evoenergy

24 July 2018

Ms Paula Conboy
Chair
Australian Energy Regulator
GPO Box 520
Melbourne Victoria 3000

Dear Ms Conboy

Proposal for the remittal of Evoenergy's 2014-19 determination

Following reviews of the Australian Energy Regulator (AER) 2015 final decision on the distribution determination for ActewAGL Distribution for the 2014-19 regulatory period (2015 determination)[1] by the Australian Competition Tribunal (Tribunal)[2] and Federal Court[3], Evoenergy submits this proposal to the AER for the purpose of remaking its 2015 determination.

This proposal is aimed at achieving an expedited resolution to the remade determination that is in the long term interests of consumers by providing price stability and certainty and enabling Evoenergy to continue to maintain a safe, reliable and secure supply of electricity for ACT consumers. The proposal follows consultation with the AER and consumer groups on achieving these key objectives.

Overview of this proposal

This proposal, if accepted, would allow the AER to remake its 2015 determination without a need to increase prices for standard control services (SCS) in the 2019-24 regulatory control period.

The Tribunal and Federal Court directed the AER to remake its decision for (among other things) SCS operating expenditure (opex) and the cost of debt. Evoenergy estimates that the value of these matters, if remade in accordance with the Court orders, would be approximately $124 million (this and all other amounts in this letter are expressed in terms of 2018/19 dollars).

Evoenergy's proposal does not seek to recover $124 million, but instead limits the revenue recovered under the remade determination as compared to the 2015 determination to $26 million. This includes redundancy expenses of $20.9 million, service target performance incentive scheme (STPIS) penalties of -$1.2 million and the retention of $6.5 million in revenues as part of the overall resolution of the remittal proposal. Limiting the additional revenue recovered by Evoenergy to $26 million provides consumers with a benefit of $98 million. Evoenergy therefore considers its proposal to be in the long-term interests of consumers.

Significantly, Evoenergy's SCS revenues for the 2014-19 regulatory period under the undertakings[4] are expected to exceed the revenue allowance in this proposal. This over-recovery relative to Evoenergy's

[1] On 1 January 2018, in accordance with the AER's revised Ring-fencing Guideline, ActewAGL Distribution's energy networks business changed its name to Evoenergy.

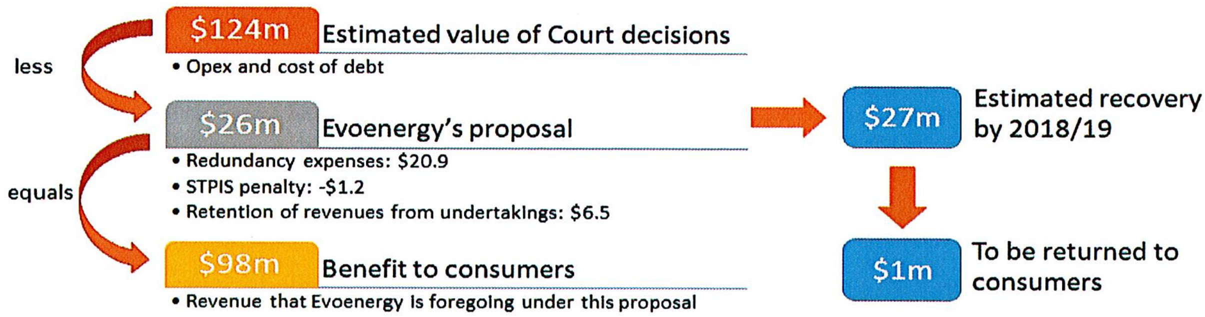
[2] Australian Competition Tribunal 2016, Application by ActewAGL Distribution [2016] ACompT 4.

[3] Federal Court 2017, Australian Energy Regulator v Australian Competition Tribunal (No 2) [2017] FCAFC 79.

[4] In the absence of a final determination, prices for 2016/17, 2017/18 and 2018/19 were set based on undertakings made by Evoenergy to the AER. Evoenergy proposed to increase prices by CPI and the AER accepted Evoenergy's undertakings.

proposal, currently estimated at $1 million, would be returned to consumers in the 2019-24 regulatory period. That is, Evoenergy's proposal will ensure that there is no increase in prices for SCS in the 2019-24 regulatory period as a consequence of remaking of the 2015 determination. Evoenergy's proposal is summarised in Figure 1 below.

Figure 1: Summary of Evoenergy's remittal proposal



The key benefit of this proposal is that it would provide price stability and certainty for consumers. Other benefits include:

- Resolution of the long-running difference between the AER and Evoenergy, allowing the AER to finalise its remade 2015 determination.
- Passing onto consumers the 22 per cent reduction in opex achieved in the current regulatory period (compared with the 2009-14 regulatory period), which will also flow through to the 2019-24 regulatory period.
- Maintenance of a safe, reliable and secure supply of electricity for ACT consumers at an efficient cost.
- For all stakeholders, including Evoenergy and its customers, this proposal would provide certainty about the application of the AER's methodology and approach in the forthcoming AER determination for Evoenergy for the 2019-24 regulatory control period, in particular:
  - This proposal would resolve the methodology to calculate the cost of debt for the 2019-24 regulatory control period.
  - This proposal would provide certainty for the methodology used to calculate opex. In particular, given the substantial opex efficiencies achieved by Evoenergy over the current regulatory period, this proposal would deliver a resulting base year opex for forecasting 2019-24 opex in line with the AER's opex allowance in the 2015 determination and an anticipated return to a revealed cost methodology.
- The continued application of incentive schemes designed to encourage efficiencies and to share these with consumers, including the re-instatement of the efficiency benefit sharing scheme (EBSS) for 2019-24.

Performance during the 2014-19 regulatory period

Evoenergy's remittal proposal consolidates efficiency gains made over the 2014-19 regulatory period.

Evoenergy's opex in the 2014-19 regulatory period will be approximately 22 per cent lower in real dollar terms than opex in the 2009-14 regulatory control period. These savings have been achieved through:

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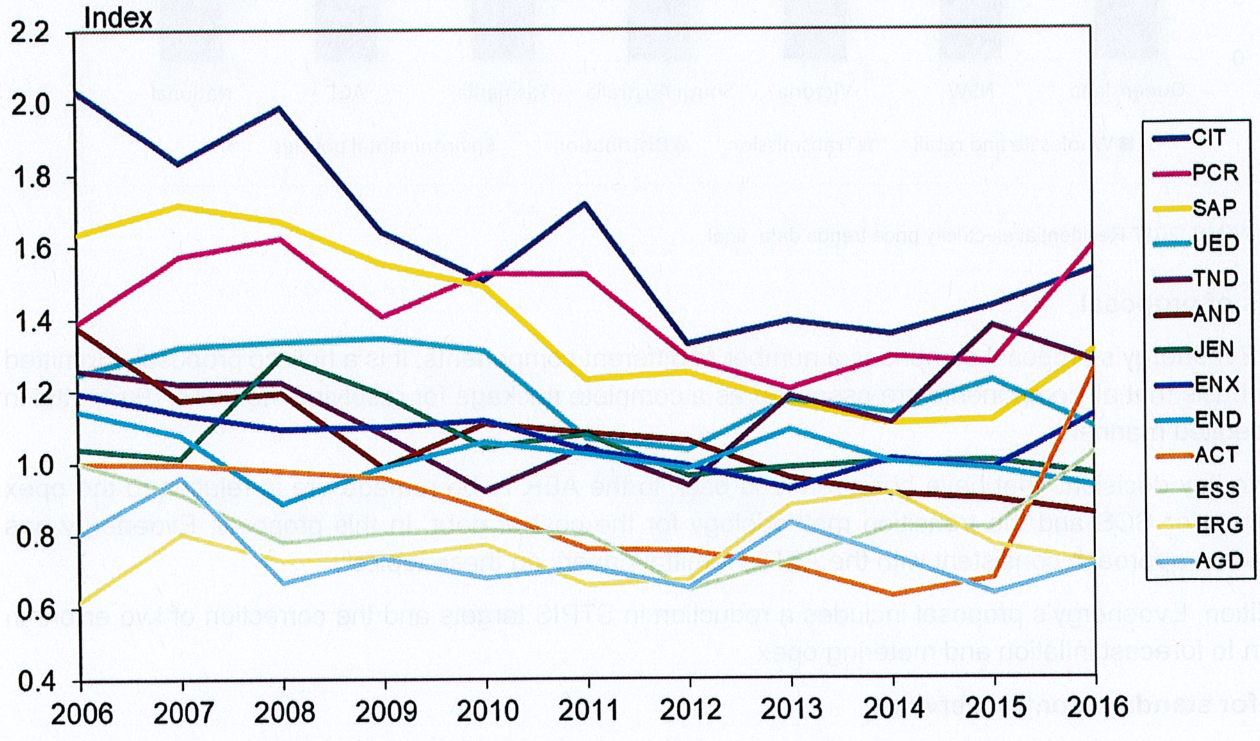
- an extensive restructuring of the workforce including redundancies;
- re-engineering and asset optimisation to reduce the program of works;
- savings on vegetation management using new light detection and ranging (LiDAR) technology and improved contractual arrangements;
- investment in systems technology to drive smarter operation of the network, including improvements in automation and asset management practices; and
- a reduction in overtime and staff training.

However, the rapid and extensive nature of the opex reductions Evoenergy undertook to align its opex to the AER's 2015 determination have given rise to enduring challenges in meeting operational safety requirements and reliability performance.

Evoenergy's significantly lower opex is reflected in the AER's most recent benchmarking report, in which Evoenergy's ranking (ACT) has improved to fifth out of thirteen Distribution Network Service Providers (DNSP) on the AER's preferred opex multilateral partial factor productivity (MPFP) measure, only slightly below TasNetworks (TND) and South Australia Power Networks (SAP) (see Figure 2 below).

Figure 2 Opex multilateral partial factor productivity (MPFP), 2006-16

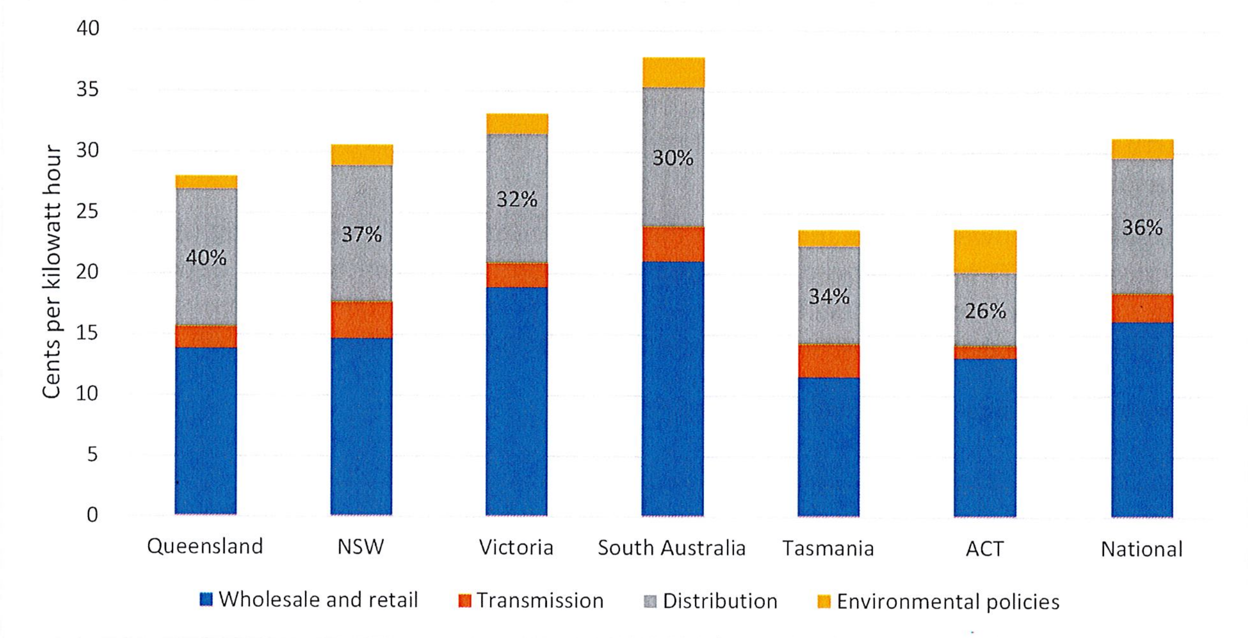


Source: AER 2017, distribution networks service provider benchmarking report, p 37.

Over the 2014-19 regulatory period, Evoenergy's actual capital expenditure (capex) was below the AER's 2015 determination capex allowance and the business expects to underspend the allowance by $9.8 million by the end of the regulatory period.

Between 2014/15 and 2018/19, Evoenergy expects to deliver a 16 per cent real reduction in the typical residential customer Distribution Use of System (DUoS) bill and Evoenergy's distribution charges make up the lowest share of retail charges in the National Electricity Market (see Figure 3 below).

Figure 3: Composition of retail charges by jurisdiction, 2017/18



Source: AEMC, 2017 Residential electricity price trends data, final.

Details of proposal

While Evoenergy's proposal comprises a number of different components, it is a holistic proposal submitted on the basis that all components are assessed as a complete package for resolving the 2014-19 remittal in an expedited manner.

The two key decisions that have been remitted back to the AER to be remade are in relation to the opex allowance for SCS and the transition methodology for the cost of debt. In this proposal, Evoenergy has adopted an approach consistent with the AER's remittal papers on these topics[5].

In addition, Evoenergy's proposal includes a reduction in STPIS targets and the correction of two errors in relation to forecast inflation and metering opex.

Opex for standard control services

In the interests of an expedited resolution on opex, Evoenergy proposes to accept the AER's final determination on opex for SCS with the addition of redundancy expenses. Evoenergy's understanding of the

[5] AER 2017, Issues paper remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure and AER 2017, Position paper, remitted debt decision for NSW/ACT 2014-19 electricity distribution determinations and Jemena gas networks 2015-20 (NSW) access arrangement.

AER's issues paper is that, given the principles and remarks made by the Tribunal and the Federal Court, the AER would reconsider its approach to transition costs for the purposes of the remade determination[6].

In Evoenergy's view, redundancy expenses are efficient transition costs necessarily incurred to achieve the reduction in opex consistent with the final determination within the constraints of the Enterprise Agreement in existence at the time. For the reasons outlined by the Tribunal and Federal Court, and consistent with the AER's opex issues paper, it is Evoenergy's view that these costs should be included in the opex allowance for the purposes of the remade determination.

The inclusion of redundancy expenses would result in an increase in Evoenergy's opex allowance of $20.9 million or 6 per cent over the 2014-19 regulatory period.

Cost of debt

In the interests of an expedited resolution to the remittal, Evoenergy's proposal involves implementing the AER's proposed approach to the trailing average debt estimation methodology by applying a revenue neutral transition[7]. Evoenergy's proposal includes updating the cost of debt for each year of the regulatory period in line with the methodology set out in the final determination[8].

Reliability performance targets

Evoenergy appealed the 2015 final determination for STPIS on the basis that it was not possible to maintain historical levels of reliability with the significantly reduced opex allowance in the final determination. The AER's STPIS decision was set aside by the Tribunal and remitted back to the AER to be remade.

As foreshadowed by Evoenergy in the appeal, Evoenergy has been unable to meet its STPIS targets in 2015/16 and 2016/17 while reducing its opex in line with the opex allowance in the 2015 determination. In Evoenergy's view, it is unreasonable to expect no change in historical reliability performance given a 26 per cent reduction in the opex allowance in the 2015 determination (compared with actual opex in the 2009-14 regulatory control period) with no corresponding increase in capex.

In the interests of an expedited resolution to the remittal, Evoenergy proposes to reflect the impact of the opex reductions on its reliability performance by implementing a simplified adjustment of 5 per cent to all STPIS targets, which would have a relatively minor impact on target performance levels[9]. This change to Evoenergy's STPIS targets results in a STPIS penalty for the current regulatory period of approximately $1.2 million.

Correction of errors

Evoenergy's proposal includes the correction of two errors in the 2015 determination:

1. The correction of an error in relation to the estimation of forecast inflation[10], which increases forecast inflation from 2.38 per cent in the original decision to 2.42 per cent in the remade decision.

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[6] AER 2017, Issues paper remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure, p.34

[7] AER 2017, Position paper, remitted debt decision for NSW/ACT 2014-19 electricity distribution determinations and Jemena gas networks 2015-20 (NSW) access arrangement, p.19.

[8] AER 2015, Final Decision ActewAGL distribution determination 2015-16 to 2018-19, Attachment 3 – Rate of Return, p.3-546 to 3-556.

[9] For example, a 5 per cent increase to the urban SAIDI target would increase the target from 30.32 minutes off supply to 31.92 minutes off supply. Similarly, a 5 per cent increase to the urban SAIFI target would increase the target from 0.59 outages per customer per year to 0.62 outages per customer per year.

[10] See https://www.aer.gov.au/system/files/DORIS%20-%20D17-178599%20AER%20letter%20proposed%20inflation%20correction-ActewAGL%2015%20....pdf

2. The correction of an error in the calculation of metering opex, which will be reflected in the pricing for alternative control services in the 2019-24 regulatory period[11].

Looking to the future

Evoenergy submitted its regulatory proposal for the 2019-24 regulatory control period to the AER on 31 January 2018[12]. The regulatory proposal follows a period of extensive consultation, particularly with the Energy Consumer Reference Council, which was established during the current regulatory period to provide views and guidance from a consumer perspective.

Evoenergy's regulatory proposal for 2019-24 reflects the substantial efficiency improvements achieved during the current regulatory period as well as the new challenges and opportunities arising from technology driven industry transformation. While the medium to long-term impacts of reduced operating expenditure on safety and reliability are not yet clear, Evoenergy will continue to monitor the impact of these changes.

Evoenergy's proposal includes increased expenditure on preparing systems for the expected growth in adoption of new technologies and a reduction in traditional replacement and growth related expenditure. Evoenergy's proposal also reflects new responsibilities for vegetation management around network infrastructure, transferred from the ACT Government.

Significantly, under this proposal for the 2014-19 remittal, the outcome will not increase the SCS prices that would otherwise apply in the 2019-24 regulatory control period as a consequence of the review of the AER's 2015 determination.

Evoenergy looks forward to finalising the current remittal process and focusing on delivering consumers the safe, reliable and sustainable energy solutions they want.

Yours sincerely

Michael Costello
Chief Executive Officer
ActewAGL

[11] See Australian Competition Tribunal 2016, Application by ActewAGL Distribution [2016] ACompT 4, para 57-71. Evoenergy estimates that the value associated with the correction of this error is $3.8 million.

[12] See https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-actewagl-determination-2019-24.