

# Revised Regulatory Proposal 2019-24

EXECUTIVE SUMMARY









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# Message from our CEO



Since submitting our Regulatory Proposal in April 2018 (Initial Proposal), we have continued to engage with customers while the Australian Energy Regulator (AER) conducted a detailed review of our expenditure plans.

Over recent months we have worked collaboratively with customer advocates to develop a Revised Regulatory Proposal (Revised Proposal) which better reflects customer expectations, whilst ensuring Ausgrid has the resources it needs to continue to provide safe and reliable services. We believe this Revised Proposal strikes the right balance. It meets customer expectations, continues to drive our ongoing transformation and allows the safe and sustainable operation of the network. Our Revised Proposal, if accepted by the AER, will reduce annual network charges by \$71 for the average residential customer from 1 July 2019.

Customer engagement is critical for Ausgrid as our network evolves to meet changing customer needs. We are improving how we listen to, and respond to, customer feedback. This feedback has informed our investment priorities which are targeted at providing more value for customers.

We have comprehensively reviewed our capital expenditure plans in response to stakeholder feedback and the AER's Draft Decision. We concluded that although our Initial Proposal was consistent with our network risk profile, some reductions in our future investment levels are possible in the coming period.

Given the rate of technological change in our sector, we agree with customers that it may be possible to defer some capital expenditure that would be required under traditional cost benefit analysis. We are challenging ourselves to achieve more with less. Our Revised Proposal capital expenditure forecast is 13% lower than our Initial Proposal. This reflects a balance between cost efficiency, the need to transform the network and our ongoing responsibility to manage network reliability and risk.

In our Revised Proposal we are adopting the AER's 2018 Rate of Return Instrument and incorporating productivity improvements in our operating expenditure forecast from 1 July 2020. We will also work with the AER to implement the changes required to give effect to the 2018 Tax Review Final Report.

The projected cost savings resulting from these decisions build on the considerable efficiencies we have already achieved, which are also incorporated in our forecasts. We accept that our customers want us to work harder to deliver more efficiencies – and we

have accepted that challenge. Our operating expenditure forecast is \$20 million lower than the AER's Draft Decision and \$119 million lower than our Initial Proposal.

Through our customer engagement, we also heard that our pricing plans could be improved. As a result, we have collaborated with our Pricing Working Group to develop a pricing strategy that reflects customer preferences, while delivering on the long-term need to transition to a lower cost energy system.

To further embed customers in our day-to-day operations we propose the establishment of new advisory committees, through which customers will remain at the centre of our future network plans. For example, we are establishing a Network Innovation Advisory Committee to drive our innovation program and the future direction of our network. Customer engagement will not stop at the conclusion of the AER's review – it is now an ongoing feature of our business processes.

The submission of this Revised Proposal is a significant step in Ausgrid's commitment to work closely with our customers. I would like to thank each of our customer advocate groups for their contribution to our 2019-24 Revised Proposal, which I believe reflects an appropriate balance for all stakeholders.

We welcome feedback on this Revised Proposal from customers and our wider community.

Yours sincerely,



**Richard Gross**  
Chief Executive Officer  
Ausgrid

# How our Revised Proposal responds to customer feedback



## AFFORDABLE

Lower revenues

↓ **16%**

in annual network revenue from 1 July 2019

Fairer pricing structures  
in our tariff structure statement

We are proposing additional

**Opex productivity improvements**

from 1 July 2020



## RELIABLE

Replacing ageing assets

**\$280m pa**

Keeping the grid safe and reliable for the long term

Maintaining current levels of reliability

Investing in technology

**\$44m pa**

including cyber security



## SUSTAINABLE

We are investing in an

**Advanced Distribution Management System**

to create a more flexible grid

A new

**Network Innovation Advisory Committee**

to collaborate with customers to deliver the future grid sooner

**Supporting distributed energy resources and demand management**



# Our Revised Proposal at a glance

We recognise that affordability is our customers' number one concern.



<sup>1</sup> Revenue forecast does not include the impact of changes to the AER's tax approach.

# Transforming our business

We are changing to place customers at the centre of our decision making. This will help ensure customers trust us to make decisions that are in their long-term interests.

In this time of rapid change and increasing customer choice, we recognise that we must earn the right to continue delivering valued services to our customers. To do this, we must ensure that our customers are central to our plans and have the opportunity to contribute to our strategic and operational planning over the longer term. We must also ensure that there are no surprises and that the price fluctuations of the past do not reoccur.

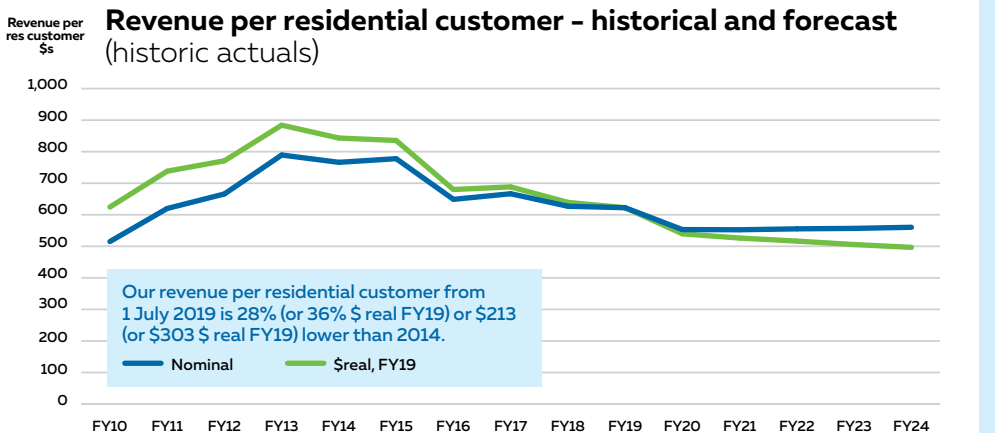
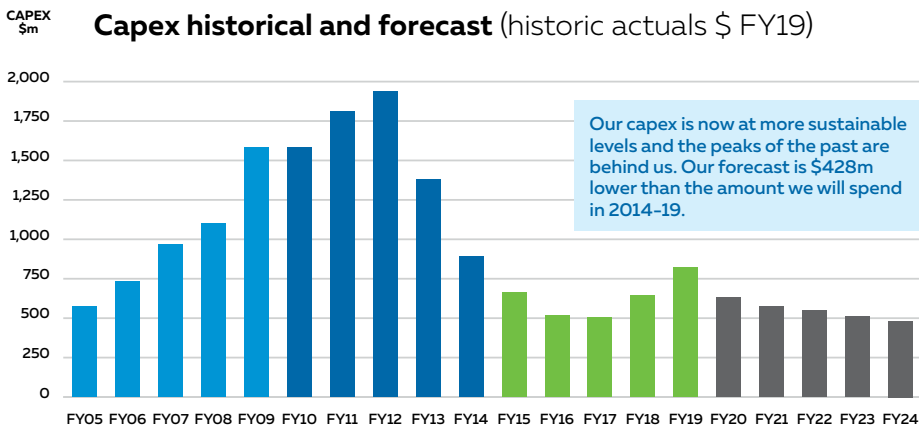
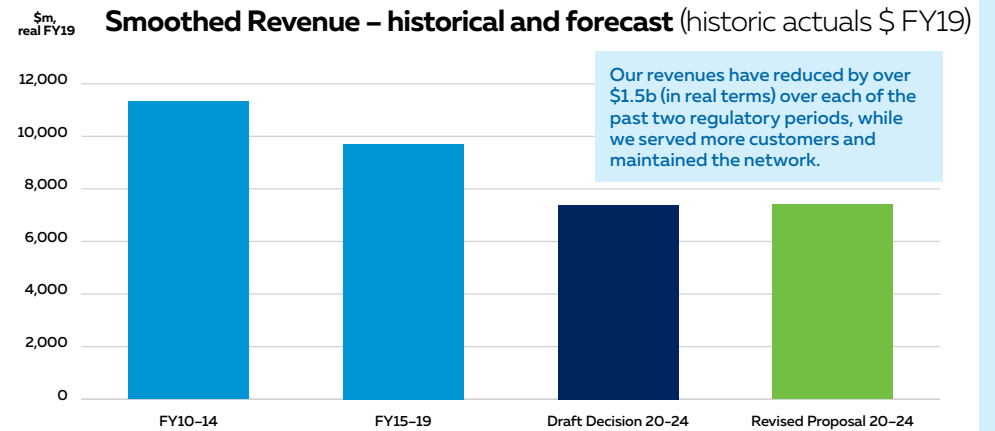
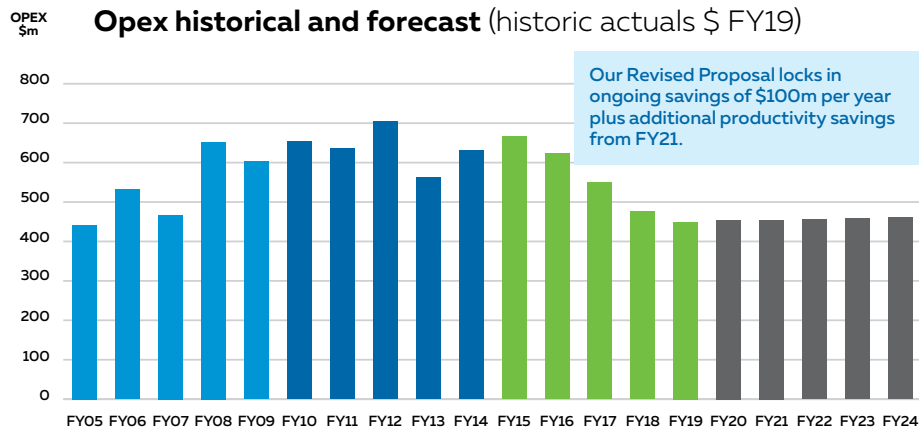
In the past, our capital investment profile was not stable. Underinvestment in the 1990s and early 2000s led to reliability problems creating a need for new network infrastructure. The reliability problems also prompted the government to impose strict reliability standards that required us to invest. We reached peak investment during the 2009-14 period.

In line with government's shift to less stringent reliability standards, our capital expenditure (capex) and operating expenditure (opex) are now at more sustainable levels. Consistent with the incentive regime under which we operate, we will continue to seek efficiencies in opex and capex. We will only replace network infrastructure that needs to be replaced, augment just enough, and invest on a no regrets basis in light of emerging technologies and changing customer needs. We will also consider how emerging technologies and demand management can help us solve problems at lower cost.

All this means that there is a continued focus on affordability. We will consider how every dollar we spend will benefit customers. The charts below show that our revenue forecasts and revenue per customer for the 2019-24 regulatory period are now at more sustainable levels.







# Our customers



**4m**  
Australians



**20%**  
of Australia's  
GDP



**1.5m**  
Homes



**200k**  
businesses



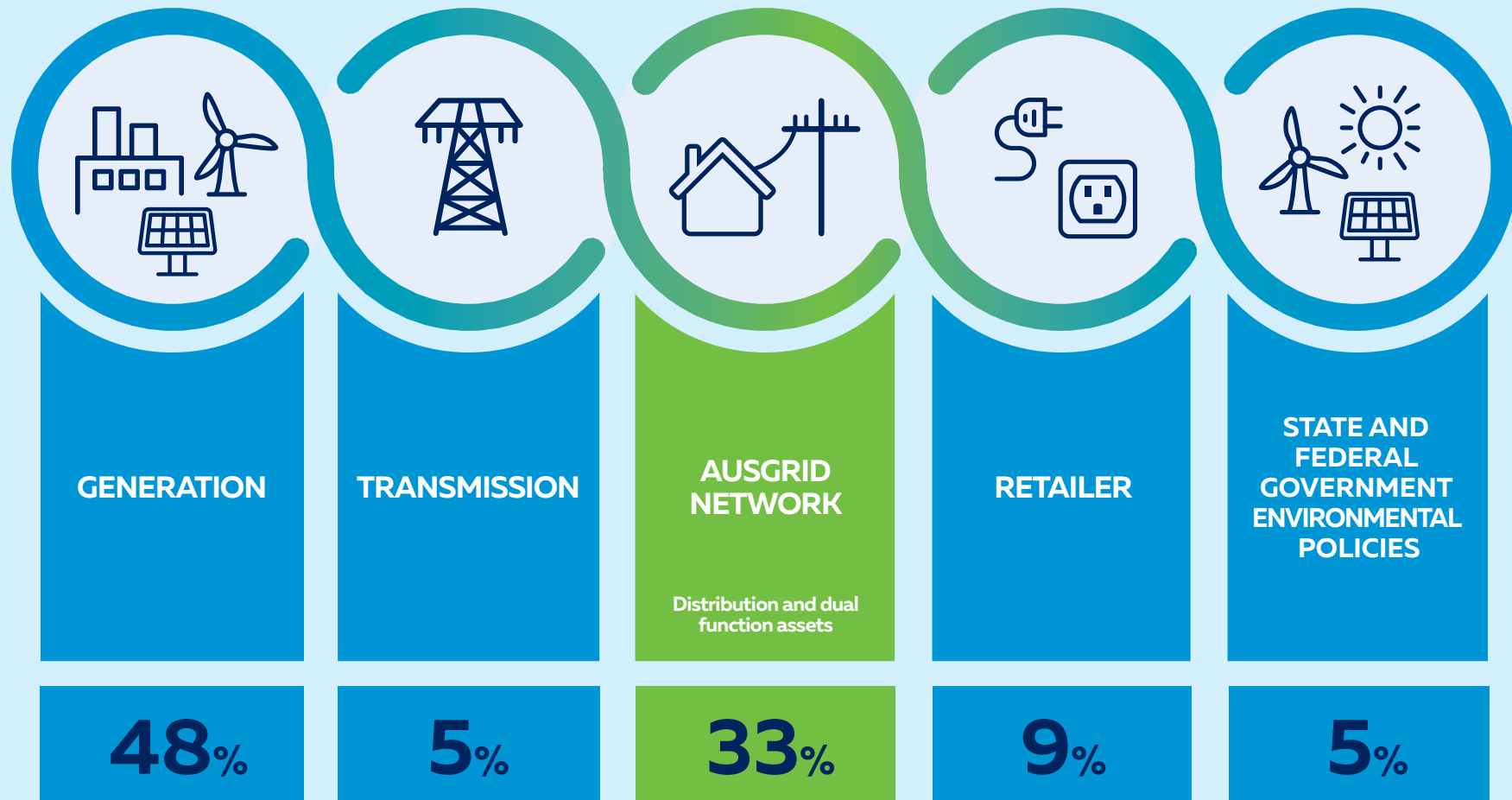
**1,238**  
Schools



**105**  
Hospitals

# Electricity supply chain

The different cost components of a typical residential customer bill.



Source: Ausgrid analysis for FY17/18, based on standing offer in Ausgrid's network, Ausgrid's network charges (including NSW Government Climate Change Fund costs) and Australian Energy Market Commission data for wholesale generation costs and other Federal and State Government Environmental policies.



# Safety – our number one priority

Keeping the public and our employees safe is our number one priority.



## Keeping our people safe



### Recordable injuries

↓ **25%**

in the last 12 months

### Lost time injuries

↓ **29%**

in the last 12 months

### 2019 safety focus areas

- Embedding the Health and Safety cultural shift
- Behaviour, ownership and reporting
- An engaged, fit and capable workforce
- Use of leading indicators, e.g. field observations, engineering controls
- Use of technology and safety innovation, e.g. Hazard Assessment Checklist (HAC), PowerBI analytics, improved engineering controls

# Keeping the public safe



## Electricity Safety Week



**92%** of schools  
in network area participated

## Dial before you dig

## Look High Wide Low

campaign rolled out

## Storm Safety



- Community safety campaign
- Storm safety radio campaign reaching 1.3 million residents
- Year-round proactive Facebook and twitter safety alerts and safety tips with potential reach of 470,000

## Bushfire Safety



- Community private poles safety campaign
- Bushfire safety radio campaign reaching 470,000 residents
- Year-round Facebook and twitter bushfire alerts and tips reaching 1.7m
- Addressing network bushfire risks

# Introduction

Energy markets are changing rapidly, and customers want more control over how they buy and consume energy. We are evolving our network to provide the services customers are looking for whilst delivering on customer key priorities: affordability, reliability and sustainability.

Ausgrid is also continuing its transformation journey. To ensure we provide better customer outcomes, we are transforming the way we run our business and the way we engage with customers.

## OUR VISION

Our vision is to become a leading energy solutions provider, recognised both locally and globally





## 1.1 Why are we submitting a Revised Regulatory Proposal?

Every five years, Ausgrid submits a revenue proposal to the AER. Our current 2014–19 regulatory period ends on 30 June 2019.

On 30 April 2018 we submitted our Initial Proposal. Our Initial Proposal set out our proposed capital investment and operating expenditure plans for the next five years, as well as our total revenue requirements.

Following a detailed review of our plans, the AER published its Draft Decision on 1 November 2018. In response to the AER's Draft Decision, we now submit a Revised Proposal that responds to the issues raised in the Draft Decision.

In formulating our capex and opex plans for our Revised Proposal, we need to balance our obligation to provide safe and reliable network services with the need to do so at the lowest possible cost. This task is made ever more challenging given the transformation that is taking place in the electricity sector across Australia.

### Our Revised Proposal sets out:

- how we have responded to customer feedback on our Initial Proposal, particularly in relation to concerns around affordability
- how we propose to meet our safety, reliability and other obligations over the next five years
- how we propose to modernise our grid to meet sustainability expectations into the future
- how we considered and responded to what the AER said in its Draft Decision

Where we agree with the AER's draft decision, we have said so. Where we believe a better outcome for customers can be achieved, we have explained why and provided evidence to support our revised approach.

## 1.2 Context for our Revised Proposal

We are in the midst of a significant reform program to reduce our costs to deliver more affordable network services. We recognise that we must earn the right to continue delivering valued services to our customers.

Our reform program has been successful in reducing network charges for our customers, without compromising safety or reliability. We have reduced our workforce significantly in order to deliver lower operating expenditure, which is now \$100 million lower, per annum, compared to 2014.

We developed our Initial Proposal with the intent of it being viewed by the AER and customers as capable of acceptance. Over recent months, through working closely with customer advocates and the AER, we have revised our capex, opex and pricing plans for 2019–24 to better reflect customer expectations while providing us with sufficient resources to safely operate and maintain our network. We believe this Revised Proposal is capable of acceptance when looked at as a whole. We value the support customers have provided and look forward to their feedback.

## 1.3 Our transformation is continuing

We are continuing to transform our business to provide more cost-effective network services and deliver greater value for customers. This transformation involves structural, financial and cultural change, which has led to:

- New processes, systems, and internal structures
- A lower cost base and new capital governance processes
- A new focus on our future role as we transition to a new energy eco-system
- Better and more productive relationships with our customers.

Change is rarely an easy journey but we are optimistic we can find the right balance for our customers, shareholders and employees:

- **Our customers** know we have improved, but also believe we can do better. We are working with customer representatives to embed changes so together we can become the business customers want us to be: lower cost, customer focused and planning for the future
- **Our shareholders** understand that this transformation will be difficult and that the business will need to work harder to deliver on their expectations.
- **Our employees** have worked hard through a difficult period of transformation and our total workforce has reduced by 3000 staff.

Even so, we have heard that our customers want us to be focused on continuing to reduce our cost base, and so we make the commitment that our transformation won't stop here.

## 1.4 Energy markets are changing rapidly

The electricity industry is undergoing a significant transformation. For over a hundred years energy flows have been predominantly one directional, with energy moving from large thermal generators to households and businesses along high voltage transmission lines and lower voltage distribution lines.

This old paradigm is rapidly changing. Households, communities and businesses now want to generate, consume, and store their own electricity, and sell any excess back into the grid. The grid must evolve to enable this distributed 'two way' energy flow. We are committed to working with customers and stakeholders to realise this lower carbon future at the lowest possible cost.

The grid has a pivotal role in managing a growing mix of distributed energy resources and supporting customers to control their energy use and realise the value of their investments. This will support an efficient, least cost transition to our shared, lower carbon future.



## 1.5 We are transforming the way we engage with customers

We are continuing to improve the way we engage and collaborate with customers. While there is more work to be done, the development of our relationships with customers and their advocates is improving the decisions we make.

Building on the engagement principles we developed for the Initial Proposal, we refined these further to continue to focus our efforts on building trust and reflecting the AER's principles in its Consumer Engagement Guideline. Our engagement principles (discussed in more detail in Chapter 2) aim to enhance customer trust in our business, facilitate more effective engagement and make our plans more customer focused.

**Figure 1.1**

### Our Engagement principles

The following principles aim to build customers' trust and improve decision making:

**Be collaborative** – Don't be defensive and remain open to possibilities

**Be quantitative** – Provide data from the customer's perspective

**Be accountable** – Agree a timeframe and deliver

**Be transparent** – Encourage and support our stakeholders in holding us to account on progress, agree timeframes and deliver

**Be adaptable** – Be prepared to change based on feedback

Ongoing collaboration with customer advocates has been a key driver of changes to our approach that will ensure we deliver better long term outcomes for customers.

At the heart of the changes is a desire to involve customers in implementing our business strategy and driving the future direction of our network. This will be achieved by collaborating with customers on our innovation program, internal processes for forecasting investment, cost benefit analysis and making better use of our existing assets.

Delivering on these improvements will ensure when the next regulatory process commences, customers will have an improved understanding of how we operate



our network and will be in a much better position to engage and influence both the substance and direction of our plans.

Our customer engagement plans are designed to achieve the following goals:

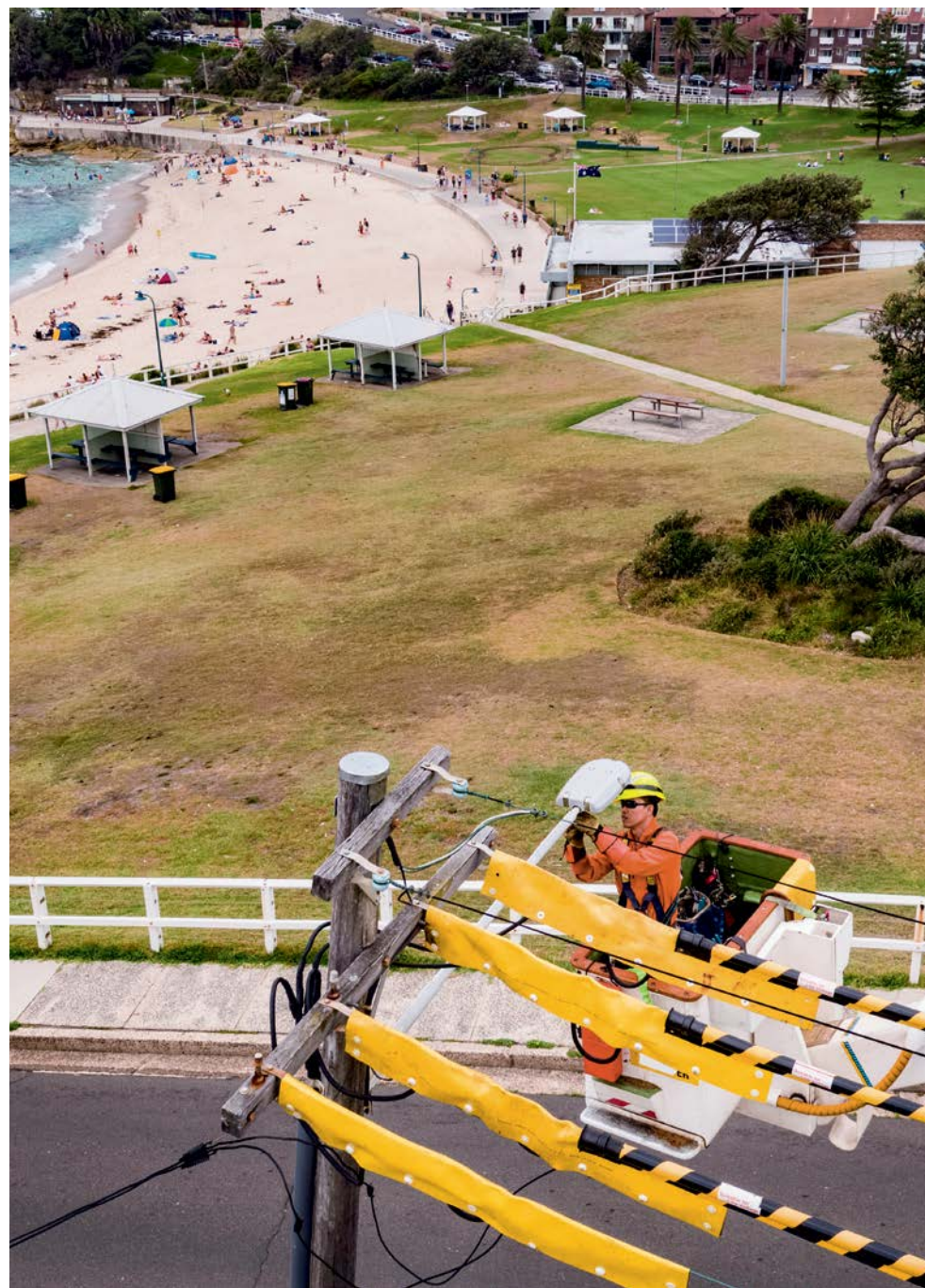
- **Identify opportunities to drive policy change** – Customers have told us that they want Ausgrid to play a role in identifying and driving policy changes where improvements can be made to the regulatory framework. Working together with customers, Ausgrid has the potential to become a thought leader and recommend changes that are in the long-term interests of customers.
- **Drive the direction of our innovation and demand management investment** – Our customers, shareholders and employees all agree that Ausgrid must do more to lead in the sphere of innovation and technology. To this end, we propose the establishment of a Network Innovation Advisory Committee to help set our direction and review our innovation projects and pilots before we proceed. This will ensure we get the most effective spend for every customer dollar.
- **Implement pricing reforms** – Our Pricing Working Group has worked collaboratively to produce our new pricing strategy in a short period of time, a fantastic effort from a combined customer and Ausgrid team. This forum will continue to help us develop the right information to help our broader customer base make the right decisions in order for them to get the best value out of their network services.
- **Review ongoing technological expenditure** – Feedback from customer groups has indicated that they would like greater visibility of expenditure on IT, cyber security and related expenditure. We will establish a specialist group that will work with customers and the AER to explore these issues.

Ausgrid is committed to expanding our customer collaboration through a number of initiatives, which are discussed in further detail in Chapter 2 of the Revised Proposal.

## 1.6 How to provide feedback

We welcome your feedback on the Revised Proposal. You can send us feedback directly by emailing us at [yoursay@ausgrid.com.au](mailto:yoursay@ausgrid.com.au).

You can also provide comments directly to the AER at <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausgrid-determination-2019-24>.





# What our stakeholders told us and how we are responding

In our engagement, customers and stakeholders re-affirmed their three common priorities: they want energy to be affordable, reliable and sustainable. Presently, affordability is their number one priority.

## 2.1 What customers said about our Initial Proposal

<b>Prudent and efficient</b>	The prudence and efficiency of Ausgrid's capex proposal, including both growth projects and the replacement program, needs better justification. Further cost-benefit analysis is also required on the Advanced Distribution Management System (ADMS).	<b>Benefits on past investments</b>	Stakeholders want to better understand how past investments have delivered benefits to customers.
<b>Non-Network Expenditure</b>	Further explanation is required to show the customer benefits of ICT investment, in addition to our proposed investments in Fleet and Property.	<b>Demand management</b>	Improvements in demand management and the use of new technology are needed.
<b>Forecasts</b>	Continued focus is needed to provide more accurate growth forecasts, taking into account growth in distributed energy resources and the impact of improved price signals.	<b>Opex productivity</b>	Customers expect us to include a productivity improvement in our operating expenditure forecasts.
<b>Capital Support Costs</b>	Customers recognised that capital overheads have reduced, but would like to see steps to deliver further savings.	<b>Demand tariffs</b>	Our Tariff Structure Statement (TSS) was not supported, with a number of submissions asking for immediate introduction of demand tariffs.

## 2.2 What the AER said about our Initial Proposal

<b>Capital review</b>	The AER and its technical consultant raised concerns about our internal capital expenditure review and challenge processes.
<b>Cost benefit analysis</b>	More evidence of project need is required, accompanied by quantitative cost benefit analysis of our capex program.
<b>Rate of Return</b>	The AER applied its draft rate of return guideline in its draft decision, rather than adopting the rate we proposed.
<b>Network Innovation</b>	Our proposed monitoring system upgrade and network innovation projects are likely to have economic benefits which will be further scrutinised after submission of the Revised Proposal.
<b>Demand tariffs</b>	The AER did not support our delayed introduction of demand tariffs and elements of our tariff assignment policy in our TSS.

## 2.3 How we have responded to feedback

<b>Prudent and efficient</b>	Subjected a large proportion of our capex proposal to additional quantitative risk assessment and cost benefit analysis in order to ensure our total capex forecast is efficient. Better explained the costs and benefits of our ADMS project.
<b>Capital review</b>	We have made changes and continue to improve the internal review and challenge of our capex program. We are committed to making further improvements (see Chapter 5).
<b>Opex</b>	We have provided further information in relation to emergency recoverable works and reviewed our proposed demand management programs. We have included a productivity forecast in our Revised Proposal from FY21.
<b>Demand tariffs</b>	We worked collaboratively with stakeholders through our Pricing Working Group to develop a revised Tariff Structure Statement.
<b>Continued consumer engagement</b>	We engaged intensively with customers prior to lodging our Revised Proposal and will continue to engage with customers on an ongoing basis.

## 2.4 Our commitments

In our discussions with consumer advocates we have identified a series of commitments that represent how we will go about improving customer outcomes. Our commitments demonstrate how we will work towards being the best distributor in the National Electricity Market.

The commitments are summarised here (and outlined in more detail in Chapter 2):

### Develop our business and shared understanding

- Further granularity of customer benefits from IT and engagement in an AER review of IT forecasting expenditure
- Develop a Revised Proposal that is capable of acceptance
- Share improved forecasting and cost benefit analysis
- Explore options analysis
- Engage with customer representatives on cyber expenditure and maturity levels

### Drive industry development

- Co-design tariffs, communications and complementary measures through the Pricing Working Group
- Jointly develop policy and regulatory framework submissions with our customers
- Collaborate with the AER to improve the repex model

### Deliver better outcomes

- Deliver improvements in our business
- Long term commitment to achieving and sharing productivity gains
- Ensure deeper engagement in customer strategy and business planning
- Network Innovation Advisory Committee to drive innovation (with accompanying CESS exclusions)
- Ensure greater focus on non-network solutions
- Support the Energy Charter

# Network innovation – transitioning to a sustainable future

The environment in which Ausgrid operates is fundamentally changing. Many customers want new services that allow them to connect their rooftop PV and battery storage systems and charge their electric vehicles, while others will simply wish to continue to access affordable and reliable power. These services must be provided at a price that reflects efficient costs and delivers value for our customers.



## 3.1 The technology landscape is changing

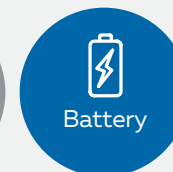
The electricity industry is undergoing a significant transformation. Households, communities and businesses now want to generate, consume, and store their own electricity, and sell into the grid. Technological developments and improvements in the economics of renewable generation and storage, as well as smarter energy management systems and controls, are accelerating the pace of change.

At Ausgrid, we believe the grid holds the key to unlocking greater competition in the energy sector, and we aspire to become the open platform that underpins a thriving ecosystem of disruptive technologies, empowering customers with greater choice and control.

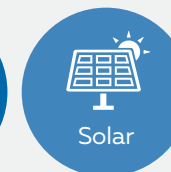
### Smart demand management



Demand response



Battery



Solar



Smart controls



Energy efficient



## 3.2 Consumers want a greater role in driving the network transformation

During stakeholder consultation consumers told us that they want to see more use of innovation and demand management options. While demand management has traditionally been used to reduce the need to build additional capacity, consumers want to see how it can be used to defer or avoid replacing aged assets, which drives the bulk of our replacement capital expenditure program.

Stakeholders also said that they want a greater role in driving the direction of innovation in electricity networks. In its submission to our Initial Proposal, CCP10 stated:

*CCP10 expects distributors to demonstrate active engagement with developers, technology providers, retailers and consumers with a clear commitment to not only carry out trials but reflect a genuine and intentional focus on demand management, new technologies, customer engagement and non-wires solutions in their planning for growth and asset replacement.*

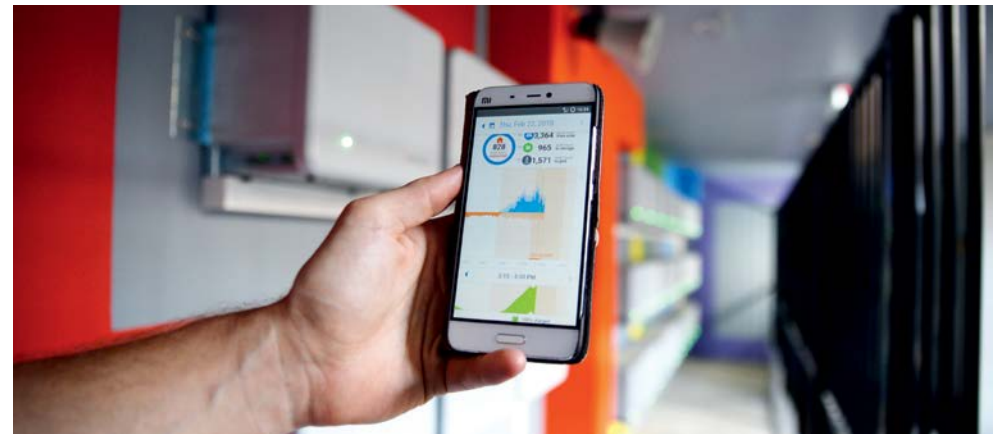
In our Initial Proposal, we proposed \$42 million of network innovation capex for innovative projects and trials. This program was informed by stakeholder feedback early in 2018. Our plans include a range of projects which will integrate new and innovative solutions into our network. Projects include microgrid trials as well as partnering with customers to reduce the need to replace ageing network infrastructure by using batteries, smart meters and other technologies. Our \$42 million innovation program has been independently reviewed and forms part of our Revised Proposal.

## 3.3 Network Innovation Advisory Committee

Consumers support innovation and a focus on using new technology to reduce the need for network investment in the future. To support active consumer engagement in this process, we are proposing the establishment of a **Network Innovation Advisory Committee (NIAC)**.

The purpose of the NIAC is to place our customers at the centre of investment decisions as we transform our network. The NIAC puts in place arrangements to give customers a role in driving our innovation investment program and providing advice on the innovation projects and pilots that are undertaken. This will ensure that our network becomes one that supports efficient investment and greater choice and control, things that customers expect from a network of the future.

The NIAC will be supported by a terms of reference, a copy of which can be found at Attachment 3.02 to our Revised Proposal. For further information, see Chapter 3 of our Revised Proposal.



# Capital expenditure – supporting growth and reliability

Our revised capex forecast reflects a real effort to reconsider and reprioritise our capex projects and programs with a view to maintaining reliability while addressing the affordability concerns of customers.

## 4.1 Why we are changing our approach in the Revised Proposal

In our Initial Proposal, we planned to invest \$617 million per annum (in real terms) over the next regulatory period. We explained that our average annual capex in the next period would be 1.3% lower than our actual expenditure in the current period. By 2024, we proposed expenditure levels that would be 69% below the 2012 peak.



Our revised capex forecast totals \$2.69 billion or \$538 million per year for 2019-24. This is \$394 million (13%) lower than our Initial Proposal and \$363 million (16%) higher than the AER's Draft Decision. We have given careful consideration to the concerns raised by the AER and customers.

In response, we have:

- enhanced our internal capital review and challenge processes to better demonstrate how we weigh up risk to safety, security and reliability
- revised and re-prioritised requirements for our replacement expenditure (repex) program by undertaking further cost-benefit analysis
- given the rate of technological change, we have deferred some investment which cost benefit analysis indicates is optimal at this time
- looked for more ways to adopt non-network solutions, where savings can be achieved without compromising customer outcomes
- subjected our property, fleet and ICT capex to further review and cost benefit analysis.

In revising our capital program, we believe we have addressed AER and customer feedback. Our revised forecast allows us to meet our regulatory obligations and customer expectations in a prudent and efficient way.

Figure 4.1 shows that our proposal reflects our focus on sustainable expenditure following the substantial savings in recent years.

Figure 4.1

## Capex spend is more sustainable

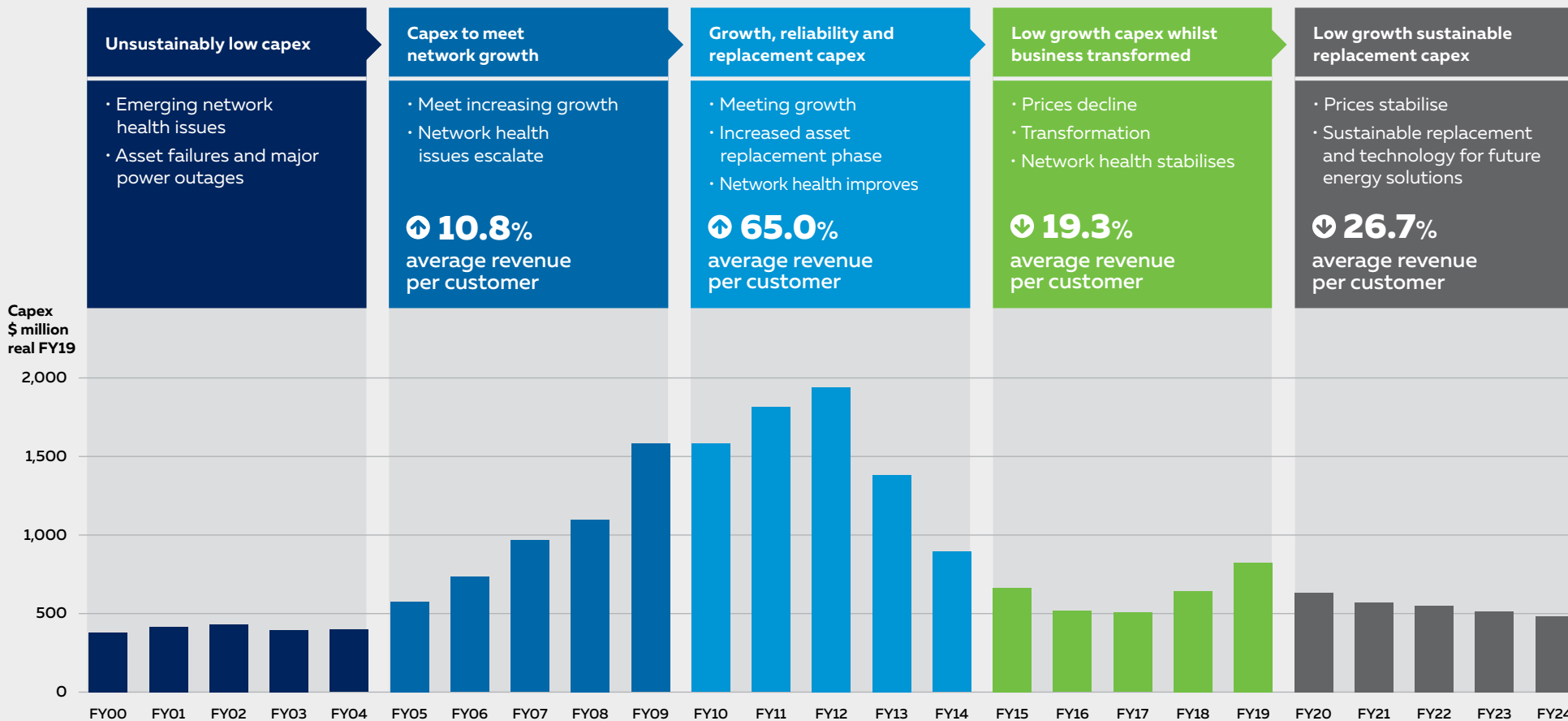
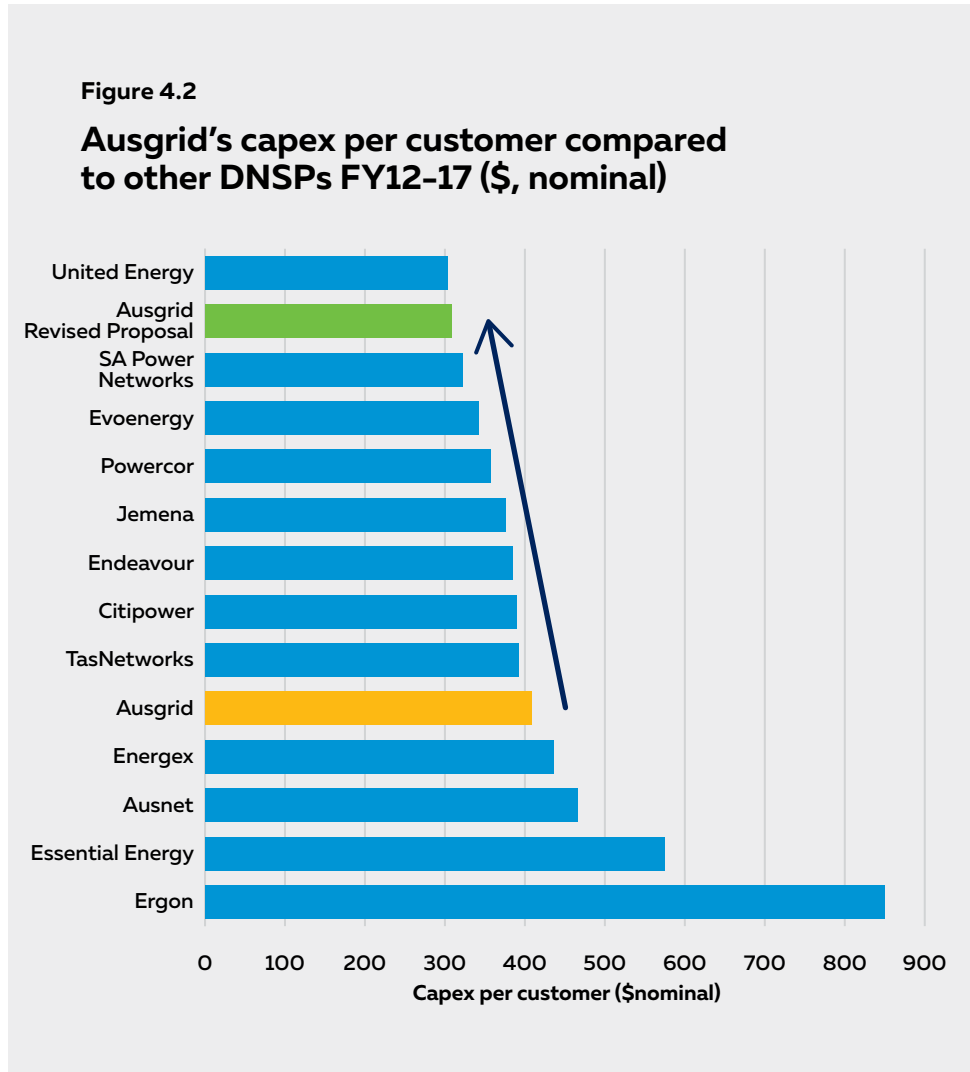


Figure 4.2 below shows that the capex forecast in our Revised Proposal will result in average capex of just over \$300 per customer, which is a significant reduction compared to recent history. We have sought to balance the cost of managing risk during a period of technological change with the need to focus on affordability.



## 4.2 How our Revised Proposal benefits customers

Our revised capex proposal reflects our efforts to reconsider and reprioritise our capex projects and programs to address the issues raised by the AER's Draft Decision and our customers' feedback, while having appropriate resources to maintain the safety and reliability of our network. The resulting reduction in our capex forecast contributes to the reduction in network prices over the 2019-24 regulatory period. Our further analysis and commitments to deliver productivity improvements appropriately balance affordability with our safety, reliability and security obligations.

Customers will benefit from our change in approach in many aspects of our Revised Proposal:

- Our revised repex forecast is \$271 million lower than our Initial Proposal and substantially lower than actual expenditure over 2014-19. In response to AER and customer feedback we have undertaken further detailed quantitative cost benefit analysis of our modelled repex programs. Our revised forecast is lower than the level of capex the cost benefit analysis shows should be undertaken. We're committed to the challenge of investing less repex while still maintaining the reliability, safety and security of the network. The need to undertake the deferred investment in future may be dependent on the rate of technological change.
- We have deferred the refurbishment of one of our buildings, saving \$19.8 million in capex over the next regulatory period.
- We have reduced our proposed fleet replacement rate, resulting in further capex savings for customers.

The changes in our largest categories of investment are shown in Figure 4.3 and 4.4.

### Network Innovation

In response to customer feedback that we need to focus more on innovating and transforming our network, our Revised Proposal includes the following capex programs that will ensure our network continues to meet the changing needs of customers:

- Advanced Distribution Management System
- Network Innovation Program
- Demand Management Innovation Program
- Planning and Technology Data Usage.

Our approach to innovation is to undertake the minimum investment necessary to prepare ourselves for the challenges ahead, so that our network is ready to deliver benefits to our customers in response to technological change.

For example, our plans include eleven initiatives focused on implementing new grid technologies that improve customer outcomes, such as pilots of microgrids, stand-alone power systems, and electric vehicle charging systems. Investing wisely now will drive better, lower cost services to our customers in the future.

Many of these innovation projects will be overseen by a customer driven Network Innovation Advisory Committee. See Chapters 3 and 5 of our Revised Proposal for more information.



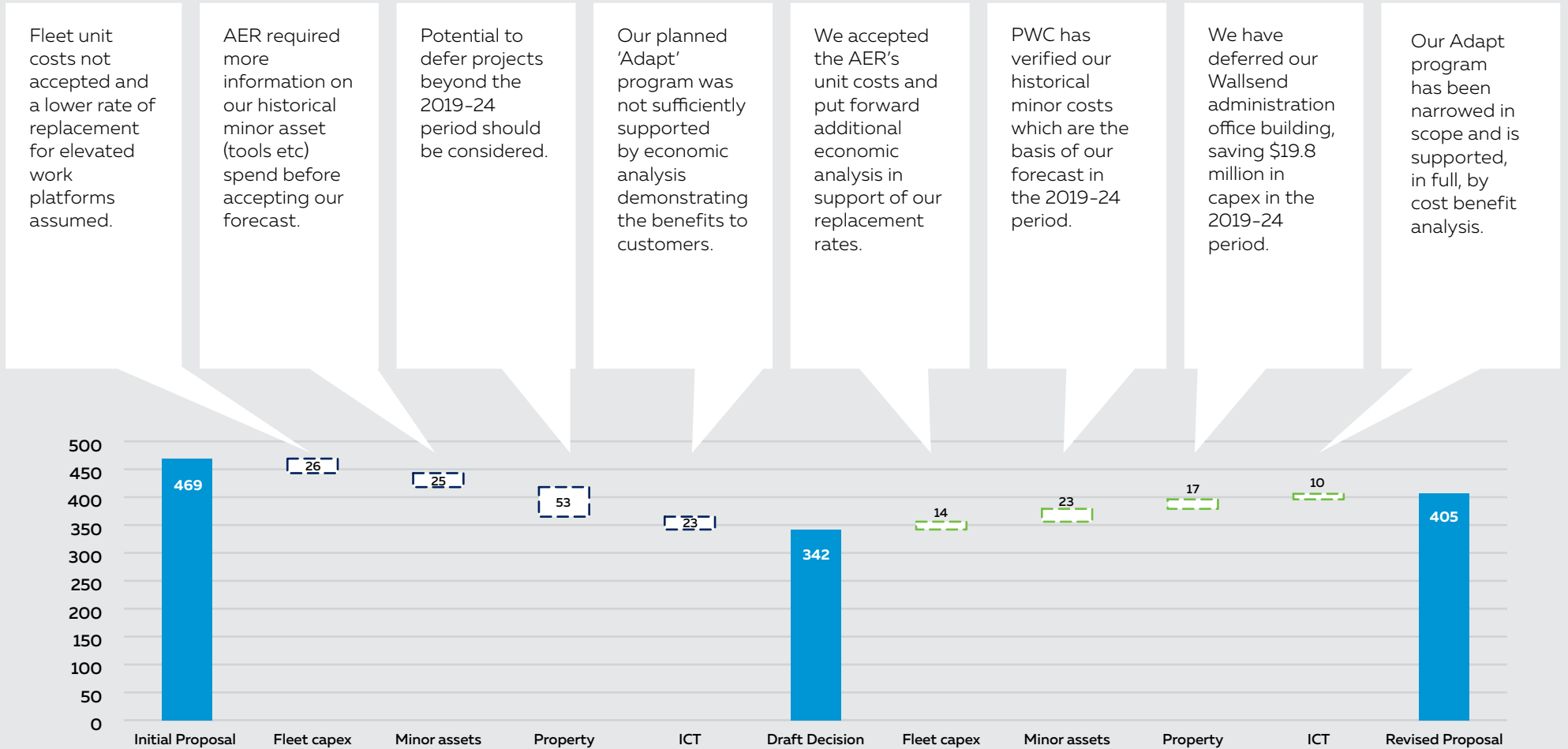
Figure 4.3

## How we incorporated feedback in our revised replacement capex



Figure 4.4

## How we incorporated feedback in our revised non-network capex



Note: Numbers may not sum due to rounding.



# Operating expenditure – driving affordability

Customers have told us that affordability is their number one concern. We have subsequently reviewed our forecasts and increased our commitment to future productivity improvements. As a result, our revised opex proposal is now \$21 million lower than the AER's Draft Decision, which we believe will deliver better value for our customers.

## 5.1 Why we are changing our approach in the Revised Proposal

The AER did not accept our proposed opex forecast in its Draft Decision. Its substitute estimate for total opex was \$98.4 million (or 4 %) lower than our Initial Proposal. In responding to the AER's Draft Decision, we have paid careful consideration to the issues raised by the AER and the feedback we received from our customers.

Our Revised Proposal is \$119 million (or 5%) lower than the Initial Proposal and \$20 million lower than the AER's Draft Decision. The key differences between our Initial Proposal and Revised Proposal are:

- Rolling forward the base year - we have adopted the AER's Draft Decision approach for rolling forward the base year from 2017/18 to 2018/19.
- Trend escalation - we have updated our labour price escalation forecasts using the AER's standard approach, and incorporated the most recent information. We have also adopted the AER's revised approach for estimating the output growth escalation factors.
- Productivity factor - we have revised our approach to forecasting productivity, in light of the AER's Draft Decision. We are collaborating with customers and the AER regarding its current productivity review and have applied the AER's productivity Draft Decision trend of 1%. However, we have applied this from FY21 reflecting specific issues to our business in achieving these savings in earlier years.

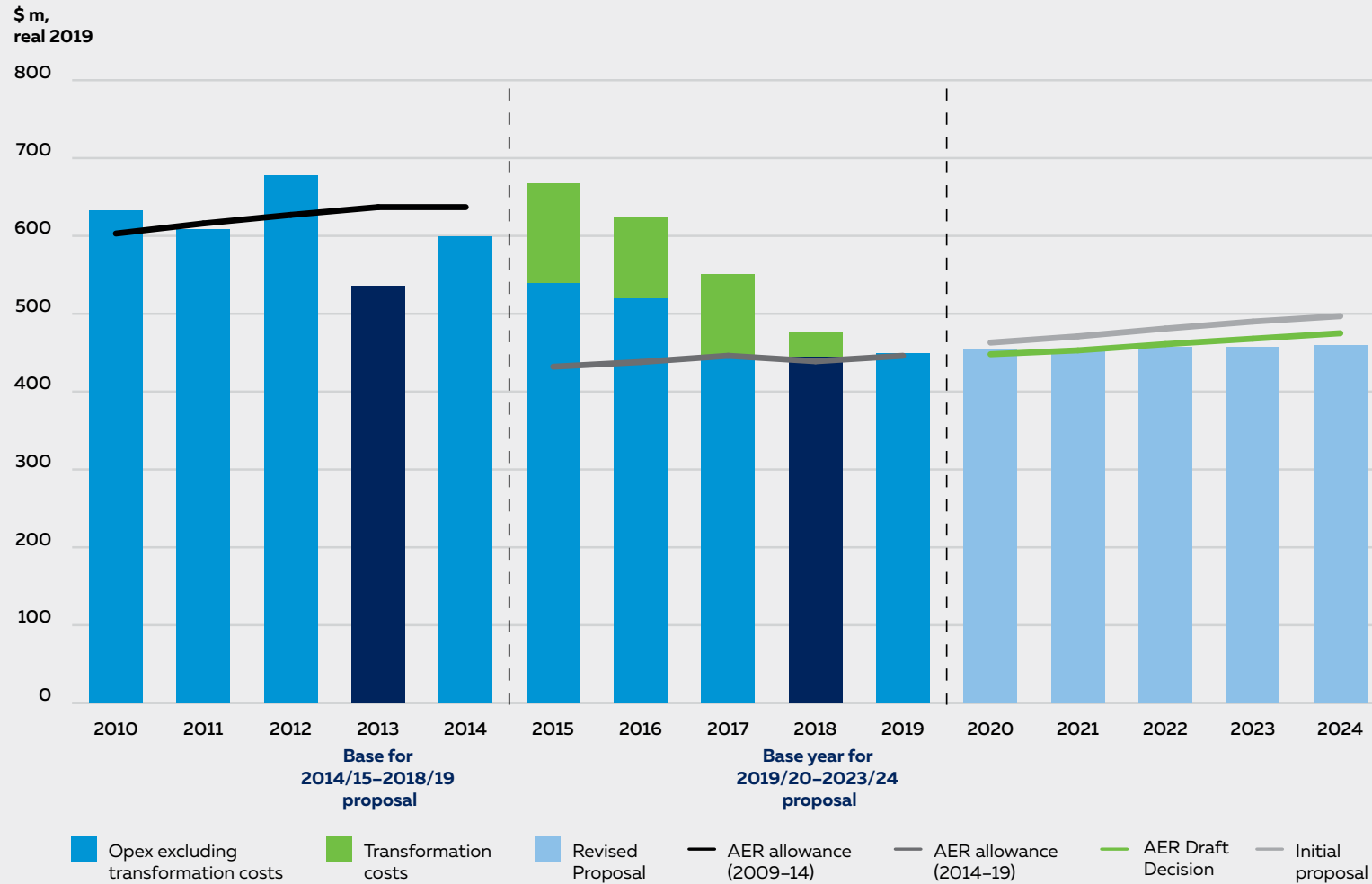
- Step changes - we have accepted the AER's Draft Decision to not approve our price reform research step change. We are still committed to undertaking price reform research, however we will do so in a more cost effective way within the total opex allowance.
- We have revised our demand management projects in response to the AER's observations in its Draft Decision, and in light of new information to ensure that they are efficient and meet the needs of our customers.

Figure 5.1 provides a detailed comparison of our revised forecasts with our historical spend.



Figure 5.1

Actual and forecast opex for 2009/10 to 2023/24 (\$million, real FY19)





## 5.2 How our Revised Proposal benefits customers

As noted in our Initial Proposal, Ausgrid operated with a higher cost base in the past.

Since the AER's Final Decision for the 2014-19 regulatory period, we have worked hard to reduce our costs to the challenging levels that were set. We have transitioned to a more sustainable, efficient level of opex through an ambitious program of transformation that reduced our workforce, improved our efficiency and reset our cost base.

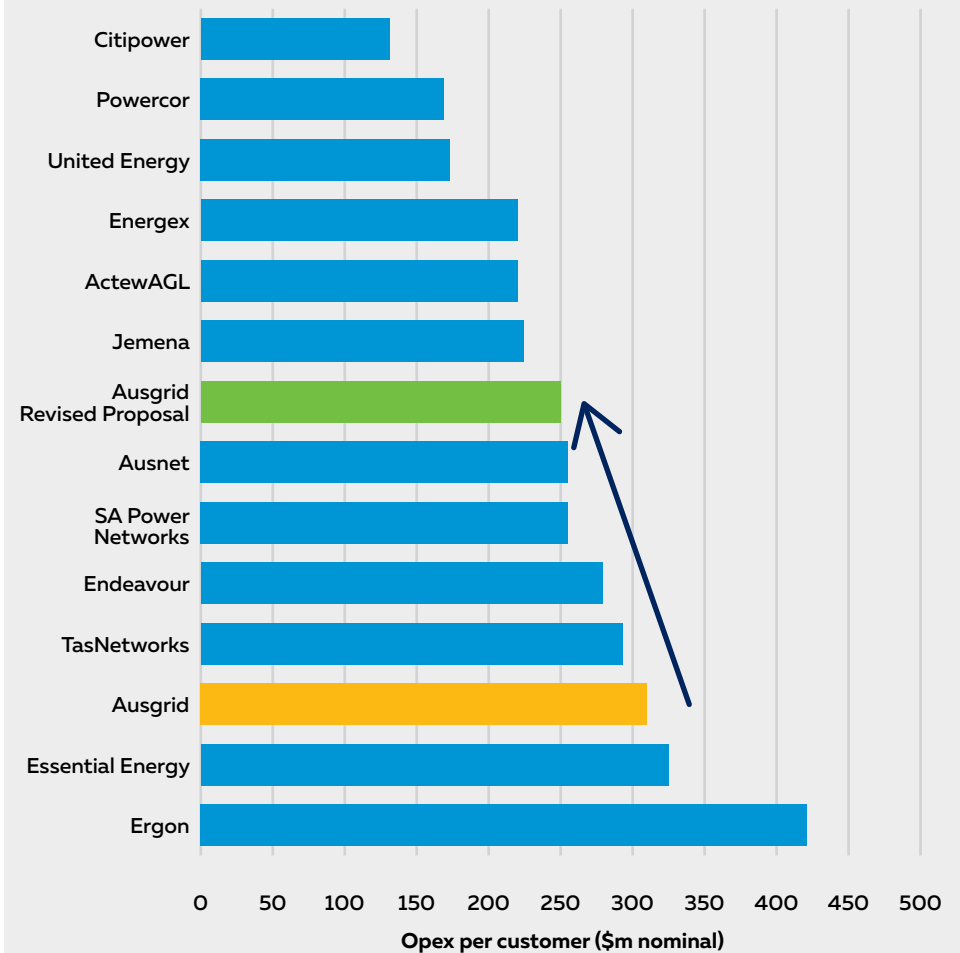
Our Revised Proposal has been developed in collaboration with consumers and continues to address concerns about affordability. Essentially, our Revised Proposal commits us to delivering more for the same expenditure—which means building on the productivity improvements achieved to date. In addition, in response to customer feedback, we have applied the AER's productivity review draft decision of 1% per annum from 2020/21. This results in a further \$52 million reduction in revenues from our Initial Proposal. We will continue to work with the AER as it finalises its review in early 2019.

Overall our opex is increasing slightly over the next regulatory period, largely due to growth in our customer numbers. However, on a per customer basis, our forecast opex declines over the next regulatory period—maintaining the savings achieved in the current regulatory period as well as passing through efficiencies we are challenging ourselves to achieve over the 2019-24 period.

As part of our efforts to improve opex performance we have compared our opex revised proposal against our peers. Figure 5.2 shows our improved opex performance using up to date information from Regulatory Information Notices. We know that our peers are also improving, however the chart demonstrates the significant improvement in our operating expenditure performance since 2016/17.

Figure 5.2

### Ausgrid's opex per customer compared to other DNSPs FY17 (\$, nominal)







# Pricing – we have responded to feedback

Our revised Tariff Structure Statement responds directly to feedback from both the AER and customer advocates. Our aim is to promote the efficient use of our network by customers, encourage efficient investment in distributed energy resources (DER) and energy efficiency, and ensure lower network charges in the long run.

## 6.1 Why we are changing our approach in the Revised Proposal?

We received clear feedback from both the AER and customer representatives that we could improve the way we structure our tariffs and recover revenue from customers. The AER recognised that our existing tariffs are the most cost reflective tariffs of any NSW distributor, but sought a number of changes necessary in order to approve our Tariff Structure Statement (TSS).

Peak demand is the principal driver of our future costs. Reducing peak demand will reduce costs for all customers in the long term by avoiding the need for network investment or demand management action. Our revised TSS incorporates changes that promote the efficient use of our network by customers and encourage efficient investment in DER and energy efficiency.

Our Pricing Working Group developed a revised pricing strategy which addresses the issues raised by the AER. The key change in our Revised Proposal is that we now intend introduce a set of demand tariffs (i.e. tariffs with a demand component) for residential and small business customers with a smart meter.

Demand tariffs encourage customers to use our network when the cost of doing so is low and ensure that all customers make a fair contribution to the cost of the network service they use.



## 6.2 How our Revised Proposal benefits customers

Our revised TSS proposes changes to our pricing approach that will drive more efficient use of our network and place downward pressure on network charges in the long run. Our proposed demand tariffs ensure that customers retain control over the network component of their bills. Small businesses will also benefit from our tariff reform. In response to customer feedback, we have ensured that the fixed component of network charges remains steady in real terms from 2018/19.

We recognise that introducing demand tariffs is a big change for some of our customers. We are working with customer advocates through our Pricing Working Group and Consumer Consultative Committee to support the communication of our tariff changes. We are also working with retailers on the implementation of the proposed new tariffs.



### AFFORDABLE

#### How can pricing promote these outcomes

- Encourage customers to use our network when the cost of doing so is low.
- Promote fairer outcomes between customers with different characteristics (e.g. DER and non-DER).
- Ensure all customers make a fair contribution to the cost of the network service they use.
- Unlock greater competition in the delivery of new technologies and services to drive innovation and the efficient use of the network.



### RELIABLE

#### How can pricing promote these outcomes

- Empower customers to actively manage their contribution to peak demand.
- Reduce inefficient spikes in demand and network congestion at peak times.
- Encourage a more responsive demand-side to deliver the reliability outcomes that our customers want at a lower cost.



### SUSTAINABLE

#### How can pricing promote these outcomes

- Empower customers to invest efficiently in DER that can provide the services they want at a lower cost.
- Encourage further use of the network at times of the day when renewable generation is more prevalent and our costs are low.
- Encourage customers to invest in DER that helps them to better manage their consumption at peak and non-peak periods.
- Promote the lowest cost transition to a lower carbon economy.



# What else is in our Revised Proposal

The AER will examine every aspect of our Revised Proposal, which includes detailed information on:

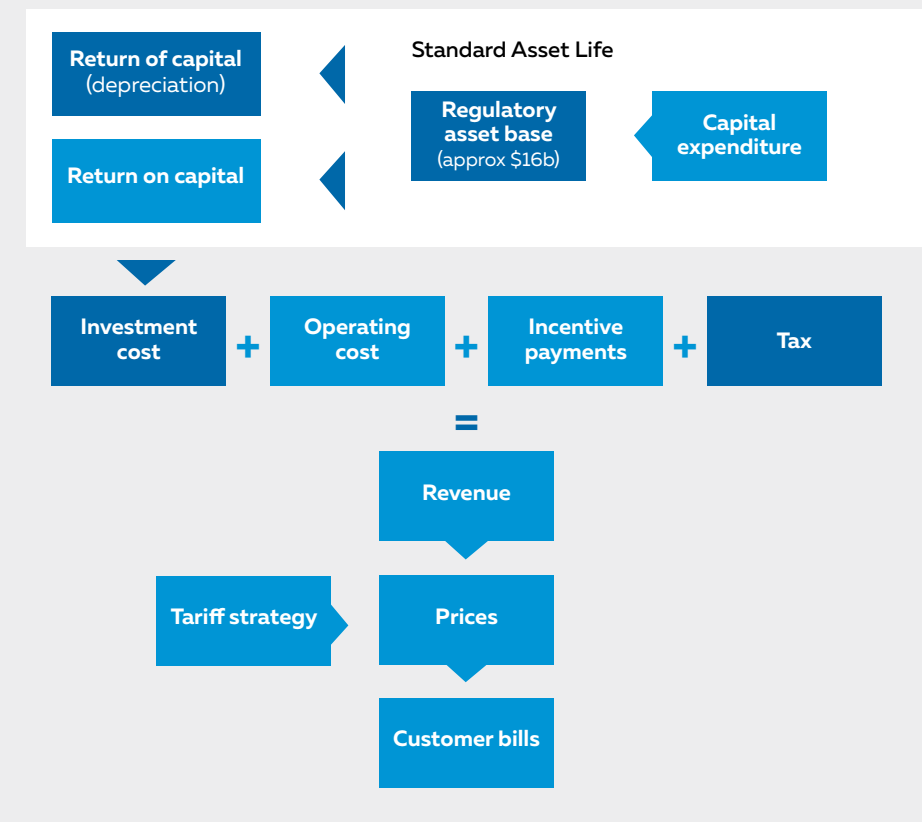
- Capital Expenditure
- Operating Expenditure
- Return on Capital Expenditure
- Asset Depreciation
- Tax liabilities
- Incentive Schemes.

These elements are sometimes described as the “building blocks” because together they determine our revenue requirement and the prices our customers pay for using the distribution network.

In the earlier sections of this paper, we provided a summary of our expenditure plans. In the paragraphs below we provide an overview of the remaining components of the building blocks shown above.

Further details can be found in our Revised Proposal.

## Key components of our Revised Proposal and how they fit together





## 7.1 Return on capital

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We receive an allowance for return on capital to fund the efficient costs of debt and provide a reasonable return on equity. We calculate the return on capital based on the value of our opening asset base, the allowed rate of return and our forecast capital expenditure.

In our Initial Proposal we applied the AER's 2013 Rate of Return Guideline. In our Revised Proposal we adopt the 2018 Rate of Return Instrument. This resulted in our Rate of Return dropping from 6.33% to 5.99% in FY20.

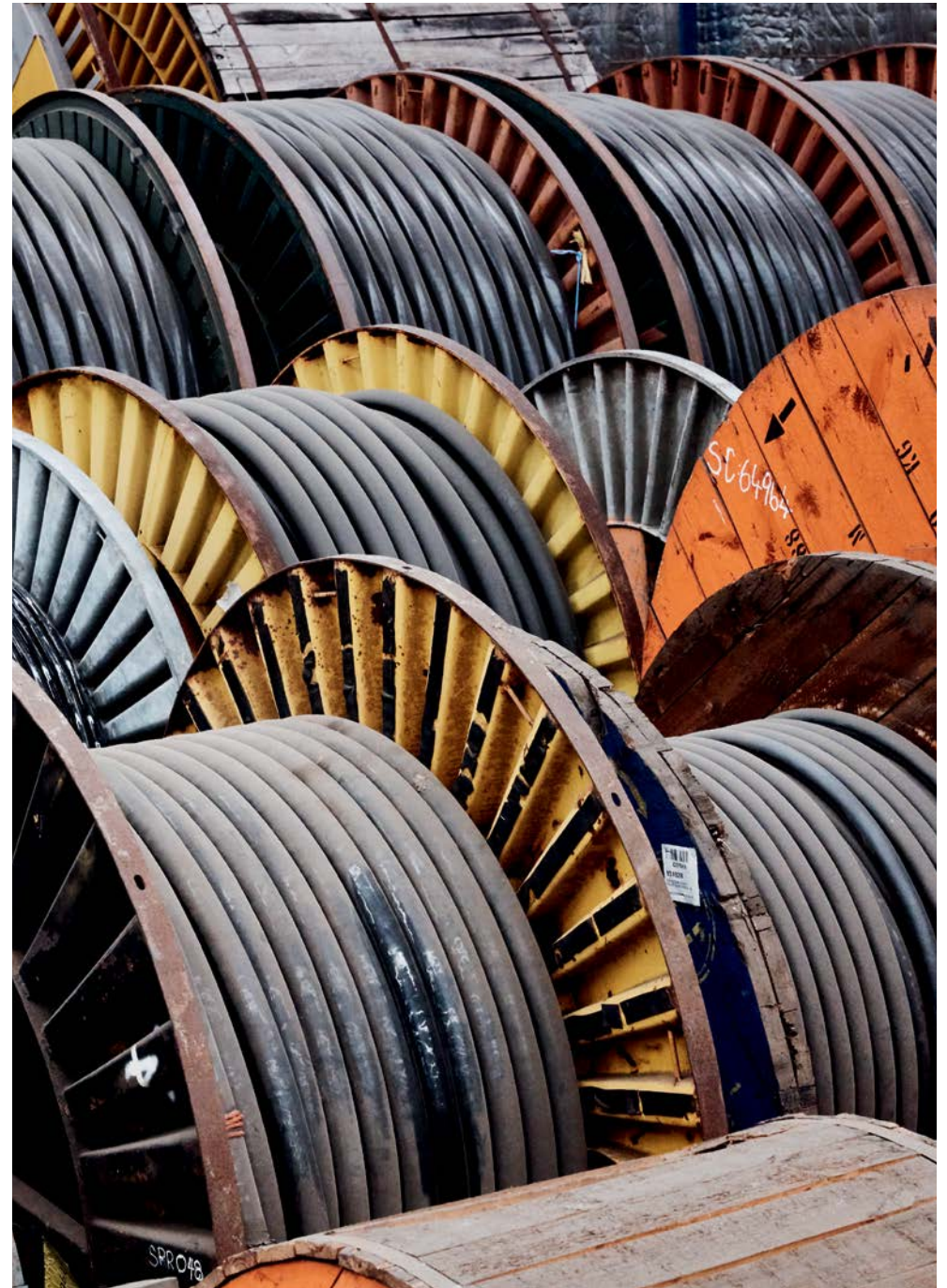
## 7.2 Asset depreciation

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We receive an allowance to recover the cost of our investments as they depreciate over time. This "return of capital" or depreciation is calculated using inputs such as the projected value of the opening asset base as at 1 July 2019 and the assumed remaining asset lives.

In its Draft Decision, the AER accepted our proposed asset classes, our proposed use of straight line depreciation method and standard asset lives. However, the AER did not accept our proposed regulatory depreciation allowance, mainly because of the impact of its decisions regarding our opening RAB, proposed forecast capex and expected inflation. .

Our revised regulatory depreciation has been updated based on our revised opening RAB and updated capex forecasts. We have accepted the AER's placeholder forecast inflation rate of 2.42% to calculate RAB indexation. The inflation rate will be updated according to prevailing forecasts at the time of the final determination.



## 7.3 Tax liabilities

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We receive an allowance to meet our income tax liabilities, taking into account the benefit that shareholders receive from imputation credits.

The AER has recently released its 2018 Tax Review Final Report. We will work with the AER through January to March 2019 to make the required modelling changes to give effect to this decision.

We estimate that the Tax Review Final Report will reduce our regulatory tax allowance by \$44m over 2019–24. This is based on the AER’s decision to move to the diminishing value approach for calculating depreciation expense in our tax allowance.

The Tax Review Final Report also indicated that the AER would move to the immediate expensing of refurbishment capex for tax purposes. The AER is yet to implement its proposed changes and has indicated that it will take into account the actual practices of individual businesses with respect to the immediate expensing of capital expenditure for tax purposes.

Ausgrid does not immediately expense its refurbishment capex. We therefore do not expect that this proposed change will impact our tax allowance.

## 7.4 Incentive schemes

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We receive a revenue increase or decrease based on penalties or rewards from various incentive schemes that are applied by the AER. The incentive schemes are an important component of incentive-based regulation. In particular, the schemes encourage us to pursue expenditure efficiencies and demand side alternatives to capex and opex, while maintaining the reliability and overall performance of our network.

Our Revised Proposal maintains our earlier position that the AER’s standard schemes should apply in the next regulatory period, apart from the Service Target Performance Incentive Scheme (STPIS). In relation to the STPIS, we propose that the AER’s 2018

amended scheme should apply, because we consider this new scheme to be in the best interests of consumers. In particular, the revised scheme will provide a greater incentive for us to restore supply to customers faster once they have experienced an outage.

The new scheme had not been published at the time of the AER’s Draft Decision. We propose that it is adopted in the AER’s Final Decision.

## 7.5 Alternative control services

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The “building block” components described above relate to our standard control network services – the services that our customers use regularly and pay for through network prices.

In addition to these services, we also provide “alternative control services”, which are typically requested by customers as a particular need arises, such as moving house or seeking a new connection. Public lighting (street lights) and some metering services are also classified as alternative control services.

In the 2019–24 regulatory control period, the most significant change relates to public lighting. Councils acknowledged our improved transparency and consultation on our public lighting proposal, which includes the mass rollout of 125,000 energy efficient street lights. This initiative will lower our carbon footprint and lead to a more sustainable and environmentally responsible service.

Further information on all the matters discussed in this executive summary are provided in our Revised Proposal.







