



# NSW Electricity Distribution Networks Regulatory Proposals: 2014- 19

AGL submission to the Australian Energy Regulator  
8 August 2014



## Table of Contents

1.	Comments.....	1
<b>1.1.</b>	<b>Structure of Submission.....</b>	<b>3</b>
2.	Energy and Demand Forecasts .....	4
<b>2.1.</b>	<b>Forecast Consumption.....</b>	<b>4</b>
<b>2.2.</b>	<b>Forecast Maximum Demand .....</b>	<b>5</b>
3.	Capital and Labour Productivity .....	7
4.	Capex and the Regulated Asset Base .....	10
<b>4.1.</b>	<b>Regulated Asset Base.....</b>	<b>10</b>
<b>4.2.</b>	<b>Capital Expenditure.....</b>	<b>11</b>
4.2.1.	Asset Replacement Capital Expenditure .....	12
5.	Operating Expenditure .....	14
5.1.1.	Comparison with Victorian DNSPs .....	15
5.1.2.	Efficiency Benefits Sharing Scheme.....	16
6.	Weighted Average Cost of Capital.....	19
<b>6.1.</b>	<b>Transitional Arrangements for Return on debt.....</b>	<b>20</b>
7.	Alternate Services - Metering .....	21
<b>7.1.</b>	<b>Metering service provision .....</b>	<b>21</b>
<b>7.2.</b>	<b>Cost recovery for stranded assets .....</b>	<b>22</b>
<b>7.3.</b>	<b>Recovering the cost of stranded meters.....</b>	<b>23</b>
<b>7.4.</b>	<b>New connections and meter replacement .....</b>	<b>24</b>
7.4.1.	New connections .....	25
7.4.2.	Aged asset replacement programs .....	25
7.4.3.	Demand Side Participation (DSP) programs .....	25
8.	Network Tariff Principles.....	27
9.	Ancillary Service Fees .....	28
<b>9.1.</b>	<b>Disconnection services.....</b>	<b>28</b>

# 1. Comments

AGL Energy Ltd (AGL) welcomes the opportunity to provide comments to the Australian Energy Regulator (AER) on the New South Wales distribution networks service providers (DNSPs) Regulatory Proposals for the period 1 July 2014 to 30 June 2019.

AGL is both a significant retailer and generator of energy with around 3.8 million electricity and gas customers and over 6,000 MW of generation located in Queensland, New South Wales, South Australia and Victoria.

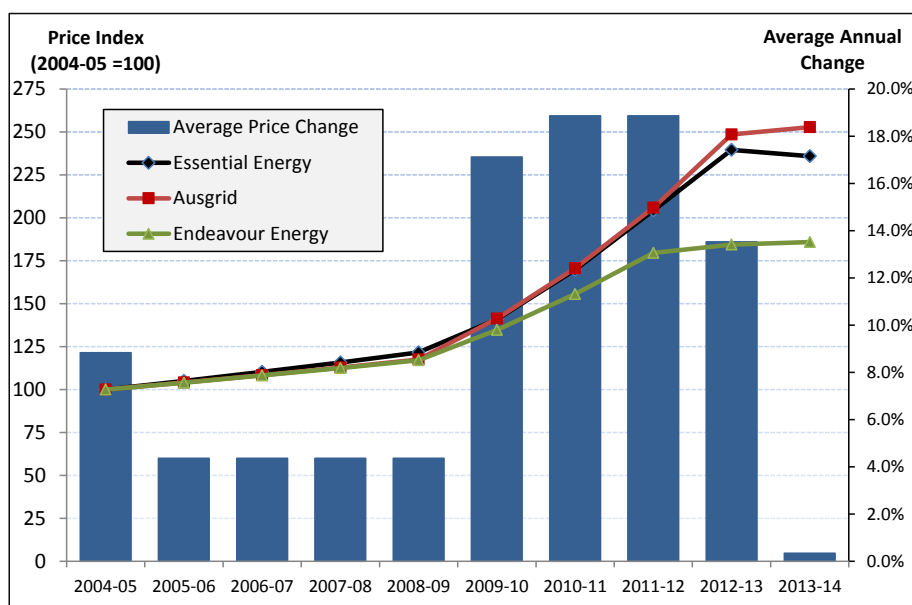
In the Australian energy market, all network charges are passed through to customers in their retail electricity prices so any increase (or reduction) in network charges has no direct commercial impact on retailers. In addition, retailers do not have the resources nor expertise to review the enormous amount of information submitted by the DNSPs in support of the cost components in their Regulatory Proposals.

As a consequence, AGL's participation in previous distribution network determinations has focussed almost entirely on the scope, quality and cost of the ancillary and alternate services being provided to retailers and consumers. AGL's submission will again review these proposed services, including the welcome addition of metering as an alternate service.

In the current sequence of AER determinations, AGL will also look to extend its review to include the underlying cost components proposed by the DNSPs but primarily will seek to comment on the price outcomes guided by the regulatory proposals and whether they are reasonable from a customer and retail supplier point of view.

Figure 1 shows the annual changes to NSW network prices over the last 10 years and the aggregate impact via an index of network prices. Recent double digits increases have result in network charges that have more than doubled since 2004-05.

**Figure 1: Network Price changes from 2004-05 to 2014-15**

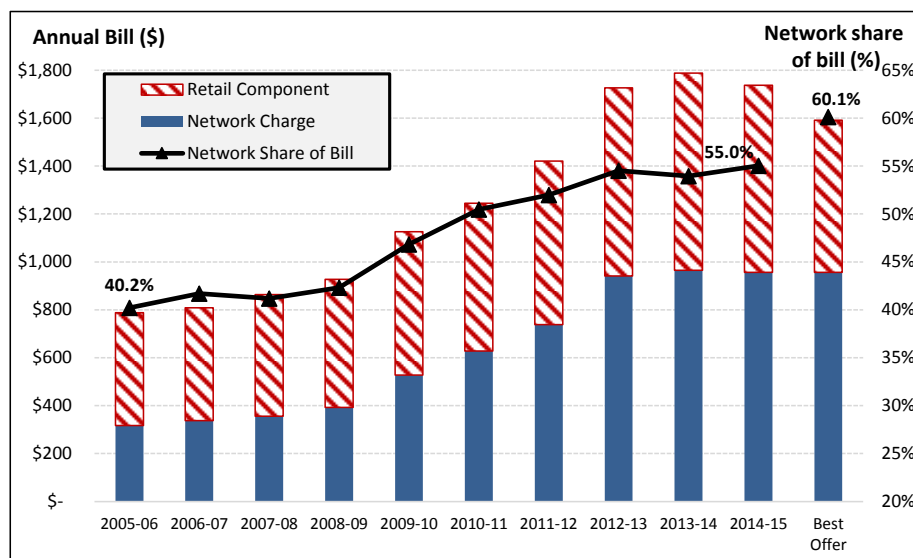


Source: Calculated based on reported CPI-X annual changes.

The consequence of the large increases in network prices are clear:

1. They've had a direct impact on electricity customers. AGL, as an energy retailer and hence the first point of contact for its 3.8 million customers is well aware of this including increasing customers numbers on financial hardship programs, a general fall in the affordability of energy and a large adverse reputational impact for the energy industry as a whole. The industry needs to rectify this situation;
2. Industry has found that demand is not inelastic. The increasing price of electricity has been a major driver of falling energy consumption and peak demand through impacts on average consumption, industry closures and take-up of replacement energy sources such as solar PV. This is a significant structural change for the electricity industry to deal with and must be considered on an industry-wide basis. The DNSPs need to make economically sound decisions rather than simply rely on regulated frameworks to provide short-term revenue recovery; and
3. Network prices are now the single most important driver of retail electricity prices. Figure 2 shows the retail and network component of a typical Ausgrid residential customer over the last 10 years. The network share of the bill has risen from 40 per cent 55 per cent in 2014-15, assuming carbon has been removed from retail prices. Most importantly from a competition point of view, these costs cannot be varied or discounted by retailers. The last column in Figure 2 refers to a current AGL market offer including usage discount in the Ausgrid region. Network share of the customer's bill now equates to over 60 per cent. Any efficiencies driven by the competitive market are clearly being swamped by the fixed recovery of network charges.

**Figure 2: Domestic Bill – network/ retail components (Ausgrid)**



Source: Calculated for a residential customer consuming 5 MWh of domestic all-time and 2 MWh of controlled load using Ausgrid network charges and Energy Australia Standing Prices.

AGL notes that Networks NSW has acted responsibly under the price cap framework and curtailed unnecessary capital expenditure in the final years of the regulated period. However, the regulatory proposals of the NSW DNSPs are disappointing and do not attempt to wind back the previous imposts on customers nor appear to address the obvious decline in asset utilisation to any extent.

Consequently, AGL will be actively participating in the AER's consultation for the Regulatory Proposals of the New South Wales DNSPs.



## **1.1. Structure of Submission**

In this submission, AGL is responding to the Regulatory Proposals and supporting documentation of all three NSW DNSPS, namely:

- Essential Energy;
- Endeavour Energy; and
- Ausgrid.

AGL's submission addresses its major concerns with the DNSPs proposals using the following structure:

- Section 2 discusses the energy and demand forecasts;
- Section 3 examines capital and labour productivity trends for the businesses to date;
- Section 4 considers the DNSPs forecast capital expenditure for the 2014-19 period and impact on the Regulated Asset Bases;
- Section 5 reviews the quantum of the operating expenditure forecasts over the period 2014-2019 including proposed efficiency benefits ;
- Section 6 comments on the weighted average cost of capital proposal;
- Section 7 highlights AGL's views on Metering Contestability and how the DNSPs Alternate Service proposals may impact this;
- Section 8 notes some necessary considerations with regard to the future directions of network pricing; while
- Section 9 reviews the DNSP approach to ancillary services including changes to fees and charges.

## 2. Energy and Demand Forecasts

As noted by the DNSPs and the AER, energy consumption has fallen significantly since 2010-11 and this has in the main been accompanied by reductions in peak demand. The change in regulatory framework from a price cap to a revenue cap would suggest that the DNSPs' energy forecasts are less important given that aggregate revenue recovery over the period will be unchanged irrespective of forecast accuracy.

This is correct from a network revenue recovery perspective but ignores the impact that an inaccurate forecast will have on future price changes. This is clearly demonstrated by the use of a revenue cap framework in Queensland over the current period when actual energy consumption has fallen well below the approved forecast. This has resulted in unexpected annual network price increases that are significantly above those indicated by the AER's previous determination. The lack of transparency and lack of certainty surrounding these network price changes is in conflict with the move to deregulated retail price settings and has a negative impact on customers' confidence in the industry, their investment decisions and retailers' product development (e.g. fixed price products).

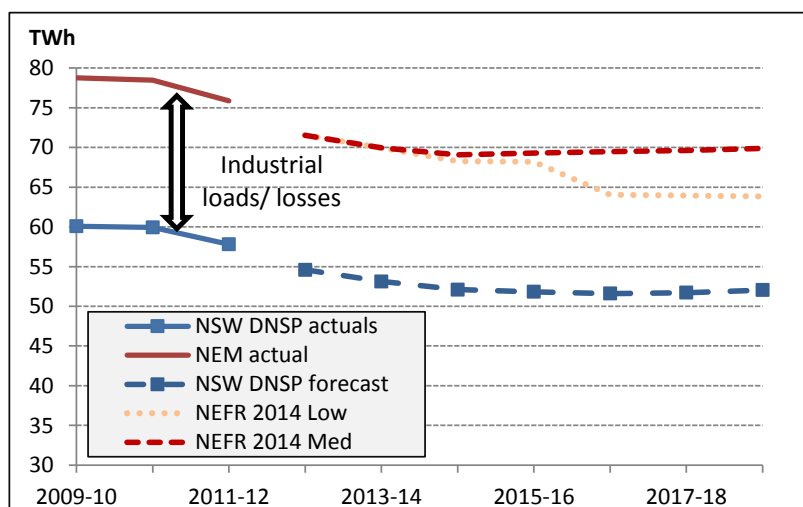
As such, the AER needs to ensure that conservative energy consumption forecasts are used by the DNSPs to ensure the Determination's indicative price paths are unlikely to be exceeded, noting that the DNSPs cost recovery will be unaffected under the revenue cap framework. The DNSPs' forecasts of peak demand must also be closely considered by the AER as they indicate whether capital expenditure is required.

AGL has reviewed the DNSPs overall energy and demand forecasts against the Australian Energy Market Operator's (AEMO) *National Electricity Forecasting Report 2014* (NEFR 2104). As the official market forecast it provides an appropriate benchmark and AGL assumes NSW trends should be comparable with the NEFR Low and Medium scenarios.

### 2.1. Forecast Consumption

All three New South Wales DNSPs have forecast reduced energy consumption between 2014-15 and 2018-19.

**Figure 3: Total Energy Forecast of NSW DNSPs**

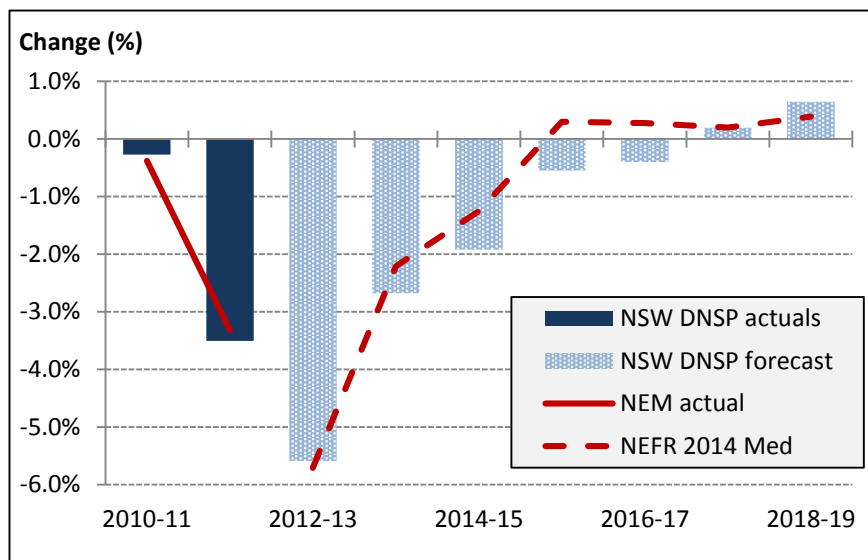


Source: DNSP Regulatory Information Notices 2014, NEFR 2014

Figure 3 shows the aggregate DNSP forecast compared to the NEFL 2014 Medium forecast. The DNSP forecasts are at the network level and therefore do not include energy consumed by wholesale customers and transmission losses but the comparison shows that they are consistent with NEFR.

An examination of energy growth rates is also meaningful and Figure 4 shows the annual percentage changes in actual and forecast.

**Figure 4: Energy growth rate forecast of NSW DNSPs**



Source: Derived from DNSP Regulatory Information Notices 2014, NEFR 2014

AGL believe the aggregate growth rates for the New South Wales DNSPs are broadly consistent with the NEFR 2014 Medium level forecast and therefore reasonable.

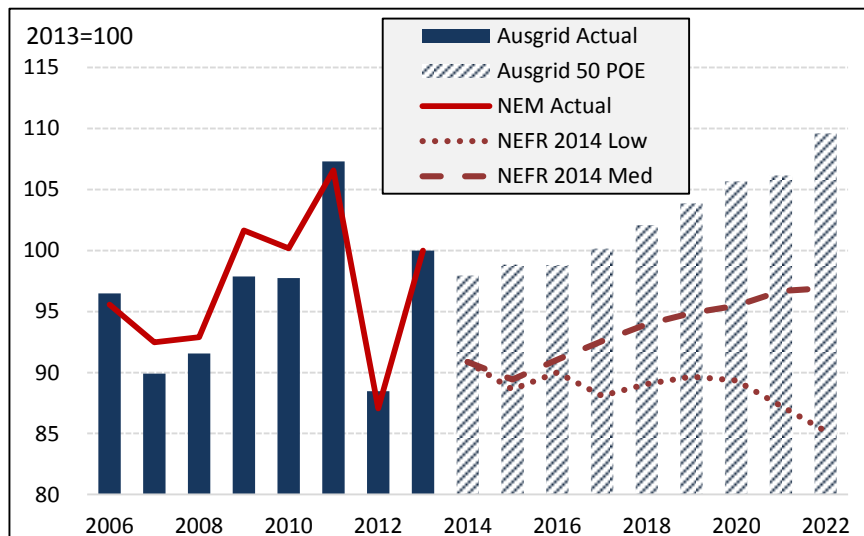
## 2.2. Forecast Maximum Demand

The AER has included the DNSPs forecasts of peak demand in its Issues Paper and highlighted that they vary considerably with Ausgrid and Endeavour Energy forecasting significant increases in peak demand from 2013-14 onwards. Essential Energy’s peak demand is noticeably more conservative with minor demand growth from 2014-15.

Unfortunately, Essential and Endeavour Energy have not provided any details on their Maximum Demand forecasts in the supporting information to the regulatory proposals. Consequently, due to this lack of transparency, AGL has only been able to consider the Maximum Demand forecasts provided by Ausgrid.

AGL has compared the Ausgrid peak demand forecasts against the NEFR 2014 Low and Medium forecasts for both summer and winter periods. Creating an index of Ausgrid’s summer peak demand forecasts using its actual peak demand in 2013 allowed AGL to compare it to the NEFR Low and Medium forecasts, also shown as indices based on the NEM peak demand in 2013. These are shown in Figure 5 and highlight that while the annual changes in Ausgrid summer peak demand have closely followed the actual NEM changes from 2006 to 2013, the growth forecasts are very aggressive.

**Figure 5: Ausgrid Summer Peak Demand v NEFR 2014**

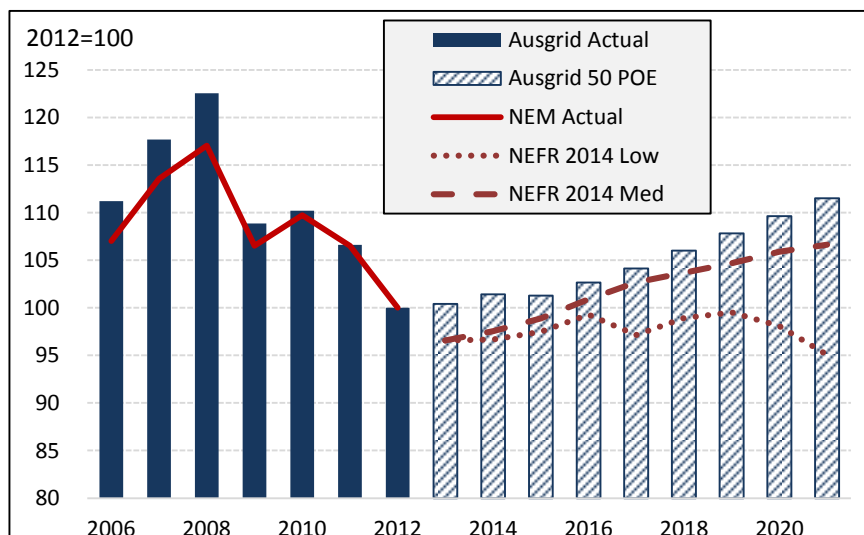


Source: Derived from Ausgrid Spatial Demand forecast, Attachment 5.03, NEFR 2014

Ausgrid is forecasting aggregate growth in summer peak demand of almost 4 per cent from 2013 to 2019. This is well above the -5 and -10 per cent growth over the same period estimated for the NEFR 2014 Medium and Low scenarios respectively.

The Ausgrid forecasts of winter peak demand are also quite high. Using the winter peak demand in 2012 as the index base, Ausgrid is forecasting aggregate winter peak demand growth of almost 8 per cent by 2019. This is higher than the NEFR 2014 Medium scenario of 4.7 per cent and much higher than the Low scenario of -0.5 per cent.

**Figure 6: Ausgrid Winter Maximum Demand forecast vs. AEMO**



Source: Derived from Ausgrid Spatial Demand forecast, Attachment 5.03, NEFR 2014

AGL believes the Ausgrid peak demand forecasts are aggressive and questions their usefulness in justifying any capital expenditure. We also raise similar concerns regarding the Endeavour Energy peak demand forecasts but as mentioned, due to a lack of transparency we are not in a position to examine them.



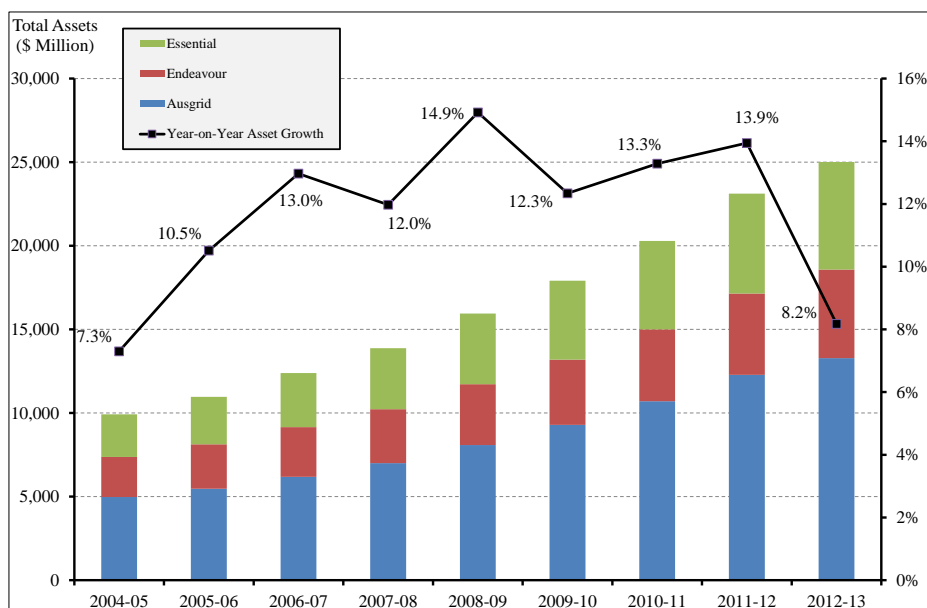
### 3. Capital and Labour Productivity

As the AER has noted, electricity consumption and demand have been contracting and when considering the large investment made by the New South Wales DNSPs over the last 10 years, this is a significant macroeconomic issue.

In order to highlight how significant this issue is and what it means to the AER’s consideration of the New South Wales DNSP regulatory proposals, AGL believes it is appropriate to review the current situation with regard to some broad indices such as capital and labour productivity.

Energy consumption and demand may be reducing but it is being serviced by an ever-increasing capital stock. Figure 7 shows total assets from the 3 NSW distribution network businesses has risen from \$10 billion in 2004-05 to over \$25 billion in 2012-13 - an enormous investment expansion averaging 12 per cent year-on-year in fixed capital.

**Figure 7: NSW DNSPs Regulatory Asset Base**



Source: DNSP Regulatory Information Notices

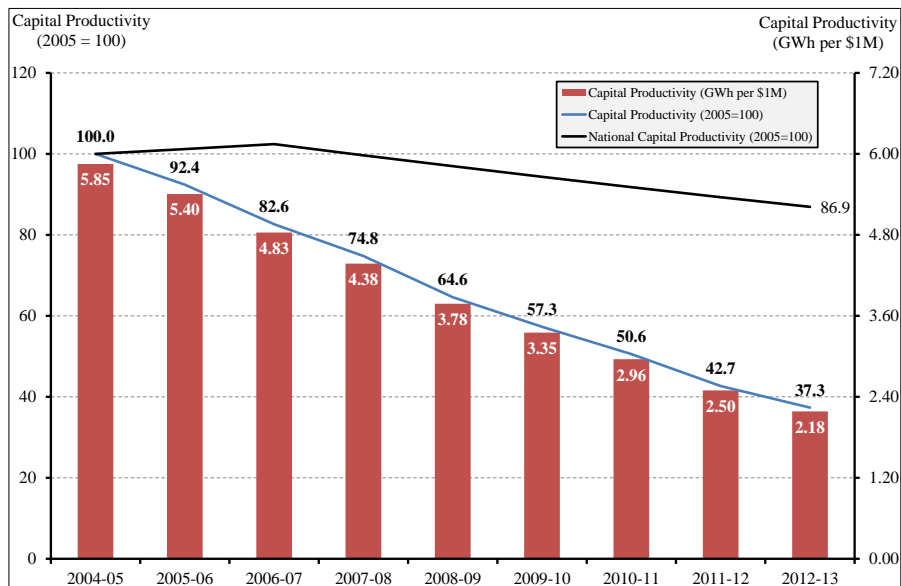
To examine capital productivity, Figure 8 measures energy throughput (GWh) per \$1 million of capital deployed. In 2005, almost 6 GWh of energy was delivered per \$1m but by 2012-13 this has fallen to only 2.2 GWh. When converted into an index with the level of capital productivity in 2005 set as 100, capital productivity of the NSW DNSPs has fallen to just 37.3 by 2012-13.

At a national level, capital productivity is usually quite flat but as also shown in Figure 8, it has declined by 14 per cent since 2004-05 (generally considered a consequence of the “Mining Boom”). A fall in capital productivity is quite unusual at the macroeconomic level. Conversely, one would not expect capital productivity to rise unless there is a technological break-through. As a result, capital productivity tends to be flat over time – i.e. when capital is deployed in an efficient manner and holding technology constant.

The capital productivity in network businesses has fallen by 62.7 per cent in 8 years. This unprecedented collapse in capital productivity should be taken as a signal to the AER and NSW DNSPs that capital has not been allocated efficiently. Unlike equivalent episodes

during the 1980s and 1990s, rapid load growth is not forecast and therefore this situation will not self-correct.

**Figure 8: Capital productivity of NSW DNSPs**

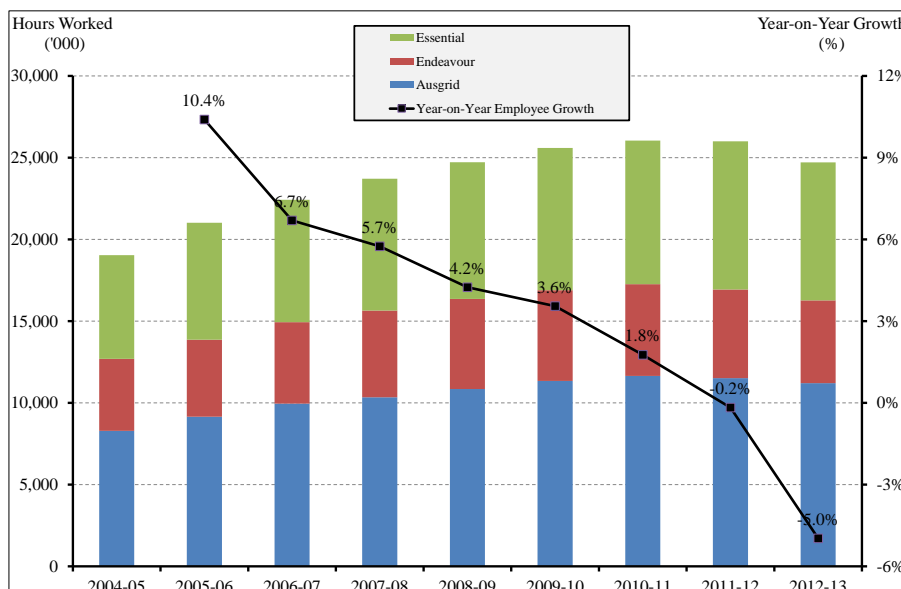


Source: Derived from DNSP Regulatory Information Notices, ABS data

As well as capital formation, the annual reports of the three DNSPs highlight the number of FTEs required to service and operate the network capital.

Figure 9 shows the annual hours worked by employees for each business and in aggregate. It also shows the Year-on-Year change has finally fallen in 2011-12 and 2012-13. Unfortunately, aggregate hours worked is still 30 per cent higher than in 2004-05 despite the significant capital investment.

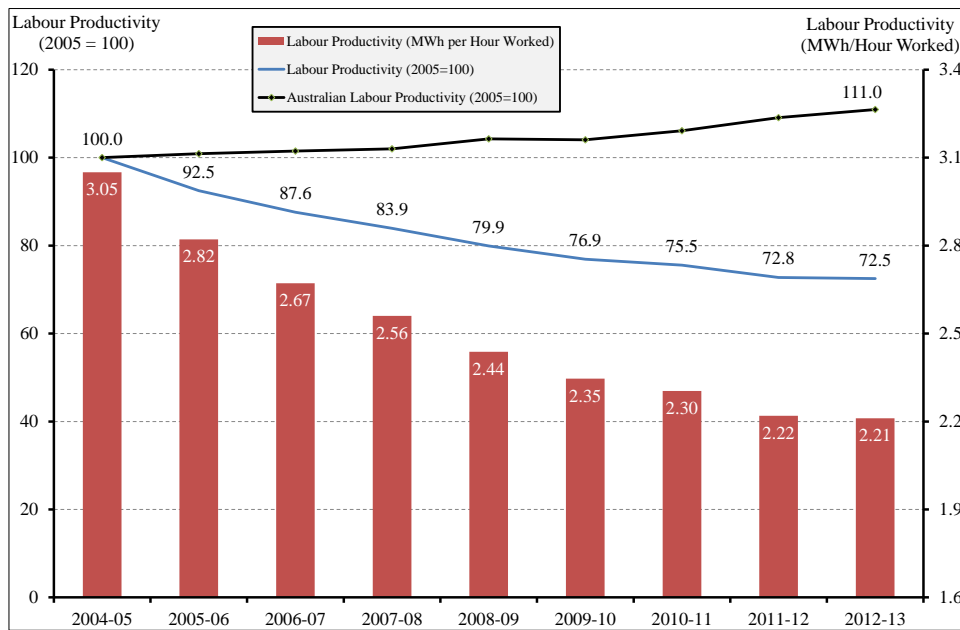
**Figure 9: NSW DNSP Hours Worked**



Source: DNSP Annual reports.

To examine labour productivity, Figure 10 measures energy throughput (MWh) per hour worked. This has been converted to an index with the level of labour productivity in 2005 set as 100 and compared with an index of Australian labour productivity.

**Figure 10: Labour productivity of NSW DNSPs**



Source: Derived from DNSP Annual reports, OECD data.

AGL finds this result surprising. Labour productivity of the NSW DNSPs has consistently declined since 2005 while average labour productivity in Australia has consistently improved.

This is not a statistical anomaly of falling energy demand either, as labour productivity consistently falls over the 10 years despite increasing energy demand in the first 6 years of the period. Even if we were to assume energy demand did not contract from 2010, and instead expanded by 1 per cent year-on-year, it doesn't change the direction of labour productivity (and capital productivity). Productivity still falls dramatically with the exception of 2012-13.

The result of this decline in both capital and labour productivity has been a doubling of electricity network prices in NSW.

Given this frame of reference and projected further declines in energy consumption, AGL does not believe the NSW DNSPs Regulatory Proposals for the period 2014-15 to 2018-19 sufficiently address the issues of:

- poor utilisation of the regulated asset base and the need to avoid exacerbating this through further fixed capital formation;
- network planning and reliability standards that may better accommodate an environment of declining energy consumption and peak demand; and
- apparent inefficiencies with regard to operating and capital expenditures.



## 4. Capex and the Regulated Asset Base

Given falling energy consumption and no peak demand growth, the size of the Regulated Asset Base (RAB) of each DNSP appears excessive and a major impediment to correcting the high cost of delivered energy.

For a competitive firm, the current low asset utilisation and capital productivity would almost certainly require asset impairment. We acknowledge that this is not an option under the regulated network framework. Initially Endeavour Energy, and then all DNSPs after the formation of Networks NSW, have recognised this issue and curtailed unnecessary capital expenditure in recent years by underspending the capital expenditure allowances made under the current Determination. The DNSPs' regulatory proposals have also made some allowance for this by reducing capital expenditure on network augmentation or growth.

Unfortunately, the DNSPs' regulatory proposals still result in substantial increases in the real value of RABs over the forecast period. This is not consistent with the state of the NSW energy market and would appear ill-considered when long-lived assets are involved. DNSPs are investing and expecting consumers to pay regulated returns on new assets for 40 plus years. Without the certainty of the regulated framework and guaranteed rate of return, our view is that it is highly unlikely any firm would make these investments.

AGL believes an efficient firm would focus on utilising its current RAB by:

- limiting augmentation capital investment to new connections;
- delaying any major capital works until the risks posed by decreasing network utilisation or technological replacement are clearer;
- reviewing its capital replacement program to slow capital replacement;
- increasing the focus on driving efficiencies in capital expenditure; and
- ensuring the RAB depreciation outweighed any new capital expenditure during this regulatory period.

### 4.1. Regulated Asset Base

The issue of falling utilisation of distribution assets is a problem for all Australian electricity distribution networks but the problem is intensified in New South Wales because of the enormous spending in previous years and consequent impact on RABs.

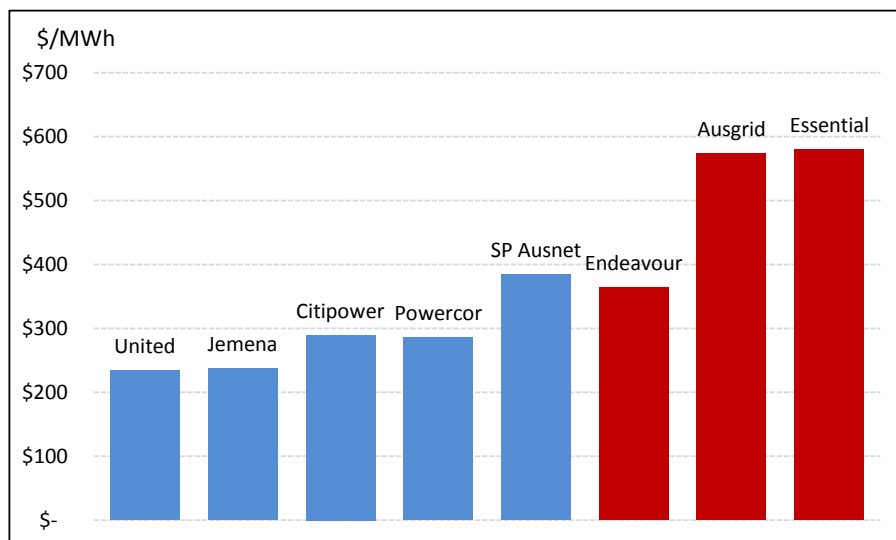
This is inarguable and can be clearly demonstrated by comparing the RAB of the NSW DNSPs with their Victorian counterparts.

The total RAB value for NSW DNSP's is projected to be over \$25 billion in 2014 compared to a value of around \$11 billion for Victorian DNSPs. Figure 11 indicates the RABs of the NSW and Victorian DNSPs on a per MWh delivered basis with the NSW average value of distribution assets approximately 60 per cent higher per MWh.

Asset values are not simply a function of energy consumption and demand with area and consumer density being other major drivers. Therefore, it is understandable that Essential Energy's RAB metric would be greater as its network provides coverage to 95 per cent of NSW. However, there is no economic basis for the other NSW DNSPs to have a ratio so much larger than similar Victorian businesses.

To be clear, customers pay for the impact of the RAB so NSW customers are paying significantly higher network charges than Victorian customers for ostensibly the same service.

**Figure 11: RAB/MWh for Victorian and NSW DNSPs (2014-15)**



Source: Derived from AER Victorian Determinations, NSW Regulatory Proposals.

The rate of change of this metric in NSW is highly problematic. RAB values should remain relative stable in real terms (i.e. RAB per MWh) over the long term but for the NSW DNSPs, the value of RAB per MWh has more than doubled in real terms over the last 10 years.

Unfortunately for consumers, the necessity and efficiency of past expenditure and the current RAB is not up for consultation but it should be considered as an input to the NSW regulatory proposals and the AER determination.

AGL believes the above metric gives weight to closer examination of any proposed capital expenditure to ensure that only essential capital investment is included during this regulatory period so that the real value of the RAB can be contained to its current levels.

## 4.2. Capital Expenditure

As we acknowledged above, AGL is not in a position to review the detail underlying the DNSPs' capital expenditure forecasts nor the extensive supporting information. However, we can comment on the proposed changes in relation to growth trends and the aggregate levels of the capital investment.

AGL believes the AER should take into account the following factors when assessing the DNSPs' capital expenditure proposals:

- There is declining energy consumption and no growth in electricity demand;
- RABs have already been built to satisfy higher energy usage and peak demand than is forecast over the next period;
- The sector has rapidly declining capital productivity;
- The NSW networks are already outperforming key reliability targets of their license conditions; and
- The cost metrics for the NSW DNSPs rate poorly against industry, specifically the Victorian cost benchmarks.



The DNSPs' proposals have given some regard to these factors with the most obvious being the significant reduction to growth related capital expenditure forecasts compared to the previous determination.

AGL notes that the DNSPs have still proposed material amounts of growth related capital expenditure in the next period, and supports the inclusion of efficient capital expenditure that is required to connect new customers or to establish additional capacity in areas of certain growth.

However, AGL would encourage the AER to confirm that:

- any augmentation of existing capacity is founded on realistic peak demand forecasts. As highlighted in section 2, the DNSP forecast of peak demand appear aggressive;
- the estimates of new connections in the identified pockets of growth are reasonable; and
- unit cost of new connections are efficient when compared to other DNSPs.

If these criteria are strictly met then capital expenditure on growth of customers and consumption can only improve the productivity of the network and, with all other parameters kept constant, can only lower network charges for NSW customers. This would appear to be a minimum test before the AER should accept the DNSPs forecasts for growth capital expenditure.

In contrast to the moderation of capital expenditure for growth, the DNSPs appear to have ignored the external factors on our industry when proposing replacement or renewal capital expenditure.

#### 4.2.1. Asset Replacement Capital Expenditure

AGL is concerned that the NSW DNSPs have continued to propose significant renewal or replacement capital expenditure for the next regulatory period despite undertaking large replacement programs over the last period.

The DNSPs have justified these expenditures based on the need to:

- maintain high levels of network reliability and security;
- replace ageing assets; and
- maintain an average age of the network within an acceptable range.

To support this approach, the DNSPs have largely focussed on customer responses that consumers support the maintenance of the current levels of reliability if achievable without additional price increases.

AGL endorses the increased level of consumer consultation carried out by the NSW DNSPs prior to submitting their proposals, including consulting with other industry stakeholders. However, AGL is well versed in surveying customers' preferences and understands that it is usually difficult to draw specific conclusions on value based on these responses.

In this instance, AGL doubts that customers would be able to clearly determine what the current level of reliability being provided is, what changes to this notional level of reliability would actually mean for them and what value they could notionally ascribe to it. As such, AGL doubts the DNSPs were able to:

1. link changes in customers' reliability to relevant changes in costs; and therefore
2. determine whether customers would choose to forego a change in potential service reliability for a financial benefit.



AGL believe that quoting customer expectations in this manner is inconclusive and the findings alone do not merit the continuance of such large expenditure on replacement assets.

The NSW Government has removed various planning standards and made some of its reliability standards more flexible. Given NSW DNSPs are outperforming the current reliability targets, more fundamental questions are how much expenditure can be reduced (capital and operating) and still meet the new targets that apply from 1 July 2014 and secondly, what cost/benefit would this provide for consumers?

The NSW DNSPs purported need for significant capital replacement expenditure is tested when one examines the replacement capital spent over the last regulatory period, the forecasts for next period and the residual life of the DNSPs' regulatory asset bases.

The NSW DNSPs are expecting to replace over \$4.7b of assets over the next regulatory period, after replacing over \$5b in the current period. 5 years ago the RAB was around \$16b. Replacing assets worth \$10b in a 10 year period prima facie seems unreasonable. This may be justifiable if replacing end of life assets, but the benefits of this program when analysing the DNSPs' asset base data appear to have been only extending average residual asset life from 20,32 and 38 years in 2009 to 20, 36 and 42 years for the respective DNSPs in 2014. Furthermore AGL:

- cannot understand how the DNSPs could be justifying the high levels of capital replacement given the high average residual life of the RABs – noting that this is probably understated given low utilisation of the assets would tend to extend their asset life significantly;
- recognises that the NSW DNSPs construct asset replacement plans based on detailed risk analysis however, we query whether these models, parameters or criteria guiding the replacement of assets are still based on an environment of growing demand or have been updated. In other words, are the DNSPs too risk averse given the circumstances;
- believes that the DNSPs should be seeking to reach the long-term balance that occurs when capital spending on asset replacement aligns with straight line depreciation allowances. Given the capital investment up to this point and the continued expectations of declining energy and demand over the long term, this would be prudent; and
- recommends that the AER review the DNSPs' asset replacement programs for efficiency and should, where possible, look to slow the capital replacement programs on a risk-adjusted basis. This would be in the long term interest of consumers and potentially, the long-term interests of the DNSPs themselves given the long-life of the assets involved.

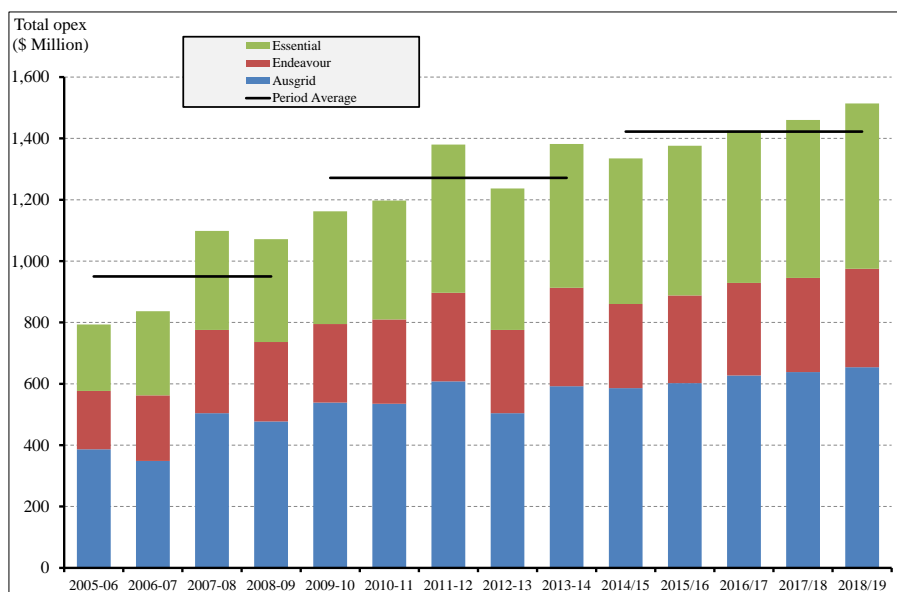
## 5. Operating Expenditure

As highlighted in section 3, labour productivity of the NSW networks has consistently declined since 2005 despite Australian labour productivity increasing over this period.

Our view is that the NSW DNSPs' regulatory proposals for the period 2014-15 to 2018-19 need to incorporate substantial efficiency and productivity improvements, especially in operating and maintenance expenditure.

Aggregate operating cost allowances for NSW DNSPs have increased by over 90 per cent in nominal terms over the past two regulatory periods. Even a cursory examination of the latest operating expenditures proposed by the DNSPs suggest that, although some efficiency improvements may have been made, they are not significant with the quantum of the proposals largely just a continuation of the levels from the previous period in real terms.

**Figure 12: NSW DNSPs Operating Expenditure (nominal)**



Source: AER Determination 2009, NSW DNSPs' RINs, Regulatory Proposals.

AGL does not have the resources to conduct a detailed review of the extensive DNSPs' proposals regarding operating expenditure. However, because of the direct impact this cost component has on the price charged to NSW consumers, AGL in combination with Energy Australia and Origin Energy contracted Oakley Greenwood<sup>1</sup> to critically assess the DNSPs' operating expenditure proposals. The Oakley Greenwood report will be submitted to the AER separately.

AGL does make the following comments based on its initial assessment of the levels of operating expenditure in the regulatory proposals.

First, AGL strongly supports the AER's use of benchmarking to review the DNSPs' cost proposals. The networks indicate that past expenditure is a preferred indicator because

<sup>1</sup> Oakley Greenwood, *Review of NSW DBs Regulatory Submission*, prepared for Energy Australia, Origin and AGL, August 2014





benchmarking does not take into account individual network's cost drivers. This is partially correct but:

- an approach that only considers a businesses' past expenditure would largely institutionalise any inefficiencies that may exist; and
- the AER is clearly faced by a large information asymmetry issue despite the use of its Regulatory Information Notices. The movement in operating expenditure for the NSW DNSPs over the last period is a case in point with operating expenditure falling by 20 per cent in one year and then increasing by 15 per cent the next. The explanation that labour and costs has been moved between operating and capital expenditure categories cannot provide the AER with any comfort regarding underlying efficient costs.

Benchmarking can provide useful guidance and AGL has compared the operating expenditure of the NSW DNSPs versus the Victorian DNSPs (see Section 5.1.1).

Secondly, the proposals appear to have been largely based on the DNSPs' current cost structures including labour force and overheads while the AER is tasked with regulating the businesses' expenditures for efficiency and prudence.

That NSW DNSPs are facing increased short-term costs such as loss of synergies and the cost of restructuring the business is unquestioned. The relevant question is who bears these costs. This would be the owners of the business in a competitive firm because the benefits of the restructure will accrue to the owners in the long-term. For a regulated firm, this requires the AER not regulating the benefits away from the firm.

AGL believes that benchmarking provides a suitable method for ensuring benefits are not regulated away in the short-term noting that the AER is not required to ensure that the removal of cost inefficiencies would accrue benefits to a business.

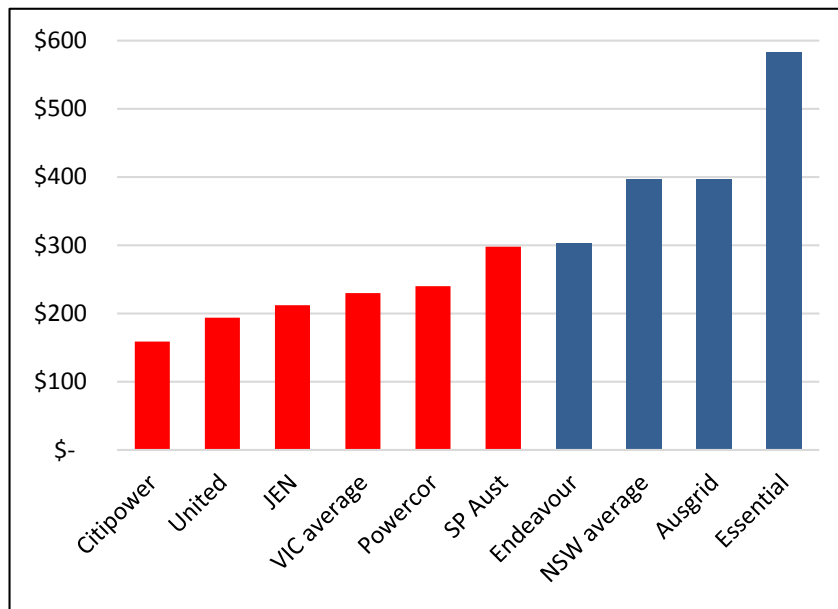
Finally, AGL is concerned with the 'additional revenues' in the DNSPs' proposals that arise from the efficiency benefits sharing scheme (EBSS) and questions the economics of these outcomes in section 5.1.2. In saying this, AGL is not in a position to gauge whether the DNSPs are actively seeking this additional revenue through the EBSS or following strict regulatory process outlined in the current determination. AGL expects the AER to actively assess and remove these additional revenues that on face value, and when taken in the aggregate, have provided no benefit to consumers.

#### 5.1.1. Comparison with Victorian DNSPs

To assess the reasonableness of the NSW DNSPs' proposals for operating cost, AGL have estimated the operating costs per customer for both the NSW and Victorian DNSPs. The figures for the Victorian distribution networks are for the 2014 calendar year and based on the AER's Final Determination 2010-15 adjusted following the Australian Competition Tribunal's decision. The NSW figures are for 2014-15 and based on the DNSPs' regulatory proposals.

Figure 13 shows this metric with the operating cost for Victorian DNSPs ranging from \$159 to \$298 per customer, with a weighted average of \$230 per customer. In comparison, the operating cost for NSW DNSPs ranges from \$300 to almost \$600 per customer, with a weighted average of around \$400 per customer.

**Figure 13: Current operating expenditure/customer, by DNSP**



Source: AER Determination 2009, NSW DNSPs' Regulatory Proposals

Of course, there are other cost factors which may explain some of the differences between the operating expenditures of these networks but AGL is unable to understand why:

- NSW DNSPs would have an average cost 70% higher than in Victoria;
- Ausgrid's cost would also be 70 per cent higher than the Victorian average;
- the best performing NSW DNSP in Endeavour Energy would have a slightly higher cost per customer than the most expensive DNSP in Victoria, SP Ausnet, which also covers a regional area three times that of Endeavour; and
- Essential, which is expected to have a higher cost than its peers due to its rural base and regional area, has a cost per customer twice that of SP Ausnet which is similarly required to cover a large region.

This analysis highlights that small reductions in operating expenditure by NSW DNSPs compared to their previous performance does not suggest any level of efficiency unless they can also benchmark themselves other Australian DNSPs.

#### 5.1.2. Efficiency Benefits Sharing Scheme

AGL understand that the Efficiency Benefit Sharing Scheme (EBSS) is supposed to reward DNSP's for any efficiency gains achieved during a regulatory control period while penalising them for efficiency losses.

The effectiveness of the EBSS, namely providing benefits to consumers, is totally reliant on any efficiency gains exposed by the scheme being provided to consumers over the long-term. If this occurs correctly, then the benefits to consumers will eventually outweigh their short-term losses noting they continue to pay inflated costs to DNSPs for the initial 6 year period.

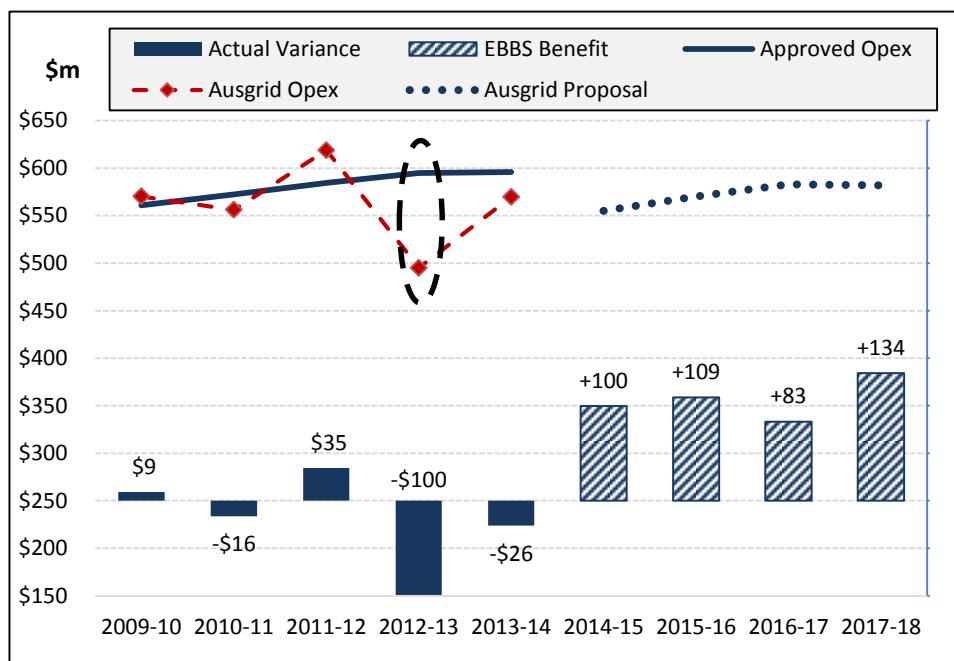
In other words, consumers will only benefit if the efficiency saving is genuine and permanently included in the relevant DNSP's future operating cost allowance. On immediate inspection, the NSW DNSPs' proposals for EBSS carryover are groundless and

do not meet these principles. An example arising from the current EBSS is shown by the Ausgrid proposal examined below, but the situation equally applies to Endeavour Energy.

Ausgrid has claimed real increases in operating expenditure (and revenue) of \$426 million over the next 4 years based on the EBSS. That is, because there was a \$100 million underspend of operating expenditure reported by Ausgrid in 2012-13 (highlighted in Figure 14), customers are required to pay on average, an extra \$105 million per year until 2018. To be clear, this is not for any network services but to reward Ausgrid's efficiency, even though they already collected the \$100 million in revenue above their costs in 2012-13.

This may have credence under the EBSS if the operating expenditure of Ausgrid remained at that level or indeed, if the operating cost proposals for Ausgrid from 2014-15 to 2018-19 clearly identified the \$100 million of savings that customers could then expect to benefit from in perpetuity. However, this does not appear to be the case. Based on our analysis, Ausgrid's actual operating costs appear to be rebounding to the AER approved levels in 2013-14. Furthermore, proposals for future real operating expenditures continue to be \$50-100 million above that of the 2012-13 base year, which is driving the efficiency benefits.

**Figure 14: Ausgrid Operating Expenditure and EBSS (\$2013-14)**



Source: Ausgrid Regulatory Proposal Attachment 4.09

AGL would encourage the AER to either:

- require Ausgrid to rebalance its operating cost forecasts to remove the efficiency gains it is then claiming ; or
- reassess the EBSS amounts so they only include efficiencies that have been removed from the DNSPs' operating cost forecasts so they provide a real and lasting benefit to consumers.



Even if the AER can resolve the current EBSS outcome to be an economic one, AGL would highlight two other concerns with regulating this scheme which we believe raises doubt on its usefulness going forward. These are:

- There must be a degree of concern over the calculation of actual annual operating expenditure by businesses and determining the variance (efficiencies) to allowable expenditure. For example:
  - In the public forum held by the AER on 10 July 2014, Networks NSW indicated that the network underspend in 2012-13 was purely an accounting policy anomaly driven by changes in bond rates;
  - Ausgrid' attachment 5.01 identifies that the increase in operating expenditure in 2013-14 was driven by the movement of costs attributed to capital expenditure, including labour, being moved into operating expenditure;
  - How can underlying efficiencies be derived in these instances; and
- Capital and operating cost allowances are approved based on forecasts of the cost drivers such as customer connection and peak demand. If these forecasts are inaccurate then any expenditure variations would likely be in response to these changes, and not efficiency gains. For example:
  - if energy consumption was a linear driver of operating expenditure then one would expect Ausgrid's operating cost allowance over the 2009-14 period to be \$115million lower than allowed; and
  - this should not be a cause of efficiency benefit.

AGL assumes these issues will be magnified if the efficiency sharing schemes are expanded to include DNSPs' capital expenditures programs (which AGL would expect to vary considerably due to external factors).

AGL suggests the AER review whether efficiency benefit sharing schemes are enforceable and equitable before it includes them in its final determination to avoid the potential risk of NSW consumers paying for a poorly designed framework.



## 6. Weighted Average Cost of Capital

AGL's views on the weighted average cost of capital (WACC) have been publicly articulated in its many submissions and working papers, and can be easily found by referring to articles such as *What is Normal Profit for Power Generation*<sup>2</sup> and *The cost of capital for power generation in atypical capital market conditions*<sup>3</sup>. However, these views largely refer to the treatment of rates of return in the competitive generation and retail sectors of the electricity industry. The cost of capital for lower risk, regulated monopolies has and must continue to be viewed accordingly.

The AER guidelines were extensively consulted upon and AGL considers the final decision a compromise. While we would argue on different input assumptions, the headline result attempted to provide an equitable balance between the interests of consumers and investors. The headline result was not a punitive result for regulated asset owners with the AER determining conservative estimates at the top end of the calculated range for most parameters. This view is supported by:

- Stock market analysts responses to the release of the AER Guidelines - generally describing them as benign to listed asset companies with positive surprises such as the increased market risk premium; and
- reports such as the Independent Expert's Report released by Envestra on 4 March 2014<sup>4</sup>. This report notes the AER Guidelines, but determines a WACC based on current market conditions and estimated that almost all parameters, excepting the value of gamma, are at or below the AER guidelines.

This lends little support to the NSW DNSPs proposal to increase parameters outside of the AER Guidelines.

Noting that AGL disagrees with some of the input assumptions, but accepts the headline result attempted to strike a balance, the AER should enforce its rate of return guideline as good regulatory principle because:

- it seems to provide a realistic benchmark rate of return for a low risk, regulated monopoly asset. If DNSPs continue to argue selectively for higher individual parameters at each regulatory reset then the Guideline is only effectively setting a floor for the WACC; and
- consistent use of the Guideline will avoid the repetitive and costly regulatory debate on the WACC. AGL note that the DNSPs have included 31 documents to support the increase to the WACC proposal (we note mostly from consultants, which is costly). Given the nature of the regulatory framework, NSW customers are essential paying for this debate. The extent of these submissions is, based on our own regulated retail price-cap experience, excessive and raises the question as to whether regulatory proposals should be funded by asset owners, and not recovered through regulated revenues.

---

<sup>2</sup> Simshauser, P. (2014a). *The cost of capital for power generation in atypical capital market conditions*. *Economic Analysis & Policy*, 44(2014), 184-201.

<sup>3</sup> Simshauser, P., & Ariyaratnam, J. (2014). *What is normal profit for power generation?* *Journal of Financial Economic Policy*, 6(2), 152-178.

<sup>4</sup> Grant Samuel and Associates, *Financial Service Guide and Independent Expert's report to the Independent Board Sub-committee in relation to the Proposal by APA Group*, 3 March 2014



## **6.1. Transitional Arrangements for Return on debt**

The AER rate of return guideline introduced a new approach to determining return on debt, a ten year trailing average portfolio approach with annual updates.

The AER has also introduced a transitional arrangement in the guideline to recognise that moving from one methodology to another will change the incentives and potentially the behaviours of the regulated businesses with regard to debt financing.

Under the transitional arrangements, the AER will set 100 per cent of the allowed return on debt for the first year of the 2014–19 period based on current corporate bond yields, in 2015-16 it would set 90 per cent of the allowed return on debt based on the new corporate yields, in 2016-17 it would use 80 per cent, and so on.

This transition is clearly set to accommodate the AER's previous return on debt methodology which was that network businesses were assumed to refinance all debt at the time of the regulatory reset and were compensated accordingly. The transition arrangements would therefore seem appropriate.

As AGL understands, the NSW DNSPs have requested an immediate move to the ten year trailing average approach because it better reflect their actual debt financing behaviour. This appears to make economic sense and is financially robust from a business point of view.

However, AGL believes that in principle this may risk setting a poor regulatory precedent. DNSPs are reimbursed a cost of debt based on a stated methodology. If a business decision is made to deviate from this methodology, then any additional costs or benefits should naturally accrue to these businesses.

In this instance, the AER previously calculated a cost of debt based on a point in time method. We assume the staggering of debt finance by the NSW DNSPs was a business decision. By acting contrary to the AER methodology, the NSW DNSPs have avoided much of this cost impost over the last 5 years and should have received a monetary benefit from doing so. AGL has no issue with this behaviour given consumers were not negatively impacted – this was a risk taken by owners, and the profit/loss should go to the owners accordingly.

However, we consider it inappropriate that the DNSPs would argue against a transition and methodological change designed to assist them. It is not the AER's issue that the NSW DNSPs are using their own method for financing debt and that the transitional provisions may work against their earlier business decision.

It is not obvious to us that the AER should accept a proposal for no transitional arrangement. To do so would require NSW consumers to pay more in aggregate over the 2009-14 and 2014-19 regulatory periods than they would have otherwise if the DNSPs had followed the assumed AER methodology.



## 7. Alternate Services - Metering

AGL supports the direction of policy developments towards enhancing competition in metering and specifically, AGL supports the policy direction and effort related to the Power of Choice review (and, in particular, proposed reform #3):

*"To introduce competition in metering services and develop a framework for smart meters: establishing the regulatory framework to encourage commercial investment in smart meters and associated services to promote consumer choice."*<sup>5</sup>

AGL also notes the COAG Energy Council decision published in the communiqué dated 14 December 2013 which states:

*"SCER agreed to progress work on the recommendations in the AEMC Power of Choice review... agreement that officials should prepare Rule change proposals for consideration by the AEMC addressing the following areas: Expansion of competition in metering and related services to all customers, consistent with a business-led, optional approach to adoption of more advanced metering in states where a widespread roll-out is not underway".*<sup>6</sup>

AGL in principle supports the AER's positions outlined in response to recent consultation by the AEMC on 'Expanding Competition in Metering and related services' (Rule Change) submitted by the COAG Energy Council that specifically related to removing exclusivity in current regulated arrangements<sup>7</sup>.

AGL notes that chapter 7 of the National Electricity Rules (NER) in its current form already allows for metering competition where the metering installation has remote capability. AGL believes that the only impediments to enable the provision of smart metering on a competitive basis are related to the unbundling of meter charges from existing DUOS and any charges for cost recovery of regulated assets.

### 7.1. Metering service provision

AGL is of the view that there are key principles fundamental to enabling metering competition and ensuring that barriers are not introduced that may inhibit future innovation and choice. These are in line with the AER positions<sup>8</sup> outlined in their submission to the Rule Change which include:

- Distribution businesses should be ring fenced if wanting to compete for contestable metering and or compete as a Meter Coordinator once the rule change takes effect;
- Regulated distribution businesses should pay for services enabled by smart meters on an equal access basis. This allows DNSPs to obtain network benefits while not inhibiting competition in metering services; and
- The cost of the load control device (Asset and maintenance) and meter device (Asset and maintenance) should be unbundled from DUOS and reclassified as Alternative control serviced in all scenarios including:
  - New connection installations

---

5 <http://www.aemc.gov.au/market-reviews/completed/stage-3-demand-side-participation-review-facilitating-consumer-choices-and-energy-efficiency.html>

6 <https://scer.govspace.gov.au/files/2012/12/Final-SCER-Communique-14-December-2012.pdf>

7 <http://www.aemc.gov.au/getattachment/92acc41b-f5a4-4d78-9453-9df69ee2d882/Australian-Energy-Regulator.aspx> page 1 'Removing Exclusivity'

8 <http://www.aemc.gov.au/getattachment/92acc41b-f5a4-4d78-9453-9df69ee2d882/Australian-Energy-Regulator.aspx>



- Replacement of aged / faulty assets; and
- Funding for Demand Side Participation program Metering service provision.

## 7.2. Cost recovery for stranded assets

AGL notes that one of the key characteristics of a Market Led approach is that smart meters are installed based on customers choice, and should not involve a duplicative charge, thereby requiring the unbundling of current metering charges.

The unbundled metering charges and the recovery of any DNSPs' stranded investment costs are therefore critical.

Given the Market Led approach characterised above, there is a strong case that the economic value of any meters replaced through contestability are zero. Oakley Greenwood highlight that if using an Optimised Deprival Value to value the metering assets, they are only worth the opportunity cost of the services and functionality of the meter to the existing meter owner. Given these current services will continue to be provided to the network by the contestable meters free of charge, there is no opportunity cost and no prescribed value of the current meter set.<sup>9</sup>

AGL recognises that this would be a severe interpretation given the circumstances behind the current regulated provision of meters by the DNSPs, however, it does provide context regarding what is the appropriate amount of cost recovery and how should it be accomplished. This is a 2 step process, determine the:

- stranded costs on the meter investments; and then
- best mechanism for recovery.

The COAG Energy Council proposed a set of criteria to determine this calculation which include the proposal for the cost recovery charge to be based on the average depreciated value of the stock of the existing accumulation and manually read interval meters and that it may include administration fees.

Putting this particularly blunt methodology to one side, AGL notes that using these principles have led to significant cost recovery fees of ~\$67 to ~197 in the NSW DNSP proposals. We also note the administration fee is a significant part of this calculation and is very clearly excessive and a barrier to a more efficient market – since networks will gain some benefit from smart meters regardless of who installs the meter.

Furthermore, the calculation does not differentiate meter asset types i.e. accumulation meters which are predominantly older aged or the manually read interval meters that were installed by NSW DNSPs in the last five years.

AGL believes there is a significant difference in calculating the residual life of the asset when considering these factors.

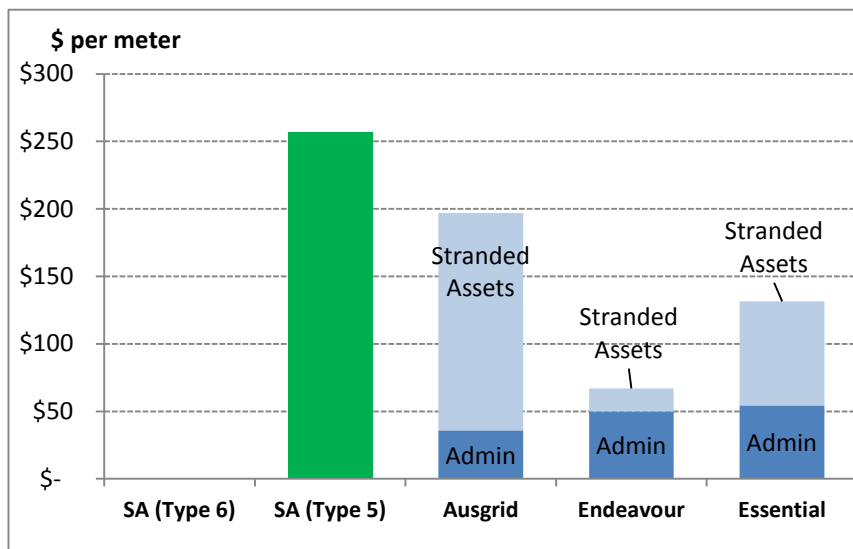
The NSW results in Figure 15 below read like a barrier to entry for metering services. In AGL's view, the recovery of costs on DNSPs' meter investments should purely be based on any residual value of the asset. That is, all other costs including administration fees, operating expenditure, capital investments on plant, buildings and IT etc. should be removed from cost recovery.

---

<sup>9</sup> Oakley Greenwood, *Review of NSW DBs Regulatory Submission*, prepared for Energy Australia, Origin and AGL, August 2014



**Figure 15: Exit fee comparison**



The administration costs are the cost of processing a customer changing its current meter to a contestable meter of another provider. These activities will almost certainly be conducted by the DNSP's resources that are currently employed to provide the metering alternate services. AGL notes that the DNSPs have made no adjustment to operating costs to allow for reductions in future meter numbers so this administration cost is already being absorbed in the unbundled metering charges. AGL believes these costs are incremental to the metering operating expenditure already forecast by the DNSPs and therefore, retaining in the alternate service cost structure will be the most equitable solution.

Similarly, the costs of shared business and IT assets should not be included in any cost recovery fee. As highlighted above, the economic value of the meter services actually being replaced is in principle zero and if this was being rigorously applied, the DNSPs would naturally retain all shared costs with the Standard or Alternate Service asset bases. This should continue to be the case even though cost recovery is being provided.

### 7.3. Recovering the cost of stranded meters

Once appropriate cost recovery is calculated (to be clear, the current DNSPs amounts for cost recovery are not appropriate), the question is what method should the AER use to reimburse DNSPs.

As a retailer interested in the contestable metering market, AGL is not in favour of an upfront exit fee as it will impede a Market Led approach to installing smart meters. The penalty on the first provider to install a smart meter at a given NMI will make it uneconomic to install smart meters in the majority of cases.

AGL places a high value on the potential benefits provided by a successful market for metering and therefore believes the cost recovery mechanism should be constructed without any upfront cost but allowing a DNSP to recover the fair value of the stranded meter.

Another consideration, often raised by the AEMC, is that consumers who access the contestable metering market should pay for the stranded meter cost and therefore an upfront charge is appropriate. This principle is along the lines of user pays but is not accurate in this instance because:



- The upfront recovery charge will rarely, if ever, be cost reflective. The DNSPs current exit fee structure of one size fits all is obviously flawed and entirely unworkable but even separating the exit fee by metering type does not make it cost-reflective. The major driver of stranded metering cost is asset age and cannot be accounted for. For example, the stranded value of a 25 year old meter is zero while that of a brand new meter may be \$200. An average exit fee of \$50 will not induce any economic efficiency as the brand new meter is just as likely to be replaced as the old one; and
- This assumes the customer selects installation of a new meter. The Market Led roll-out instead is predicated on the fact that meter providers may provide customers with smart meters and associated benefits for the same cost as they currently pay. Consequently, they will be selected to receive additional services at no extra cost.

Consequently, AGL does not believe an upfront charge will create any economic welfare via a user pays method but instead, it will simply slow metering competition and create significant economic loss.

Instead, AGL believes the stranded asset depreciated value is calculated by type of meter and is directly recovered through the Standard or Alternate Services (Metering).

The DNSPs currently propose that stranded meter assets upon replacement will be removed from the Metering RAB by asset disposal. AGL recommend that instead, the value be removed from the RAB through depreciation. This would reduce the asset base accordingly but would provide immediate cost recovery for the DNSPs.

If this was performed on the Metering RAB, its value would remain reflective of the asset stock but the unbundled metering charges may be impacted depending on metering roll-out and what the recovery charge is?

If this was performed on the Standard RAB, the metering asset base would not reduce with asset replacement but the impact of metering replacement would be minor and paid by all consumers.

AGL encourages the AER to explore these options.

#### **7.4. New connections and meter replacement**

The COAG Energy Council has proposed changes to the National Electricity Rules, under the proposed Metering Competition Rule Change, that allow state jurisdictions to determine their own new and replacement policies<sup>10</sup>. AGL does not support a fragmented and jurisdictional approach to new and replacement metering across the NEM. In AGL's view this will:

- Create barriers to any future market-led roll out of smart meters under competitive arrangements;
- Limit the ability of energy retailers to offer products supported by smart meters across all jurisdictions; and
- Create greater economic inefficiencies with increased likelihood of additional meter asset replacement at new and replacement sites.

AGL recommends the AER consider new connections and replacement of aged meters assets as distinct activities.

---

<sup>10</sup> COAG Energy Council (2013), *Introducing a new framework in the National Electricity Rules that provides for increased competition in metering and related services*, page 33 (section 5 of Attachment A), <http://www.scer.gov.au/files/2013/10/Rule-change-request-Meter-competition.pdf>



#### 7.4.1. New connections

New connection assets and installations need to be unbundled from the metering asset base.

New connections are new homes and properties and the metering cost and installation is recovered directly from the customer/ developer/ builder (with the exception of South Australia). The meter asset and installation recovery of cost today varies by network and state in that in some states the charge of the new connection (asset and installation is a hidden charge in the DUOS). In AGL's view, meter charges (asset and installation) for new connections need to be unbundled from the regulated asset base to allow for smart metering to be provided on a competitive basis in this scenario.

#### 7.4.2. Aged asset replacement programs

AGL believes that competitive neutrality is a fundamental principle to ensuring smart metering and services are provided on a competitive basis. Any meter provision to a customer needs to be based on providing value to the customer, and needs to provide an incentive for the customer to engage with and support the services and benefits that smart meters enable.

Therefore AGL believes that the costs for metering and metering services regardless of scenario must be unbundled from the regulated asset base funding arrangements that currently exist. Furthermore, meter provision and meter data service provision should be provided by separate entities that are ring fenced from other regulated activities financially and operationally also carried out by them. This not only ensures that, where DNSPs wish to compete in meter provision or meter data provision markets, they are not able to use regulated revenue to compete in unregulated activities, but it is also a step towards achieving interoperability of metering standards and protocols.

This is consistent with the existing NER under chapter 7, whereby the DNSP must put in an offer to the Financially Responsible Market Participant (FRMP) who can either accept the offer from the DNSP or seek alternative metering arrangements.

In the case where the FRMP accepts an offer from the DNSP, the DNSP is required to provide a meter at the lowest cost. AGL proposes that where a DNSP is providing a meter in the scenario of new and replacement that the following approach should apply:

- the DNSP, as the party who has exclusive visibility of asset age on their network, identify sites that need replacement every 12 months; DNSP be obliged to notify the FRMP which NMIs are due to be replaced and put in an offer to the FRMP for metering replacement;
- FRMP has the option to either accept the offer from the DNSP or choose a Metering Service provider of choice (under the new arrangements, that will be through the Meter Coordinator);
- In this case, the DNSP will apply funds available under its determination to:
  - provide the cheapest basic accumulation meter; or
  - Go to tender to contestable Metering Service provider (or the Meter Coordinator under the proposed new Metering Competition rule change proposal) of their aged meter replacement program

#### 7.4.3. Demand Side Participation (DSP) programs

Consistent with the Rule Change, and similar to the approach proposed for the Aged asset replacement programs, AGL believes that if a DNSP requires a smart meter installed at a premise for DSP programs or other network benefits and does not wish to participate in



the competitive metering space under a separate ring fenced entity, the DNSP can tender these services to competitive accredited metering service providers. This allows the market to operate on a competitive neutral basis and hence smart meter benefits to be realised across the value chain.

However in all scenarios, AGL recommends that the DNSP is required to go through the FRMP in the first instance due to possible financial implications and customer impacts.

It is yet unclear to AGL how the funding for metering will be allocated for the DSP programs and if this allocation of regulated funding can be utilised by the DNSP to offset the provision of a smart meters needed to achieve the network benefits that are forecast through the DSP programs (see recent ENA submission<sup>11</sup> to the Rule Change).

---

<sup>11</sup> <http://www.aemc.gov.au/getattachment/996c9319-39d8-49e2-b2ba-26afb8d0ff3b/Energy-Networks-Association.aspx>



## 8. Network Tariff Principles

AGL notes that at this point, the NSW DNSPs have included little guidance with regard to changes to network tariffs except for restating their objectives of:

- Revenue sufficiency;
- Economic efficiency; and
- Equity.

In the 2014-15 tariff schedules, the DNSPs began to remove any inclining block structures inherent in current network charges. AGL believes this move to a conventional fixed charge and 'flat-rate' variable energy charge was eminently sensible given the environment of falling energy consumption and low network utilisation.

However, AGL is not confident a move to a declining block structure is the best option for the DNSP and industry. Instead, AGL would prefer to see the DNSPs establish a constant variable rate for 2015-16 and apply any further price reductions to all customers through a reduction in this variable charge.

AGL's recent Working Paper <sup>12</sup> demonstrated that existing tariffs dominated by a flat rate variable charge are inefficient and inequitable to customers. It highlighted the efficiency impacts from restructuring the existing flat-rate tariff to a time-of-use and dynamic critical peak pricing structure. From an economics perspective, this was expected.

Furthermore, given recent contractions in energy demand, the fixed and sunk capital costs of an electricity distribution networks and the use of revenue cap to regulate networks, it is highly likely that simple tariffs dominated by the variable charge component are likely to become unstable if volumes continue to decrease.

AGL has previously noted that the benefits of shifting to time-of-use tariffs included slower growth in peak demand, delayed or avoided network augmentation, increases in the efficiency of generation, delayed requirements for costly peak load generation equipment and greater tariff stability (and therefore enhanced welfare).

However, AGL believe the DNSPs will need to consider other plausible solutions in the medium term such as critical peak pricing or demand charges to optimise cost-reflectivity if they are to 1) ensure utilisation of the networks and 2) avoid service replacement by technology because of inherent cross-subsidies in network charges.

Our current research in this area tends to indicate a shift away from existing structures and towards a two part tariff based on a demand charge, and an energy charge to enhance the cost reflectivity, and stabilize tariff structures under a range of plausible conditions.

---

<sup>12</sup> Simshauser, P and Downer, D. (2014). *On the inequity of flat-rate electricity tariffs*, AGL Working Paper No. 41

## 9. Ancillary Service Fees

AGL is of the view that all proposed fees in the list of Ancillary Services need to be carefully reviewed and analysed by the AER to ensure that the fees charged to customers are fair and efficient.

AGL notes that the service fees for similar processes vary significantly across the three DNSPs and their regulatory proposals fail to adequately explain the reasoning behind these discrepancies. Furthermore, when comparing Ausgrid, Endeavour and Essential fees, different DNSPs have higher charges for different services which means the differential cannot simply be explained by location of network or other consistent factor.

AGL believes that:

- the quantum of the proposed fees is generally prohibitive and third party service providers are able to provide the same services at significantly lower rates;
- many of the fees are not cost reflective; and
- most of the fees are significantly higher than in other states and it is unclear why this is the case.

Costs of energy services is an industry wide issue and any new fee or proposed increase to a fee should be efficient as well as cost reflective because of the impact on customers.

AGL has reviewed the proposed labour rates as set out in Ausgrid's *Attachment 8.22: Ancillary Network Services Proposal* and believe that they are extremely high when compared to industry benchmarks. The methodology for calculating the cost of a service advises that labour on-costs and overheads are additional to the proposed labour rates and this is confirmed when reviewing the worksheets that break down the cost components. Using the base Ausgrid labour rates suggests FTE cost estimates as shown in Table 1.

**Table 1: Ausgrid Hourly Rate Extrapolation**

Ausgrid	Hourly Rate (2015-16)	Estimated Annual FTE Cost*
Admin R1	\$138.01	\$ 245,000
Technical Specialist R2	\$182.63	\$ 324,000
Engineer/Senior Engineering Officer R3	\$175.79	\$ 312,000
Field Worker (R4)	\$139.84	\$ 248,000
Senior Engineer R5	\$244.25	\$ 434,000

\*Estimated Annual FTE Cost assumes 37 hour working weeks for 48 weeks a year.

AGL's view is that Ausgrid's proposed labour rates need to be reviewed and may need to be replaced by benchmark rates as high labour costs is a major factor driving up the majority of ancillary service fees, resulting in an outcome that is not fair to NSW electricity customers.

### 9.1. Disconnection services

AGL considers that the fees for disconnection and reconnection should be separated for all DNSPs to provide transparency to customers.



Transparency is a significant issue in the energy market with customers not understanding services and associated fees. The service type name does not make it clear that it includes a reconnection charge. Other states separate each fee and unbundling these fees would create consistency across the market and allow customers to more readily understand the fees they are being charged.

Splitting out these fees would enable customers to make informed decisions on how they manage their properties. Some customers may choose to disconnect properties for a variety of reasons, including renovations or vacancy. It does not seem appropriate to force a customer to pay a reconnection fee when they may be uncertain when they wish to reconnect or if they intend to reconnect at all.

Some properties may be reconnected by a new customer and it is inequitable that customers are expected to pay for a service they will not be using.

AGL also believe the disconnection fees are generally prohibitive. Unfortunately, disconnection in a timely and effective manner is often the only option for retailers due to the accumulation of debt. The customers that are disconnected for debt are likely to have significant debt issues and AGL is concerned that disconnecting customers for non-payment with such high associated fees will significantly increase debt levels and place such customers further at risk.

## Attachment 1: Comments on Alternate Services Fees

AER Service Group	Service Type	Comparable Prices In Other States			Ausgrid		Endeavour		Essential		Comments/Issue/Concerns
		SA	VIC	QLD	Now	FY15	Now	FY15	Now	FY15	
Reconnections/ Disconnections	DeEn - Meter Box [failed, but site visited]	<p>All other states separate De-energisation and Re-energisation fees.</p> <p>Provides more transparency for the customer and the Retailer. To ensure customers who move into a property that was disconnected are not disadvantaged, a general Move-In fee is charged, which covers the cost of a Move-In read and any re-energisation work and is comparable to the Move-In (read Only) fees later as proposed by NSWs DNSPs.</p> <p>Separating the fees also allows the distributors to offer additional services, like express ReEns, ReEns after DNP and Move-In ReEns.</p>			\$45.10	\$43.27 -4%	\$45.10	\$69.29 +54%	\$45.10	\$91.01 +102%	
	DeEn/ReEn - Meter Box, Non Technical [completed]				\$90.20	\$144.73 +60%	\$90.20	\$206.68 +129%	\$90.20	\$121.44 +35%	AGL considers the fee for each distributor is too high. It is significantly higher than the disconnection fee in other states and the supporting information provided by the DNSPs does not adequately justify these price increases. AGL considers that the fees for disconnection and reconnection should be split to reflect the service being carried out. That would avoid move in residents not being unfairly penalised because a previous occupant was disconnected for debt.
	DeEn/ ReEn - Meter Box, Technical [completed]				-	\$243.63 New	1	\$252.49 New	-	\$121.44 New	AGL considers the fee for each distributor is very high. It is significantly higher than the disconnection fee in other states and the supporting information provided by the DNSPs does not justify these prices.
	DeEn/ReEn - Pillar/Pole [failed]				-	\$323.16 New	-	\$183.87 New			AGL considers this fee is not appropriate and the amount high. It is not clear in what circumstances a pole top disconnection should fail. It is also unclear why the fee is so high for what technically a site visit and why the fee for Ausgrid is much higher than Endeavour. Ausgrid's network is predominantly metropolitan. Travel times and distances would be greater for Endeavour than Ausgrid and it would be expected the fee be higher to reflect this. The explanations provided by each distributor do not adequately explain the discrepancies.
	DeEn/ReEn - Pillar/Pole [completed]				\$151.70	\$775.25 +411%	\$151.70	\$430.78 +184%	\$151.70	\$447.86 +195%	AGL queries the significant increase in proposed fee. If such a disconnection was contemplated by a retailer or distributor for non-payment of debt, the customer would have significant debt issues. Setting a fee at this level would force a customer significantly further into debt. It will also act as a disincentive to retailers and distributors to disconnect a customer for debt resulting in debt growing when there is limited likelihood of the debt being recovered.



AER Service Group	Service Type	Comparable Prices In Other States			Ausgrid		Endeavour		Essential		Comments/Issue/Concerns
		SA	VIC	QLD	Now	FY15	Now	FY15	Now	FY15	
	ReEn - Outside Bus. Hours	\$71.00	\$76.61	\$89.18	\$97.38	\$99.21 +2%	\$97.00	\$127.16 +31%	\$97.38	\$127.16 +31%	
	Attendance to perform a statutory right where access is prevented				-	\$77.72 New					Service currently provided with no fee. AGL requires a better understanding of when this fee would apply. AGL believes that if a distributor wishes to insert a new charge there should be a clear definition of the fee, how it is calculated and justification why it should now be charged.
Ancillary Metering Services	Emergency Maintenance of Failed Metering Equipment not owned by DNSP				-	\$163.21 New					
	Franchise (CT) Meter Install				-	Quoted New					
	Meter Test	\$176.21	\$302.91	\$245.27	\$74.83	\$576.17 +670%	\$74.83	\$603.33 +706%	\$74.83	\$442.03 +491%	The supporting information provided by the DNSPs does not justify this significant fee increase. While, AGL appreciates and supports the motive to discourage unnecessary meter testing, it is often a requirement to resolving Ombudsman complaints and on many occasions the retailer is expected to absorb the cost. Other states have different Meter Test fees to account for the variability in the type of meter testing required, and hence have a range of Meter Test Fees, which may be a more applicable as residential sites tend to have single phase meters, which should be less expensive to test compared to multiphase meters, etc. This would also reduce the cost burden on Residential customers.
	Replace/Remove T5/6 Meter										No price proposed for the regulatory period
	Meter Test (additional meter)	\$0.00	\$117.10	\$0.00					-	\$325.03 New	
	Type 5-7 non-standard meter data services				-	\$13.83 New					

AER Service Group	Service Type	Comparable Prices In Other States			Ausgrid		Endeavour		Essential		Comments/Issue/Concerns
		SA	VIC	QLD	Now	FY15	Now	FY15	Now	FY15	
Move In/Out Meter Reads	Move in move out meter reads	\$32.00	\$26.78	\$24.87	-	<b>\$10.12</b> New	-	<b>\$33.77</b> New	-	<b>\$80.17</b> New	AGL supports Ausgrid's proposed move in move out meter reads. AGL considers Endeavour and Essentials fees are expensive and should align with other distributors in other states.  <b>NOTE: The fees displayed for other states represent a Re-energisation Cost, which include reconnecting and reading the meter. Hence they are larger than Ausgrid's fee.</b>
Network Tariff Change Requests	Network tariff change - invalid request								-	<b>\$160.78</b> New	AGL considers it is inappropriate for a fee to be charged if the request is invalid. The retailer has no visibility as to whether the request will be valid, a customer should not be penalised because this function sits with the distributor rather than the retailer to assess such a request.
	Network tariff change request				-	<b>\$48.99</b> New	-	<b>\$84.40</b> New			AGL objects to this new fee. This function sits with the DNSP and customers should not be charged because the DNSP has not placed a customer on the correct network tariff.
	Off-peak conversion				\$60.48	<b>\$207.50</b> +243%	\$60.00	<b>\$115.04</b> +92%	\$60.48	<b>\$80.17</b> +33%	There is a significant variances in the service fees for what appears to be a similar process without any clear explanation. AGL queries these fees.
	Site Establishment				\$142.48	<b>\$54.74</b> -62%	?	<b>\$45.19</b> New		<b>\$84.91</b> New	AGL does not support such a fee unless it is a new connection fee that should be passed to customer by the ASP. If it is for an existing site where a new NMI needs to be allocated, there is no activity performed to warrant such a fee and it should not be approved
	Special Meter Reading	\$11.61	\$18.11	\$21.63	\$45.10	<b>\$10.12</b> -78%	\$45.10	<b>\$33.77</b> -25%	\$45.10	<b>\$80.17</b> +78%	AGL supports Ausgrid's proposed special meter reads. AGL considers that Endeavour and Essential's fees should align more closely with the special read fees in other states.
	Supply of conveyancing information - desk inquiry				\$37.00	<b>\$37.65</b> +2%				<b>\$61.39</b>	

AER Service Group	Service Type	Comparable Prices In Other States			Ausgrid		Endeavour		Essential		Comments/Issue/Concerns
		SA	VIC	QLD	Now	FY15	Now	FY15	Now	FY15	
	Supply of conveyancing information - field visit				\$73.00	<b>\$301.54</b> +313%					
Vacant Property Reconnect / Disconnect	Vacant property reconnect/ disconnect				-	<b>\$141.99</b> New			-	<b>\$121.44</b> New	AGL believes this fee is too high. A high fee makes disconnecting vacant sites prohibitive and may result in illegal usage if a new occupant moves into a previously vacant site that has not been disconnected due to the price of disconnection. Retailers having to absorb the costs of illegal usage increases the cost that is ultimately paid by customers. AGL considers that the fee should be split. A customer should not be prepaying to reconnect if they do not know when or if they will reconnect. Further it is not appropriate to charge one customer a reconnection fee when it is likely to be an entirely different customer that actually reconnects.
	Vacant property reconnect/ disconnect (site visit only)				-	<b>\$36.13</b> New			-	<b>\$91.01</b> New	