2022-2027 Victorian EDPR

Joint submission from Victorian community organisations – summary document

May 2020

Contents

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1 Summary of recommendations

Victorian community organisations have prepared this joint submission to represent the interest of consumers, and especially vulnerable households, in the upcoming Victorian electricity distributors' revenue period, recognising the importance of distribution spending in maintaining an affordable and sustainable electricity supply.

Brotherhood of St Laurence, Renew, Victorian Council of Social Service, Consumer Action Law Centre, Council of the ageing, St Vincent de Paul, Uniting and Yarra Energy Foundation are signatories to this submission.

Our recommendations are informed by research undertaken through an Energy Consumers Australia (ECA)-funded project. Analysis was undertaken by Headberry Partners – the detailed analysis informing this submission is included as the second part of this submission.

Recommendations

1. **Reducing network charges must be prioritised to ensure the affordability of an essential service for all Victorians**

   Affordable electricity remains critical for vulnerable Victorians. There are persistent indications that high energy costs are a major cause of financial stress for many Victorians, and can lead to further debt. Ongoing indicators show that a lack of energy affordability denies vulnerable Victorians sufficient access to an essential service. Furthermore, consumers consulted by all the network businesses expressed a strong desire for lower prices, even when they were supporting network investment in specific areas (e.g. DER enablement). Lowering prices is a consumer priority, and all other new investment must be balanced against that.

2. **Revenue reductions must reflect actual efficiency improvements to ensure affordability over the long term**

   It is important to pursue electricity cost reductions that are underpinned by improved network efficiencies and fundamental costs savings, and that do not simply reflect the current low cost of capital. Currently, the moderate bill savings listed by the distributors are wholly dependent on this external factor. Further revenue reductions are important to secure affordability for consumers.

3. **Continued growth in the Regulatory Asset Base should be avoided, to reverse the ongoing trend of rising electricity prices**

   The Regulatory Asset Base (RAB) is continuing to grow in absolute terms for all distributors – and for most distributors it is also growing in relation to consumer numbers and peak demand. Consumers pay for new assets over their lifetime, so a higher RAB will lock in higher costs over decades. As the asset base has grown over the last decade, assets are used at a lower proportion of their full capacity. This

suggests the RAB is increasing beyond consumer requirements - proposed augmentation should be closely scrutinised, to avoid a net increase in the RAB.

4. **The forecasts for consumer numbers, peak demand, and total consumption, appear to be unusually high, raising a risk of overbuilding**

   Forecasting for all parameters will need to be reassessed as the impact of the COVID-19 pandemic becomes clear.

   The current combined forecasts for peak load from the distributors are significantly higher than AEMO's forecast for load at the transmission connection point, despite AEMO forecasts proving to have been conservatively high in the past.

   This may indicate that proposed peak-driven augmentation expenditure exceeds requirements.

5. **Capital expenditure is increasing, despite consistent underspend in previous periods. This suggests that proposed expenditure is likely to be higher than needed**

   Actual capital spending has consistently fallen below proposed and allowed capex revenue allowances over the past 20 years, delivering rewards to distributors through the Capital Expenditure Sharing Scheme (CESS) incentive program.

   Despite the current period's underspend, distributors have proposed increased capex for the next period, raising the concern that this will again exceed actual requirements and create unnecessary costs for consumers.

6. **Expenditure to accommodate solar PV must clearly demonstrate consumer benefits**

   In principle, we support investment to accommodate rooftop solar PV on the distribution network, but in the interests of all consumers, it is important that this reflects the consumer priority for lower network costs.

   It also important to work towards a consistent investment approach across the networks to accommodating DER, albeit an approach that is flexible enough accommodate real differences in the local grid conditions.

   We support a standard approach for valuing exported generation, that reflects the expected changes in the value of DER exports over time and the requirement for export capacity on the network – including benefits such as the provision of network services and downward pressure on wholesale energy prices.

7. **Past replacement expenditure trends suggest that proposed repex is likely to be higher than required, and should be reduced**

   The repex proposed by distributors at the last reset proved to be much higher than the amount required – even while reliability indicators have improved through the current period. Networks were rewarded for this discrepancy through the CESS.

Despite the current period's underspend, some networks are proposing a significant increase in repex for the next period, that is inconsistent with past trends. We are concerned that this is likely to exceed actual requirements, so that consumers may pay the cost of unmerited incentive scheme rewards and financing costs.

8. **Further consultation on Environment Protection Authority (EPA) noise regulations needed**

   Significant expenditure initially proposed by some networks to meet new noise regulations has been withdrawn with a delay to implementation of the new EPA regulations.

   Noise complaints to distribution networks are relatively rare, and it is not clear that this investment is required to meet the regulations, or protect the public or the environment.

   We recommend ongoing consultation between stakeholders, to clarify appropriate management for distribution infrastructure.

9. **A standard depreciation schedule should be developed and applied across Victorian distributors**

   Establishing a standard schedule across Victorian distributors would allow a fair, consistent and optimal approach to charging consumers for new investment.

   Where distributors are allowed to set depreciation lifetimes that are shorter than the real average service life, then consumers will pay higher prices through the return of capital.

10. **Operational expenditure productivity has been declining for most networks, which highlights the need for increased operational efficiencies, and the importance of close scrutiny of proposed step changes**

    Opex productivity declined on a long-term trend for most networks between 2006 and 2018 – this makes the case for ongoing productivity improvements.

    Many of the step changes proposed by the networks do not match the criteria for valid step changes, especially the requirement that they are a response to ongoing external factors. Step changes increase costs on an ongoing basis, and lower the bar against which efficiency gains are measured – so it is important to test the validity of step change claims.

11. **The NewReg trial has demonstrated gains for consumers – a full assessment of the negotiated AusNet Services proposal will be useful to evaluate the impact of this process and the efficiency of all aspects of the proposal**

    AusNet Services and the Consumer Forum negotiated an initial proposal that achieved significant savings for consumers, when compared to the draft version.

A detailed assessment from the AER of how this was achieved is needed to fully understand the impact of this new approach.

Applying a standard approach to the evaluation of revenue proposals by the regulator will remain an important aspect of the determination process if this approach is more widely adopted in future, especially in terms of preserving consistency and benchmarking efficiency between networks.

12. **Further analysis is needed to support an informed decision on proposed tariff structures**

    The networks have proposed a time-of-use tariff, with a peak charge between 3 and 9 PM, which will be assigned by default, on an opt-out basis, to new solar consumers, new connections, and households with electric vehicles and three-phase connections. We understand that retailers will be required to continue to offer a basic flat tariff through the Victorian Default Offer. We recommend that further analysis is important to underpin a properly informed decision of the impact of these tariffs on Victorian households.

2 The EDPR and Victorian consumers

Distribution costs make up 30-40% of an average Victorian household's electricity bills. Where distributor revenues are allowed to be higher than necessary, this will drive high energy costs over the long term.

In Victoria, electricity bills rose by 104% in real terms between 2008 and 2019,[1] with the distribution component rising steadily to a peak in 2015, driven by investment in programs like smart metering and bushfire prevention upgrades. [2]

Although the growth in electricity prices has recently slowed, there are many indications that high energy costs are still a cause of financial stress for many Victorians.

A 2019 study of calls to a financial helpline found that energy debts remain a strong early indicator of economic hardship, and can lead households into further debt.[3] Energy bills are known to consume a high and growing proportion of the expenditure of low-income households.[4]

[1] The St Vincent de Paul Society, 2019, Households in the dark II, accessed 1 March 2020, https://alvissconsulting.com/households-in-the-dark2/
[2] Australian Competition and Consumer Commission, 2018, Restoring electricity affordability and Australia's Competitive Advantage, accessed 1 March 2020, https://www.accc.gov.au/regulated-infrastructure/energy/retail-electricity-pricing-inquiry-2017-2018/final-report
[3] Consumer Action Law Centre, 2019, Energy Assistance Report, accessed 1 March 2020 https://consumeraction.org.au/wp-content/uploads/2019/07/190620_Energy-Assistance-Report_FINAL_WEB.pdf
4 Australian Council of Social Service & Brotherhood of St Laurence 2018, Energy stressed in Australia, ACOSS, viewed 2 September 2019, http://library.bsl.org.au/jspui/bitstream/1/10896/4/ACOSS_BSL_Energy_stressed_in_Australia_Oct2018.pdf

For many households, high energy costs restrict access to essential services. Many JobSeeker and Youth Allowance recipients are unable to afford to heat or cool their homes.[5] An Alfred Health study found most of their hypothermia patients had been discovered inside, with a lack of adequate home heating likely a significant contributing factor[6].

Given that the EDPR will establish the rates charged for a significant proportion of household bills over a five-year period, energy affordability and its implications for vulnerable Victorians in particular remain critical.

Key points:

1. The distributors' proposed revenue would be higher than in the current period were it not for the historically low cost of capital.

   Secure affordability over the long term will require cost reductions that do not rely on external factors, but that instead reflect a real decline in the fundamentals of distribution costs, including operational costs and the value of the regulatory asset base (RAB).

3 Revenue trends show a need for further savings, to ensure long term affordability

The attached analysis of revenue trends and proposed revenue shows there is a need for reductions in the proposed revenue in order to deliver affordability.

Key points:

1. The revenues proposed by distributors are level-with or slightly lower-than the current period's revenue, however, any reduction is entirely dependent on the current low cost of capital, without which revenues would actually be increasing. The distributors' revenue includes an allowance for the cost of financing the network, which is calculated by the AER in line with current financial metrics – that are currently at historical lows.

[5] Australian Council of Social Service, 2019, 'I regularly don't eat at all': Trying to get by on Newstart, accessed 1 March 2020, https://www.acoss.org.au/wp-content/uploads/2019/07/190729-Survey-of-people-on-Newstart-and-Youth- Allowance.pdf

[6] DS Forcey et al, 2019, Cold and lonely; emergency presentations of patients with hypothermia to a large Australian Health Network, accessed 1 March, https://www.ncbi.nlm.nih.gov/pubmed/30963670

2. The total value of the network assets – the RAB – is continuing to grow for all distribution businesses. It is continuing to grow on a per-consumer basis for most businesses, and also growing relative to peak load, which is the historical driver for the RAB. Allowing the RAB to continue to expand will drive higher prices for decades, as consumers pay for the capital expenditure through depreciation over the assets' lives.
3. The increase in the RAB is not caused only by new requirements for investment like bushfire risk reduction programs. Asset utilisation – the loads served by assets relative to their capacity – is continuing to decrease, showing we are investing to expand the network beyond our needs. Network reliability is also continuing to increase, while consumers state a preference for maintaining, rather than improving reliability. These indicators suggest that the RAB is expanding in excess of consumer requirements.

4 Forecasting

The accuracy of forecasts – for consumer numbers, peak energy, and total energy served – is critical in planning infrastructure to meet our needs. The anticipated bill savings for some distributors are also reliant on the expectations for increased consumer growth – where this proves to be an overestimation, bills will increase.

The COVID-19 crisis and resultant economic downturn will necessitate that all forecasts be revisited, and associated augmentation expenditure be reassessed. While there may be uncertainties remaining about the impact of the crisis over the timeframe of the EDPR process, we stress the importance of establishing forecasts that reflect the potential for a substantial economic downturn and slower population and load growth in Victoria.

The analysis below underlines the following concerns regarding the forecasting adopted by networks:

Key points:

1. Some distributors – AusNet Services, Powercor and United Energy – have forecast consumer numbers to increase at a faster rate than recent trends. These assumptions should be verified against independent data. In addition, the impacts of COVID-19 to migration and to the construction industry will require a thorough re-examination of these metrics, as the probable outcomes become clearer.

2. Some distributors – Powercor, United Energy and Citipower – have forecast a significant growth in peak demand, while AEMO has forecast a decline. AEMO forecasts for Victoria can be demonstrated to have been conservative – which raises doubt regarding the distributors' forecast for peak demand, and associated augmentation expenditure.

3. The accuracy of forecasts for total energy will impact tariffs charged to consumers. All distributors except AusNet Services are forecasting an increase in total energy, reversing the current trend of stable or falling loads.

5 Capital expenditure

A top-down analysis of capex trends discovers indications that estimations for capex requirements may exceed requirements.

Key points:

1. Capex productivity has declined for most networks (with Jemena falling the least) between 2006 and 2018.

2. Current rules incentivise distributors to overestimate the amount of capex required for the upcoming period in a number of ways:

    - the revenue allowance includes an allocation for financing forecast capex – this finance allowance is retained, even where the associated capital spending is not made;

    - the Capital Expenditure Sharing Scheme (CESS) rewards capex below the total determined for the period, which further incentivises setting high initial estimates;

    - the current regulatory method means that most of the profit available to the businesses is chiefly through the financial allowance for capital expenditure – which is a further incentive for high capital investment.

3. Between 2001 and 2020, there has been a consistent tendency for the actual capital investment made by networks to be significantly lower than the amounts they have proposed, as well as the AER's allowance.

6 Expenditure to accommodate solar PV

Investment to increase the network's capacity to host PV is a new area of significant augmentation expenditure. The particular solutions deployed will have implications for the energy costs of solar and non-solar consumers, and the shape and function of our future grid.

Key points:

1. Networks have demonstrated that consumers broadly support investment to accommodate solar PV capacity into the grid. However, it is still important to test that proposed investment is efficient. It is also important to ensure that network planning to accommodate DER is consistent with delivering lower costs for consumers, in line with consumers' stated priority.

   We support a standard approach for valuing exported generation that reflects the expected changes in the value of DER exports over time, and other recognised benefits – such as the provision of network services and downward pressure on wholesale energy prices – where they can be quantified to a reasonable degree of accuracy. This may include a broader consideration of the amount of export capacity that would benefit the network.

2. Distributors have generally proposed programs that include a 'smart-grid' element and physical network augmentation, with the Digital Networks program proposed by Powercor/Citipower/United Energy being largely a smart-grid project to accommodate DER.

   Smart grid elements include functions like low-voltage network visibility, dynamic voltage control, and dynamic export constraints. However, it is important for consumers that the functionality, and the technical requirements for interaction with smart-grid systems, is not significantly different between Victorian networks. We feel that it's important to confirm that a consistent approach has been adopted between networks, in line with an optimal pathway for accommodating solar PV and other DER.

7 Replacement expenditure

Key points

1. Proposed repex for most distributors is significantly higher than the allowance for the current period. However, for most distributors, the repex undertaken in the current period will be significantly lower than the allowance in the revenue – with the allowance being lower again, compared to the initial proposal.

   For the current period, the AER allowed the distributors 80% of their combined claim. This ended up being 60% higher than the amount needed – even while networks continued to deliver ongoing improvements in reliability. This context casts doubt on claims for an increase in repex from some distributors in the upcoming period.

2. We note that networks who were proposing significant replacement expenditure associated with new EPA regulations, have withdrawn this element from their propsals, with the delay in implementation of the new rules.

   Ongoing consultation is required with the EPA regarding the implications of the regulations for distribution infrastructure, to avoid the potential for significant expenditure where there is no real risk to people or environment.

3. Proposed repex for wood poles has jumped significantly for some networks, in response to concerns raised in fire-risk areas. We are concerned that findings for a particular, rural area appear to be being applied across network areas spanning different conditions, environmental exposure and failure risks.

8 Depreciation

The depreciation schedule determines the rate at which distributors recover the cost of capex from consumers through their bills.

Key points

1. Different distributors apply different depreciation schedules to the various asset types – and the asset lifetimes nominated in the depreciation schedules are also different to the asset lifetimes used for repex. Establishing a standard schedule across Victorian distributors would allow a fair, consistent and optimal approach to charging consumers for new investment.

9 Operational expenditure

Opex allowance accounts for the ongoing cost of running the network. Increased opex claims are the driver of the proposed increase in revenue for Jemena, Citipower and Powercor, who anticipate an increase of 20% in network running costs.

Key points

1. Opex productivity declined on a long-term trend for most networks between 2006 and 2018, in contrast to the general obligation for a business in a competitive market. The productivity of the networks has been significantly lower than the average for Australian industries over the long term. This calls into question the efficiency of the base year, and makes the case for establishing a requirement for ongoing productivity improvements by the networks.
2. We are concerned about the high number of proposed opex step changes, and their capacity to increase electricity costs on an ongoing basis, and lower the bar for opex efficiency improvements. We recommend that the validity of these step changes, as ongoing changes to the operational environment, be tested carefully.

10 Consumer engagement and the NewReg trial

All distributors undertook consumer engagement that expanded significantly on the last reset's programs, and the results from this engagement have led to useful interventions on behalf of consumers.

The NewReg trial conducted by AusNet Services demonstrated significant gains for consumers, between the draft and the initial proposal.

However, limitations remain on the extent to which the results of a distributor-run engagement program can be interpreted as a full representation of consumer priorities – a knowledge imbalance remains between distributors and their consumer base in an engagement process.

As such, the results of engagement should inform the regulator's decision, rather than be adopted as deterministic.

We recommend that AusNet Services' proposal, negotiated through the NewReg trial, be subject to the same assessment as the proposals from other networks.

As a pilot, it is useful to gain a detailed understanding of what aspects can be usefully negotiated through this type of process, and what can't. A thorough evaluation of the NewReg will allow a proper evaluation that would highlight the potential contributions and specific limitations of this additional tool in informing revenue determinations in regulated markets.

Applying a standard approach to the evaluation of revenue proposals by the regulator will remain an important aspect of the determination process if this approach is more widely adopted in future, especially in terms of preserving consistency and benchmarking efficiency between networks.

11 Tariff Structures

The networks have proposed a time-of-use tariff for distribution pricing, with higher residential charges between three and nine PM for affected households. The tariff will be assigned to some consumers (new solar consumers, new connections, electric vehicle owners, and three-phase consumers), on an opt-out basis for most networks. We understand that retailers will be required to continue to offer a basic flat through the Victorian Default Offer.

In their Issues Paper, the AER has said that they will also consider the merits of a 'solar sponge' tariff, as well as a common tariff structure complemented by additional measures to address location specific issues.

While there has been some assessment commissioned by the networks regarding the impact of the proposed time-of-use structure for vulnerable consumers,[7] we recommend that further analysis in the following areas is important to underpin a properly informed decision:

What will be the impact of the proposed tariff for vulnerable consumers?

While understanding the impact of the time-of-use tariff for vulnerable consumers may be less essential given that it will be optional for most households, it is nonetheless an important question to address in the context of ongoing tariff reform.

High-level assessments undertaken by Acil Allen have established that some vulnerable consumers will be better off under the proposed tariff, and some will pay more.

We need to better understand how different types of vulnerable consumers will be impacted – including working and non-working households, consumers with energy-related health conditions and existing hardship consumers and consumers with energy debt.

We also need to better understand the impact of a proposed tariff structure on behaviour in vulnerable households – in this case, peak rates through the late afternoon and evening – to determine whether there may be undesirable consequences, such as an increased incidence of rationing essential heating or cooling.

[7] ACIL Allen, 2019, Vulnerable consumer tariff impact

How would the proposed tariff structure accommodate a high EV uptake scenario?

Preparedness for a high EV uptake scenario is often cited as a driver for tariff reforms.

Analysis should be undertaken to determine how effective this tariff – and the associated assignment arrangements – would be, and how the tariff would interact with other essential measures for managing EVs on the network.

Are the proposed tariffs targeted to reliably deliver network and wholesale savings, and can these savings be quantified or estimated?

If tariffs allow some consumers to reduce their distribution charges by changing their behaviour, it is important to be confident that this will lead to benefits that are shared by all consumers. It is also important to be confident that shared benefits will outweigh the additional network costs borne by consumers unable to respond to the price signal.

12 References

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