

Operating expenditure



Negotiating position for the Customer Forum

Negotiating Scope

The operating expenditure proposal is in scope of the proposed expenditure negotiations between AusNet Services and the Customer Forum. AusNet Services is seeking Customer Forum endorsement to include the proposed innovation expenditure in our expenditure for the 2021-25 period.

Box 1: Questions for the Customer Forum

- What are the Customer Forum's views on whether AusNet Services current (base year) expenditure is appropriately targeted to deliver customers good value across the following areas:
 - Customer service and experience
 - Restoring supply after emergency events
 - Safety and reducing bushfire risk
 - Connecting new customers
- Are there areas where AusNet Services should increase and/or decrease proposed opex to deliver an alternative mix of customer outcomes?
- Are customers adequately sharing the benefits of efficiency improvements being made by AusNet Services?
- In considering the customer research and engagement, the customer outcomes provided, is AusNet Services' total proposed opex reasonable? This should take into account the regulatory obligations AusNet Services must meet.

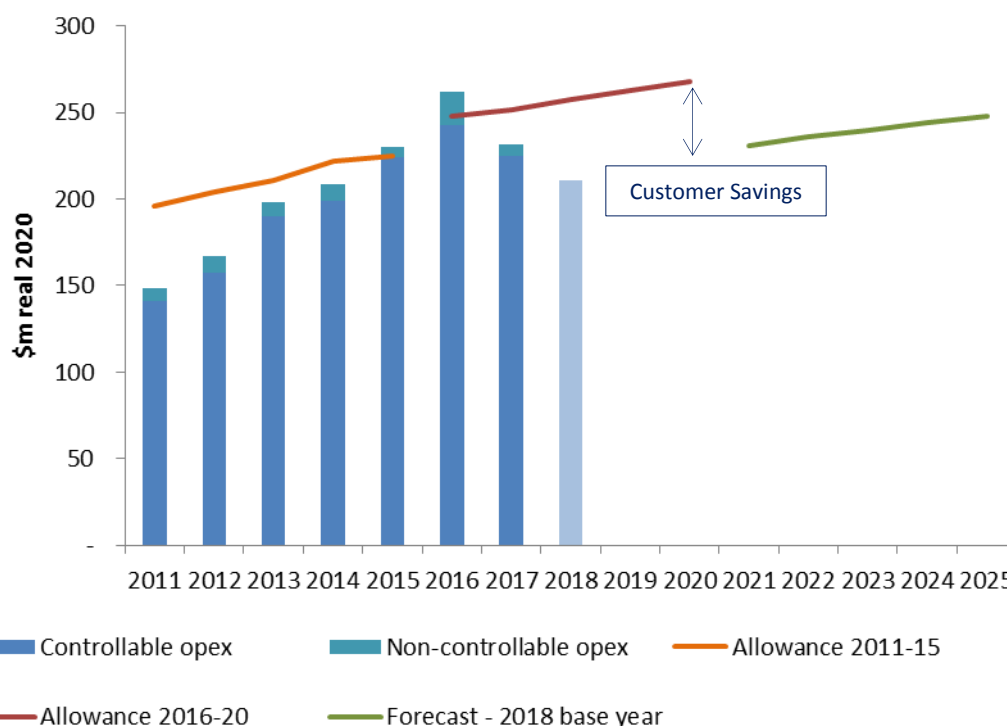
Proposed expenditure

AusNet Services is actively pursuing cost cutting and efficiency gains in its operations and maintenance programs. These efficiency gains deliver a positive outcome for customers, placing downwards pressure on our prices, whilst ensuring that the safety and reliability of our network is maintained. We consider that our opex proposal delivers great value to customers and are pleased to propose real reductions in opex in the 2021-25 regulatory period. Total opex in the 2021-25 regulatory period is forecast to be \$1,199 m (real 2020), which is 7% lower than our opex allowance of \$1,288 m (real 2020) in the 2016-2020 regulatory period. We consider our opex proposal provides value for our customers, as we will continue performing the services most valued by customers at a lower price than in 2016-20, and also deliver improvements in customer experience (see Customer Experience Note).

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Figure 1: Customer outcomes



Customer benefits and bill impacts

Overall 2021-25 opex is a reduction of 7% in real terms compared to 2016-20, with a reduction of the opex allowance in 2021 of 13% compared to 2020. This will result in a reduction in the opex costs flowing through to a customer’s bill.

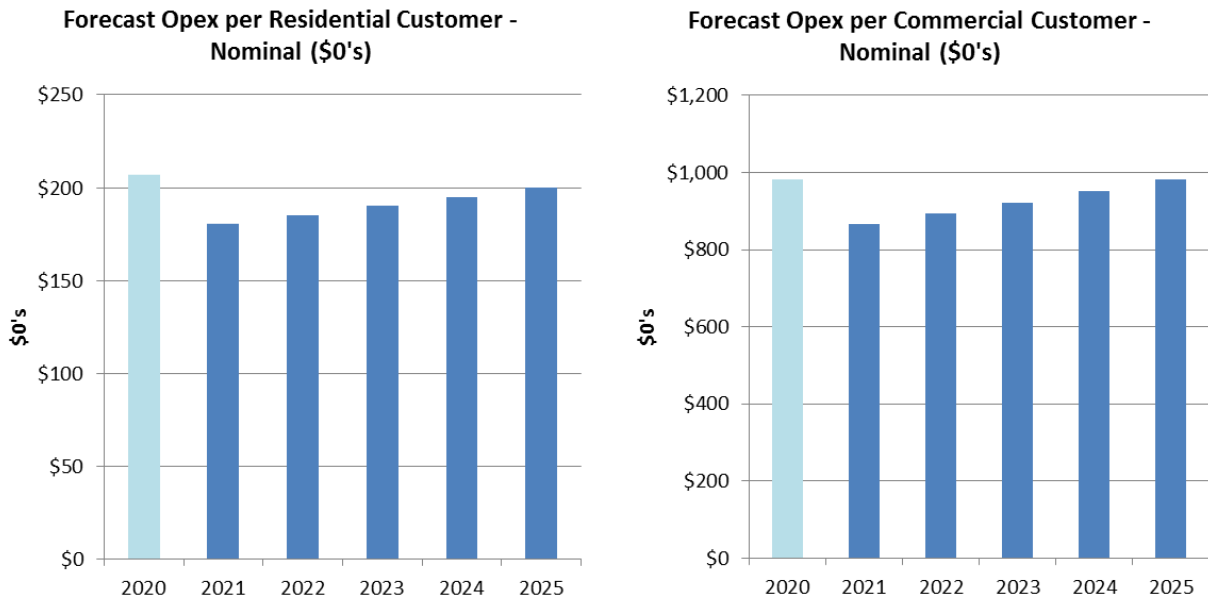
This reduction is driven by efficiency improvements that AusNet Service is in the process of implementing and will be reflected in reduced opex in 2018. Under this proposal AusNet Services continues to face strong incentives to find opex efficiencies, which is likely to lead to even lower prices for an improved level of service beyond 2025. Customers will get:

- Continuation of AusNet Services delivering the services most valued by customers, including providing a safe and reliable supply, for a lower cost than in 2016-20, given the ongoing efficiency gains that AusNet Services has, and will continue to, achieve in 2016-20; and
- Improvements in customer experience, as described in the Customer Experience Note; and
- Improved safety benefits through a reduction in bushfire risk due to the completion of the Rapid Earth Fault Current Limiter (REFCL) program. There is a modest opex increase to progress the third tranche of the REFCL program and to cover the ongoing costs of testing and maintaining the REFCL installations; and
- Beyond 2025, improved customer value from the services that the distribution network provides due to investment in innovation. Further details on the innovation program can be found in the Innovation Expenditure note.

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Figure 2: Customer outcomes

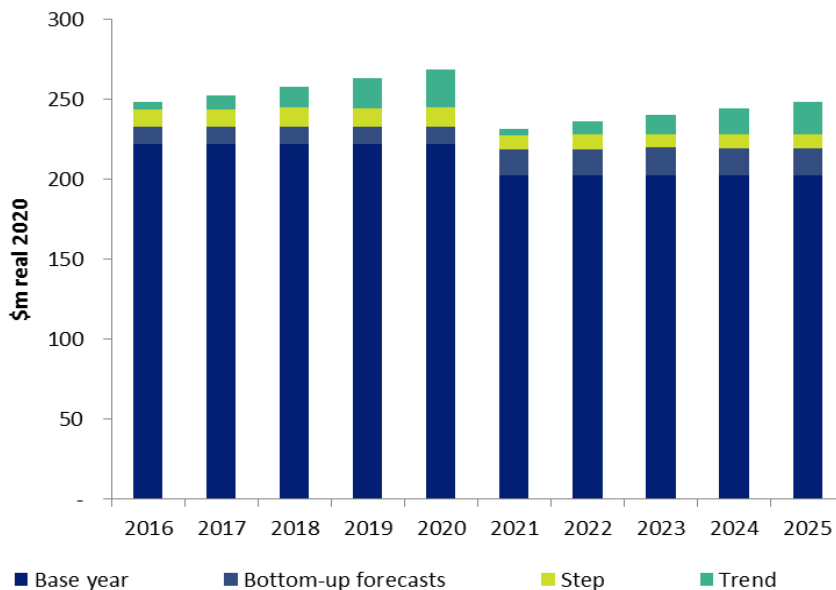


After the initial reduction in opex per customer in 2021 of 13%, opex per customer is expected to grow at a rate of 2.5% per annum for residential customers and 3% per annum for commercial customers. The difference between these growth rates is due to faster growth in demand and energy per customer in the commercial sector compared to the residential sector. Note that the proportion of opex recovered from different customer types may vary within the period due to pricing rebalancing.

Overview of position

AusNet Services has adopted the AER's Base, Step and Trend approach to forecasting opex, which has been designed to work with the strong incentives to continuously identify ways to reduce operating expenditure to efficient levels.

Figure 3: Opex forecast



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AusNet Services considers that its expenditure in the 2018 base year is prudent and efficient and as such is a suitable basis for this forecast. AusNet Services has achieved significant opex reductions in 2017 and is forecasting further reductions in 2018. When the AER releases its next economic benchmarking report around November 2018, we expect it to confirm that in comparison to our peers we are a reasonably efficient business and that our efficiency is now improving.

AusNet Services has proposed modest adjustments for increased costs that it faces in the 2021-25 regulatory period due to regulatory and technological changes.¹ Five drivers of change in our expected opex are:

- Accounting treatment of leases – From 1 April 2019, operating leases must be capitalised, rather than treated as opex. This reduces our operating expenditure by \$31m over the 2021-25 regulatory period with an equivalent increase in capex (which is recovered more slowly from customers lowering near term prices). This saves each customer approximately \$8 per annum.
- Bushfire Mitigation (REFCL) – This program delivers great safety benefits to all of AusNet Services customers through reduced bushfire risk. There is an additional \$8.5m of expenditure in the 2021-25 regulatory period, to progress the third tranche and for ongoing testing and maintenance of the REFCLs at 22 zone sub stations. This costs each customer approximately \$2 per annum.
- Cloud base software – IT software is increasingly moving to cloud based software as a service approaches. Cloud based systems are opex solutions rather than the traditional approach, where we purchased and maintained our IT equipment and services. This increases our operating expenditure by \$30m over the 2021-25 regulatory period. This costs each customer approximately \$8 per annum.
- 5 minute metering – The operation of upgraded systems to handle 5 minute metering data requires additional ongoing activities. This program is being implemented to meet our obligations under a rule change, which is designed to assist the functioning of the wholesale market. This rule change is designed to deliver benefits to customers through reduced retail prices by improving price signals for more efficient generation and use of electricity. However, this increases our operating expenditure by \$5.5m over the 2021-25 regulatory period. This costs each customer approximately \$1.5 per annum.
- Cost allocation of shared data and communication systems – AusNet Services has adjusted the allocation of costs for key data and communication systems to better reflect their integrated role in the delivery of core distribution services and metering services. This provides a higher allocation to the distribution service opex which increases by \$16m over the 2021-25 regulatory period. This increases usage charges by \$4 per annum, but with an offsetting reduction in metering charges of the same amount.

In addition to this, AusNet Services expects ongoing cost pressures to arise as a result of:

- Increases in wage prices above CPI, albeit at a slower rate than in 2016-20.
- Increased scale of our network, due to new connecting customers. Again, this growth is forecast at a lower rate than in 2016-20.

¹ These are often referred to as step changes and trend parameters.

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Our forecasts of these ongoing cost pressures are modest and are slightly below those forecast in the 2016-20 regulatory period. After an initial reduction of the opex forecast in 2021 compared to 2020 of 13%, we forecast real opex increases of 1.42% per annum (which is a nominal increase of 3.8% per annum).

Productivity adjustment

The regulatory framework allows for DNSPs to retain 30 per cent of the benefits from DNSP specific productivity improvements through the operating expenditure incentive scheme. However, customers rather than the DNSP should immediately benefit from industry wide productivity improvements that allow all firms (including the most efficient firms) to become more efficient.

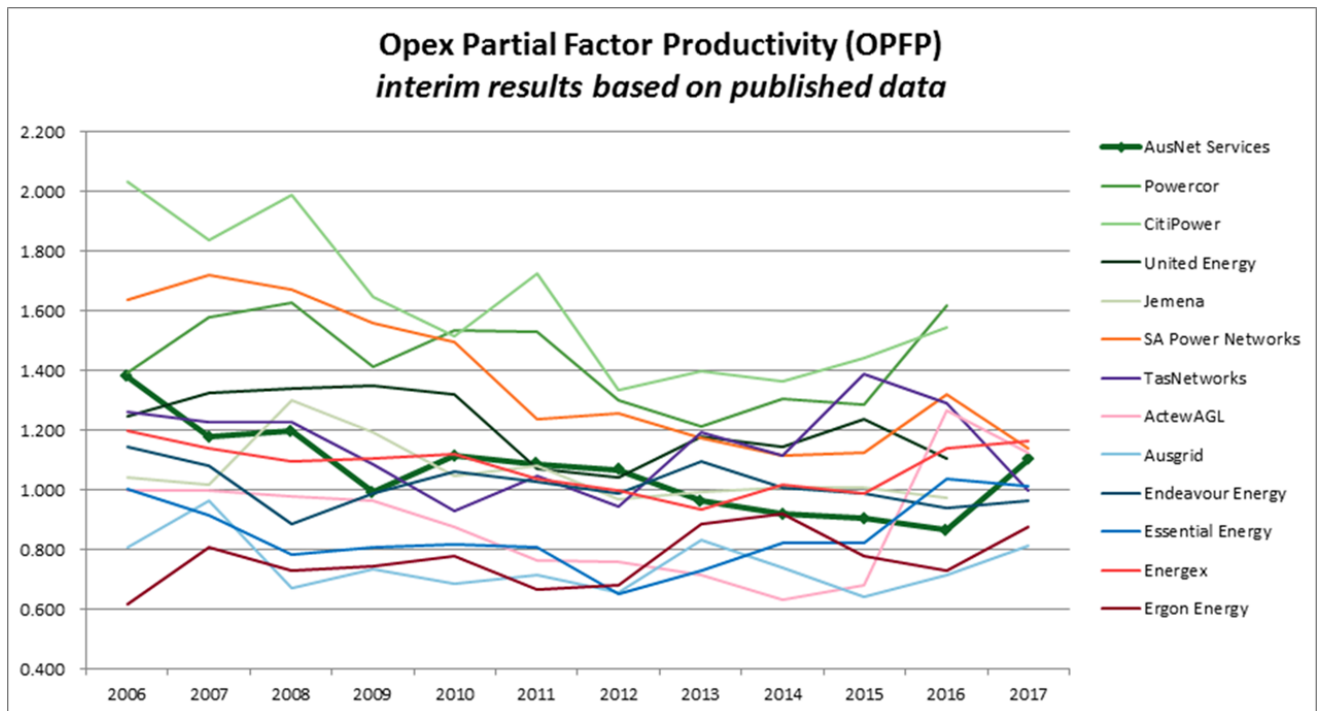
We do not consider there is evidence of industry wide productivity improvements at this time and as such, the operation of the operating expenditure incentive scheme is the way in which the benefits of AusNet Services productivity improvements will be shared with customers. Accordingly, AusNet Services is not proposing any additional productivity adjustment to its opex allowance for the 2021-25 regulatory period. This is also consistent with recent AER decisions (although we are aware the AER has flagged it may change its approach).

The electricity distribution industry has had declining productivity since 2006. In the past few years, most DNSPs have returned to positive opex productivity, but capex productivity has largely remained negative and only some DNSPs have had a positive MTFP. We consider that much of the opex productivity improvements have been driven by DNSP specific factors – such as the recent privatisations of some networks in the sample – and so do not consider the recent trend provides good evidence of genuine, industry wide productivity improvements.

Benchmarking

Figure 4 below shows the productivity performance we expect will be reported in the AER's next benchmarking report.

Figure 4: Productivity



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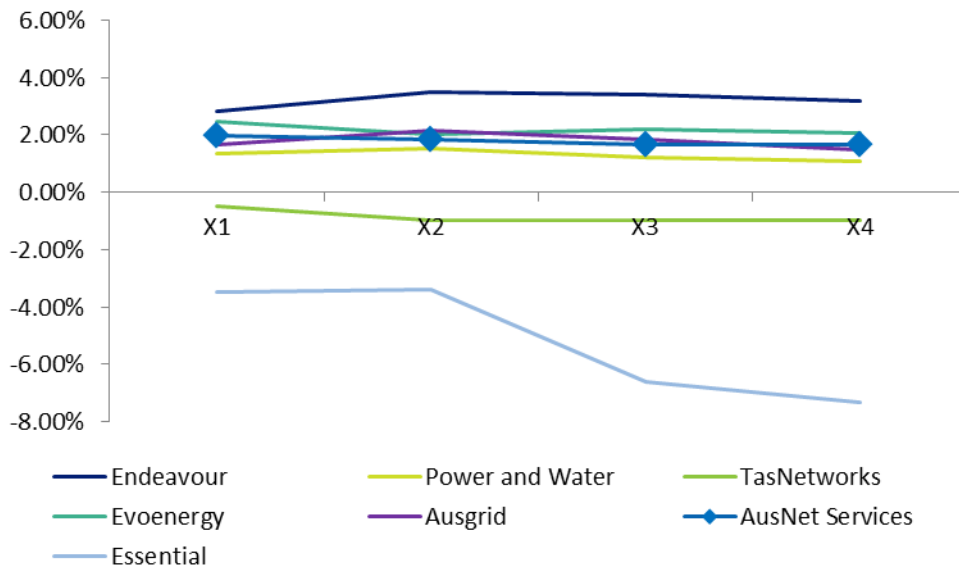
Source: AusNet Services adjustment to the AER's 2016 benchmarking report.

This improved benchmarking result demonstrates that AusNet Services:

- Is committed to delivering lower cost services, without a detrimental impact on the service quality.
- Responds to the incentives in the regulatory framework to drive efficiency gains.

Figure 5 below shows the % change in opex for each year of the regulatory proposal. AusNet Services growth in opex is reasonable compared with the other DNSPs proposals.

Figure 5: Percentage change in opex



Comparison of key inputs against other recent proposals

The charts below show how our proposed forecast parameters compare against recent proposals from other distribution networks. Each network will have specific factors impacting its operating environment, so some variation between proposals is expected. AusNet Services is not at the top of the range on any of these growth parameters.



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Figure 6: Comparison of labour price increases from recent proposals

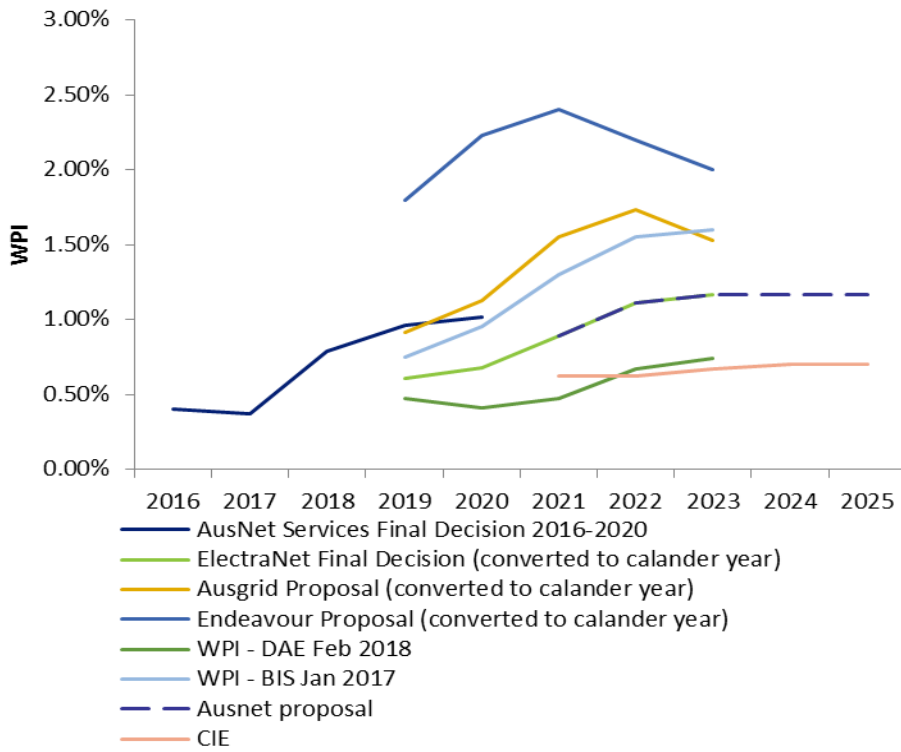
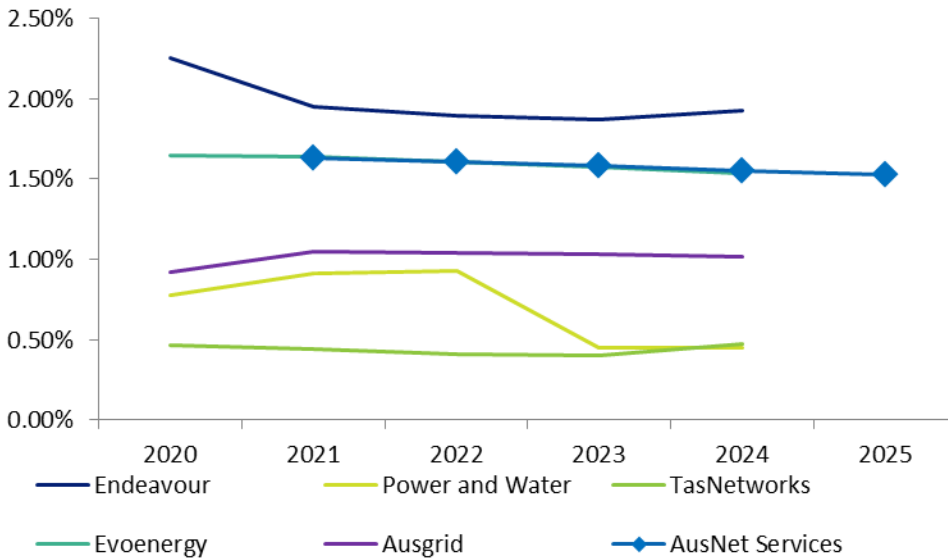


Figure 7: Comparison of customer number growth from recent proposals



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Figure 8: Comparison of circuit length increases from recent proposals

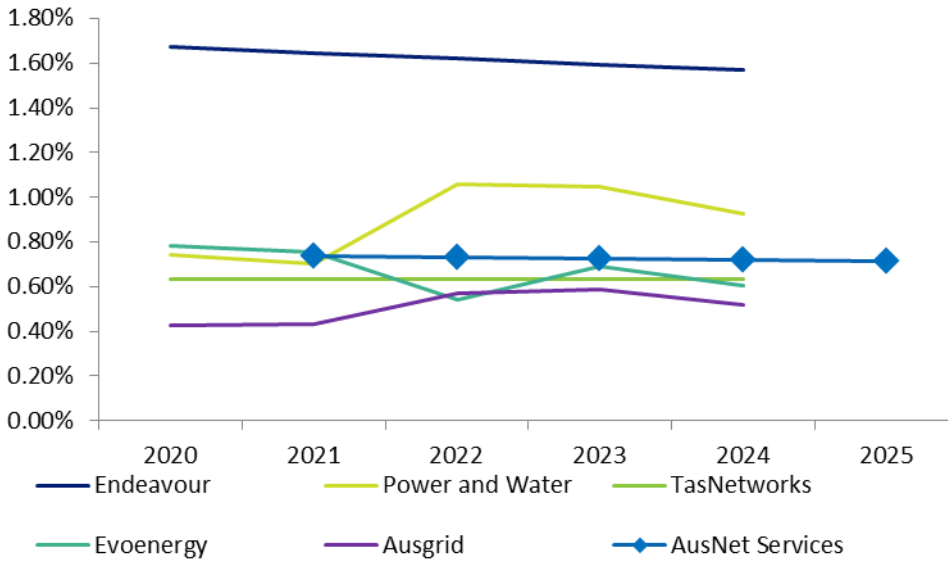
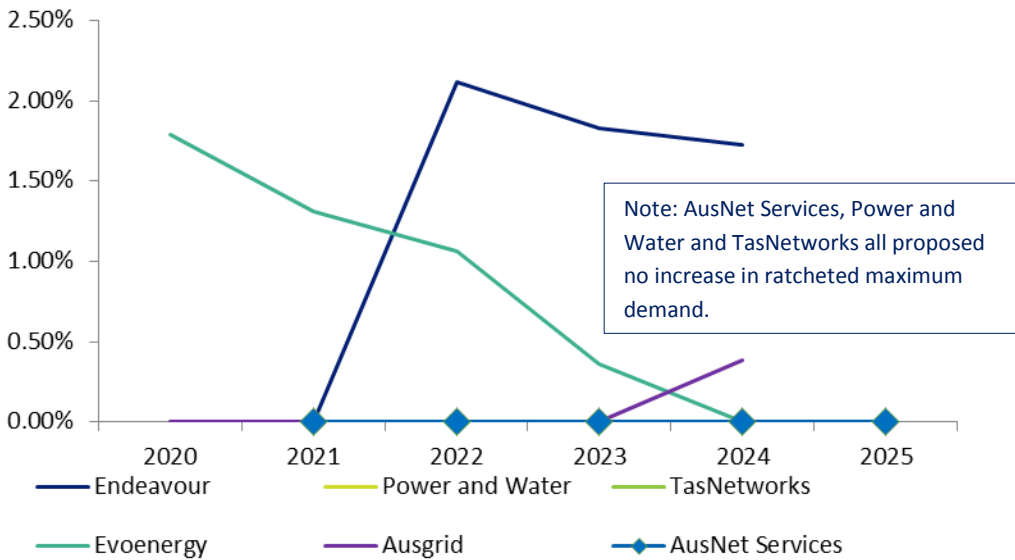


Figure 9: Comparison of ratcheted maximum demand increases from recent proposals



Relevant customer research findings

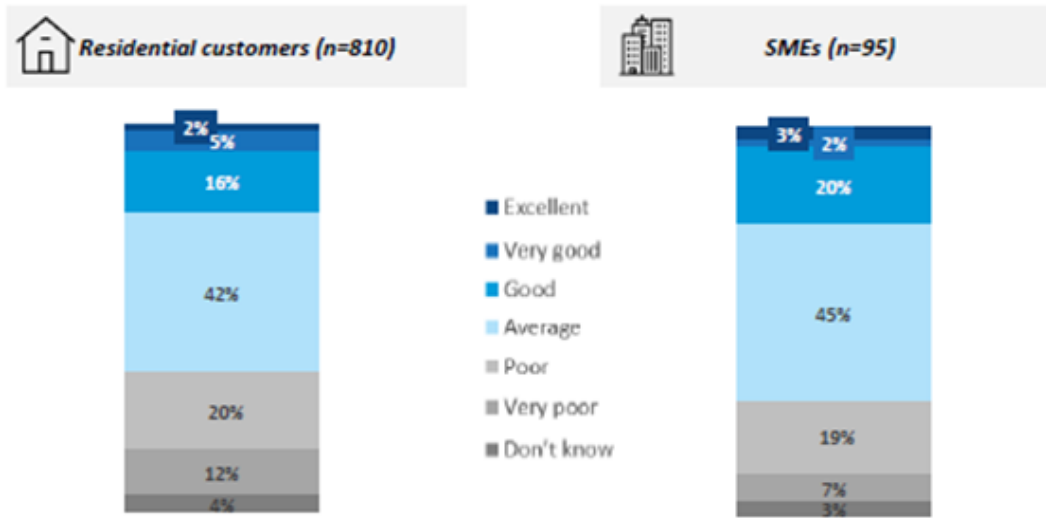
In our customer research, participants repeatedly noted that the price of electricity had risen significantly and was continuing to do so. Many were concerned it was becoming increasingly unaffordable and hard to pay their bills.

Costs and prices dominate the energy conversation and most customers are already changing energy use in response to higher bills. Three in 10 residential customers felt that their electricity provided poor or very poor affordability. Our opex proposal will help reduce bill pressures in the 2021-25 regulatory period.

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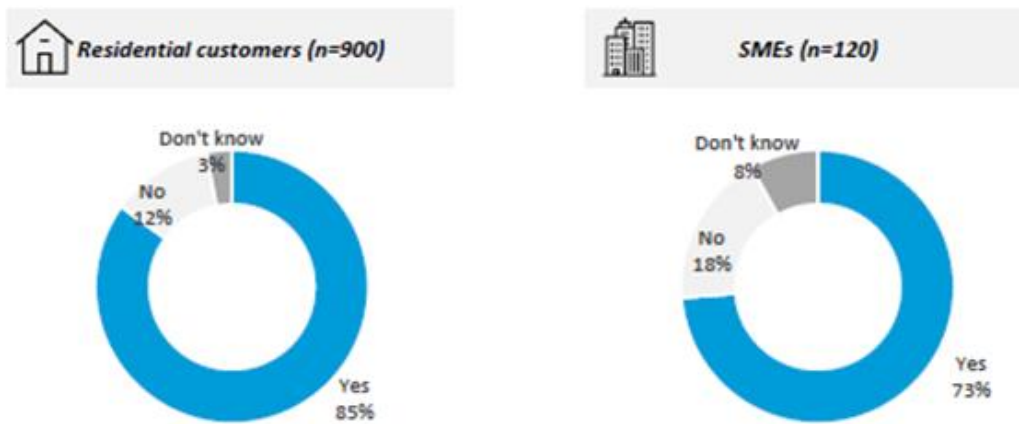


Figure 10: Perceptions of value for money



Around one in five (22%) residential customers and a quarter (25%) of SMEs felt their electricity provided excellent, very good or good value for money. However, a higher proportion felt that their electricity was poor or very poor value for money (31% of residential customers, and 26% of SMEs).

Figure 11: Proportion of customers who have taken steps to reduce energy usage



The majority of residential customers claimed that they actively try to reduce their energy usage to reduce costs. Only one in ten (12%) claimed that they did not actively try to reduce usage. Vulnerable Households (92%) and Solar Households (90%) were significantly more likely to have actively tried to reduce their energy usage, compared to Regular Households (82%). A higher proportion of SMEs claimed they did not actively try to reduce their energy usage to reduce costs, with almost one in five (18%) saying this.

Participants were also asked to consider the relative importance of AusNet Services core services. These core services are partially delivered by our operational expenditure program and are highly valued by our customers.

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While we are seeking to deliver these core services more efficiently and are achieving cost savings, the cost reductions will not be delivered through reduced standards, as this is incompatible with what our customers want.

In order of importance participants the key issues expressed by customers include:²

Figure 13: Importance of core services

Core Service	Importance	Why this should be prioritised
Providing a reliable, continuous electricity supply	97%	Central to the reason AusNet Services exists and essential for enabling the everyday lives of everyday people to function. Crucial for businesses.
Safety measures to prevent accidents for our staff and the community	97%	A core responsibility of any organisation involved in the supply of electricity. Many linked this service with vegetation management and bushfire prevention, and would allocate finance across the three.
Getting the power back on during unplanned blackouts	97%	Related to the core reason for AusNet Services' existence; providing reliable and continuous electricity and restoring it quickly if/when interrupted.
Keeping customers informed regarding their electricity supply	97%	When better informed about blackouts, they can either prepare, plan or take action to be less impacted by them. Important if needing electricity for health reasons, and (most commonly) for avoiding food spoilage.
Reducing the likelihood of bushfires	96%	Safety should be a foundation for AusNet Services' operations – a given part of its licence to operate.
Customer service (e.g. responding to enquiries and complaints)	90%	Some denoted high importance, as customers need help with connections and a way to engage with AusNet Services if they have an issue. Others felt that more investment into reliability would eliminate the issue to begin with.
Managing vegetation around poles, wires and electricity sub-stations	86%	Some related this to bushfires and allocated funding there, while others felt this should be the council's responsibility, rather than AusNet Services'.
Keeping customers informed about energy issues in general	85%	After hearing about smart meters many were eager to learn more, though on further discussion, most were only interested in blackouts or reducing their bill.

² AusNet Services 2021-25 EDPR Customer Research – Qualitative Research Report, July 2018

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Appendix: Technical assumptions

Category	Issue	2021	2022	2023	2024	2025	Total
Base year adjustment	Accounting policy change	-6.3	-6.3	-6.3	-6.3	-6.3	-31.7
Step Changes	REFCL (Bushfire Mitigation)	1.6	1.6	1.8	1.8	1.8	8.5
Step Changes	Cloud based software	6.0	6.0	6.0	6.0	6.0	30.0
Step Changes	5 minute meter data - step change	1.5	1.6	0.8	0.8	0.8	5.5
Bottom-up Forecasts	GSL Payments	10.5	10.5	10.5	10.5	10.5	52.6
Bottom-up Forecasts	Metering	10.2	10.6	11.5	11.4	11.3	54.9
Bottom-up Forecasts	Debt Raising Costs	2.2	2.3	2.4	2.4	2.4	11.8
Bottom-up Forecasts	Innovation expenditure	0.5	0.5	0.5	0.5	0.5	2.6

Category	Issue	2021	2022	2023	2024	2025	Average 2021-22	Average 2016-2020 Total (or average)
Trend Parameter (input to output change)	Customer number growth	1.62%	1.59%	1.57%	1.54%	1.52%	1.57%	1.73%
Trend Parameter (input to output change)	Circuit length growth	0.73%	0.73%	0.72%	0.72%	0.71%	0.72%	0.86%
Trend Parameter (input to output change)	Ratcheted Maximum Demand	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	1.41%
Trend Parameters	Forecast Price Change % (real)	0.53%	0.66%	0.70%	0.70%	0.70%	0.66%	0.86%
Trend Parameters	Forecast Output Change % (real)	1.31%	1.29%	1.27%	1.25%	1.24%	1.27%	1.73%
Trend Parameters	Productivity Adjustment % (real)	0.0%	0.0%	0.0%	0.0%	0.0%	0%	1.41%