30 November 2017

Mr Sebastian Roberts
General Manager, Network Expenditure
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001
via email: NSWACTremittal@aer.gov.au

Dear Mr Roberts,

Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations – Operating Expenditure

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people.

The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers in NSW, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to comment on the AER's issues paper on the operating expenditure (opex) component of the remitted decisions for NSW/ACT 2014-19 electricity distribution determinations. PIAC has been actively involved in the NSW 2014-19 electricity distribution determinations, including in Limited Merits Review (LMR). This letter refers only to NSW distributors and we do not address the ActewAGL remittal.

PIAC supports the proposal made by Essential Energy, to accept the AER's final determination and retain some over-recovered revenue with a limit of $100 million across the period. Some of our observations and recommendations below apply therefore only to Ausgrid and Endeavour Energy, and are predicated on Essential's proposal being accepted by the AER.

Revealed costs should be used in conjunction with other methods (Question 1)
PIAC supports the use of revealed costs to determine opex allowances for DNSPs, where they are not materially inefficient. Given that the AER will have at least three years of revealed cost data when making the opex decisions, they should give strong consideration to this information.

However, PIAC is concerned that the revealed opex of NSW DNSPs is still somewhat inefficient.

The AER issues paper reports that the revealed costs of both Ausgrid and Endeavour Energy are above even what was considered prudent and efficient in the final 2014-19 determination. PIAC has previously contended that the

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AER's final 2014-19 opex allowances for NSW DNSPs were too high, and on this basis, it appears that the DNSPs' revealed opex is also inefficient.

To address the issue that both the original allowance and subsequent actual opex were inefficiently high, when re-making the remitted opex decisions, the AER should compare revealed costs to the updated benchmarking models and/or any bottom-up assessments they conduct to ensure opex has been efficient.

If opex has been efficient, PIAC would support its use in determining the final revenue allowance for 2014-19. However, if the expenditure is found to have been materially inefficient, the AER should continue to rely on information other than revealed costs in re-making the remitted opex decisions.

With respect to Ausgrid's and Endeavour's opex, PIAC would strongly support the approach that Essential has taken on its remittal, of seeking to reach an agreement between the AER, consumer representatives and the network on what would be an appropriate quantum. This approach needs to be underpinned by good consumer engagement, however, and while the AER has made efforts in this regard, PIAC has to date not been party to good engagement by Ausgrid or Endeavour with respect to this issue.

DNSPs should bear transition costs (Questions 3, 4 and 5)

PIAC has previously considered the transition path issue in submissions to the AER:

> PIAC recommends that there should be no transition period towards more efficient opex spend by the NSW networks. The Draft Determinations already allow for a level of inefficiency, including a 10% downward adjustment from the "efficiency frontier". Restructures should be funded out of profits as would be the case in a competitive market and consumers should not wear the costs of reforms on the path to efficiency.[1]

PIAC would be open to considering reasoned alternatives to this position if raised in the context of good consumer engagement. As noted above, however, the NSW DNSPs have not sought to engage with PIAC about transition. As such, PIAC is not aware of any reason to take a different view and maintains that the networks should fully bear these costs.

PIAC's position is consistent with both the revenue and pricing principles (RPP) and the NEO. The RPP states that a regulated network service provider 'should be provided with effective incentives to promote economic efficiency with respect to direct control network services the operator provides.'[2] The RPP does not suggest that businesses should receive any extra allowance for meeting these incentives.

The NEO is to 'promote efficient investment in, and efficient operation and use of, electricity services in the long-term interests of consumers'.[3] Requiring the NSW DNSPs to recovery only efficient opex is wholly consistent with this the 'efficient operation' objective. Furthermore, it is not in the 'long-term interests of consumers' to pay for this reduction through transition costs. While the reduction itself is in their interests, an increase in price is not. For this reason, DNSPs should absorb the costs.

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1 PIAC, *A missed opportunity? Submission to the Australian Energy Regulator's Draft Determination for Ausgrid, Endeavour Energy and Essential Energy*, February 2015, 32.

2 NEL, 7A(3).

3 NEL, 7.

Low capex and high opex are not related for NSW DNSPs in this control period (Question 6)

In principle, PIAC supports the ability of DNSPs to increase opex as a way deferring or avoiding capital expenditure (capex). In doing so, DNSPs may increase opex costs but, by reducing growth in a DNSP's regulated asset base, create a saving for consumers in the long term.

However, PIAC's understanding is that neither Ausgrid nor Endeavour Energy consider their opex to be related to capex substitution. In both cases, the businesses argue that their high opex in the early years of the 2014-19 period largely relates to the transition costs discussed above. If that is the case, the AER should not consider high levels of opex an efficient substitution for the capex underspends by the DNSPs.

Furthermore, Endeavour Energy recently informed its Customer Consultative Committee (of which PIAC is a member) that they intend to significantly increase capex over the final years of the 2014-19 period and will have spent their full capex allowance by the end of the period. If Endeavour Energy does not finish the 2014-19 period with a material capex underspend, any increased opex over the period cannot be considered related to their capex.

Endeavour Energy's EBSS should not impact cost allocation for other DNSPs (Question 7)

As discussed above, PIAC contends that consumers should not have to bear the costs associated with reforms to make a regulated network business efficient. The application of the efficiency benefit sharing scheme (EBSS) to Endeavour Energy does not change our position on this matter.

PIAC acknowledges that the EBSS means that Endeavour Energy will only bear 30 per cent of the costs and other DNSPs would have to bear the full amount. This is a function of Endeavour Energy having operated more efficiently in the 2012-13 base year. Unlike the other NSW DNSPs, Endeavour Energy's base year actual opex was not materially inefficient and they were therefore eligible for application of the EBSS.

If other DNSPs had been similarly efficient, they would have been eligible for this cost sharing arrangement. Because they were not, PIAC considers it appropriate for only Endeavour Energy to have its transition costs capped at 30 per cent under the EBSS.

PIAC would welcome the opportunity for further engagement with the AER and the networks on these matters.

Yours sincerely,

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