AUSTRALIAN ENERGY REGULATOR

Summary of Meeting

Consumer Reference Group (CRG) Meeting No. 7

17 October 2013

Held via video conference between AER offices in Adelaide, Melbourne, Canberra, Sydney, Brisbane

Attendees:

CRG members (including representatives) – Katrina Lee, Graham Mawer, Bruce Mountain, David Headberry, Belinda Sandilands, Bev Hughson, Heather I'Anson, Luke Berry, Jonathan Pavetto, Robert Mallett, Dr Si Wei Goo, Martin Jones, Mark Henley, Geoff Zoeff, Chris Dodds, Belinda Sandilands, Helen Scott, Tenant Reed.

AER staff members—Andrew Reeves, Warwick Anderson, Tanja Warre, Kurt Stevens, Blair Burkitt, Scott Sandles, Adam Petersen, Bruno Coelho, Jonathan Deridder, Arek Gulbenkoglu, Lawrence Irlam, Mark McLeish, Moston Neck, Shahrina Quader

Apologies: Deanna Foong, John Hin, Alexandra Geddes, Matt Helme, Janine Rayner, Carly Allen, Carolyn Hodge, Damian Sullivan, Loren Days, Sue Fraser, Angus Nardi,

On 17 October 2013, the AER held the seventh meeting of the CRG. The meeting was chaired by AER Chairman, Andrew Reeves, and was attended by AER staff members and CRG members who represent various consumer groups.

This summary broadly covers the key topics and themes that were discussed. The outline follows that of the agenda.

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1 Welcome and update (Andrew Reeves)

Andrew Reeves welcomed participants to the final CRG meeting of the year. Andrew noted that submissions on draft guidelines are closed for all workstreams and thanked CRG members who provided written submissions. We have attempted to provide the CRG an opportunity to contribute at every important milestone of the Better Regulation program. This meeting was for CRG members to present positions on the draft guideline and clarify any points.

Andrew stated it is the first time we have held this type of forum for consumer engagement and we are considering this model for future engagement work. Importantly, the CRG has challenged our positions resulting in robust discussion and influenced the outcomes we have reached.

2 Expenditure Forecast Assessment

CRG members noted the positive aspects of the expenditure forecast draft guideline in its approach to benchmarking, spreadsheets and modelling. The guideline required further information regarding the specifics of benchmarking.

CRG members stated that demand forecasting suggested a reduction in network growth while consumer costs were still rising. CRG members stated that the incentive system in the regulatory regime encourages over forecasting and that reviewing forecasting each year could stop errors occurring. CRG members queried how the draft guideline can ensure overly optimistic demand forecasts will not be set.

Andrew noted that this may be an issue to be considered by the Australian Energy Market Operator (AEMO) but ultimately network growth is driven by demand growth. The regulatory framework determines the circumstances in which an annual review can be conducted.

CRG members noted that there is little data available for consumers to understand and engage with demand forecasting by NSPs. Members raised concerns around demand in regional areas that are driven by major industries. Where a major user exits the market there is a concern that smaller users are paying for a network with redundant assets.

AER staff noted that there is always an element of uncertainty in demand forecasting and it is a question of whether the regulatory framework adequately deals with this uncertainty.

CRG members noted difficulties in determining real costs without strong historical data from NSPs. CRG members would like AER decisions to indicate its confidence in the data. In addition, AER decisions are clear regarding the data that NSPs must provide. As collecting such data is a part of operating efficiently, NSPs should not be claiming a higher opex in order to collect data.

AER staff noted that the accuracy of data generally depends on how disaggregated the information is. AER staff broadly agreed with the view expressed by members regarding collection of data but noted we are working towards having accurate data sets.

3 Expenditure Incentives

CRG members noted that the purpose of expenditure incentives is to drive businesses towards the efficiency frontier. The draft guideline achieves this objective better than the previous approach but there are aspects that could be improved in EBSS, CESS, rolling in forecast depreciation and the reliance on ex-post reviews.

CRG members considered as there is a soft trigger for an ex post review (ex post review is only permitted if a business exceeds its capex allowance) and revisions such as cost pass throughs are allowed during the regulatory control period, the regime is biased toward NSPs. Having a symmetric regime for penalties and rewards does not recognise that there are asymmetric incentives in favour of NSPs. Penalties should be higher than rewards to account for contingent projects and cost pass throughs which convert symmetrical arrangements into asymmetrical arrangements favouring the networks.

CRG members noted that the guideline should be more upfront on what can be achieved by an ex-post review. Consumers will not get anything back until years later. The AER should emphasise accurate forecasting at the determination stage as this has an impact on the effectiveness of the incentive regime.

CRG members are concerned that the CESS and EBSS apply to government owned entities the same way as private entities, given government entities have a lower WACC. This creates an incentive for government entities to over invest despite penalties, particularly where there is a symmetric regime.

A CRG member noted that overseas regulators have adopted the ‘Used and Useful’ test to costs. Another CRG member stated that the AEMC rejected a proposal to apply this test.

4 Rate of return

AER staff provided an overview of the key points of the equity beta paper released in October 2013. AER staff noted that data on equity data is dispersed and our approach was to find a value that brings all the information together.

We are proposing a reduction of the equity beta from 0.8 to 0.7. Empirical data suggest a range between 0.4 – 0.7. Overseas patterns indicate a higher equity beta.

CRG members expressed the opinion that an equity beta of 0.7 is too high. Members noted that the equity beta has always been set high which is a bias toward NSPs. When overseas data suggested a lower equity beta the AER still adopted a high value.

CRG members pointed to the following evidence which suggests that an equity beta of 0.7 is too high.

- Opinion from AER’s external adviser is that businesses face a low risk.
- Share price market capitalisation is greater than the RABs of these regulated businesses.
- The Black CAPM data has issues, which the AER accepts
- The AER is based on water data but the water data is based on the energy / AER data.

Andrew noted these views and invited members to participate in the submission process for the equity beta paper.

CRG members outlined their concerns in relation to the rate of return guideline more generally.

- there should be a different benchmark for private and government owned entities.
- in setting the equity beta NSPs should not be compensated for risks that other businesses face in the market.
- the approach to cost of debt was not bringing businesses close enough to the benchmark efficient level.

5 Shared assets

CRG members expressed the view that consumers are 'flying blind' on shared assets, that is there is a lack of data to determine the proportion of revenue to be shared. The AER should revisit the issues when there is more data and make clear that the current guideline is a short term approach.

CRG members expressed concern that the reset process will not provide better data. In the absence of strong data CRG members discouraged giving the benefit of the shared assets to NSPs. Revenues should be shared with consumers and adjusted as better information becomes apparent.

6 Confidentiality

CRG members made the following comments on the confidentiality guidelines.

- consumers generally support the intent of the guidelines that stakeholders have as much access to information as possible.
- the guideline sets out how information will be protected, where the explanatory statement covers how information will be disclosed. Consumers are concerned that the explanatory statement is more detailed than the guideline and contains guidance on disclosure but is not mandatory.
- there needs to be more information about the process, enforcement and approach to resolving disputes. Additionally there is a question of where consumer engagement fits when there is a dispute over confidentiality.
- there is concern the confidential category 'Market Sensitive Cost Inputs' will allow NSPs to claim confidentiality over a wide range of items.

AER staff noted that the explanatory statement details two stages in confidentiality:

- pre-lodgement discussions
- submitting information.

Further, the purpose of the first stage is to reach consensus with NSPs on what information is confidential and what can be disclosed but this is out of the scope of the rules and cannot be included in the guidelines. In relation to 'Market Sensitive Cost Inputs' we will take each claim for confidentiality case by case. Simply labelling something in a confidential category does not mean it is protected, we will undertake an analysis of the claim. In regard to enforcement, AER staff noted that this is also outside the scope of the rules.

CRG members noted the need for consumers to know what information is not disclosed. Consumers need a broad description of confidential information to understand the kinds of information subject to confidentiality.

7 Power of Choice

CRG members raised issues around how network tariff structures operate. Consumers are concerned where a business increases network capacity to meet peak demand but do not have a time of use tariff applied. Without the right tariff structure certain users are cross subsiding other users.

AER staff noted that tariff structures do need to be robust to changes in the network and that it has a big impact for consumers.

8 Other Business

CRG members provided positive feedback on the CRG process. Members indicated that it would be useful for the AER to outline how the CRG operated to the AEMC for its consumer engagement programs, as the CRG did well in incorporating consumer input, particularly in providing opportunities for oral submissions.

AER staff outlined the next steps in the CRG.

- as the program is reaching its end staff are conducting an evaluation of the program. We will send a survey for CRG members to complete and also conduct a feedback session with each member via phone.
- the expected release for each guideline was outlined.
- we are intending to hold a final CRG meeting early 2014 after the release of all guidelines. This meeting will wrap up the CRG and outline next stage of our work.

9 Concluding remarks

Andrew thanked CRG members and AER staff for their participation and work in the CRG. Andrew thanked the CRG organisations for making individual members available to us and noted our intention to write to each organisation thanking them for their time and encouraging future participation.