

They came to a similar conclusion on REFCL testing. So, both issues should be subject to no different level of scrutiny that step changes proposed by the other Victorian DNSPs.

Just because "AusNet Services' proposal opex and capex compares well to their peers, historical allowances and historical expenditure levels" does not support a less rigorous review. What happens if the rigorous review applied to the other Victorian DNSPs that did not use the New Reg process results in a significant reduction in their total opex/capex such that AusNet does not compare well with them?

There is another reason for a rigorous approach to the AusNet proposal. The counterfactual for assessing New Reg is what AusNet would have done in the absence of New Reg. This suggests that the AER will need to examine how it would have assessed an AusNet proposal if it were under a different consumer engagement model. This means the AER should examine the proposal to answer questions like "Would the AER have come to a different decision in the counterfactual consumer engagement model than what was agreed as part of the Consumer Forum negotiation process?"

THE EXTENSIVE 'COMMERCIAL-IN-CONFIDENCE' CLAIMS HAVE LIMITED OUR ABILITY TO EVALUATE THE PROPOSAL

We will draw on three documents to illustrate how it was impossible to properly evaluate the key DER integration proposals. It is interesting to note the Key Objectives and Key Benefits of each program where substantial C-I-C was present.

<u>Technology Program Brief – Integration of Distributed Energy Resources</u>

Key objective(s) of the program	Initiatives to integrate and manage Distributed Energy Resources (DER) efficiently during the next regulatory period, to support increased customer choices in DER connection options and improved economic investment options, and to progress AusNet Services on the path to a digitally optimised utility that can participate in future orchestration business models
Key benefits to customers	• Enhanced and more efficient network planning, incorporating DER forecasts • Faster DER connections, facilitated by clearer hosting capacity limits • Peak demand savings generated by demand response, leading to lower network augmentation costs • Preparation for potential orchestration role • Giving customers more options through facilitation of peer to peer trading

<u>Technology Program Brief - Customer Information Services</u>

Key objective(s) of the program	To improve the interactions between AusNet Services and our customers, to visualise their energy use behaviour, and consumption profile, and to remain compliant with increasingly sophisticated regulatory rule changes around the collection, storage and distribution of customer information.
Key benefits	• Improved customer interaction by focussing on individual 'connection points' rather than overall sites • Improved ability to more cost effectively meet increasingly sophisticated regulatory driven data collection requirements • Expands the range of options and channels for customers to engage with AusNet Services • Improved customer categorisation and segmentation allows AusNet Services to offer tailored network solutions to a broader range of customers. • More informed investment decisions around asset and network management for the benefit of changing customer needs • Lower risks and costs associated with notifications and customer outages.

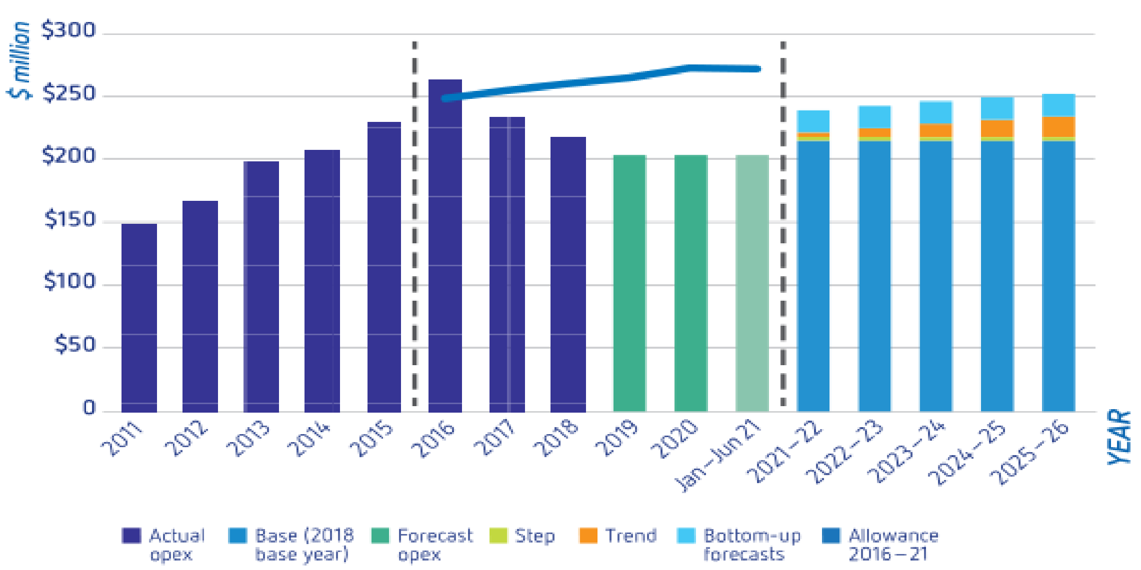
C-I-C examples:

Document	C-I-C sections
Technology Program Brief – Integration of Distributed Energy Resources	• Page 4 – Forecast expenditure over the reset period • Page 8 – forecast of solar PV uptake • Page 9 – forecast of solar penetration on a feeder • Page 10 – current limitations • Page 13 – one of the three options for DER integration • Page 16 – costs of Option 1 • Page 25 – costs of Option 2 • Pages 28-31 – any discussion of Option 3 • Pages 32-33 – data on assessment of the options
Technology Program Brief - Customer Information Services	The C-I-C sections in the previous document are reflected in this document with exclusion of information on option costs and assessment results across many pages
Distribution Proposal Capex Model	• Costs in 'Augmentation' tab • Costs in 'Major rebuild' tab • Number of units and costs in 'Stations' tab

OPEX PERFORMANCE IS IMPROVING, BUT IS THE BASE YEAR 'NOT MATERIALLY INEFFICIENT' AND STEP CHANGES PRUDENT AND EFFICIENT?

We welcome the significant improvement in opex in the current period, the agreement to the 1% productivity improvement and additional $21m in absorbed costs in 2021-26.

Figure 6: Actual and forecast operating expenditure ($2021)



There has been a substantial reduction in current period opex relative to the AER allowance which will result in a very large ($91m – or > 5 months opex in 2020) EBSS carryover. This suggests that the AER may have been too generous in its current period allowance, even though its final decision did not accept AusNet's proposal and substituted its own estimate[6].

[6] See Attachment 7

Table 7.1 Our final decision on total opex ($ million, 2015)

	2016	2017	2018	2019	2020	Total
AusNet Services' initial proposal	235.5	241.1	247.6	249.3	254.1	**1227.6**
AER preliminary decision	211.2	214.6	218.7	223.1	227.3	**1095.0**
AusNet Services' revised proposal	239.4	244.4	250.6	255.5	260.8	**1250.7**
AER final decision	223.3	226.8	232.1	236.4	241.3	**1160.0**

We do not agree with AusNet's argument that[7]:

> "The first year of the current period (2015) was actually higher than the AER allowance, demonstrating the original allowance set in the 2015-20 EPRDR was appropriate."

All sorts of factors can influence one particular year's expenditure. A much better indication is a trend over time – and that shows expenditure significantly below the AER allowance.

We share the Customer Forum's concern about the proposed 2018 Base Year and look forward to the AER analysis around the selection of the base year and whether it is 'not materially inefficient'. Given the forecast 2019 opex is expected to remain stable in 2020 and on an annualised basis in 2021, we look forward to AusNet explaining why 2019 is not an appropriate and sustainable base year.

The debate around the measure of base year efficiency is around the level of efficiency improvement that should go 100% to consumers and what should be shared 70/30 under EBSS. The large reduction in actual opex suggests there should have been an efficiency adjustment before the EBSS applied in the current period. As the AER notes in its response to CCP17's Public Forum comments on the high EBSS carryover, they take a conservative approach to measuring 'not materially inefficient' with the use of the benchmark comparison score of 0.75. This conservatism is indicted by the AER's recently released final decision on Ergon concluding for the first time since benchmarking was introduced that a network's base year (here Ergon in 2018-19) was materially inefficient[8]. Being in the bottom quartile for many years and being inefficient on a couple of the AER's four benchmarking models is not enough to be classed as 'materially inefficient'.

As the AER also notes, opex efficiency is influenced by changes in cost allocation and capitalisation practices that vary across DNSPs and we support a more formal review of these practices to eliminate this as a reason for taking such a conservative approach to the measurement of relative inefficiency.

The agreement to effectively have a 1% annual productivity improvement is welcome given the AER requirement of 0.5% and the Customer Forum negotiations were important here.

We await the AER's analysis of the remaining step changes and labour cost trends. We note the AER's recent final decisions on EQ and SAPN have re-instated the labour cost forecasting based on the average of their (Deloitte) and the networks (BIS Oxford) forecasts rather than their Draft Decision position on just using Deloitte which we supported. We look forward to seeing both revised forecasts incorporating a post COVID view on wage rises. Our members are certainly not budgeting for any increase in real wage costs over the next five years.

We look forward to the AER applying its usual rigorous analysis to the proposed step changes.

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[7] See AusNet's response to a CCP17 question at the Public Forum on efficiency – p.7
[8] See the discussion in Section 6.4.1.1

THE REDUCTION IN CAPEX IS WELCOME BUT COULD IT HAVE DONE MORE?

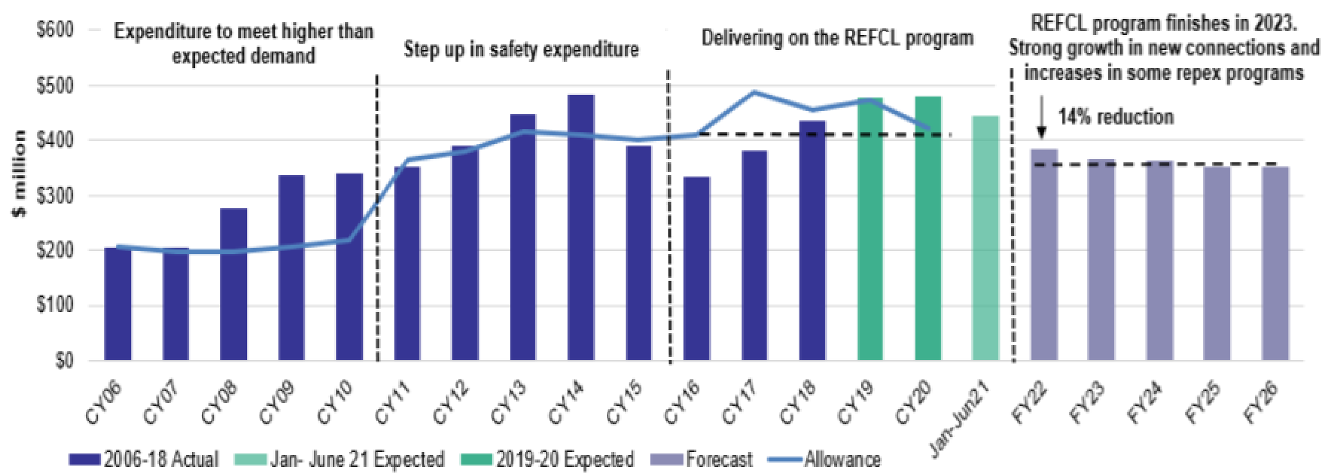
The message from our members is that they are generally happy with the existing level of reliability which they expect to be delivered at lower cost. This expectation of continued productivity improvement is because that is what their businesses have to achieve to stay in business. The other message from our members is that they treat capital as a constrained resource – there is not an unlimited supply of capital and many positive NPV projects are not implemented – there is "a lot of fish that John West rejects'. By contrast they see networks as being able to get approval for any project that meets the rules criteria. It would be interesting to see how many projects AusNet did not include in its proposed capex that still met the rules criteria.

We welcome the overall 20% reduction in net capex compared to forecast in the current period, though most of this is driven by the finishing of the REFCL programme. Excluding the impact of the significant Tranche 3 of REFCL, capex is down just 5.2% from the current period.

Consistent with the recent slower growth in demand and the aging of assets, the focus is moving strongly towards repex. Proposed repex at $543.3m is 14% higher than the $476.3m expected repex in the current period. Proposed augex, with a particular focus on incorporating increased DER, is forecast to be $92.2m, 39% lower than expected augex in the current period. A comprehensive evaluation of capex was limited by the level of confidentiality and by the change in what is in particular capex categories which made it difficult to category spend over time.

Capex negotiated with the Customer Forum was ~7% of net capex with the outcomes around deferral of augex for the Doreen Zone Substation and repex on two zone substations.

Figure 9-1: Gross capex, actual and forecast 2006 to 2026 ($m, real 2021)



Note: Jan to June 2021 is presented on an annualised basis.

As with opex, there has been a been a substantial reduction ($138.4m or 6%) in current period capex relative to the AER allowance driven by reduced safety related capex. This has resulted in a large $47.5m CESS carryover. This again, suggests that the AER may have been too generous in its current period allowance, even though, as with opex, its final decision did not accept AusNet's proposal and substituted its own estimate[9].

[9] See Attachment 6

Table 6.1 Final decision on AusNet Services' total forecast capex ($2015, million)

	2016	2017	2018	2019	2020	Total
AusNet Services' revised proposal	347.7	389.9	340.2	342.2	329.4	1749.4
AER final decision	316.2	348.6	316.6	318.1	300.9	1600.4
Difference	-31.5	-41.3	-23.7	-24.0	-28.5	149
Percentage difference (%)	-9.1	-10.6	-7.0	-7.0	-8.6	-8.5

It also highlights the need for the AER, within the limits of the rules, to closely examine the shortfall in capex spend to understand how much is really efficiency gain and how much is a delay to the next period.

Given our concern in our Draft Plan comments about the level of ICT capex being similar to the current period, it is pleasing to see the proposed 12% reduction compared with current period forecast. It is inherently difficult for consumers to analyse the efficiency of ICT expenditure and it is pleasing to see at least a high level link between increased ICT expenditure and AusNet's opex productivity of 1%. While a Mercedes is a nice car, we can easily get by on a Toyota. Vendors often have market power to force upgrades even if they may not be required in the expectation that increased costs can be passed on to consumers relatively easily. Given that current period spend is forecast to be 17% below the AER allowance, this provides increased focus for the AER's assessment, especially for non-recurrent expenditure.

There has been a lot of debate around the benefits of installing roof-top solar and exporting excess power to the grid. The Victorian Government's $1.3b solar homes programme provides generous subsidies to residential consumers to put solar panels on their roof and export the excess to reduce their electricity bills. There was a lot of discussion in the AusNet consumer engagement around whether there might be restrictions on the ability of these subsidised consumers being able to export to the grid.

To be clear, we do not accept the proposition that the grid should be expanded to allow some consumers unconstrained grid exports. Nor do we accept the implicit assumption around the analysis of DER that consumer engagement supports the view that all consumers are prepared to pay for grid augmentation to allow unconstrained export even if the consumer does not have roof-top solar themselves. Willingness to pay surveys and using 'Coffee equivalent' cost measures are very unreliable indicators of desired capital expenditure.

Further, this view on willingness to pay is based on a potentially misleading assumption in the engagement process that this non-solar consumer will always obtain value from the increased solar export in the form of lower pool prices that offset the additional network cost they are sharing.

As we have seen in both South Australia and Queensland in the last 12 months or so, at some times in the middle of the day, increased solar PV can have no value, or a negative value with the incidence of negative pool prices increasing. AEMO is now having to constrain large scale solar farms to cope with the rise in rooftop solar exports. Its response is to seek more control over roof-top solar exports and inverter standards that facilitate this.

An expanding part of the solar homes programme are the subsidies for battery installation. This subsidy plus the influence of the continuing fall in battery costs and expansion of community batters and microgrids will serve to perhaps limit the level of exports. Why export to receive 10c/kWh feed in tariff when you can store it in a battery and save 25c/kWh?

In response to our Public Forum question on the risk that C&I customers are cross-subsidising investments to allow residential roof-top solar exports, AusNet responded that:

> "Our proposed expenditure on DER will put downward pressure on wholesale electricity prices due to additional low marginal cost generation. This benefits all customers, including our business customers. Our proposed expenditure will also ensure our customers can export excess energy only where the cost of us carrying out works is economically efficient. That is, we will only invest until such time as our solar, non-solar and business customers are better off.

and went on to discuss the $20.9m capex for 'Hosting capacity for DER' which will allow AusNet to improve the experience of 97% of our customers and reduce constrained exports by 70% rather than investing $626.1 million to ensure zero constraints. We doubt the benefit of this hosting capacity expenditure, particularly in a post COVID-19 world and using a more appropriate benefit that includes zero value of export power at certain times of the day.

Perhaps the best way to illustrate our concern over this augmentation investment is to discuss the assumptions AusNet have advised that they used to justify it:

- Asset life is assumed to be 45 years
- The value of solar exports is the 2019 single rate of 12c/kWh (between the shoulder rate of 11.6 cents/ kWh that applies from 7am – 3pm on weekdays and the peak rate of 14.6 cents/kWh that applies from 3-9pm on weekdays) for tat asset life
- There is no modelling on the likelihood of zero or negative pool prices in Victoria over the 45-year asset life despite the State Government's 50% renewables target and zero/negative prices now regularly occurring in South Australia and Queensland; it is the expectation of increasing incidence of these events over the next 5-10 years which is a major factor driving AEMO to want to control rooftop solar like a large distributed generator, change inverter standards etc.

We do not believe that this approach to modelling is consistent with prudent and efficient capex that meets the NEO.

Finally, we look forward to the revised AusNet demand forecasts post COVID-19 and in particular, their impact on forecast grid exports. With the large residential customer base, expected significant fall in immigration over the 2021-26 period and increased working from home all contributing to a reduction in grid exports, there is reason to review the DER capex.

PROPOSED ACCELERATED DEPRECIATION IS NOT SUPPORTED

In common with other networks, AusNet is proposing a change to asset lives that effectively accelerates depreciation with increased depreciation the major factor (+$232m) offsetting WACC and tax in in 2021-26 revenues. This comes from a significant reduction in remaining asset lives for:

- IED protection relays (30-35 yrs. down to 5-6 yrs.) - + $139m, and
- Remote technical units (30 yrs. down to 3-4 yrs.) - + $22m

There was no consumer consultation on this issue and hence we are unable to support it. In this context it is interesting to see the discussion in the Farrierswier's Stage 3 Monitoring Report. It seems there were a range of views on whether it should have been part of the Customer Forum scope. The AER staff:

> "… questioned why depreciation methodology wasn't included, given its materiality."

The Forum said it should have been and that AusNet should have inferred the Forum's views on the matter given:

> "…the Customer Forum's focus on the need to minimise customer prices during the 2021-26 period." (p.12)

AusNet:

> "… commented that it had not included depreciation methodology in the engagement earlier largely due to its perception of the rules governing the AER's decision making on depreciation methodology." (pp. 12-13)

Our experience in other network resets is that discussions on accelerated depreciation are very much part of consumer engagement. The network needs to get consumers views on whether they want a larger or smaller price decrease now and issues of intergenerational equity. It is beginning to emerge as a central issue in gas resets as consumers engage on potentially large stranded asset issues.

While the AER decides whether there should be accelerated depreciation, consumers views inform the AER decision on the time scale of when any approved accelerated depreciation should occur. The pre-COVID-19 consumer research highlighted in the Forum's Final Engagement report highlighted the focus on affordability for all consumer classes[10].

While there may be a case for shorter lives, in the current environment EUAA members want a larger price decrease now to help them cope with the post COVID-19 disruption. Our members want as much as possible of the fall in WACC and tax allowance to flow through in lower prices. This means that were the AER to approve the concept of accelerated depreciation then it should extend well beyond just one reset period.

The long-term interests of our members are more assured when you look after their short-term interest to survive.

Please do not hesitate to be in contact should you require additional information.

[redacted]

Andrew Richards
Chief Executive Officer

[10] See the discussion on pp.50-1