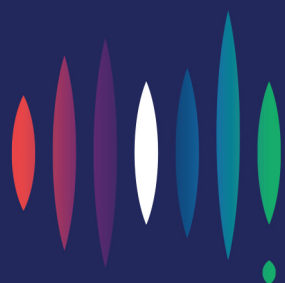


Australian Energy Regulator

Preliminary framework and approach

AusNet Services, CitiPower, Jemena, Powercor
and United Energy for the regulatory control
period commencing 1 January 2021

November 2018



**ENERGY
CONSUMERS
AUSTRALIA**

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Version history

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Introduction

The fundamental purpose and objective of electricity networks as regulated businesses is to serve the long-term interests of energy consumers with respect to price, quality, reliability, safety and security of the supply – an objective and purpose that is enshrined in the legislative framework as the National Electricity Objective or ‘NEO’.

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments Energy Council in 2015, we promote the long-term interests of energy consumers with respect to price, quality, reliability, safety and security of supply.

We appreciate the opportunity to respond to the Australian Energy Regulator’s (AER) consultation on the preliminary framework and approach for the 2021-25 determinations for the Victorian electricity distribution businesses: AusNet Services, CitiPower, Jemena, Powercor and United Energy. This is a critical launching point for these businesses as they continue to engage with energy consumers and prepare their revenue proposals.

This process also provides consumer groups, such as Energy Consumers Australia, with the opportunity to provide a perspective on consumers interests and expectations, as well as to share insights from revenue determination processes in other parts of the National Electricity Market (NEM). It also provides us with the opportunity to communicate the way that we plan to engage with the distribution businesses, based on our previous experience engaging in revenue determination processes.

The objective – the long-term interests of energy consumers

In our view, this means that current and future consumers pay no more than they need to for the quality of service they require. To put it in even simpler terms, that not one dollar more is spent than necessary; not one day earlier than it is needed. This is an outcome that can be best achieved through a process of dialogue and alignment between network businesses and the consumers they serve. When this happens businesses are demonstrably very careful with consumers’ money and investors are earning reasonable returns.

It does not happen when investors or managers are incentivised to follow a strategy that is distorted by objectives beyond the regulatory framework. In our assessment of regulatory proposals, we are guided by three principles to explore and understand the direction the business is taking:

1. The network business should be able to demonstrate that it has developed a deep understanding of the preferences of its consumers.
2. The business should be able to talk about its longer-term strategy and business plans to provide a context for the five-year revenue proposal under consideration, including a long-term price path expectation.
3. The business should be able to acknowledge the problems created by decisions made previously – comparatively less spending per se, is not enough. Consumers are looking for positive assurance that spending is designed to meet the NEO.

How we assess draft plans and regulatory proposals

Over the last three years, we have directly participated in the revenue determination process (including the appeals and acquittal) for NSW and the ACT. A list of these processes and links to our submissions are included below:

- Ausgrid – [2014-19 remitted decision](#) and [2019-2024 Revenue Proposal](#)
- Essential Energy – [2014-19 remitted decision](#) and [2019-2024 Revenue Proposal](#)
- Endeavour Energy – [2014-19 remitted decision](#) and [2019-2024 Revenue Proposal](#)
- Evo Energy – [2014-2019 remitted decision](#)

This year, we have commenced our formal engagement with the South Australian and Queensland businesses on their draft plans:

- South Australia Power Networks – [2020-2025 Draft Plan](#).
- Energy Queensland – [2020-2025 Draft Plans](#).

Through our grants function, we are also resourcing local advocacy groups to participate in current revenue determination processes. This includes the [Queensland Council of Social Service \(QCROSS\)](#), the [ACT Council of Social Service](#), the [Tasmanian Small Business Council](#), and the [Tasmania Council of Social Service \(TasCOSS\)](#).

We also engage expert revenue consultants to help us assess businesses' draft plans, revenue proposals and the AER's decisions. We are hoping to see draft plans and revenue proposals that successfully demonstrate the link

between the business strategy and revenue proposal. In these documents, we are hoping to see the businesses unpack why the decisions being made by the business are in the long-term interests of consumers. We will be seeking evidence about the claims in the proposal and how they link back to consumer preferences and outcomes; and how informed consumer preferences have influenced decisions within the business.

We also follow this approach when we engage with networks on related matters, a good example being our work with TransGrid to get assurance for consumers around *Powering Sydney's Future* electricity transmission project.

Based on our experiences over the past few years, we have come to the position that if one party has information that would make the choice between two alternatives in a draft plan, or revenue proposal, clear but will not provide the information, we will assume the information works against the proposed preferred option. Consequently:

- If we are not provided with the information we request, our position is that the expenditure is unjustified.
- If we cannot see evidence of consumer preferences, our position is that the expenditure is unjustified.
- If we cannot see clear evidence of ring-fencing integrity, our position is that the expenditure is unjustified.

Our observation is that different businesses are at different stages of maturity as we move away from the old way of making revenue determinations. Some businesses have taken us on the entire journey; some have willingly shared non-public information with us and our experts; and some re-started this journey with a clear and demonstrated commitment.

At the end of the process, we would ideally be in a position where we can confidently assure consumers that the very best use of their next \$1 is to spend it with their local network to deliver the high-quality network services consumers have said they wanted.

What are consumers telling us?

It is not an overstatement to say that the next couple of years are not only critical for the health and success of our economy and the nation. High electricity and gas prices, and an uncertain and at times disorderly process of transition in the energy market, have a stretched household budgets and undermined the competitiveness of our businesses. On overall value for money terms, 46 per cent of Victorian consumers believe they are getting good value for money for their electricity services, behind all other comparison utilities and services. This includes mobile phone (74 per cent), banking services (73 per cent) and insurance (61 per cent)¹.

¹ Energy Consumers Australia, June 2018 Energy Consumer Sentiment Survey, page 63, <https://energyconsumersaustralia.com.au/wp-content/uploads/Energy-Consumer-Sentiment-Survey-June-2018.pdf>

It is telling that after ten-years of price increases, it appears that most households and small businesses have exhausted the changes they are able to make to reduce their use and keep their bills under control. Our latest Energy Consumer Sentiment Survey saw drops in Victorian consumers' confidence that they can effectively manage their energy use and costs. Only 59 per cent are confident in their ability manage their use (down nine per cent), while half of consumers say they have enough easily understood information available to help them make good decisions about their energy supply (50 per cent, down five per cent) or the right tools (51 per cent, down four per cent).²

Great care needs to be taken to ensure that policies to -shore-up the reliability of the system do not lead to overinvestment in the network and further price rises for consumers who, according to the Energy Consumer Sentiment Survey, are relatively more satisfied with reliability (66 per cent³) than value for money (46 per cent⁴). Our thinking about striking the right balance is informed by our strategic framework for the transformation of the energy system and market:

- *Affordability* must be a constraint on investment and decisions about energy – an explicit criterion in decision making up and down the supply chain.
- Energy services must be built around *individuals* to reflect their own unique circumstances, enabling people to easily manage their own use and costs – whether that is consumers who are innovating and engaged; or the majority of consumers who are focused on affordability and costs; or consumers with vulnerabilities.
- Investment in the power system – networks, generation and retail – must be *optimised* and based on consumers' demands that not a dollar more is spent than is necessary and not one day earlier than needed.

Observations from across the NEM

We understand that each distribution network is faced with its own distinct set of challenges. Below, we share our general observations on current network determination process.

Consumer engagement

Underpinning all successful revenue proposals is thoughtful, genuine consumer engagement that results in sustained cultural change throughout all aspects of the business.

As the value of consumer engagement is becoming clearer across several industry parties, the level of maturity of consumer engagement varies. Some examples of good engagement that we have encountered include:

² Ibid, page 64

³ Ibid, page 61

⁴ Ibid, page 39

- Communicating in an open, clear and transparent way. This includes forward planning and everyone knowing what their role is and how they can best feed into the process. This also includes allowing enough time to cover the material.
- Trusting consumers and their advocates with sensitive information. One business provided us with not yet public information from its post-tax revenue model, which helped inform our analysis.
- Engaging in different ways with consumers and their advocates, providing access to experts and evidence in support of the revenue proposal. Network businesses have developed several different ways to engage with consumers. This includes “market stalls” where experts from the business can step through the strategy behind the cost component, engage in a healthy Q&A with consumer stakeholders, and demonstrate the practical outcomes of the proposed expenditure. Other businesses have undertaken deep dives; translated their revenue plans into plain English without losing the technical content; and holding bilateral conversations where desired.
- Reflecting consumer feedback in the revenue proposal. This could be either demonstrating how networks have changed their revenue proposals to incorporate consumer feedback; or outlining the reasons why consumer concerns were not addressed.
- Embedding the value of stakeholder engagement in the businesses by appointing dedicated consumer engagement teams.

We acknowledge that the different network businesses in Victoria will have their own approach to consumer engagement.

We have engaged with AusNet Services through the NewReg process. We are hopeful that the proposal submitted by AusNet Services will reflect that priorities and preferences of its consumers; and is framed in such a way that it is capable of acceptance by the AER.

While we anticipate this outcome, we will apply the same level of diligence to our assessment of its draft plan and revenue proposal that we will to all other Victorian (and NEM-wide) distributor draft plans and revenue proposals.

RABs and capacity utilization

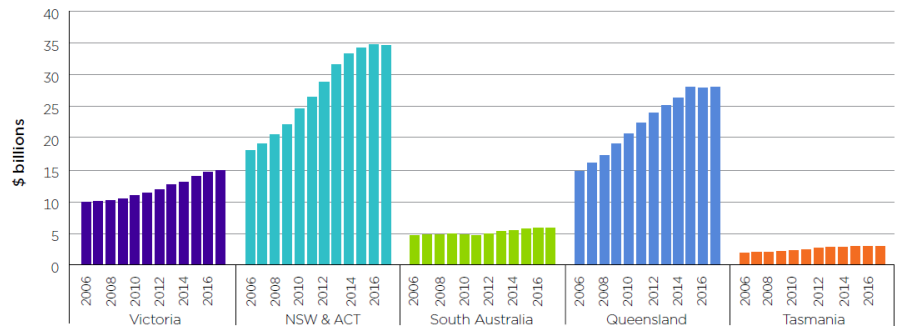
The Australian Competition and Consumer Commission (ACCC) found the RAB as “...central to the affordability of network prices” as “...over half the revenue allowance for firms comes from either the return on or of the RAB (that is, the cost of capital and depreciation allowances)”⁵.

Affordability must continue to be a constraint on all network spending. As illustrated in Figure 1 below, the Victorian businesses have done well to ensure that RAB growth has not increased at the same rate as other

⁵ ACCC, *Restoring electricity affordability & Australia’s competitive advantage*, Chapter 7.2, <https://www.accc.gov.au/regulated-infrastructure/energy/electricity-supply-prices-inquiry/final-report>

businesses across the NEM. We encourage the Victorian distributors to continue to use non-network tools to place downward pressure on the RAB and increase capacity utilization where possible.

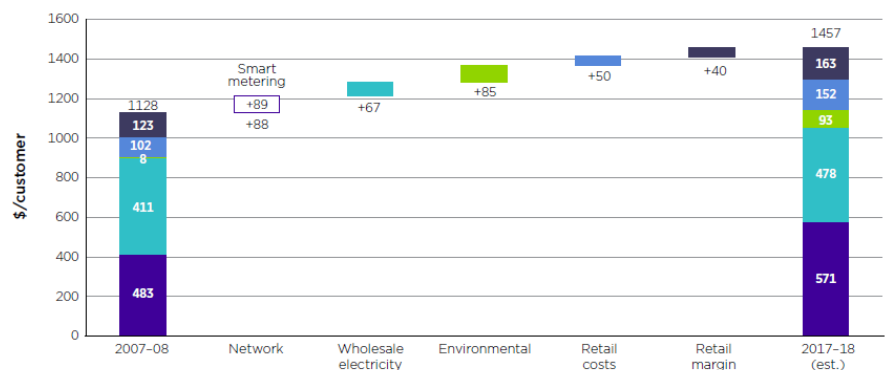
Figure 1: Regulatory asset base from 2006 to 2017, by NEM region, real \$2016-17



Source: ACCC, *Restoring electricity affordability & Australia’s competitive advantage*, Figure D

While RAB growth in Victorian distribution businesses has not been as steep as in other jurisdictions, network costs continue to make up a big part of the final consumer bill, as demonstrated in Figure 2:

Figure 2: Change in average Victorian residential customer bill from 2007-08 to 2017-18, \$ per customer, real \$2016-17, excluding GST



Source: ACCC, *Restoring electricity affordability & Australia’s competitive advantage*, Figure 1.6

Depreciation

We have been calling on network businesses to provide us with more information about how depreciation is calculated and evidence of why the option selected by the business is in the long-term interest of consumers.

Transformation of the network and Information Technology (IT) expenditure

Transformation of the network and IT expenditure have been linked in many processes. We acknowledge that IT can be one of many enablers for a future network. However, the Victorian networks are in a unique position with

significantly higher penetration of smart meters than anywhere else in the NEM. We look forward to seeing the evolving role that these existing assets will play in the future of Victorian networks.

We have also been engaging with networks across the NEM to find out how the proposed IT budgets will improve consumer outcomes and provide a tangible benefit to consumers as a return on their investment.

Productivity and efficiency

Many businesses in private industry continually seek for more opportunities to improve their productivity and efficiency. We encourage the Victorian businesses to continue to lead the way on productivity and efficiency. We are also looking for business to communicate how the savings from more efficient operation will be transferred back to consumers.

Incentive schemes

As mentioned in our submission to the Energy Queensland draft plans, we reiterated our support for initiatives that ensure investment is optimised based on consumers' expectations that not one more dollar is spent that is required; and new investments are not made one day earlier than is necessary. We also reiterated our strong support for incentives for networks to deliver projects at a lower cost.

Our support however, is contingent on rewards only being provided for cost efficiency in delivery, rather than forecasting inaccuracy.

Conclusion

We look forward to open, clear and transparent engagement with the Victorian distribution network businesses as they move closer to developing and finalizing their revenue proposals.

If you would like to discuss this submission further, please contact Shelley Ashe, Associate Director Advocacy and Communications on (02) 9220 5514 or by email at shelley.ashe@energyconsumersaustralia.com.au.

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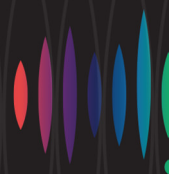
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