

Overview of the revenue proposal



Negotiating position for the Customer Forum

1. Introduction

This note has been prepared to provide the Customer Forum with a consolidated overview of our proposed revenue proposal for the 2021-25 period, the value it will provide customers and the associated price impacts.

The note aims to explain:

- Our understanding of our customer's views on valued services;
- The key drivers for our revenue proposal for the 2021-25 regulatory period;
- How the proposal responds to our customers' needs; and
- The key benefits and outcomes for customers expected between now and the end of the 2021-25 regulatory period.

The note also provides a summary of the aspects of the revenue proposal that are in scope of our negotiation with the Customer Forum and our key positions for the negotiation process.

2. What we know about our customers

The key messages and insights that have emerged from the customer research conducted to date are:

- Rising energy costs and affordability is the key concern across all customer groups;
- Customers are broadly happy with current reliability levels, although some business customers would support reliability improvements due to the potentially high cost to their business of outages;
- Customers would value improved communications, particularly regarding planned outage notification and duration of unplanned outages, but also information to facilitate energy efficiency opportunities;
- High levels of interest in installing solar PV, and dissatisfaction if restrictions were placed on customers' ability to export solar;
- The increasing integration of Distributed Energy Resources (including residential solar) should be funded by all customers, not just current DER customers, as solar is seen as something that will be prevalent across the broader customer base in future; and
- Low awareness of the benefits of smart meter technology, including its ability to help manage costs.

3. Key drivers of the 2021-25 revenue proposal

Average distribution bills and metering charges

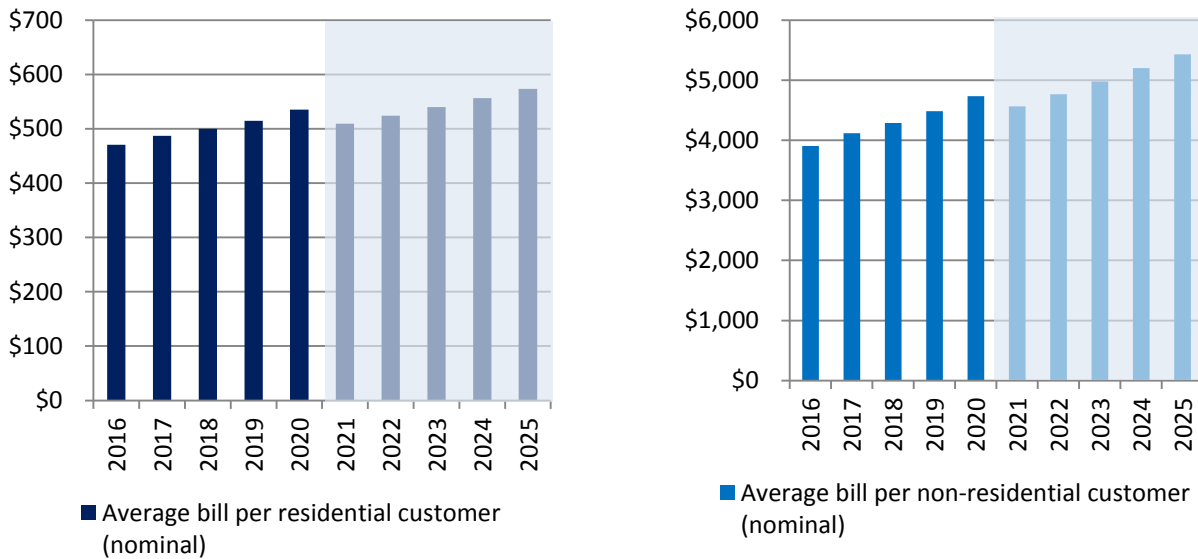
The nominal distribution bill per customer is shown in Figure 1, for residential and non-residential customers.

Under the price path presented below (the actual price path is subject to negotiation with the Customer Forum), in 2021 customers will experience an immediate network bill reduction of 5%, which is equivalent to \$26 for residential customers, and \$168 for non-residential customers. Between 2021 and 2025 nominal bills will increase by an average annual nominal rate of 2.5% per annum however, in real terms the average annual bill per customer will reduce by 3.3% in 2021-25 compared to 2016-20.

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Figure 1: Average residential and non-residential distribution component of bills (\$ nominal)



Note: The average bill is estimated as nominal revenue per customer.

The change in the average bill between 2016-20 and 2021-25 reflects the following factors:

- A modest increase in proposed distribution revenue in the 2021-25 period. In real terms, total distribution revenue is forecast to increase between the 2016-20 and 2021-25 periods by 3%, from \$3,297M to \$3,412M, or from \$659M to \$682M per annum. Excluding incentive payments, which reflect the efficiency savings we expect to achieve in the current period, forecast 2021-25 revenues are \$3,203M, or 3% lower than current period revenues. Hence, the key drivers of increased revenue in 2021-25 are incentive payments as well as an increase in depreciation (associated with short-lived assets);
 - Customer growth. Continued customer growth of around 1.5% per annum (which is lower than the rate of customer growth in 2016-20) puts downwards pressure on bills.
- and
- The nominal bill increase also reflects the impact of inflation.

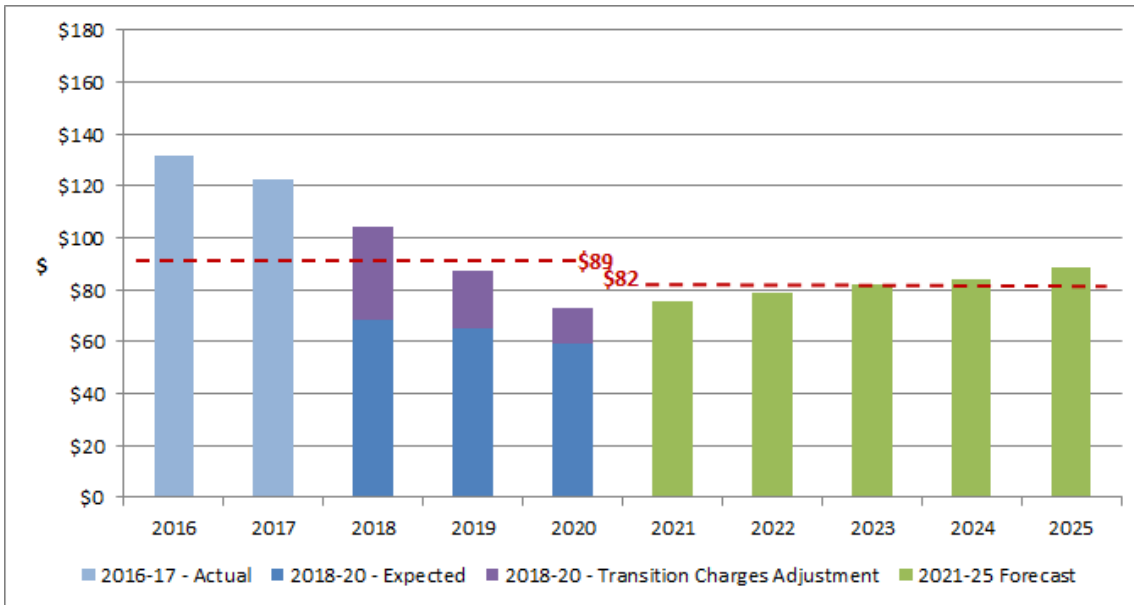
The figures above show the average bill is expected to increase at a higher rate for non-residential customers due to the forecast of non-residential customer numbers remaining flat, contrasting with the strong growth expected for residential customers. This may be adjusted within the period through the annual price setting process.

In nominal terms, metering revenue per customer is forecast to be, on average, \$82 over the 2021-25 period, which is 8% lower than average metering revenue per customer during the 2016-20 period of \$89. The reduced revenue is a result of the smart meter service reaching a more mature stage and operating at more efficient, business-as-usual cost levels. The only instances of investment beyond BAU are driven by external drivers, such as the need to transition to 4G when the 3G network is due to be switched off.

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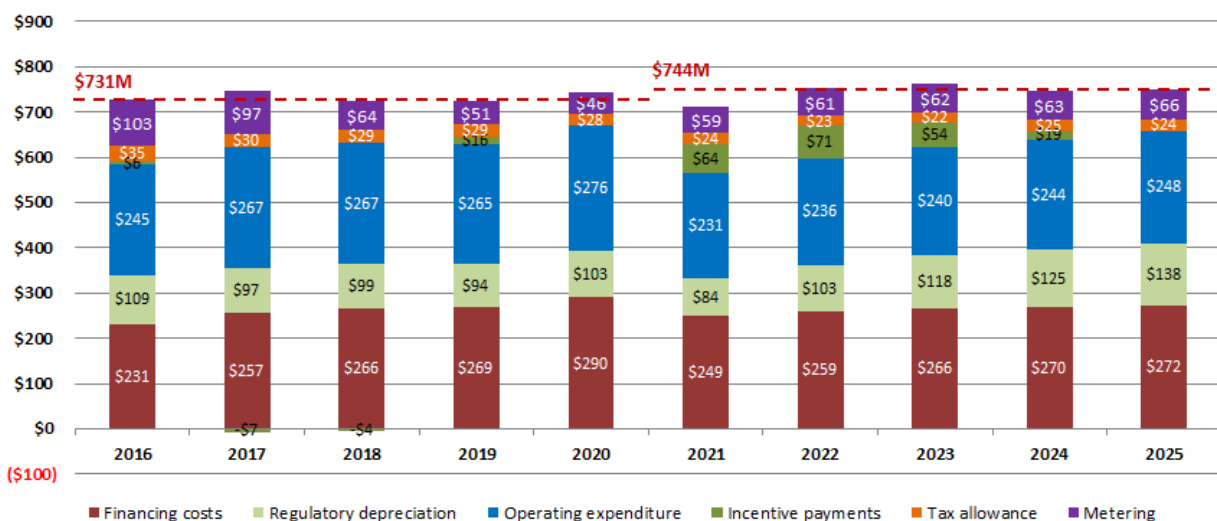
Figure 2: Average metering revenue per customer (\$ nominal)



Forecast revenue

In real terms, total distribution and metering revenue is forecast to increase between the 2016-20 and 2021-25 periods by 2%, from \$3,657M to \$3,721M, or from \$731M to \$744M per annum. Excluding incentive payments, which reflect the efficiency savings we expect to achieve in the current period, forecast 2021-25 revenues are \$3,512M, or 4% lower than current period revenues. While not all elements of the revenue proposal are in scope, AusNet Services is seeking the Customer Forum’s view on the overall reasonableness of its proposal.

Figure 4: Total distribution and metering revenues (\$M, real \$2020)



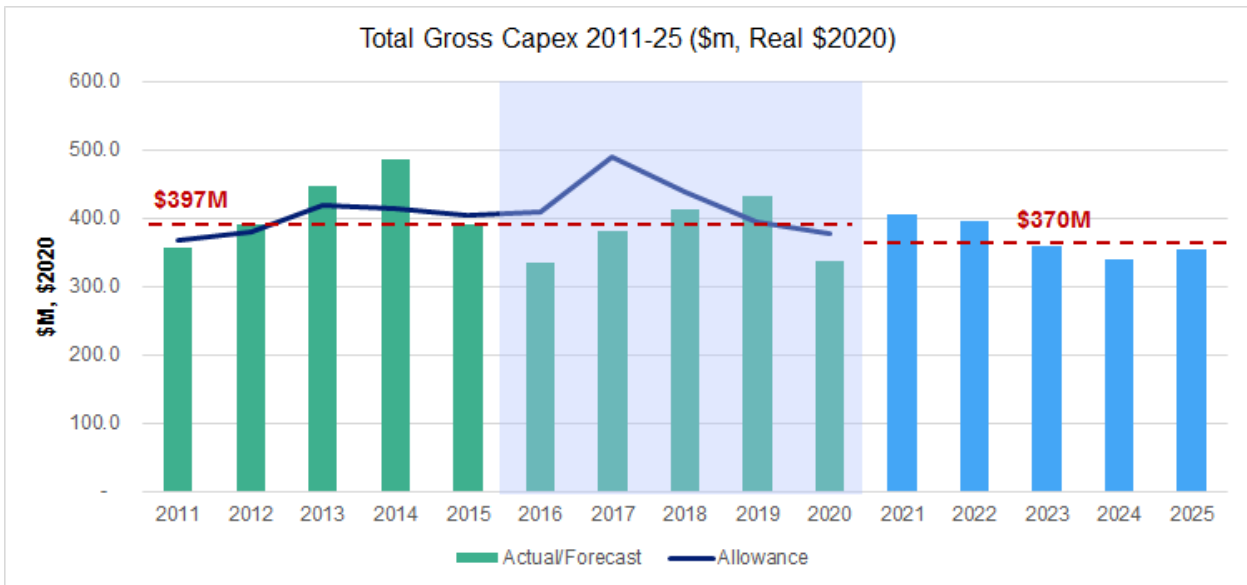
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Forecast expenditures

As shown in Figure 5, in real terms, forecast capital expenditure for the 2021-25 period is \$1,851M, or \$370M per annum. This is 2.5% less than actual/expected capex in the 2016-20 period of \$1,897M, and 7% below average annual capex from 2011-20 of \$397M.

Figure 5: Actual and forecast capex (\$M, real \$2020)



The reduction in capex reflects a reduction in augmentation expenditure (due to demand growth being limited to specific urban growth corridors), safety expenditure (as significant safety programs undertaken in the last two regulatory periods are completed such as the installation of vibration dampers) and REFCL expenditure (the REFCL installation program will be completed by 2023).

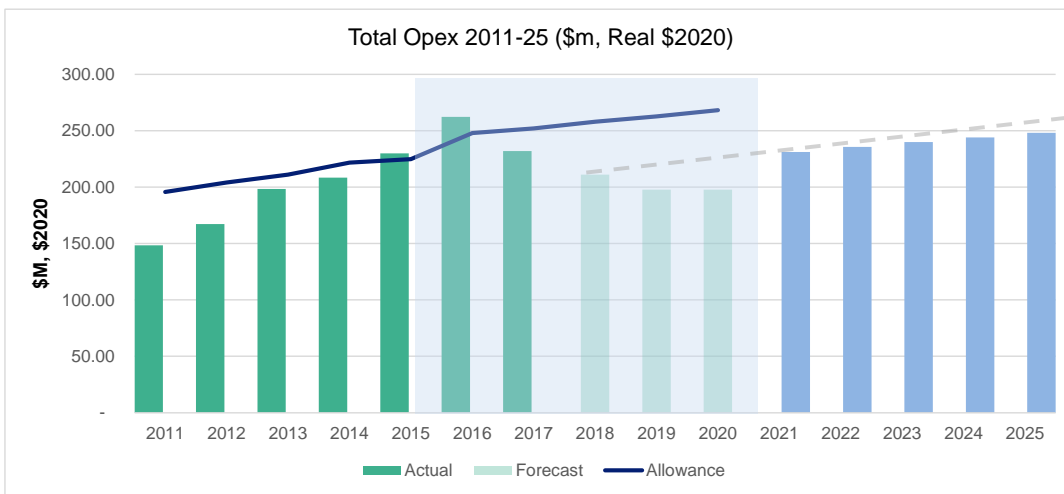
These reductions are offset by increases in replacement and IT expenditure. The replacement expenditure increase is due to an increasing volume of pole replacements and increasing volume and cost of conductor replacement (the higher cost conductor replacement is in bushfire areas where bushfire safety regulations require AusNet Services to use covered conductor or underground cable when replacing bare overhead conductor). The IT expenditure increase reflects the implementation of new regulatory obligations such as the introduction of five-minute settlement and the allocation of costs for key data and communication systems that are being more heavily used by the distribution business.

As shown in Figure 6, in real terms, forecast operating expenditure for the 2021-25 period is \$1,199M, or \$240M per annum. This is 7% lower than our opex allowance of \$1,288 m (real 2020) in the 2016-2020 regulatory period. The opex forecast has been derived by applying the AER's standard approach to forecasting opex, using 2018 as a 'base year'. This results in an opex forecast for 2021-25 of \$1,101M (\$220M per annum). The forecast includes step changes to opex in the 2021-25 period needed to meet externally imposed obligations including REFCLs and the implementation of 5-minute settlement.

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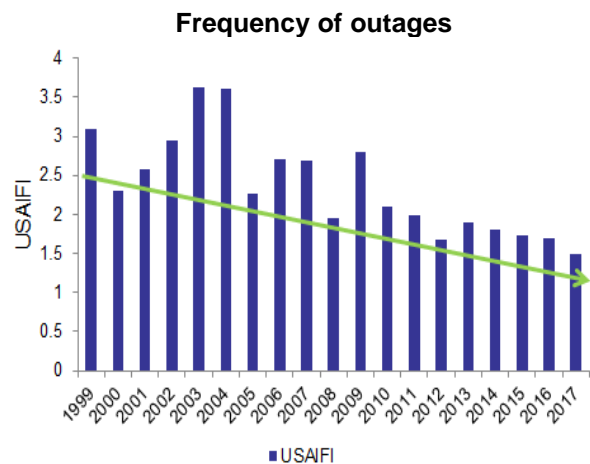
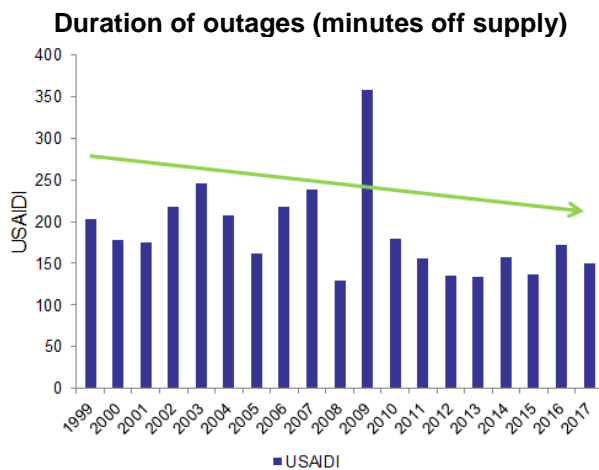
Figure 6: Actual and forecast opex (\$M, real \$2020)



Reliability

As shown by the figures below, AusNet Services has driven significant improvements in reliability over the last decade. Specifically, between 2006 and 2017, we have achieved a 31% reduction in the average duration of outages, and a 44% reduction in the average frequency of outages. Our proposal is to maintain current reliability levels in the 2021-25 period, consistent with our customers' general satisfaction with these levels.

Figure 7: Reliability improvements since 2006



4. How we are responding to our customers' needs

In response to the strong incentives we face, we are making significant operating and capital efficiency savings in the current period. This is expected to have the following consequences in the 2021-25 period which, together, will reduce cost/bill impacts for customers and provide some relief to the affordability concerns our customers are expressing:

1. A permanent reduction in operating expenditure of \$56M per annum,¹ reducing forecast operating expenditure over the 2021-25 period by **\$400M²** (11% of total 2021-25 distribution revenues);

¹ The difference between estimated 2018 opex, which is used as the base year, and the 2018 opex allowance

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2. A permanent reduction in the capital base of \$358M,³ reducing financing costs and depreciation over the 2021-25 period by **\$113M** (3% of total 2021-25 distribution revenues);
3. A one-off incentive payment in the 2021-25 period of **\$220M** (6% of total 2021-25 distribution revenues); and
4. A net reduction in 2021-25 revenues of **\$293M** (8% of total 2021-25 distribution revenues).

We recognise that customer experience improvements are needed, now and into the future, particularly around improved customer communications and better provision of information. Therefore, we are looking to agree with the Customer Forum a package of strategic and tactical initiatives to deliver in the current period, as well as a customer satisfaction incentive scheme to provide an ongoing incentive for customer service improvements and help embed a culture of customer service within the business. This would ensure that customers only pay for investments to improve service where they actually receive the benefit of improved service outcomes.

We are also proposing a broad based innovation program to respond the customer driven changes in our network, such as increasing appetites for distributed energy resources (DER), information and control of energy usage and costs. This program will benefit customers by unlocking the value of DER and reduce future network costs through smarter network technologies, smart meters and data management systems.

We consider modest investment is warranted to manage the significantly increasing uptake of Distributed Energy Resources (including solar PV) on our network, and help unlock the value of customers' investment in DER. This includes investment in technology to coordinate exports within the existing limits of the network, and network upgrades to enable increased DER exports in solar hotspots. We also propose to review our connection charges to ensure that, to the extent possible under the regulatory framework, they reflect actual costs.

We are also proposing modest network expenditure to address the strong customer growth being experienced in some areas of our network.

At the same time as we respond to our customers' changing needs and to disruptive technologies, we will continue to provide the core services that all of our customers expect from us – reliable and safe power at affordable and efficient prices.

Finally, substantial capital investment continues to be needed to ensure compliance with a range of externally imposed obligations including the bushfire safety program (e.g. REFCL) and the implementation of rule changes (five minute settlement and global settlements).

5. Bill breakdown for customers in 2025

As set out in the Customer Experience note, we are seeking to agree with the Customer Forum a number of initiatives in the remainder of the 2016-20 regulatory period to improve customer experience. Additionally, we are proposing to implement a new small scale incentive scheme, which is not directly funded through the revenue allowance. Customers will only pay for the improvements that they receive.

Figure 8 shows the distribution component of the average residential bill in 2025 broken down into the cost of providing the different high level services provided to customers. The majority of the bill is directed towards the core service of providing a reliable electricity supply.

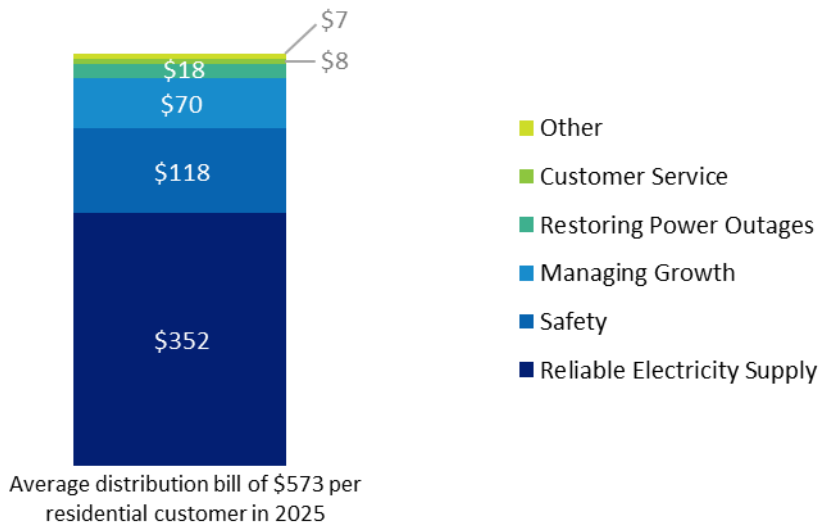
² Compared to what the 2021-25 opex forecast would be if the 2018 opex allowance is fully spent

³ Compared to what the opening 2021 capital base would be if the 2016-20 capex allowance is fully spent

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Figure 8: Approximate electricity distribution bill breakdown in 2025



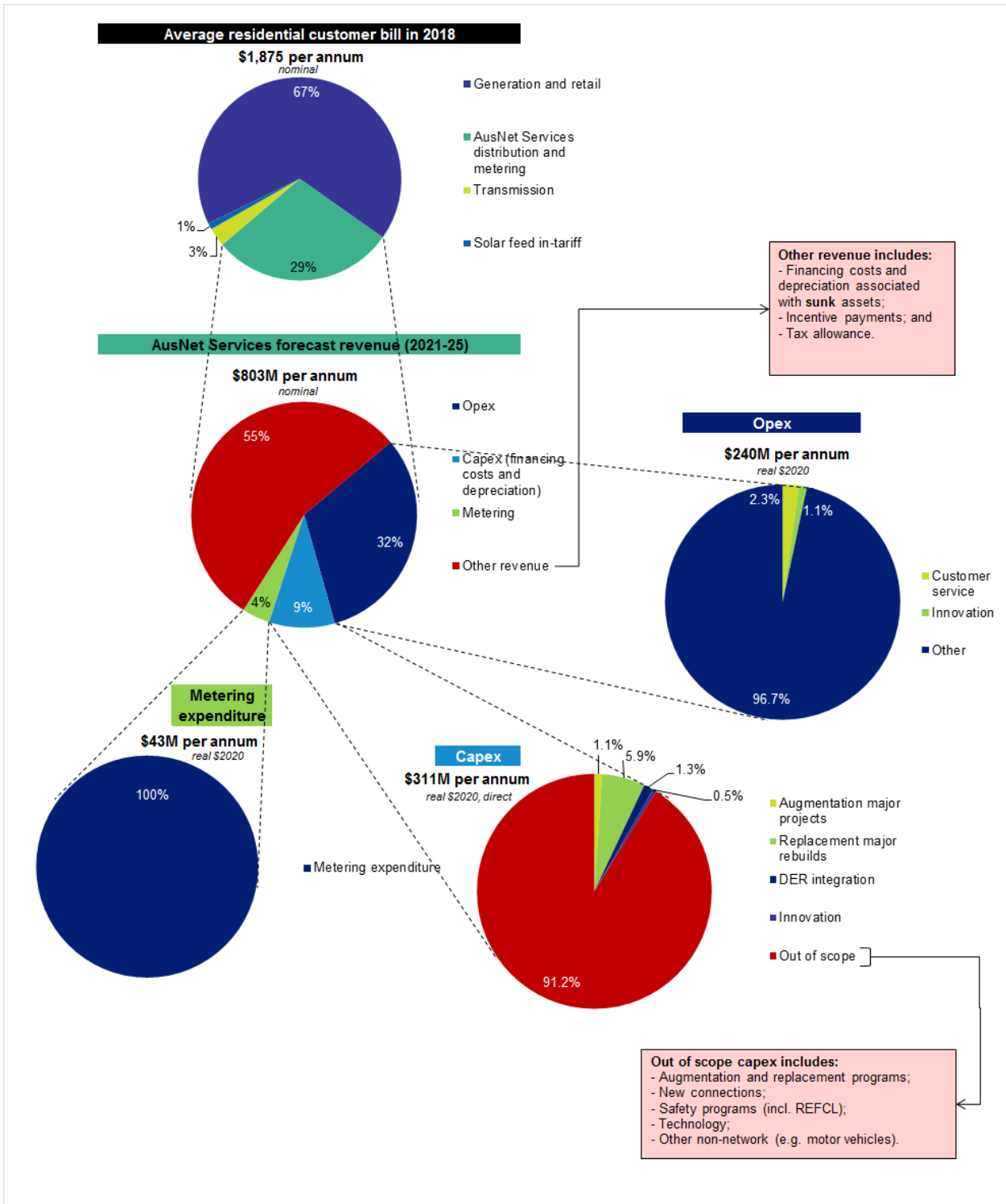
6. In-scope expenditures and summary of negotiating positions

The figure below provides an overview of the 2021-25 forecast expenditures and revenues that are included in the scope of the negotiation process. An equivalent figure for 2016-20 is included in Attachment A. The subsequent table provides more detail on each in scope topic.

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Figure 9: Overview of in-scope revenues and forecast expenditures for 2021-25



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Table 1: Summary of negotiating positions for in-scope topics

Topic	Negotiating position
Opex	We propose total opex in the 2021-25 regulatory period of \$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).
Augex large projects	AusNet Services proposes two large projects to augment zone-substations in the Clyde North and Doreen growth corridors. Options for meeting the augmentation need that have different price-reliability trade-offs are provided for negotiation with the Customer Forum. This includes options to defer the augmentations and non-network options.
Replex large projects	<p>AusNet Services is seeking to negotiate with the Customer Forum on portfolios of major replex projects that provide different price-service trade-offs for customers. Six portfolios are provided, including:</p> <ul style="list-style-type: none"> • A preferred zone substation refurbishment portfolio consisting of ten refurbishment projects over the 2021-25 period; • A range of refurbishment portfolio that alter the timing of the refurbishment projects, including project deferrals; and • A portfolio that combines project deferrals with supply risk mitigation using a non-network solution (diesel generation).
DER integration	<p>We propose to:</p> <ul style="list-style-type: none"> • Maximise the number of new solar customers able to connect to the network and to export their self-generated energy through coordinating exports within the existing physical limits of the network. This requires installation of a platform costing approximately \$8 per customer over the long term (around \$6M capex plus a small amount of opex over 2021-25). In the 2021-25 period, the average annual bill impact is 55c per customer; and • Upgrade the network where it is beneficial to customers to enable increased exports in solar hotspots. The maximum estimated cost of this option is \$27 per customer over the long term (around \$20M capex over 2021-25). In the 2021-25 period, the average annual bill impact is 63c per customer. • Review our connection charges to ensure they reflect the actual cost of the customers' connection to the extent possible under the regulatory framework.
Innovation	AusNet Services is seeking Customer Forum endorsement for \$10.8 million (\$2018) of innovation expenditure over the 2021-25 period. This program goes well beyond demand management, supporting the future transformation of our network to improve customer outcomes, particularly in terms of lower bills and

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Topic	Negotiating position
	<p>improved choice and services. The majority of the innovation program relates to testing new technologies and approaches that will take the distribution network from a statically managed centralised network to a dynamically managed decentralised network. The innovation expenditure, while not having guaranteed outcomes, is focused on achieving improved outcomes for customers including lower bills, more opportunity to use and earn a return on solar and batteries, and improved reliability of supply including for customers at the edge of the grid.</p>
Customer experience and hardship	<p>AusNet Services proposes a two pronged approach to delivering customer experience improvements in the 2021-25 period comprising:</p> <ul style="list-style-type: none">• Specific customer experience initiatives for the remainder of the 2016-20 regulatory period, which will continue to deliver customer benefits during the subsequent 2021-25 period at no additional cost to customers; and• Implementation of a customer satisfaction incentive scheme – this will provide an ongoing incentive for customer satisfaction improvements and help embed a culture of customer centricity within the business. <p>We are also considering whether we can fund from our bottom line GSL payments within our control and commit to an additional payment to customers in the event that their complex connection time exceeds a certain threshold.</p>
Metering	<p>AusNet Services is proposing an average metering charge of \$77 per customer (real 2020) over the 2021-25 period, down from an average charge of \$95 per customer in the 2016 to 2020 period.</p> <p>We consider the expenditure case put forward to be largely business-as-usual (BAU), consistent with other distributors' charges. The only instances of investment beyond BAU are driven by external drivers, such as the need to transition to 4G when the 3G network is due to be switched off.</p> <p>The smart metering systems have been a significant investment by the Victorian distribution business under the Victorian Government's compulsory meter roll-out, which was largely completed by 2014. This investment is delivering significant benefits that are highly valued by our customers. The benefits range from lower distribution network and service costs to customers to significantly improved safety outcomes for customers.</p>
Price path	<p>AusNet Services is seeking to agree a preferred high level price path with the Customer Forum, noting that the exact path will be updated based on new information before submission of the Revenue Proposal. Three options are presented for consideration:</p> <ul style="list-style-type: none">• An immediate sharp reduction in real bills in 2021, followed by a gradual annual increase to 2025;• An initial moderate reduction in real bills in 2021, followed by a gradual annual decrease to 2025; or• A gradual reduction in real bills each year until 2025.

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Attachment A: In-scope revenues and forecast expenditures for 2016-20

