
Endeavour Energy:
Electricity Price Guarantee
Compliance
2016-17

**Report prepared for the NSW Government by
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NSW Electricity Price Commissioner**

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Abbreviated terms

| Abbreviation | |
|---------------------|-------------------------------------|
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| EBSS | Efficiency Benefit Sharing Scheme |
| NEL | National Electricity Law |
| NEO | National Electricity Objective |

Executive Summary

I have prepared this report in my role as the NSW Electricity Price Commissioner in accordance with the legislative requirements of the *Electricity Network Assets (Authorised Transactions) Act 2015*, New South Wales (the Act).

Section 8(2)(b) of the Act specifies that the Treasurer is to request the Price Commissioner to provide:

“an annual report, for each completed authorised transaction, on compliance by the authorised network operator with its obligations under its electricity price guarantee”.

The Treasurer requested this report in relation to the compliance of Endeavour Energy with its obligations for the 2016-17 financial year. Specifically, this report covers Endeavour Energy’s compliance between transaction completion on 14 June 2017 and 30 June 2017.

This report may be released publically at the discretion of the Treasurer.

Endeavour Energy has provided written evidence of its intent to comply with its obligations under the electricity price guarantee. I reviewed this evidence and requested further information. I also sought information from the Australian Energy Regulator (AER).

My findings with respect to each component of the electricity price guarantee are summarised below.

Part (a) – Total network charges:

This component on the guarantee places an obligation on Endeavour Energy to ensure that its total network charges for 2018-19 are lower than its total network charges for 2013-14.

Endeavour Energy’s compliance with this component of the guarantee cannot be assessed at this stage. I will revisit this assessment in a future report.

Part (b) – Investment in, operation and use of electricity services:

This component of the guarantee requires Endeavour Energy to promote efficient investment in, and efficient operation and use of electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity. This requirement mirrors part of the National Electricity Objective.

The AER is responsible for the economic regulation of Endeavour Energy in accordance with the National Electricity Law and National Electricity Rules. In doing so, it must be satisfied that its distribution determinations for Endeavour Energy will or are likely to contribute to the achievement of the National Electricity Objective to the greatest degree.

Due to legal proceedings, there was no distribution determination applicable to Endeavour Energy in 2016-17. In the absence of a determination, the AER and Endeavour Energy entered into an enforceable undertaking to enable 2016-17 prices to be set. The AER has the ability to take enforcement action against Endeavour Energy should it not comply with the undertaking. The AER has confirmed that no such enforcement action has taken place.

The AER has also advised that it has not raised any compliance issues with Endeavour Energy in relation to the efficient investment in, and/or efficient operation and use of electricity services in 2016-17 for the long term interests of consumers of electricity.

I am satisfied that Endeavour Energy has complied with its obligations under this component of the guarantee between transaction completion on 14 June 2017 and 30 June 2017.

Part (c) – Efficiency Benefit Sharing Scheme:

This component of the guarantee requires Endeavour Energy to comply with any applicable Efficiency Benefit Sharing Scheme (EBSS) developed by the AER. The AER decides how to apply the EBSS through its distribution determinations, and also oversees network business compliance through the same process.

Due to legal proceedings, there was no distribution determination applicable to Endeavour Energy in 2016-17. In the absence of the determination, Endeavour Energy made an undertaking to the AER which bound Endeavour Energy to apply the EBSS regardless of the outcome of the appeal processes.

I am satisfied that the current regulatory framework in place is sufficient to ensure Endeavour Energy's compliance with this component of the guarantee between transaction completion on 14 June 2017 and 30 June 2017.

1. Background

1.1 Introduction

The NSW Government completed the 99-year lease of 50.4 per cent of Endeavour Energy on 14 June 2017.

Under section 8(1) of the *Electricity Network Assets (Authorised Transactions) Act 2015* (the Act), the successful consortium provided an electricity price guarantee to the effect that:

- a) the authorised network operator's total network charges for the financial year ending 30 June 2019 will be lower than the network operator's total network charges for the financial year ending 30 June 2014, and
- b) the authorised network operator will promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity, and
- c) the authorised network operator will comply with any Efficiency Benefit Sharing Scheme developed by the AER for the sharing of efficiency gains and losses between network operators and their customers that is applicable to the network operator.

The NSW Electricity Price Commissioner is required to report to the Treasurer on Endeavour Energy's compliance with its obligations under its electricity price guarantee. Specifically, section 8(2)(b) of the Act specifies that the Treasurer is to request the Price Commissioner to provide:

“an annual report, for each completed authorised transaction, on compliance by the authorised network operator with its obligations under its electricity price guarantee”.

The Act sets out requirements for provision of information to the Electricity Price Commissioner, including that:

- Section 8(3) – *“a public sector agency must comply with any reasonable request by the Price Commissioner that the agency provide information to the Price Commissioner for the purposes of reports under this section (with any dispute as to the reasonableness of a request to be decided by the Secretary of the Department of Premier and Cabinet).”*
- Section 8(5) – *“an authorised network operator must within 2 months after the end of each financial year provide to the Price Commissioner such information as the Price Commissioner may reasonably require to enable the Price Commissioner to report on compliance by the authorised network operator with its obligations under its electricity price guarantee.”*

The Act also provides for the independence of the Electricity Price Commissioner, with section 8(4) noting that:

“the Price Commissioner is not subject to control or direction by or on behalf of the Government in connection with any report of the Price Commissioner.”

1.2 The assessment process

Endeavour Energy submitted information to me under section 8(5) of the Act to demonstrate its compliance with its obligations under the electricity price guarantee.

I reviewed this submission and requested further information, which was provided. I also sought information from the Australian Energy Regulator (AER).

This report outlines the relevant evidence and assesses Endeavour Energy’s compliance with its electricity price guarantee between transaction completion on 14 June 2017 and 30 June 2017.

2. Assessment of compliance

2.1 Part (a) – Total network charges

Guarantee

Endeavour Energy has guaranteed that its total network charges for the financial year ending 30 June 2019 will be lower than its total network charges for the financial year ending 30 June 2014.

As defined under section 8(6) of the Act:

- **network charges** means revenue collected by a network operator in respect of regulated services provided by the network operator.
- **total network charges** for a period means the total revenue collected by a network operator at any time (whether or not during the period concerned) in respect of regulated services provided by the network operator during that period.
- **regulated services** means the following direct control network services (within the meaning of the National Electricity (NSW) Law):
 - (a) a standard control service or prescribed transmission service,
 - (b) any other service prescribed by the regulations.

Assessment

Endeavour Energy's compliance with this component of the guarantee cannot be assessed at this stage. I will revisit this assessment in a future report.

2.2 Part (b) – Investment in, operation and use of electricity services

Guarantee

Endeavour Energy has guaranteed that it will promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity.

This component of the guarantee mirrors an excerpt of the National Electricity Objective (NEO) defined in section 7 of the National Electricity Law (NEL):

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system.

The NEL requires the Australian Energy Regulator (AER), Australian Energy Market Commission (AEMC) and the Australian Energy Market Operator (AEMO) to have regard to, or contribute towards the achievement of, this objective when carrying out their functions or powers under the Law. It also requires the Australian Competition Tribunal to have regard to the objective in its decisions. The main requirements in this regard are summarised in Table 1.

Table 1: Selected references to National Electricity Objective in the NEL

| NEL reference | Requirement |
|---------------|--|
| s 16(1)(a) | The AER must, in performing or exercising an AER economic regulatory function or power, perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the national electricity objective. |
| s 16(1)(d)(i) | The AER must, in performing or exercising an AER economic regulatory function or power, if the AER is making a reviewable regulatory decision and there are 2 or more possible reviewable regulatory decisions that will or are likely to contribute to the achievement of the national electricity objective – make the decision that the AER is satisfied will or is likely to contribute to the achievement of the national electricity objective to the greatest degree (the <i>preferable reviewable regulatory decision</i>). |
| s 32 | In performing or exercising any function or power under this Law, the Regulations or the Rules, the AEMC must have regard to the national electricity objective. |
| s 88 (1) | The AEMC may only make a Rule if it is satisfied that the Rule will or is likely to contribute to the achievement of the national electricity objective. |
| s 49(3) | AEMO must, in carrying out functions referred to in this section (statutory functions), have regard to the national electricity objective. |
| s 71P(2a)(c) | Despite subsection (2), the (Australian Competition) Tribunal may only make a determination – if – the Tribunal is satisfied that to do so will, or is likely to, result in a decision that is materially preferable to the reviewable regulatory decision in making a contribution to the achievement of the national electricity objective (a materially preferable NEO decision) (and if the Tribunal is not so satisfied the Tribunal must affirm the decision). |

Source: National Electricity Law

Under the National Electricity Rules, the AER's distribution determination for Endeavour Energy takes into account the both efficient costs of, and the costs that a prudent operator would require to:

- comply with all applicable regulatory obligations or requirements associated with the provision of standard control services (including those that relate to quality, reliability or security of supply); and
- maintain the safety of the distribution system through the supply of standard control services.¹

Evidence of compliance

In April 2015, the AER made its original distribution determination for Endeavour Energy for the regulatory control period from 2014-15 to 2018-19. The determination allowed 28% less revenue than proposed by Endeavour Energy, with the difference primarily driven by the AER's decisions around the rate of return and forecast operating expenditure. The AER considered that:

- Endeavour Energy had sought a rate of return that was higher than necessary given the current investment environment; and
- A step change for increased vegetation management costs should not be included in Endeavour Energy's forecast operating costs.²

The National Electricity Law and National Electricity Rules provide mechanisms for the AER to review Endeavour Energy's compliance with its distribution determination. This includes:

- The requirement that the AER decide, as part of the distribution determination, how Endeavour Energy is to demonstrate its compliance with the control mechanisms set by the AER.³

¹ National Electricity Rules, Chapter 6, Part C, clauses 6.5.6 and 6.5.7

² https://www.aer.gov.au/system/files/AER%20-%20Final%20decision%20Endeavour%20Energy%20distribution%20determination%20-%20Fact%20Sheet%20-%20April%202015_1.pdf

³ National Electricity Rules, Chapter 6, Part E, clause 6.12.1(13)

- The requirement for Endeavour Energy to submit annual pricing proposals to the AER for approval, which include demonstration of compliance with the National Electricity Rules and any applicable distribution determination.⁴
- The ability for the AER to issue Regulatory Information Notices to Endeavour Energy to support its regulatory responsibilities.⁵

However, the AER's 2015 determination for Endeavour Energy was set aside by the Australian Competition Tribunal in February 2016 after Endeavour Energy and the other NSW distribution network service providers sought a limited merits review of the AER's final decisions. In March 2016 the AER sought judicial review of the Tribunal's decision in the Full Federal Court. The Court handed down its decision in May 2017, which upheld the AER's appeal in relation to the cost of corporate income tax, and upheld the Tribunal's findings in relation to Endeavour Energy's cost of debt and operating expenditure.

The AER is in the process of preparing a remade determination.

In the absence of an applicable distribution determination, Endeavour Energy entered into an enforceable undertaking with the AER in May 2016 to allow Endeavour Energy's 2016-17 prices to be set.

The undertaking, available on the AER website, set Endeavour Energy's network use of system tariffs for 2016-17 to the 2015-16 levels previously approved by the AER, escalated by 1.51% to reflect changes in the Consumer Price Index.⁶ Endeavour Energy also undertook to comply with the non-price terms and conditions of the original 2015 determination.

The AER accepted the undertaking, and Endeavour Energy's compliance with it, as discharging Endeavour Energy's obligations under the National Electricity Law and National Electricity Rules for 2016-17 in relation to:

⁴ National Electricity Rules, Chapter 6, Part I, clause 6.18.2(b)(7)

⁵ National Electricity Law, Part 3, Division 4

⁶ <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/pricing-proposals-tariffs/endeavour-energy-annual-pricing-2016%E2%80%9317>

- pricing and network charges; and
- compliance with the non-price components of the 2015 determination set out in Schedule 2 of the undertaking.

The AER also retained the right to take enforcement action at any time in respect of any breach by Endeavour Energy of the undertaking. The AER has confirmed that no such enforcement action has taken place.

Endeavour Energy has submitted its 2016-17 annual Regulatory Information Notice to the AER, which is available on the AER website.⁷

The AER has advised that it has not raised any compliance issues with Endeavour Energy in relation to the efficient investment in, and/or efficient operation and use of electricity services in 2016-17 for the long term interests of consumers of electricity.

Assessment

This component of the guarantee requires Endeavour Energy to promote efficient investment in, and efficient operation and use of electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity. This requirement mirrors part of the National Electricity Objective.

The AER is responsible for the economic regulation of Endeavour Energy in accordance with the National Electricity Law and National Electricity Rules. In doing so, it must be satisfied that its distribution determinations for Endeavour Energy will or are likely to contribute to the achievement of the National Electricity Objective to the greatest degree.

Due to legal proceedings, there was no distribution determination applicable to Endeavour Energy in 2016-17. In the absence of a determination, the AER and Endeavour Energy entered into an enforceable undertaking to enable 2016-17 prices to be set. The AER has the ability to take enforcement action

⁷ <https://www.aer.gov.au/networks-pipelines/network-performance/endeavour-energy-network-information-rin-responses>

against Endeavour Energy should it not comply with the undertaking. The AER has confirmed that no such enforcement action has taken place.

The AER has also advised that it has not raised any compliance issues with Endeavour Energy in relation to the efficient investment in, and/or efficient operation and use of electricity services in 2016-17 for the long term interests of consumers of electricity.

I am satisfied that Endeavour Energy has complied with its obligations under this component of the guarantee between transaction completion on 14 June 2017 and 30 June 2017.

2.3 Part (c) – Efficiency Benefit Sharing Scheme

Guarantee

Endeavour Energy has guaranteed that it will comply with any applicable Efficiency Benefit Sharing Scheme (EBSS) developed by the AER for the sharing of efficiency gains and losses between network operators and their customers.

In applying the EBSS, the AER aims to provide a continuous incentive for a network business to pursue efficiency improvements in operating expenditure and to share efficiency gains with customers.

Evidence of compliance

Under the National Electricity Rules (specifically Chapter 6), Endeavour Energy is required to comply with any applicable EBSS developed by the AER for the sharing of efficiency gains and losses between network operators and their customers.

The sharing of efficiency gains and losses is determined by the AER as part of its revenue determination for Endeavour Energy, in accordance with clauses 6.5.8, 6.12.1(a), 6.3.2(3) and 6.4.3(a)(5) of the National Electricity Rules (see Appendix A for extracts of these Rules).

The AER's original distribution determination for Endeavour Energy in the current regulatory control period:

- included a total EBSS carryover amount of \$93.4 million (\$2013-14) in Endeavour Energy's allowed revenue from 2014-15 to 2018-19, from the application of the EBSS to Endeavour Energy during the 2009-10 to 2013-14 regulatory control period; and
- confirmed that the AER would apply the EBSS to Endeavour Energy between 2014-15 and 2018-19.

However, as noted in Section 2.2, the AER's 2015 determination for Endeavour Energy was set aside by the Australian Competition Tribunal in February 2016. The AER is in the process of preparing a remade determination.

Nevertheless, as part of the enforceable undertaking with the AER dated May 2016, Endeavour Energy undertook to comply with the AER's constituent decision on the EBSS in the original 2015 determination for 2016-17. This confirms that EBSS allowances or penalties will accrue to the 2019-24 regulatory control period.

The AER retained the right to take enforcement action at any time in respect of any breach by Endeavour Energy of the undertaking. The AER has confirmed that no such enforcement action has taken place.

Assessment

This component of the guarantee requires Endeavour Energy to comply with any applicable EBSS developed by the AER. The AER decides how to apply the EBSS through its distribution determinations, and also oversees network business compliance through the same process.

Due to legal proceedings, there was no distribution determination applicable to Endeavour Energy in 2016-17. In the absence of the determination, Endeavour Energy made an undertaking to the AER which bound Endeavour Energy to apply the EBSS regardless of the outcome of the appeal processes.

I am satisfied that the current regulatory framework in place is sufficient to ensure Endeavour Energy's compliance with this component of the guarantee between transaction completion on 14 June 2017 and 30 June 2017.

Appendix A: National Electricity Rule excerpts – Chapter 6

National Electricity Rules – Version 92 – Chapter 6:

Efficiency Benefit Sharing Scheme

6.5.8 – Efficiency benefit sharing scheme

- (a) The AER must, in accordance with the distribution consultation procedures, develop and publish an incentive scheme or schemes (efficiency benefit sharing scheme) that provide for a fair sharing between Distribution Network Service Providers and Distribution Network Users of:
- (1) the efficiency gains derived from the operating expenditure of Distribution Network Service Providers for a regulatory control period being less than; and
 - (2) the efficiency losses derived from the operating expenditure of Distribution Network Service Providers for a regulatory control period being more than,
- the forecast operating expenditure accepted or substituted by the AER for that regulatory control period.
- (b) An efficiency benefit sharing scheme may (but is not required to) be developed to cover efficiency gains and losses related to distribution losses.
- (c) In developing and implementing an efficiency benefit sharing scheme, the AER must have regard to:
- (1) the need to ensure that benefits to electricity consumers likely to result from the scheme are sufficient to warrant any reward or penalty under the scheme for Distribution Network Service Providers;

- (2) the need to provide Distribution Network Service Providers with a continuous incentive, so far as is consistent with economic efficiency, to reduce operating expenditure;
 - (3) the desirability of both rewarding Distribution Network Service Providers for efficiency gains and penalising Distribution Network Service Providers for efficiency losses;
 - (4) any incentives that Distribution Network Service Providers may have to capitalise expenditure; and
 - (5) the possible effects of the scheme on incentives for the implementation of non-network options.
- (d) The AER may, from time to time and in accordance with the distribution consultation procedures, amend or replace an efficiency benefit sharing scheme.

6.12.1 – Constituent decisions

A distribution determination is predicated on the following decisions by the AER (constituent decisions):

...

- (9) a decision on how any applicable efficiency benefit sharing scheme, capital expenditure sharing scheme, service target performance incentive scheme, demand management incentive scheme, demand management innovation allowance or small-scale incentive scheme is to apply to the Distribution Network Service Provider.

6.3.2 – Contents of building block determination

- (a) A building block determination for a Distribution Network Service Provider is to specify, for a regulatory control period, the following matters:

...

- (3) how any applicable efficiency benefit sharing scheme, capital expenditure sharing scheme, service target performance incentive scheme, demand management incentive scheme, demand management innovation allowance or small-scale incentive scheme is to apply to the Distribution Network Service Provider.

6.4.3 – Building block approach

- (a) **Building blocks generally**

The annual revenue requirement for a Distribution Network Service Provider for each regulatory year of a regulatory control period must be determined using a building block approach, under which the building blocks are:

...

- (5) the revenue increments or decrements (if any) for that year arising from the application of any efficiency benefit sharing scheme, capital expenditure sharing scheme, service target performance incentive scheme, demand management incentive scheme, demand management innovation allowance or small-scale incentive scheme.