Submission to: **Australian Energy Regulator (AER)**

From: **Uniting Care Australia**

Subject: **Response to Electricity Distribution Business Regulatory proposals for 2015-20, from South Australian Power Networks**

Section 1: Current Context

This section is a part of our answer to the overarching question implied by the AER Issues paper:[1]

Do you think that SA Power Networks' capital expenditure proposal is adequately justified?

In answering this question we start with some of the context for this regulatory proposal

This submission regarding electricity network distribution pricing for South Australia comes at a significant time in a broader social policy sense. While working on this submission Uniting Care Australia was also engaged, to various degrees, in understanding a range of proposals that are likely to impact on lower income and disadvantaged people. These processes include uncertainty about future income support arrangements, particularly for people under 30 years of age, uncertainty about health costs, and the sceptre of diminishing government services.

Many of the measures proposed across these processes are very likely to impact on people already struggling to pay for essential services, for example through reduced minimum wages, lower income support and for some under 30 year olds, no income for extended periods of time. To assume that continuing high utility costs can be paid for by growing numbers of people facing 'energy stress' or can be ameliorated through improved concessions from governments is not a sound assumption. It is all the more important that energy prices are efficient and that the prises paid by end consumers are fair and reasonable.

The SAPN regulatory proposal has not considered the affordability of electricity context for the next regulatory period.

[1] AER: Issues paper; SA Power Networks electricity distribution regulatory proposal 2015–16 to 2019–20

At the same time, community service organisations face substantial uncertainly from a range of significant funding programs including those funding financial counselling, housing and homelessness services, labour market support and ongoing uncertainty about funding for child protection services.

Within this funding uncertainty from both Commonwealth and state governments is the expectation that community service organisations will do more with less. Similarly there is an ongoing expectation for federal and state government departments that they will cut spending costs, year on year – delivering 'an efficiency dividend.'

The SAPN regulatory proposal seeks to increase revenue with no recognition of the government community expectations that community and government agencies should 'do more with less.' SAPN should not regard themselves to be immune from this economic and social context.

SAPN has not adequately justified their implicit proposal that their revenue, and profits should increase, while many community and government agencies, as well as many small business are expected to provide more services (or products) with small budgets, year on year. In short, SAPN has not considered that it should deliver an 'efficiency dividend.'

Section 2: Is the NEO currently being met?

National Energy Objective

The starting point for network businesses lodging their regulatory proposals and for the Australian Energy regulator (AER) must be the National Electricity Objective as set out in the National Electricity Law. The Objective , 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"

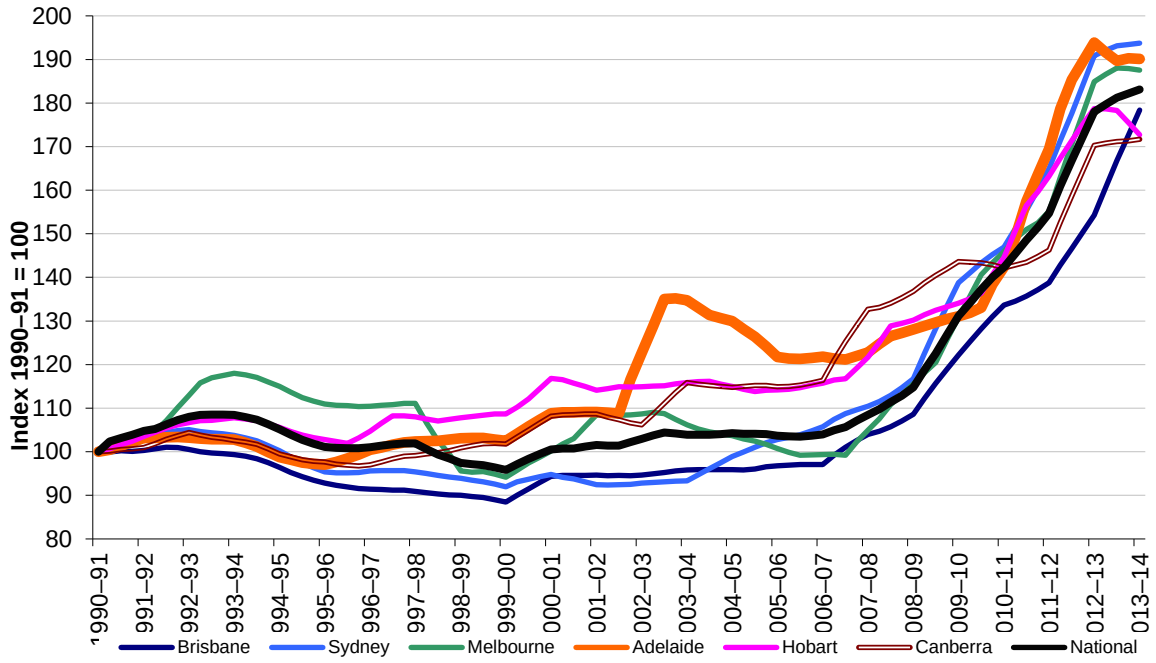
We assert that the application of this objective is crucial, now more than ever, because of the financial pressure on households from current, high energy costs and because it is highly unlikely that amelioration of lower income household bills will come from any other source, including concessions.

We commence by asking how well the NEO is being applied, now, for household consumers? At the same time, we recognise that many of the same concerns apply to small businesses, including primary producers.

Over the last 5-6 years, across Australia, electricity prices have been rising, unambiguously; near doubling in real terms for many households whose incomes have tended to decline in real terms while energy prices have risen. Figure 1 shows the electricity price rises for Australian jurisdictions.

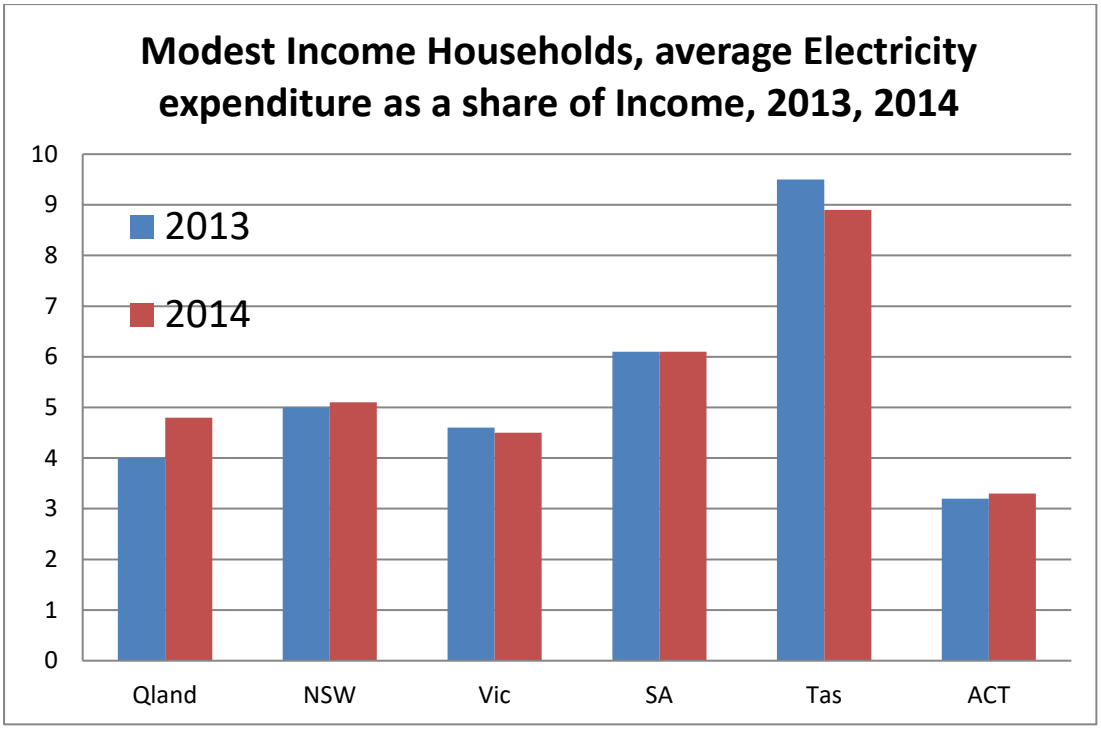
South Australian consumers pay higher than national average prices, are just short of NSW in terms of size of annual bills and have experienced substantial annual price increases over the last 5 years, after a 27% average bill spike in 2002-03 when full retail contestability was originally introduced.

Figure 1. Electricity price indexes for Australian jurisdictions, 1990-91 = 100



Source: Australian Energy Regulator, State of the Energy Markets report, 2013

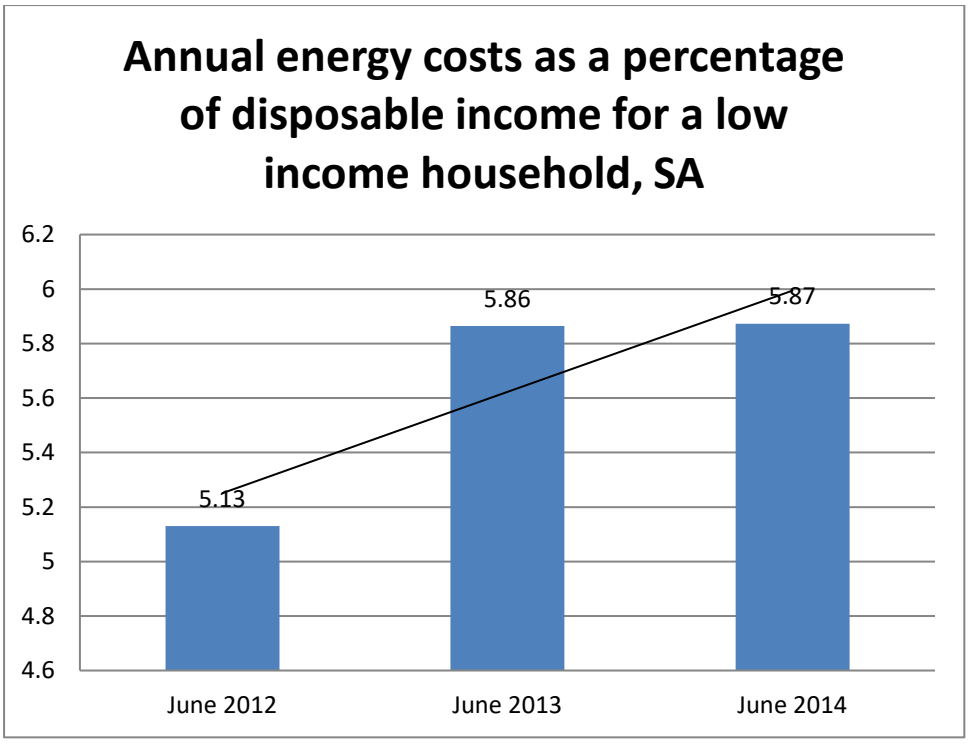
Figure 2. Annual energy costs as a percentage of disposable income for a low income households



Source: Australian Energy Regulator, Annual Report on the performance of the retail energy market, 2013-14

Figure 2 shows the average household spend, as a proportion of household income for modest income households. For the last 2 years modest income SA households have been paying the second highest proportion of income on electricity of the Australian states, averaging 6% of income, just on electricity costs.

Figure 3. Annual energy costs as a percentage of household income, 2012-14



Source: Australian Energy Regulator, Annual Report on the performance of the retail energy market, 2013-14

Figure three shows that the proportion of income spent on electricity for low income households continues to rise, with a 14% increase over 2 years in the average proportion of household income spent by lower income households. This at a time when incomes for many of these households were barely changing, in nominal dollars.

We know from financial counsellors , emergency relief and other services, that there are households paying dramatically more than these the 6% average expenditure levels for modest income households.

Noting the Australia wide trend for rapidly growing prices for electricity, we ask whether the National Energy Objective, NEO, is being met, in practice, at the moment, nationally and, in South Australia, the focus of this submission?

SAPN has not adequately justified it's proposal when we cannot consider the NEO to be met since electricity prices have increased by 3-5 times CPI and growing numbers of households can't afford to pay for electricity.

What customers are really doing

SA Power Networks say in their regulatory proposals, that they are engaging with consumers, who they say are happy with the reliability of their electricity supply, and so they conclude that all is well, their costs must be efficient, so continue on with the current arrangements, plus CPI. This is a core theme of the thousands of pages of regulatory proposals that they have submitted.

But we ask what is actually happening? We attempt to add a little 'behaviour economics' to the more conventional neo-classical economics that has been behind much of the energy regulation in Australia. Behavioural economics, amongst other questions, asks what consumers actually do, rather than what theory might have predicted they would do (rational expectations for example), and even what consumers say they will do, or have done.

In answering the question about what consumers are doing, in practice, in response to ever higher electricity prices, we observe number of behavioural responses:

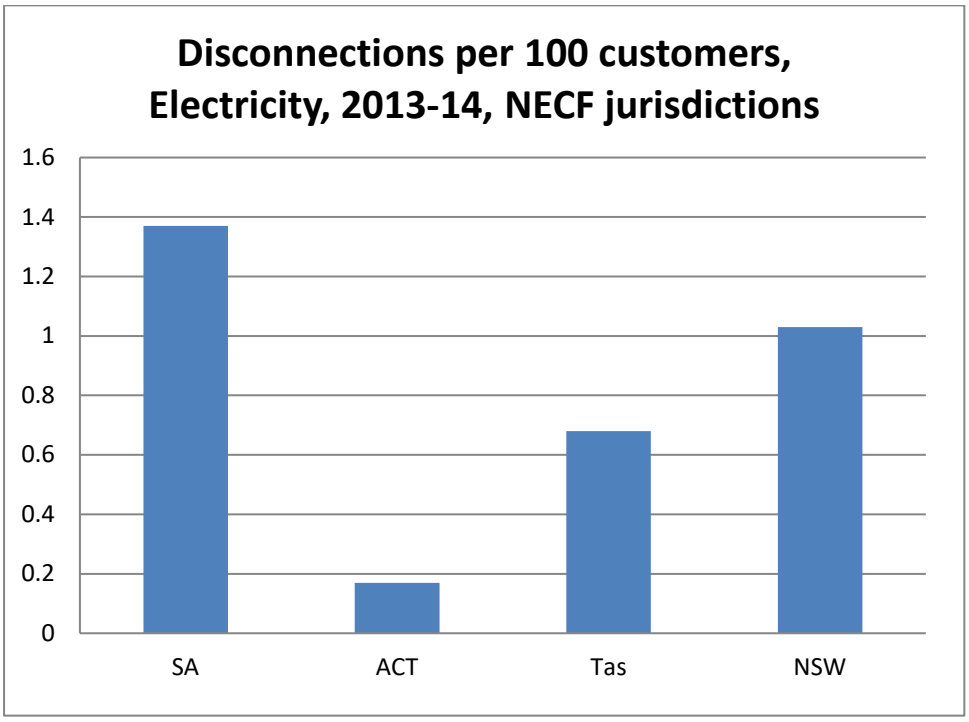
- More people being disconnected from Supply
- Growing numbers of consumers are 'walking with their feet' by installing solar PV to avoid network costs
- Increasing energy stress, both with more people affected by rising prices and a 'deepening' of energy stress for some groups of consumers.
- Growing numbers of customers being put on Hardship programs
- More complaints from energy consumers
- People are using less energy

We now consider each of these behaviours in turn

More people being disconnected from Supply

Figures 3 and 3a, below show reported disconnections due to inability to pay. Figure 3 shows electricity disconnections, by jurisdiction that has agreed to be a part of the National Energy Customer Framework. South Australia clearly has the highest rate of disconnection from this cohort.

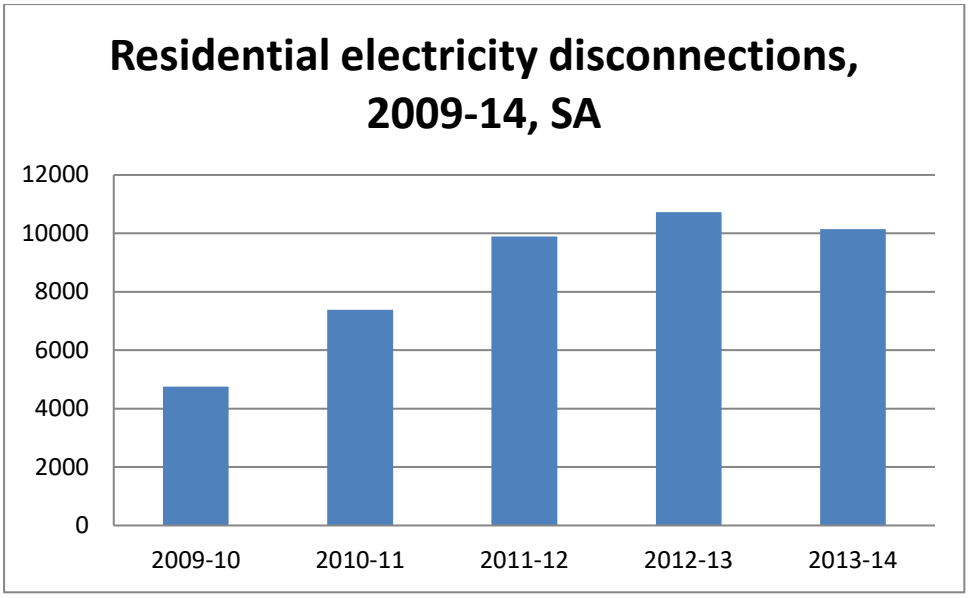
Figure 3, Electricity Disconnections, NECF Jurisdictions



Source: Australian Energy Regulator, State of the Energy Markets report, 2014

While disconnections data is likely to be variable over time, due to different collections processes employed by businesses, and other varying factors, the trend for electricity disconnections is rising for South Australia, notwithstanding a small decrease in 2013-14, but only after substantial increases over the last SAPN regulatory period

Figure 3a: Electricity Disconnections, SA, 2009-14



Source: Australian Energy Regulator, State of the Energy Markets report, 2013, reported by VCOSS

Many more people Installing solar PV to avoid network costs

In South Australia, a year ago, 21.2% of households had installer rooftop solar PV systems.[2] This is occurring at a time when there is widespread scepticism about global warming and of the merits of 'green schemes' and uncertainly about future Australian Renewable Energy Targets.

We recognise that there are many reasons for the rapid uptake of PV systems in Australia. Generous initial government inventive grants and guaranteed feed in tariffs have certainly contributed to the uptake being beyond initial expectations. These have now largely concluded with market based feed in tariffs all that remain. There was also an initial enthusiasm for people who are concerned about the environment and regarded personal PV as a means of reducing carbon footprints. These views remain; however, the current political context is quite dismissive of climate change and responses to it. The number of people installing solar PV is greater than the number of Greens voters and certainly larger than membership of environmental groups, so we suggest that there is another major reason for the rapid and continuing uptake of solar PV.

The main reason for continuing PV uptake is that rapidly rising energy costs are pushing people to seek alternatives for their energy costs, particularly the network costs, and importantly, households are wanting to 'future proof' their energy costs. This is evidenced by both the continuing installation of new PV systems, but also by the growing size of new installations. The average 1.5kw system of about 5 years ago is now nearer to an average of 4kw for each new installation. There is good evidence that the households most actively installing PV are lower-middle and middle income households, roughly deciles 3 to 7 from

[2] http://reneweconomy.com.au/2014/uptake-of-rooftop-solar-pv-surges-in-south-australia-in-2nd-half-2013-2013

income distribution data sets: “mortgage belt Australia” are the major PV installers, with households approaching retirement being significant installers.

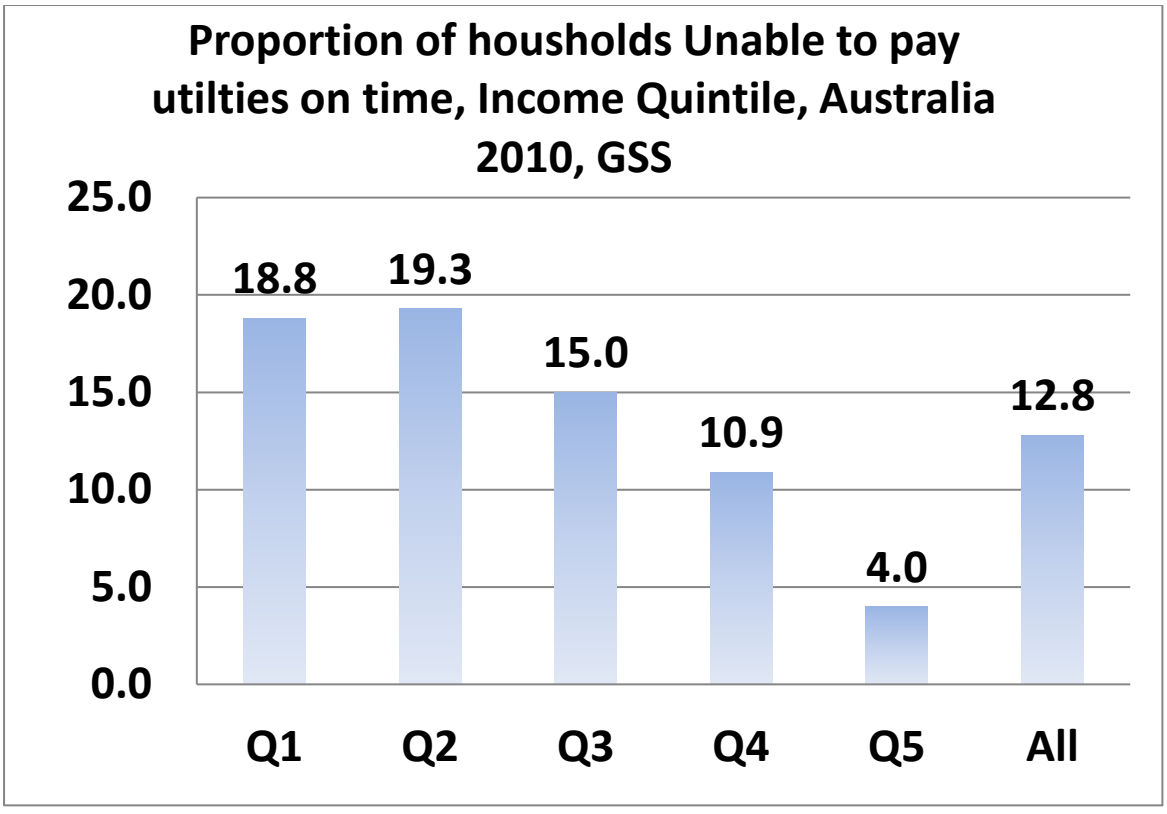
This evidence suggests two major factors in the continuing uptake of solar PV; firstly the falling cost of photo-voltaic systems, but most significantly, the rising cost of electricity for households is forcing residential consumers to vote with their feet, by installing solar PV to reduce their dependence on electricity networks and to give a degree of certainly about future electricity costs.

Large numbers of residential and small businesses are installing solar PV as a direct response to rising energy charges and, we suggest, to also reduce their reliance on networks and the ever higher costs that customers experience.

Increasing energy stress

The number of people who are unable to pay their utility bills in time is substantial, as shown in figure 4, this is shown in figure 4, using Financial Stress data taken from the ABS General Social Survey. Just over one in eight Australian households are unable to pay utility bills, mainly electricity, on time, but for the poorest 40% of Australians, close to one in five households can’t pay their bills on time. The submission from the Consumer Challenge Panel adds to this data, we endorse their comments.

Figure 4. Inability to pay utility bills on time



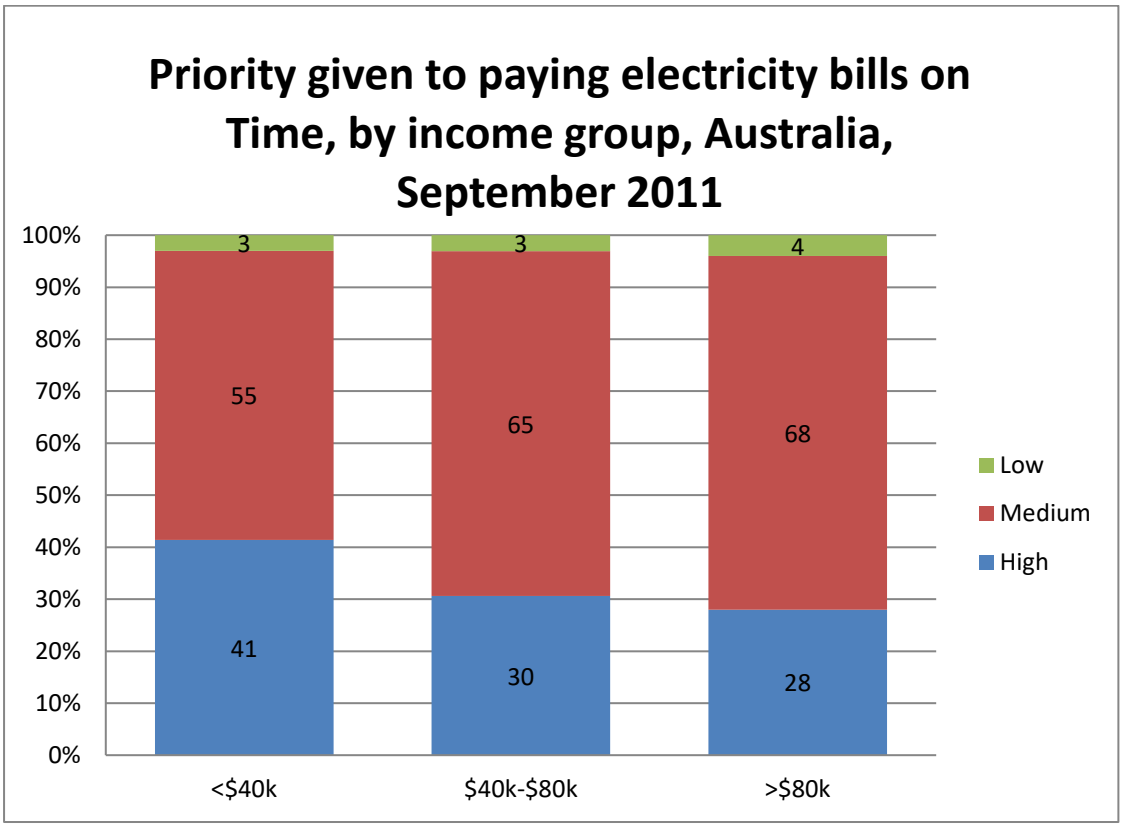
Source: ABC, General Social Survey, 2012

This situation needs to be understood in the context of priority given to paying on time by consumers. Uniting Care Australia has sought to clarify this situation and has engaged The Australia Institute to survey consumers regarding aspects of their attitude to energy bills. We have asked about the priority given to households in paying their energy bills on time, through 3 separate surveys of about 1500 people in each survey. The results for each survey are almost identical, with the results for our most recent completed survey shown in figure 5. We have classified respondents into 3 income bands; low - less than $40,000 annual income, medium income – $40,000 to $80,000pa and high – more than $80,000 per annum.

The survey results show that very high priority is given to paying utility bills on time for people in all income bands, but the lowest income households put greatest priority in paying on time, with 41% of lower income people giving is a high priority, only 3% give electricity bill paying a low priority. This evidence certainly contradicts the occasional argument that households who don't pay their bills on time are 'won't payers' rather than 'can't payers'.

Indeed, paying energy bills on time ranks second highest priority for many households, only rent / mortgage payment rates a higher priority. Indeed, Uniting Care services are seeing people who have to spend up to two thirds of their income on housing plus energy costs.

Figure 5, Priority given to paying electricity bills on time

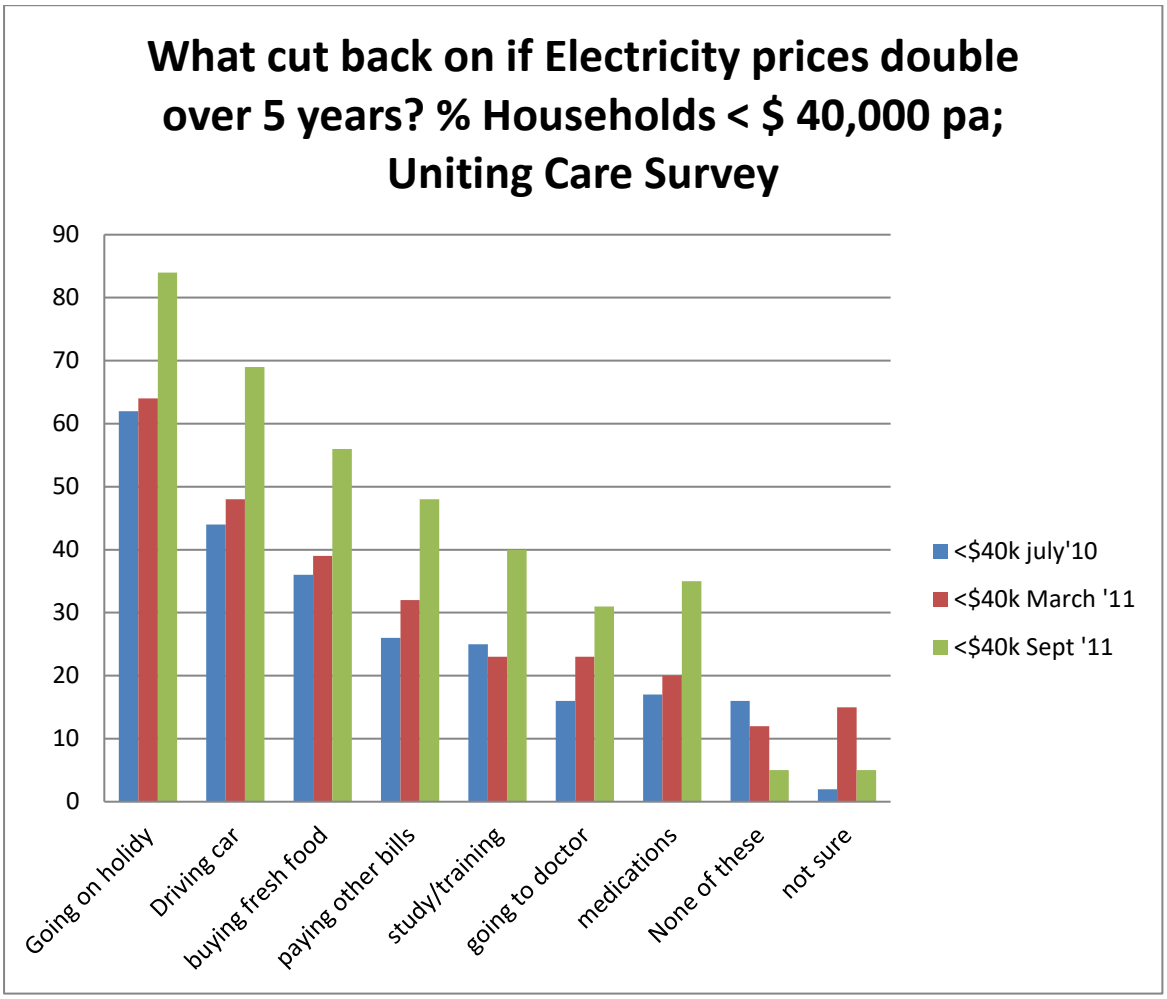


Source: Survey for Uniting Care Australia, undertaken by The Australia Institute

In the same survey mentioned above, we have asked about the impact of electricity prices doubling over the next 5 years, given that this has been the reality for a number of people over the last 5-7 years, rapidly rising energy costs coupled with declining real income, mainly as a result of less hours worked post global financial crisis.

Figure 6 shows the impact of electricity prices doubling, for the low income band, over three surveys during 2010 and 2011. The impacts increased over the period of the surveys. Of particular concern is that by September 2011, about a third of households were reporting that continuation of electricity bill increases would reduce visits to doctors and ability to buy medications. We know from our services that this current reality, not hypothetical future impacts. Over a half of respondents reported that they were cutting back on buying fresh food, indeed anecdotally we hear too many stories about 'two minute noodles' being all that families are able to afford to eat. Increasing high electricity bills is having health impacts, not just because people get too hot or too cold, but because they can't afford to buy healthy food and because they cut back on doctor visits and medications.

Figure 6. Impact of electricity prices doubling.

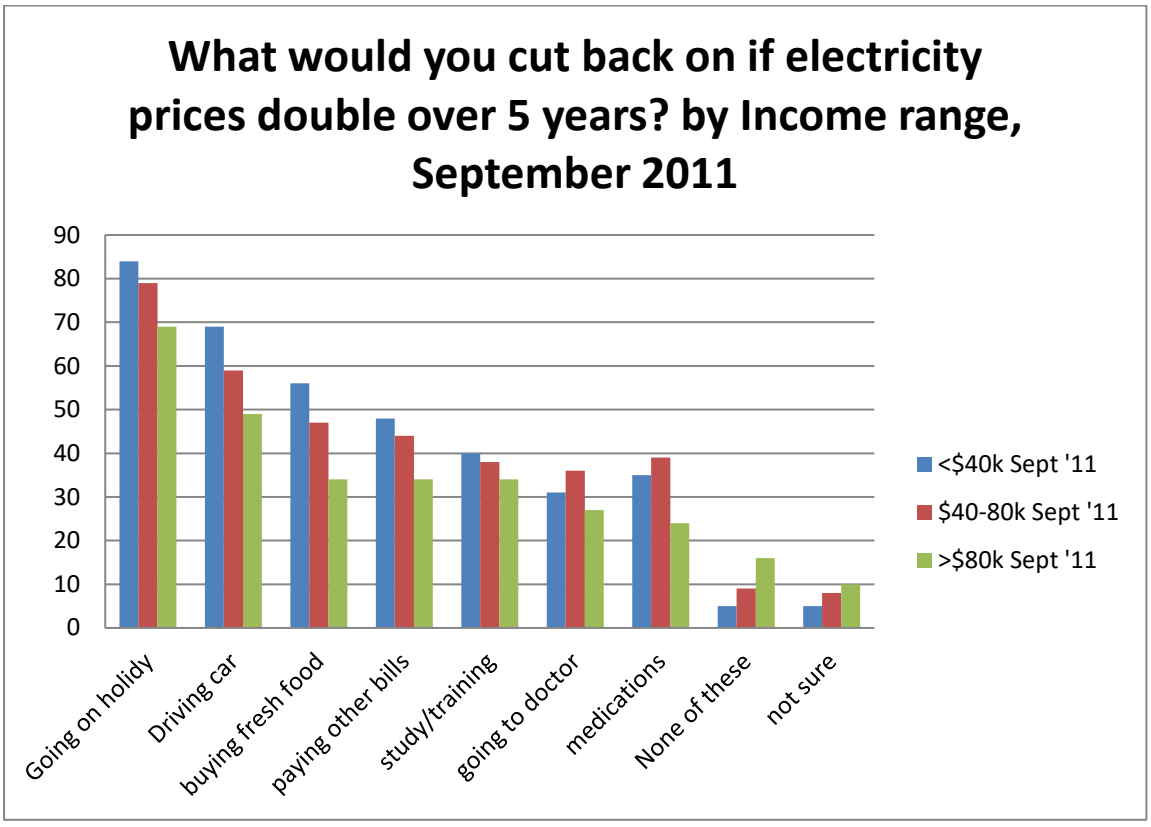


Source: Survey for Uniting Care Australia, undertaken by The Australia Institute

Also of concern to us is the reporting that about 40% of low income households will or have cut back on self education and training as a result of rapidly electricity price rises.

In figure 7 we show the impacts of electricity prices doubling for each of the income bands and are very surprised that the impacts for all income bands track each other more closely than we expected. Even moderately high income earners expect to cut back on a number of spending areas with rapid electricity price rises. Note too that the doctor visit reduction and medications decline are higher for our middle income band than the lowest income group. The impacts of large electricity price rises have been felt across the community, not just on poorer people, albeit more intensely on poorer people.

Figure 7. Impact of electricity prices doubling, by income band.



Source: Surveys for Uniting Care Australia, undertaken by The Australia Institute

The central point we make here is that electricity costs are too high for a large number of people to be able to pay. We state that the NEO is not being met in this situation because supply is not efficient if people can't afford to pay for this essential service. Reliability of supply is also compromised by inability to pay as well as associated disconnection or risk of disconnection.

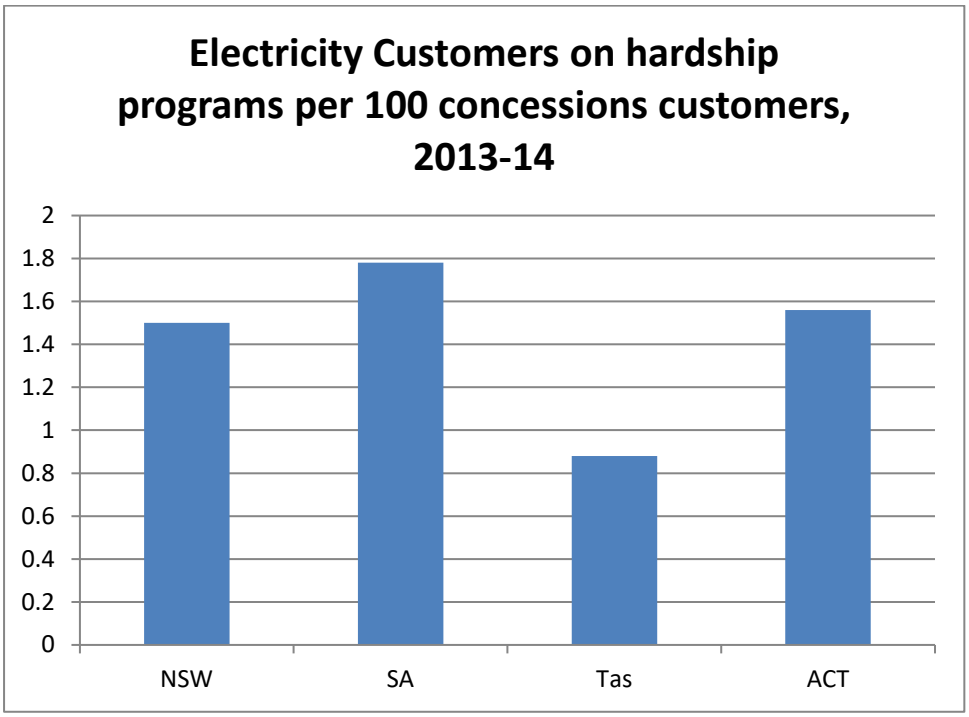
Growing numbers of Hardship customers

An important aspect of the National Energy Customer Framework (NECF) has been the requirement that all retailers offer an AER approved hardship program. This has been a

welcome development and over the last year or so the number of people being put onto hardship programs has been increasing substantially, albeit from a low base for some retailers. While this is welcome, at the level of redressing the energy stress for people in greatest need, it is also an indicator of the broader problem of growing numbers of people simply unable to pay for their basic electricity needs.

Of concern is the data in figure 8 which shows the proportion of electricity concession customers on hardship programs, with South Australia have the highest rate

Figure 8; Hardship program debt.



Source: Australian Energy Regulator, State of the Energy Markets report

More complaints

The number of complaints about electricity bills, contracts and related issues, to the SA energy and Water Industry Ombudsman scheme is shown in chart 1.

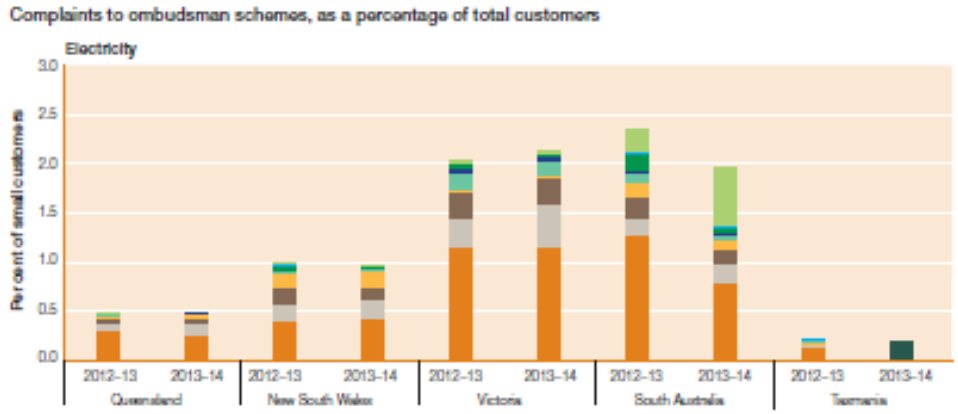
High levels of complaints is also a very clear indicator that the current arrangements are not working for consumers. More complaints is an indicator of an inefficient market that cannot possibly be working in the best interests of consumers. Figure 9 shows that while the number of Ombudsman complaints fell for SA, during 2013-14, compared to the previous year, SA complaint levels fell from the highest rate in Australia to the second highest rate, narrowly lower than Victoria. So there is still significant disquiet about electricity prices in South Australia.

Chart 1. Retail customer complaints

Issues (Received)	2012-2013	% of Total	2013-2014	% of Total
Billing	8,762	41%	7,190	39%
Sales and Marketing	2,560	12%	1,901	10%
Credit Management	1,200	6%	1,815	10%
Customer Service	1,067	5%	920	5%
General Enquiry (inc. Other)	6,854	32%	5,776	31%
Land	65	0%	100	1%
Provision	620	3%	562	3%
Supply Quality	191	1%	105	1%
TOTAL	**21,319**	**100%**	**18,369**	**100%**

Source; Energy and Water Ombudsman, SA, Annual report 2014

Figure 9



AER

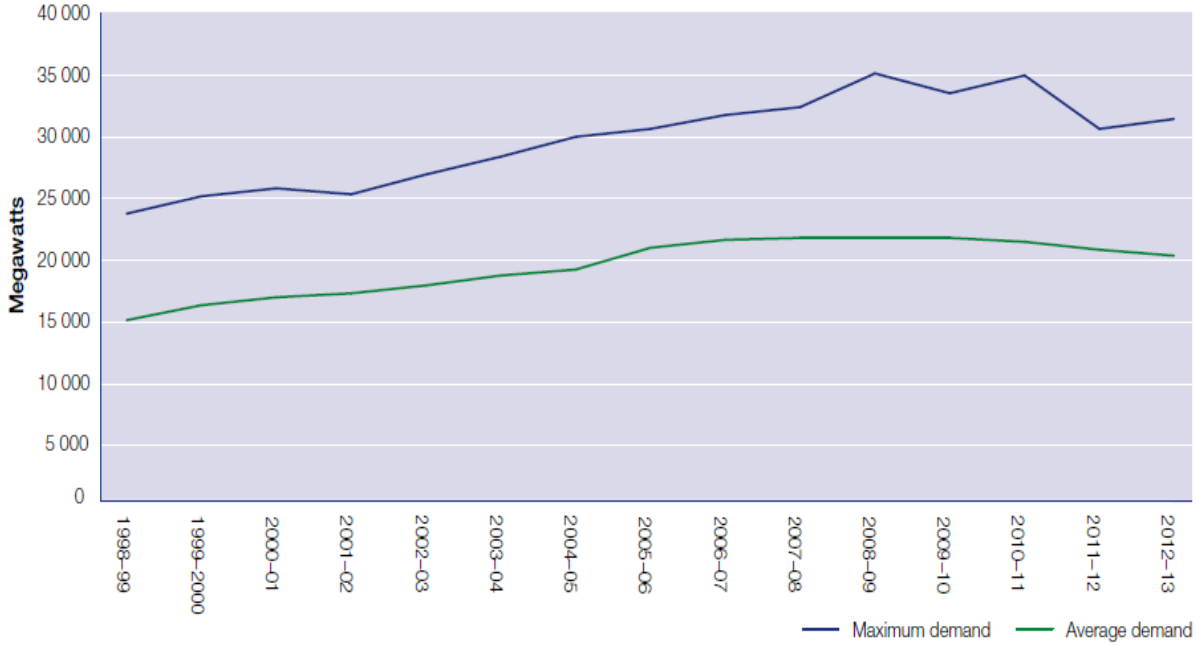
Source: Australian Energy Regulator, State of the Energy Markets report, 2013

People are using less energy

The nationaltrends described in figure 10 are well knows to energy companies and regulators. After an extended period of steady increase in annual demand for energy and more recently a more rapid growth in peak demand, demand is falling, in aggregate and at peak levels to.

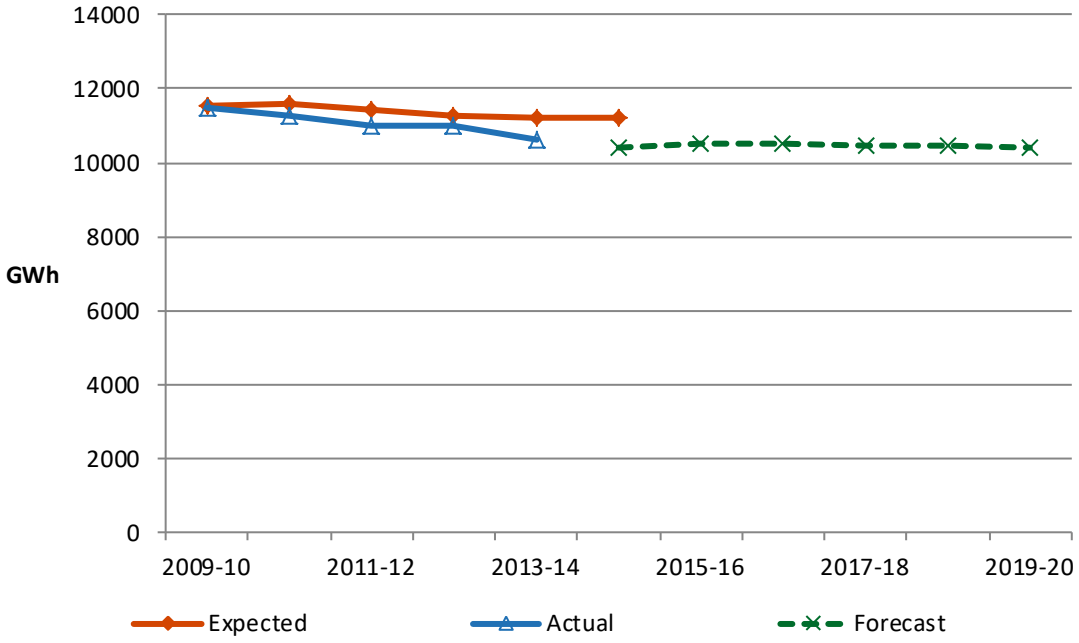
The declining demand trend is also clear in figure 11, showing htat for the most recent regulatory period, actual demand was lower than forecast, and clearly declining. The demand forecast for the 2015-20 period is also for a marginal decline.

Figure 10. Declining energy use



Source: Australian Energy Regulator, State of the Energy Markets report, 2013

Figure 11. SAPN Electricity demand actual and forecast



Source: Historical actual volumes are drawn from SA Power Networks' submitted economic benchmarking RINs. Forecasts are drawn from SA Power Networks' submitted reset RIN. From AER Issues Paper

Not all reasons for this trend can be agreed, however, factors for declining demand include shifts in industry consumption, more consumer awareness and so increased demand

management, more energy efficient appliances, the impacts solar PV installation and more poorer people being too worried about bills to use the electricity that they need.

This begs the question as to whether falling demand is an outcome of an inefficient and unresponsive market? Each of the factors listed above indicate that consumers are leaving or reducing their use of electricity networks, by conscious decision making or by being forced to by disconnection or the threat of disconnection, real or perceived.

The answer.

We commenced this section with the question as to whether the national electricity objective is currently being met?

We answer with a resounding "No".

It is evident that the behaviour of Australian electricity consumers, now and during the most recent regulatory period, has been to demonstrate through their actions, that the market is not meeting their needs. Chart 1 summarises current electricity market performance against the specific measures that the Neo must have regard to

Chart 1. Factors to be considered in meeting the NEO

NEO: regard to -	Being met currently?	Evidence
price	No	High prices push the rapid uptake of solar PV as network alternative.
quality	Yes	In general, though offices of the technical regulator in jurisdictions.
safety	No	Health risk to some vulnerable groups due to inability to pay for electricity for heating / cooling in extreme weather conditions. High energy prices leading to poorer health outcomes due to priority in household budget to electricity over healthy food and medical care
reliability	No	Disconnections due to inability to pay. Increasing complaints Self restriction of use for fear of future bills
Security of supply	No	Disconnections due to inability to pay. Increasing complaints Self restriction of use for fear of future bills

With the high costs of electricity and failure to meet other criteria specified in the National Energy Objective, we conclude that there has not been efficient investment in or efficient operation of electricity services in Australia over recent years, so the long term interests have not been met.

A market cannot be considered to be efficient if consumers are being forced from it and is growing numbers are doing everything they can to leave the network.

Implications for 2014-19 regulatory reset.

A core approach to regulatory process for natural monopolies is summarised as

Base – Step – Trend

Where the base year is often assumed to be efficient, with new or signifincat step changes added in and then a trend, often CPI – x applied. Over recent years the trend has been CPI+x and 'x' has been large.

We believe that this regulatory p0rocess must apply Base – Step – Trend from a consumer perspective.

Base – from a consumer perspective

Current levels of operation for network business, in this instance in NSW and ACT are too high and cannot be considered to be efficient. Submissions from the Public Interest Advocacy Centre and Consumer Challenge Panel both make this point, and we echo their findings. Past regulatory decisions have erred too much on the side of network returns and so the Base is too high.

Step – from a consumer perspective

For the 2014-19 regulatory resets, the 'step' changes need to be downward, to start to bring network spending back to more efficient levels and frankly to levels that are also more equitable for consumers.

Considering the end impacts in consumers over the most recent regulatory period, a downward step of 10% from the current base would be a reasonable step.

Trend – From a consumer perspective

The Uniting Care network provides a wide number of community services, many rely on government funding. It is common for program funding to locked at the same nominal levels over 3 to 5 years. Similarly some government departments are given an 'efficiency dividend' of CPI-x to achieve over a period of something like the budget forward estimates, 4 years.

We so no reason why applying an efficiency dividend, something like CPI-x, where "minus x" means "minus x" shouldn't apply to all networks businesses, to drive more efficient outcomes, in the best interests of consumers.

We strongly recommend that "x=2" for each year of the NSW and ACT 2014-19 regulatory period. This trend reduction of 2% per year, an efficiency dividend, would help to encourage more efficient outcomes for consumers.

Impacts on Individuals

For fear of losing the reality of ongoing high electricity prices, in the abstract of regulation, we present the following examples of impacts on individuals, real people, real stress, real situations as told by financial counsellors and other 'frontline' service providers

These short stories are indicative of the hundreds of similar stories we hear on a daily basis. High energy cost have real, adverse impact on the daily lives of too many people.

Section 3: Aspects of NSW and ACT regulatory proposals 2014-19

We are not able to go into the detail that we would like to relating to specific aspects of the DNSP regulatory proposals, however are aware of the submission from PIAC concerning the three NSW proposals and we endorse their submission.

There are some important issues that we wish to highlight

<u>Application of "Better Regulation" Guidelines</u>

As a consumer focussed organisation that spent considerable time and effort last year in guideline development, with all stakeholders, and with leadership from the AER, we are very disappointed that all 4 DNSPs submitting regulatory proposals have failed to follow the Rate of Return guidelines that were developed after extensive discussion and negotiation. Their failure to follow the Rate of Return guidelines also demonstrates a failure to comply with the Consumer Engagement guidelines that were developed at the same time. We are unaware of any engagement with consumer groups, by distribution businesses from NSW or the ACT, subsequent to the "Better Regulation" guideline development processes of 2013. There has certainly been no engagement about Rate of Return, o9ne of the crucial elements in these regulatory resets. As a community organisation actively involved in the processes developing guidelines, we would have expected contact and discussion with network businesses proposing significant departure from the guidelines developed.

We recognise that the guidelines developed through the Better regulation process were guidelines, and so non binding on the parties. However, we understood that general agreement was reached on the guidelines by network businesses and consumer groups.

The AER is encouraged to continue to apply the principles of the guidelines as developed during 2013.

Key Proposal - Overview

We now consider some significant aspects of the NSW and ACT distribution 2014-19 regulatory proposals that we encourage the AER to consider closely, either because we think that the DNPS have 'got it wrong' in their proposals, or because they have 'gilded the lily' beyond what could be considered reasonable. Each of the networks claim that their proposals are in the best long term interest of consumers. ActewAGL for example, states that this is evidenced by "ActewAGL distribution will continue to provide the cheapest and most reliable electricity distribution service n the country…" yet they only benchmark their residential network charges against NSW, (figure 0.2 in their proposal) which are amongst the most expensive network charges in Australia. Nowhere in the proposals can we see consideration of lower cost alternatives being considered, compared to what is proposed, yet it would be reasonable for consumers to see this sort of consideration if "cheapest…electricity" is the primary objective.

We consider:

- Rate of return
- Consumer Engagement
- Large spending areas.

Rate of return – 2014-19 regulatory proposals

The DNSP proposals, in particular for key parameters WACC (Weighted Average Cost of Capital) and equity beta (β) are proposal aspects where we believe the DNSPs have 'got it badly wrong.' All 4 DNSPs involved have proposed WACC and β parameters that are well beyond accepted levels in the 2013 AER Rate of Return guidelines, the rate of return proposals suggest risk levels at or beyond the levels at the height of the Global Financial Crisis and so are completely out of kilter with current capital markets. Australian regulated electricity network businesses are low risk businesses, global capital markets are actively seeking to invest in such businesses and at levels of return to investors much lower than at GFC levels.

Rate of return is the single largest cost for consumers from network businesses, 59% of costs for Ausgrid, the largest of the DNSP in this 'reset', other DNSPs also have rate of return as their largest cost area for consumers. Rate of return, both to debt and equity is the utmost importance in regulating for the best interests of consumers.

During the 2013 debates about the rate of return, a number of models were considered, with agreement that the Sharp-Lintner CAPM would be the base model, it is widely used in regulatory processes around the world, it is able to be applied and there is experience in

using this approach. We reject the DNSP proposals to utilise other models, including Fama-French for any purpose other than 'reality checking.' We do not believe that there has been any new and persuasive evidence of circumstances that warrant change from the guideline position.

The Sharpe Lintner capital asset pricing model (CAPM) states that the expected rate of return on an investment is determined by the risk free interest rate and a risk premium, which is the product of beta, (a measure of sensitivity of expected excess returns on an asset compared with the expected excess returns for the market) and the market risk premium:

Sharpe Lintner CAPM: Expected return = RFR + β.MRP

Risk Free Rate

In applying the S-L CAPM to the 2014-19 regulatory proposals we expect the AER to apply the guideline in determining the risk free rate (RFR), using the most recent data available at the time that the AER Board is finalising it's draft determination.

Market Risk Premium (MRP)

We recognise that market risk is a little less precise to determine than the risk free rate, so ranges for risk related parameters are determined and a point estimate chosen within the range. In the guidelines, an MRP range of 5.3 – 7.5% is specified, with values in the range all giving investors an adequate through to generous return.

We understand the range in values for the MRP to lie on a continuum between 'best interests of consumers' at the lowest end of the range and 'best interests of investors / owners' at the top end of the range.

In section 2 of this submission we have argued that the best interests of consumers are not currently being served by high prices for consumers and high returns for DNSP owners. The application of the NEO, by the AER must give priority to the best interests of consumers and so in selecting a point estimate for the MRP and must choose a value at the bottom end of the range specified in the guidelines, namely a market risk premium of 5.3.

Recommended market risk premium: MRP = 5.3%

Equity Beta (β)

As with MRP, we recognise that there is no precisely correct value for β, and that a point estimate is chosen by the regulator from within a reasonable range.

The 2013 guidelines specified a range for β of 0.4 – 0.7. We are astounded that the DNSPs are proposing a β of well over 0.8.

Subsequent to the rate of return guidelines being published, a report has been released, commissioned by the AER and undertaken by Olan Henry[3] from the University of Liverpool. He made 19 calculations and concluded that β lies in the range 0.3 – 0.8. A majority of his estimates, 14, were in the range 0.3 - 0.5.

As with MRP, we understand the range in values for β to lie on a continuum between 'best interests of consumers' at the lowest end of the range and 'best interests of investors / owners' at the top end of the range. Again we argue that the AER must act in the best interests of consumers and select at the lower end of the range.

It is therefore perfectly reasonable for the AER to select a β at the lowest end of it's guideline range, ie a β of 0.4. This value is backed up by the Olan Henry expert advice, because it is the midpoint of the range for a majority of his calculations, namely a range of 0.3 - 0.5. A value of β being 0.4 is in the best interests of consumers and consistent with low risk businesses in a benign capital market, which is the current situation.

Recommended equity beta: β = 0.4

<u>WACC and RAB</u>

For the reasons outlined above, we also are opposed to the high values of WACC that are proposed by the businesses, they are inconsistent with current global capital markets and quite contrary to the best interests of consumers, the proposed WACC values are simply too high and apply to regulated asset bases (RAB) that have grown substantially over the course of the most recent regulatory period.

The opportunity for the AER to benchmark network expenditure, including the values of their RABs will be important for the AER in determining how realistic current RABs are.

We expect that the AER will find that current RAB values are too high and will adjust accordingly. We also expect that the AER will lower the WACC, to be more in keeping with the rate of return levels proposed above.

<u>Consumer Engagement</u>

We are encouraged that the DNSPs are making some efforts to engage with consumers, but we believe that they have 'gilded to lily' in their proposals with regard to the extent of their engagement and of the interpretation of what customers are saying.

In short, we are not aware of any DNSP engagement with consumers on any of the major elements of return to businesses, including rate of return methodology, RAB values, WACC, β and the like. Yet these are the area where consumers are most impacted by the bills that they pay. Nor has there been much engagement on demand management and energy use levels or tariff setting.

[3] Olan Henry; Estimating β: An update, April 2014

Where consumer engagement has occurred, it has been focussed on areas where networks want to spend including; new investments in housing developments eg Molonglo new zone substation (ActewAGL) and network augmentation that is presented as being about 'reliability'. Substantial weight has been placed on 'willingness to pay' (WTP) surveys, but these have not given consumers much information about trade-offs between reliability and price. ActewAGL states that their 2009 study which included a survey of 1755 residential customers "found large variation in WTP". This is our experience that consumers have differing view about tradeoffs between cost and reliability, though lower income households are much more likely to prefer less reliability for lower bills, a general perspective that we support for each of the 4 regulatory resets: lower prices and a little less reliability as the trade-off.

We also submit that there was some selectivity in some consumer engagement. ActewAGL for example list their proposal list the 'consumers' they have consulted with in developing their 2014-19 proposal, all are government agencies and industry peak bodies. They then state "Engagement with consumers more broadly will involve a public information session FOLLOWING (our emphasis) submission of this proposal." Essential Energy claim a commitment to the IAP2 public participation spectrum and then claim that the final level "consumer empowerment" is not possible for energy issues. These sort of approaches suggest a selectiveness in who is consulted, a selectiveness about what is heard and a failure to really grasp the core principles to engagement with residential and small business customers.

As we have stated in our submission to the Better Regulation consumer engagement guideline, we are committed to developing appropriate and effective approaches to consumer engagement related to energy regulation.

We encourage the AER to closely consider the DNSP claims regarding the degree of consumer support for their spending proposals and their reliance on WTP surveys.

<u>Large spending areas.</u>

There are a number of major expenditure proposals regarding capital expenditure (capex) and operating expenditure (opex) that we have been unable to consider in detail, however we are aware of the excellent work undertaken by PIAC in their submission regarding NSW proposals and add our endorsement to the expenditure issues that they consider. We are also aware of the submission to the NSW proposals from Total Environment Centre (TEC), particularly dealing with the lack of adequate demand side considerations to reduce capex and even replacement expenditure (repex). We also endorse the TEC submission.

There are 2 main principles that we wish to raise regarding expenditure proposals, the first we have already stated as the need for expenditure to be reduced by a 'step down' initial amount and subsequent annual efficiency savings, of we suggest 2% per annum.

The second principle that we wish to raise relates to adding to costs through what we summarise as 'third party decisions or actions' – the third parties being entities other than network service businesses and consumers. The principle is that consumers should not have to pay a cent for decisions made by 'third parties'. The third party induced costs that we oppose being passed on to consumers include:

- Additional operating costs associated with the sale of retail businesses that were previously incorporated into the spread of operating costs for current distribution network businesses. These "dis-synergy" costs have already been met in sale proceeds and cannot responsibly be passed on to consumers
- Transitional staffing arrangements that retain additional staff over efficient operating levels and pay rate increases higher than the annual rate of increases to pensions and allowances should be met by the parties making such commitments. We are not opposed to offering employees certainty in times of change and transition and respect the merits of making such commitments, we are opposed to these costs being passed on to consumers, they should be met from sale proceeds.
- Undergrounding of cables as a requirement of government (including local government) planning or associated conditions. The costs should be met by the body or bodies making the requirement, not by end consumers, particularly when more cost effective options are available.
- Shifting capex to opex. For example sale of fleet and main building (for Ausgrid) and then leasing back, these actions may or may not be cost effective for consumers. The AER needs to carefully examine all such cost shifts.
- Vegetation management. Each DNSP is seeking very large budgets for vegetation management, the actual requirements of third party requirements need to be clearly understood so that consumers don't end up paying more than is necessary.

Summary

This submission deals with 'higher order' issues arising from the 2014-19 regulatory proposals for both ACT and NSW. We have focussed our consideration on the question of whether the NEO is currently being met and argue that it is not, largely because very large price increases for consumers over the most recent regulatory period have lead to a range of actions and behaviours that have seen significant numbers of consumers leaving the networks, or reducing their use of them, either forced by disconnection or hardship or by choice through the rapid uptake of PV installation. We have shown that high and continuing high prices are continuing to have real and adverse impacts on large numbers of low and modest income households. This shows that the efficiency objective of the NEO is not being met and consequently that high prices have lead to the best interests of consumers not being met.

In the context of the 4 regulatory proposals we recommend applying base- step – trend from a consumer perspective, and recommend that the AER accept that the current base is too high and hence not reflective of efficient costs, so then apply a 'downward step' of the order of 10% with subsequent trend reductions of 2% real, annually – an efficiency dividend for consumers.

With these proposals in mind we give attention to the rate of return and observe that the WACC proposals from the distribution businesses are too high. We recommend application of the rate of return guideline from 2013, using the Sharp-Lintner CAPM model and adopting Market Risk Premium and β point estimates from the lower, best interests of consumers, end of the ranges given in the guidelines; MRP = 5.3% and β=0.4.

There are many issues from the thousands of pages of submissions that we have not covered, but we are happy to talk further with the AER and DNSP's about specific issues.

Ian Holland

Case Studies

Mike

Mike is nearing retirement age and works part-time as an after-hours caretaker. Both Mike and his wife are proud of the fact that they have paid off their own home, have modest savings for retirement and have done everything that they can keep their energy and wateruse efficient. "I spent a small fortune on energy efficient light globes when they first became available", says Mike, "and they have no doubt reduced our energy use a little bit, but the bills keep going up."

These days, Mike and his wife dread the arrival of their utility bills, both because the bills are more expensive each time no matter how little energy they use, and also because the stress of not being able to pay, on time, is "gut wrenching" for them.

"For the first time in our lives, we had to ask for extensions to pay our electricity bills last year, and now we are having to use some of our limited savings to be able to pay our bills, and this is after we have done everything we can, to be energy efficient" says Mike, in frustration.

Their most recent gas bill was a modest $80.00, but what frustrates them is that nearly $60 of that was for the supply charge, which Mike does not regarded as fair or reasonable – "we must have bought half the network over the past 40 years" suggests

Mike. The most recent electricity bill, after a mild summer in Adelaide, was $397.00, nearly double what it was three years ago, and with lower use.

"We are really worried that we just won't be able to afford to pay an energy and water bills once we retire - already we are having to use our savings just keep head above water" says Mike. "I didn't work all my life to not be able to afford electricity when I retire."

Eleni

Eleni is a 70 + year old Greek lady who has difficulties with English, has been living in the same house for over 40 years, and was worried about her increasing energy bills. Her son who lives with her and is on a DSP is continually buying/hoarding electrical appliances . She pays her bill at the Post Office being resistant to using Centrepay and is very worried about the rising cost of electricity.

Zahra

Zahra is a proud African woman with 5 daughters, the two eldest being at university, the younger 3 in secondary school, she is very proud of her girls and the opportunities they have in Australia, "they study very hard" she says. Her husband was killed in her homeland, a reason for coming to Australia as a refugee.

"We all share a small house , we all work hard and we get by, but with only my low income and a the little the girls can add from casual; work, it's the electricity bills that I dread the most," she says. "But we use as little as possible, the girls need computers to study, I suppose that is our luxury."

Robbie

Robbie has lived on the northern New South Wales coast for all of his life, now in his 30's he is well known to the local community, and everyone loves his infectious energy, up beat personality and sense of humour.

Robbie has had a disability for all his life, being dependent on others, particularly his parents and close family. So it was a day of great excitement when Robbie moved into his new independent unit, having his own space while sharing a facility with other people he had known from much of his life. The generosity of the local community came to the fore with donations and gifts of everything that Robbie could possibly need in his own unit. – even 2 fridges.

Support workers spent considerable time with Robbie explaining the need for him to pay his own bills which meant managing his own money, and using electricity when he really needed to. Hours were spent on budgeting which included the cost of running various appliances.

Robbie's first electricity bill was over $1600 for the quarter. "How can I ever pay this?" asks Robbie.

Candice & John

Have recently purchased a house in Sydney's western suburbs. Having no real knowledge of energy efficient design, the ongoing and increasing energy costs were not taken into consideration at the time. Once they had moved into the house they discovered that it was extremely hot as there were a number of windows in the living areas exposed to the sun during the afternoon.

The couple purchased and installed a reverse cycle split system believing they were getting something that was efficient to run based on the information the salesperson had given them about the "Energy Star Ratings" only to find that their electricity bill had almost double over the previous billing period. At the same time Candice was due to give birth to their first child and had to give up work earlier than expected due to health issues.

With only one wage coming in and having accumulated a large energy bill the couple are in financial distress.

Jarred

Jarred lives in the western suburbs of Melbourne where he had been living with his wife and two daughters both below school age. Until recently, they had been getting by with one full time and one part time wage coming in, however approximately six months ago, Jared's wife left him and the two children, along with a number of unpaid bills.

With no family support locally, Jarred has had to give up work to look after the children and is struggling to balance the payment of increasing energy costs and overdue bills. He has been unable to afford the cost of running and registering a vehicle and has sold it to recoup some money to pay bills.

With limited monies available and limited mobility, the family has tended to remain home more often resulting in increased energy bills during the summer months, in an effort to maintain a comfortable temperature in the house. Energy Efficiency workers have been able to provide information for Jarred on ways to reduce the need for added cooling and reduce their energy consumption in general, but still the bills rise, and the income doesn't.