

Ref: C2076496

25 October 2016

Mr Chris Pattas
General Manager, Networks
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Mr Pattas

Update to Framework and Approach paper for the 2019-24 regulatory control period

Essential Energy's current regulatory control period ends on 30 June 2019. Accordingly, we have commenced preparation for the next revenue proposal due to be submitted to the AER in January 2018. Clause 6.8.1(c)(1) of the National Electricity Rules (Rules) requires Essential Energy to request the AER to make any amendments or replace the Framework and Approach paper (F&A paper) as required, no later than 32 months before the end of the current regulatory control period.

The AER issued Essential Energy's F&A paper for the current regulatory control period in two parts to accommodate the 2014-15 transitional year. These were published in March 2013 and January 2014. On this basis alone, the current F&A papers require amendment to remove all references to the transitional year and combine the paper back into one document. We also note that updates are required to ensure the F&A paper is applicable to the upcoming regulatory control period and reflects the current Rules and versions of regulatory incentive schemes.

Timeframe

The new F&A paper should apply to the forthcoming revenue determination for Essential Energy commencing 1 July 2019.

Service classification

The classification of services will play an increasingly important role with the introduction of the Ring Fencing Guideline, due to be published 1 December 2016. Essential Energy is keen to work with the AER and our customers on clarifying and clearly delineating service classifications. There is also a need to update the F&A paper so that the classification and definitions of services align with those in the AER's final determination for the 2015-19 regulatory control period (2015-19 determination).

Form of control mechanism

The F&A paper should be updated so that the formulas for the form of control align with those in the 2015-19 determination.

Efficiency Benefit Sharing Scheme

The AER did not apply the Efficiency Benefit Sharing Scheme (EBSS) to Essential Energy's current regulatory control period. The F&A paper should address whether the EBSS will be applied in the 2019-24 regulatory control period, after considering the outcomes of the current appeals process.

Capital Expenditure Sharing Scheme

The AER did apply the Capital Expenditure Sharing Scheme (CESS) to Essential Energy's 2014-19 regulatory control period in the current F&A paper. We expect the AER will continue to apply the November 2013 CESS (version 1) for the 2024-29 regulatory control period.

Service Target Performance Incentive Scheme

The AER departed from the Service Target Performance Incentive Scheme (STPIS) outlined in the current F&A paper in its 2015-19 determination. There may therefore be a need to align the F&A paper with these departures for the 2024-29 regulatory control period.

Demand Management Incentive Scheme

The AER applied only Part A of the Demand Management Incentive Scheme (DMIS) in the current F&A paper. Essential Energy notes that a new DMIS is currently being developed and may be completed in time for inclusion in the F&A paper after consultation with stakeholders.

Small Scale Incentive Scheme

A small scale incentive scheme had not been developed and therefore was not applied in Essential Energy's current F&A paper. Should the AER intend to develop such a scheme, then we request that this intention be outlined in the F&A paper.

Updates to incentive schemes

Given the substantial period between now and the start of the 2019-24 regulatory control period, further updates to the EBSS, CESS, STPIS or DMIS may be made following the publication of the F&A paper. We expect that the AER will consult with stakeholders as to the feasibility of implementing and applying any such new arrangements.

Depreciation

The current F&A paper states that the AER will apply forecast depreciation to establish the RAB at the commencement of the 2019-24 regulatory control period. Essential Energy supports this application and in conjunction with the CESS, it will maintain an incentive to seek capital expenditure efficiencies.

Forecast expenditure assessment guidelines

The AER applied all the assessment tools set out in the Guideline in the current F&A paper. We expect this approach to be maintained for the 2019-24 regulatory control period. Nevertheless, as detailed in our previous revised regulatory proposal and subsequent Merits Review of the 2015-19 determination, Essential Energy maintains its concerns with the benchmarking methodology and approach used by the AER for forecasting operating expenditure. Essential Energy would welcome any opportunity to engage with the AER to refine and improve the AER's benchmarking methodology and application.

Dual function assets

In the current F&A paper, Essential Energy reported to the AER that it does not operate any dual function assets. This continues to be the case and therefore, the AER will not be required to make a determination on dual function assets for Essential Energy in the F&A paper.

Essential Energy is pleased to initiate this first step in its upcoming revenue determination process with the AER. This step is particularly important as it facilitates early stakeholder consultation and will assist us in preparing our regulatory proposal. If you would like to discuss any matters raised in this letter, please do not hesitate to contact Natalie Lindsay on (02) 6589 8419.

Yours sincerely

A handwritten signature in black ink, consisting of a large, stylized 'C' followed by a horizontal line.

John Cleland
Chief Executive Officer