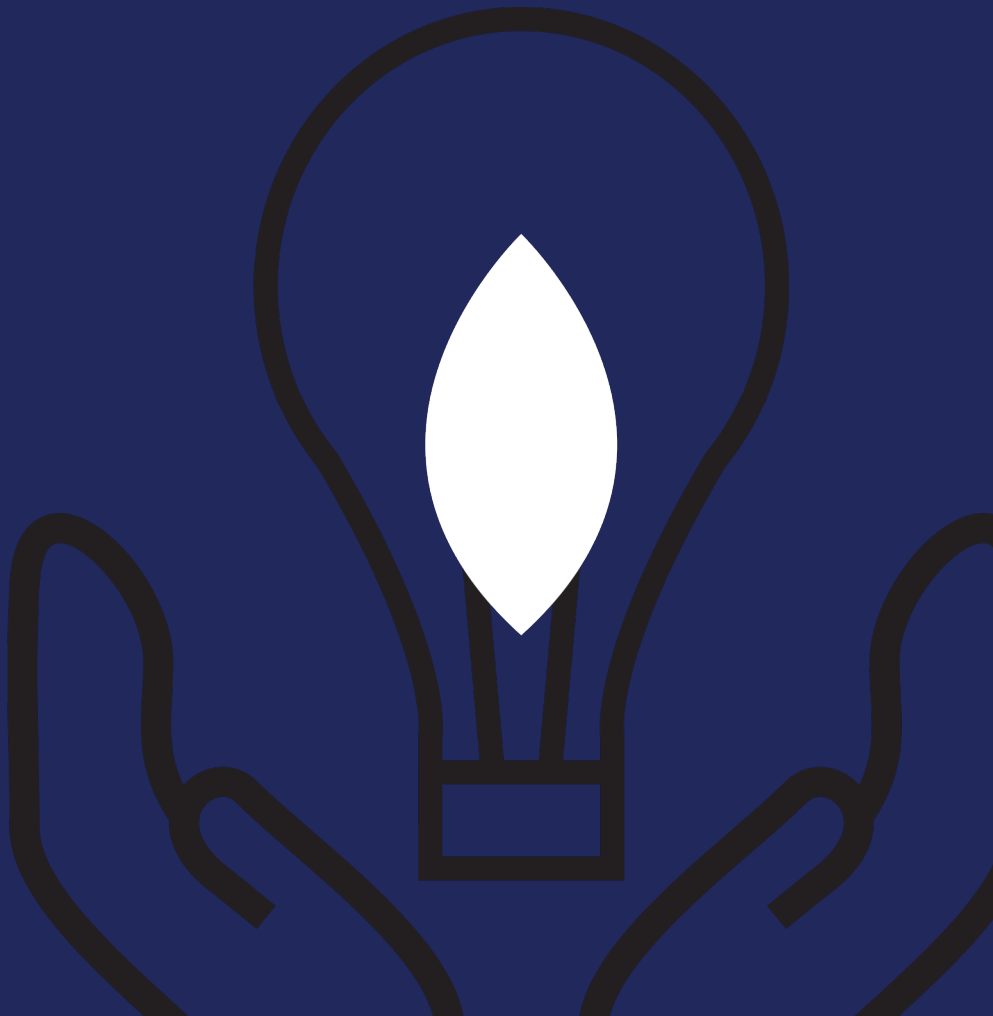
Victorian Distribution Regulatory Proposals

2021-2026

Response by Energy Consumers Australia, April 2020

ENERGY CONSUMERS AUSTRALIA

1
Customer focus



Demonstrating customer focus
Engagement is a necessary first step to customer focus

Customer engagement has been extensive, varied in approach and sophisticated

Findings and recommendations can be linked to proposals.

However, most links relate to new, higher spending

What actions are you taking to improve ?

Show us how you are 'walking the walk', not just 'talking the talk'

How are you putting customers first?

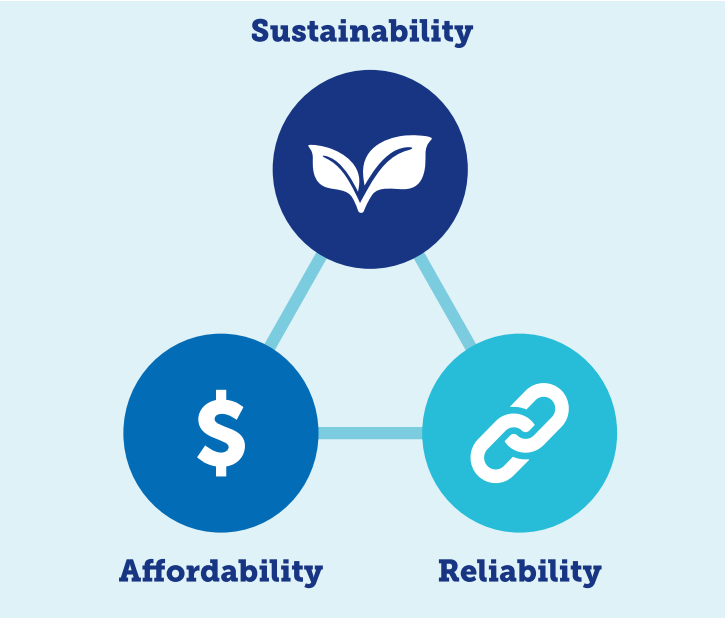
The cultural change to become customer focused is underway in some businesses

For others, it has barely started.

Actions focused on improving outcomes for customers (without asking them to pay more) shows customer focus and a balancing of customers and shareholder needs

What do customers want?

Customers want a **reliable** service that is **sustainable** at a price they can **afford**



Jemena, Regulatory Proposal Overview, p.v

What do customers want?
Reliability

1. Majority of customers don’t want to pay more for reliability

2. Majority of customers do not want to pay less for poorer reliability

3. The focus is now on customer’s experience of outages, and how to improve it through better access to information and swifter communication

“Large businesses stressed the problems and costs that outages, including momentary outages can impose. Improved communication was sought”
AusNet p46/69 – Part I Regulatory Proposal 2021-26

“Our customers won't trade off reliability for cost savings.”
Powercor Regulatory Reset Proposal, 2021–2026, p15

As the People’s Panel members explored a range of issues, they placed similar importance on maintaining the current level of reliability, and on providing access to information.
Jemena, Regulatory Proposal Overview, p.21

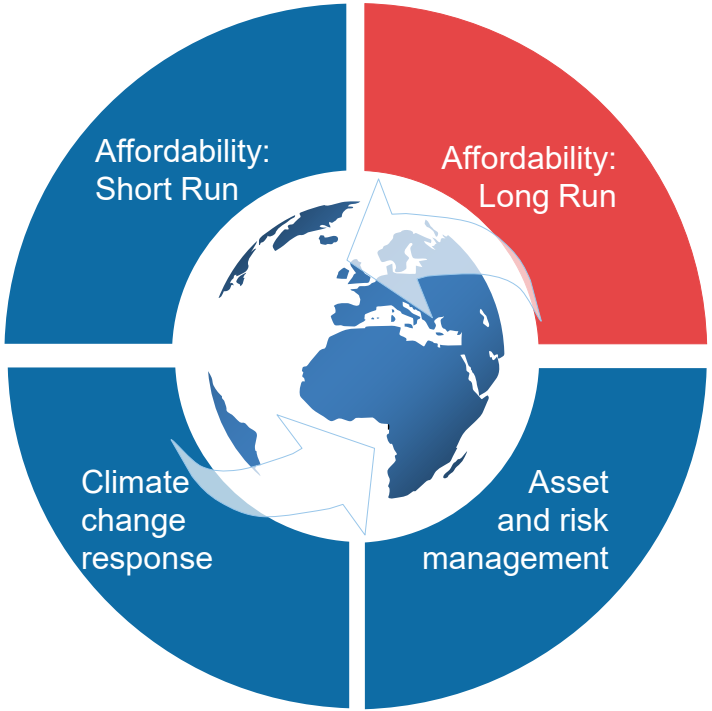
What do customers want?
Sustainability

Short term affordability – Many customers think electricity is expensive now. Prices going down improves affordability in the short term. What else are businesses doing to ensure affordability now?

Long term affordability – The Regulated Asset Base has to be paid for by customers over the long term. The RAB / customer is increasing for most Victorian businesses which means that future customers will have to pay more.

Climate change – Distributed Energy Resources (DER) enables more solar to be connected to the LV grid. It enables lower costs for all customers through access to cheaper wholesale energy produced by solar. Is it worth it?

Asset & risk management – Generally Victorian businesses manage asset performance and risk well. There is some evidence that asset management practices need to be improved (ESV). Should customers have to pay for this?



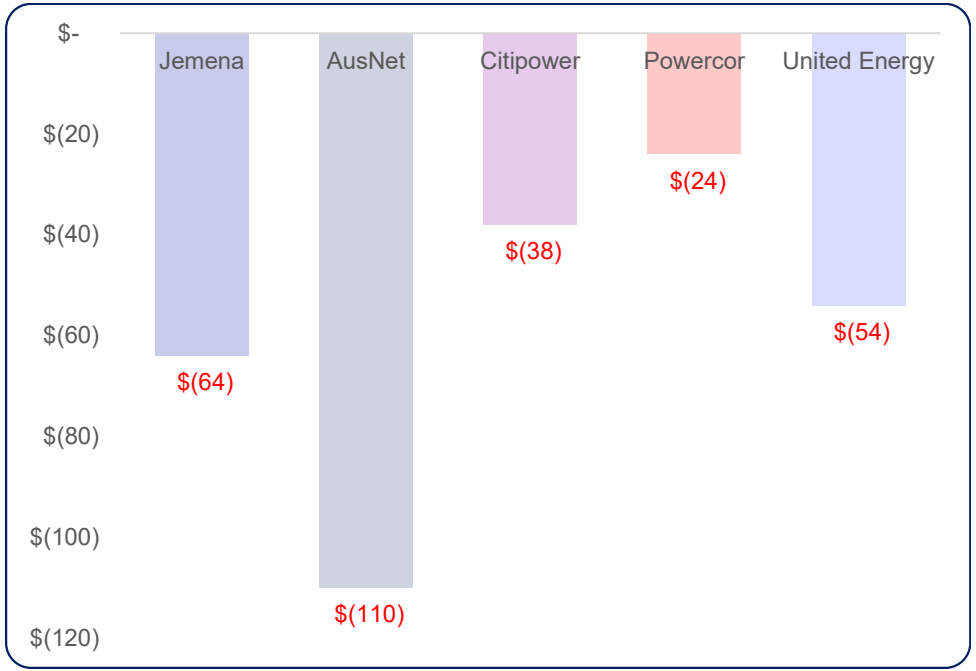
What do customers want?
Affordability

Prices will fall in 2021, and after that?

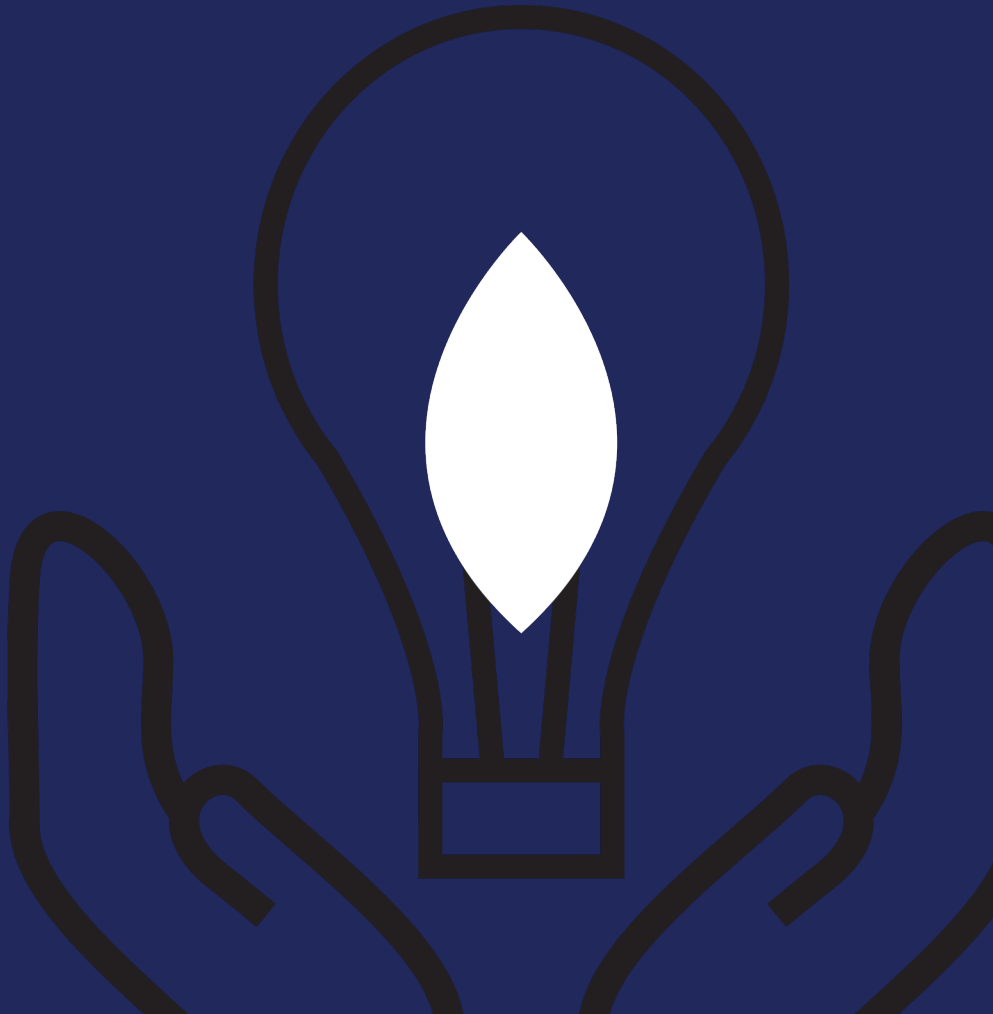
Are prices falling enough? What is the price path over the 5 years?

WACC and tax are driving revenues down. but ….

- there are large increases in opex and capex for some businesses
- RAB / customer is <u>increasing</u> despite calls for greater affordability now and in the future.
  (AusNet is only business to have a RAB that is falling)



2
Building blocks



Revenue
What is driving revenue?

Revenues are falling, but are they falling as far as we would expect?

- WACC and tax are putting downward pressure on revenues.
- This is disguising large increases in opex and capex
- The same scrutiny must be applied to increases in expenditure as would be the case if prices were rising.

Table 5 – AER Issues Paper – Victorian Electricity Determination 2021-26 – April 2020, p29

	Customer service	Revenue	Opex	Capex	RAB per customer
AusNet	↑ **Substantial improvement**	↓ **5.6%**	↓ **8.8%**	↓ **27.5%**	↓ **6.3%**
CitiPower	↑ Some improvement	↓ 4.5%	↑ 13.7%	↓ 6.7%	↑ 5.0%
Jemena	↑ **Some improvement**	↓ **6.2%**	↑ **11.8%**	↓ **18.7%**	↑ **4.2%**
Powercor	↑ Some improvement	↑ 1.0%	↑ 11.9%	↑ 6.4%	↑ 7.4%
United Energy	↑ **Some improvement**	↓ **5.8%**	↓ **4.9%**	↑ **19.2%**	↑ **7.4%**

Note: Revenue, capex and opex comparisons are relative to our previous determination. Change in RAB per customer reflects the difference between the opening (1 July 2021) and closing (30 June 2026) RABs. Detailed change in customer service is set out in section 2.2.

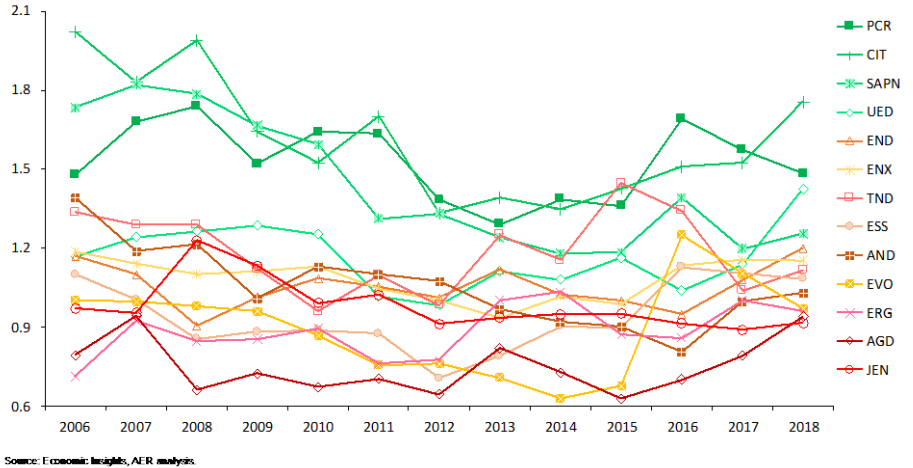
3

Opex, step changes & trends

Opex
Base year

- The AER's base-step-trend methodology for assessment of opex relies on benchmarking to determine the efficiency of the base.
- Victorian DNSPs have performed well in the AER's benchmarking over time and are consistently amongst the best performers
- Jemena and AusNet have seen their efficiency slump relative to peers in recent years.
- AusNet introduced a transformation program in 2015 which has driven improvements
- Jemena has introduced a transformation program in recent years to arrest its declining productivity relative to peers

DNSP opex multilateral partial productivity indexes 2006-18



Source: Economic Insights, AER analysis.

AER 2019 DNSP benchmarking report - November 2019 p16

Step changes
A laundry list of new costs

DRAFT

- $286.5m worth of step changes being sought
- Step changes contribute between 1.4%-10.7% increase in opex ($23 - $128/customer)
- More efficient businesses* are seeking largest increases in costs
- Step changes reveal:
  - different mechanisms being used to recover same costs
  - inconsistent views of compliance burden
  - different starting points
  - potential to catch up inadequate/poor past expenditure

The AER must ensure the step change mechanism does not undermine prudent expenditure in the pursuit of efficiency rewards.

Step changes	Jemena	AusNet	Citipower	Powercor	United Energy
5-minute settlement costs		$3,600,000	$1,900,000	$4,900,000	$3,900,000
Cyber security	$2,900,000	$4,700,000	$14,400,000	$14,500,000	$45,900,000
Insurance	$28,800,000			$5,000,000	$2,200,000
REFCL	$1,300,000	$6,000,000		$13,300,000	
Environmental Protection Act	$4,200,000		$6,100,000	$9,600,000	$11,800,000
ESV levy			$1,500,000	$4,000,000	$2,500,000
New High Bushfire Areas				$21,500,000	
Transitional hedging costs	$900,000				
Change to financial year	$500,000		$1,800,000	$1,800,000	$1,800,000
Yarra Trams pole relocation			$14,400,000		
DM projects					$8,600,000
EDO fuse replacement				$11,200,000	
IT cloud migration		$2,600,000	$2,300,000	$5,900,000	$4,700,000
Solar enablement / Future Grid	$3,800,000		$1,300,000	$6,200,000	$4,200,000
Total step changes	$42,400,000	$16,900,000	$43,700,000	$97,900,000	$85,600,000
Total opex	$576,600,000	$1,222,000,000	$569,000,000	$1,537,000,000	$798,000,000
Step change as % of opex	7.4%	1.4%	7.7%	6.4%	10.7%
Step change cost per customer	$120	$23	$128	$117	$125

* According to AER benchmarking data

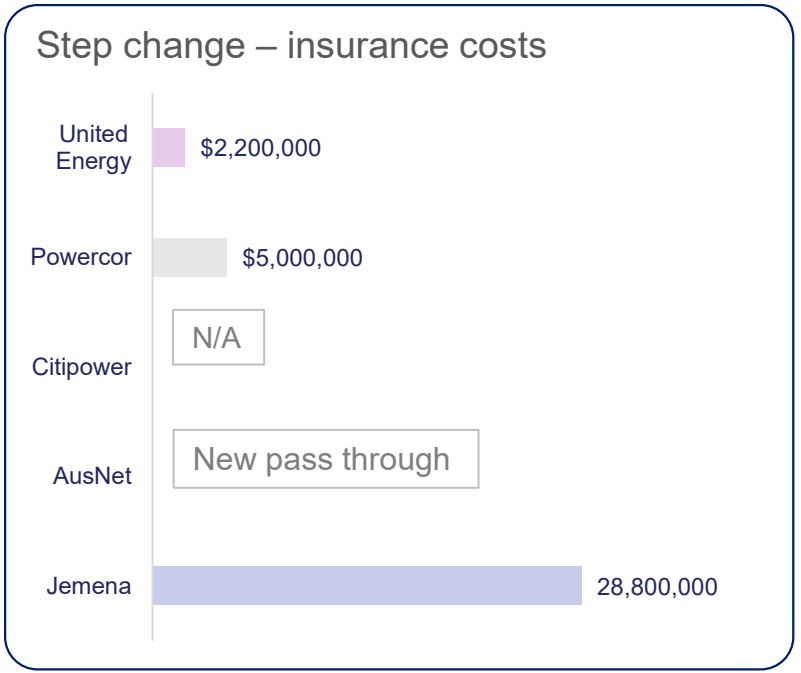
Insurance
Bush fire insurance costs are rising

Different approaches are being taken to address rising bush fire insurance costs

- AusNet has a high level of cover and is seeking to use the pass through mechanism to protect itself from future changes in cost and/or loss of affordable coverage
- Jemena is seeking a large opex step change to cover higher costs.
- Powercor and United Energy seek a more modest increase to cover premiums.

The difference in costs is based on the starting point, geography/bush fire risk, current levels of coverage, future levels of coverage.

AER needs to identify the mechanism that ensures customers pay the lowest amount for managing risks appropriately.



Environment Protection Act
Changes come into effect 1 July 2020

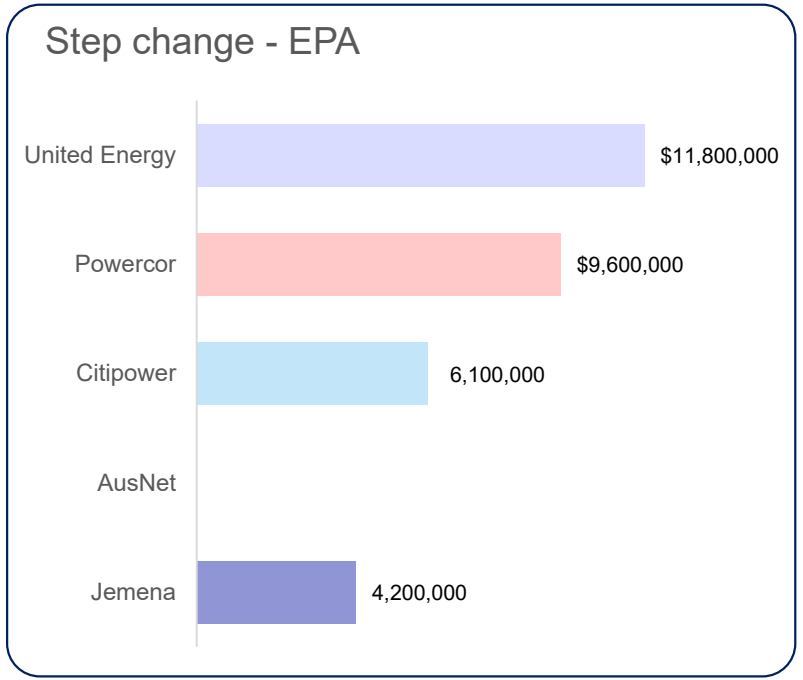
All distributors must comply with changes

Changes to the Act require businesses to take steps that are ‘reasonably practicable’ to ensure pollution does not occur

- Oil containment is well known issue. Most good asset management systems already address risk of oil contamination.
- Noise pollution requirements are untested. Current estimates by Citipower, Powercor and United Energy appear expensive

AusNet is not making any claim for additional costs as asset management system already includes steps to mitigate pollution risks

AER must ensure interpretation of compliance requirements are consistent and customers are paying for similar management of risk



Are step changes undermining the opex efficiency mechanism?

Opex efficiency
Step changes reset the baseline for opex

- Businesses receive efficiency rewards for decreases in opex
- Step changes reset the base line from which efficiency rewards can be achieved
- Rewards are more easily achieved if step change costs are inflated
- Step changes have the potential to legitimise a catch up in capability without incurring a penalty. This may occur despite decisions to underspend in a previous regulatory period which are rewarded under EBSS.

Customers pay for efficiency rewards ($179m earned by businesses in 2016-20).

It is incumbent on AER to ensure the notional benefits to customers under EBSS are real and long term.

A review of efficiency schemes is required to ensure customers are not paying 130% of costs instead of 100%.

Opex - trend
Different approaches to opex trend

Business approach to cost escalation differs

Citipower, Powercor and United Energy seek the largest increase in costs due to trend due to:

- more aggressive labour cost escalators,
- greater output growth, and
- higher proportion of labour costs to materials.

Real cost escalation	Labour	Materials	Output	Productivity	Labour / materials	Labour rate forecasts
Jemena	1.05%	0.0%	1.28%	0.5%	59.7% : 40.3%	Average of DEA and BIS
Citipower	1.99%	0.0%	1.5%	0.5%	70% : 30%	BIS Oxford
Powercor	1.99%	0.0%	1.9%	0.5%	77% : 23%	BIS Oxford
United Energy	1.99%	0.0%	1.9%	0.5%	77% : 23%	BIS Oxford
AusNet	0.58%	0.0%	1.39%	0.5%	59.7% : 40.3%	Average of DEA and BIS

We consider the averaging of forecasts is likely to produce a more accurate result.

AER must ensure businesses allocate outsourcing contract costs consistently to produce equitable trend results across franchises

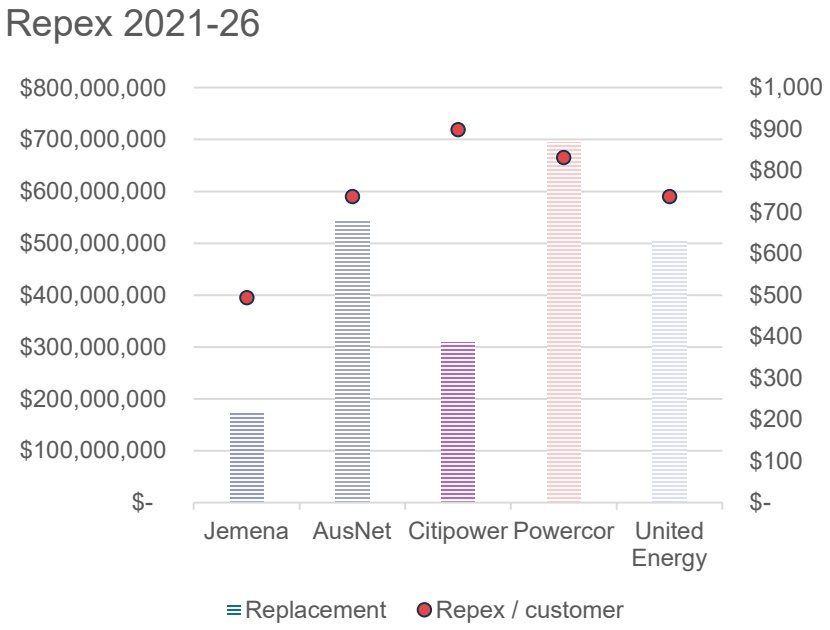
4
Replacement

Replacement spending is up

- Replacement is the major driver of capex in Victoria
- Victorian businesses will spend more on repex in 2021-26 than in 2016-20 period
- AER's repex model has been applied and forecast variances to model outcomes explained
- Powercor has significantly increased pole replacement in response to public concerns and ESV findings.

AER must test the criteria and the need for Citipower and United Energy to apply same replacement criteria given different topography.

Environmental capex estimates also appear high for Citipower and United Energy



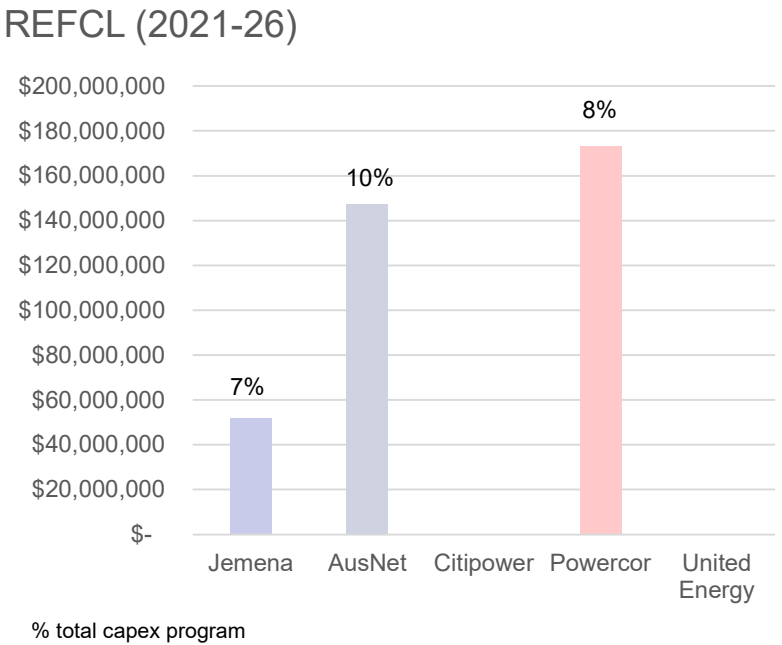
REFCL program is still driving costs

Rapid Earth Fault Current Limiter (REFCL)

- Victoria Government response to 2009 bush fires is still driving capex programs
- REFCL program Tranche 3 will be delivered in 2021-26
- Compliance requirements are costly (capex) and require ongoing testing (opex).
- REFCL is impacting negatively on reliability and driving further capex to restore reliability to normal levels
- Evidence suggests that REFCL is doing its job protecting customers from fire starts. It is an expensive government initiative, but aligns with customers feedback that they are prepared to pay more to lower bush fire risks.

AER must review forecasts to ensure they align with exemption discussions that are currently underway.

We applaud efforts by businesses to reduce costs to customers



5

Changing the grid for a changing world

Distributed Energy Resources
Network Transformation

- Victorian Government solar homes initiative is driving increased solar uptake for residential customers
- Growth rates vary in locations due to size of subsidy and socio-economic factors
- Majority of customers support renewables and support a smarter grid
- DER programs are designed to optimize asset investment through increased network visibility and better targeting of augmentation where required. Modelling has been extensive.

COMPANY	Customers with solar	Program cost (augmentation)	Program cost (IT + other)
Jemena	13% in 2020 28% by 2026	$11,400,000	$12,700,000
AusNet	19% in 2020 31% by 2026	$41,500,000	$11,400,000
Citipower	n/a	$31,500,000	$8,500,000
Powercor	18% in 2020 34% by 2026	$60,700,000	
United Energy	11% in 2020 23% by 2026	$42,400,000	
Total costs			**$220,100,000**

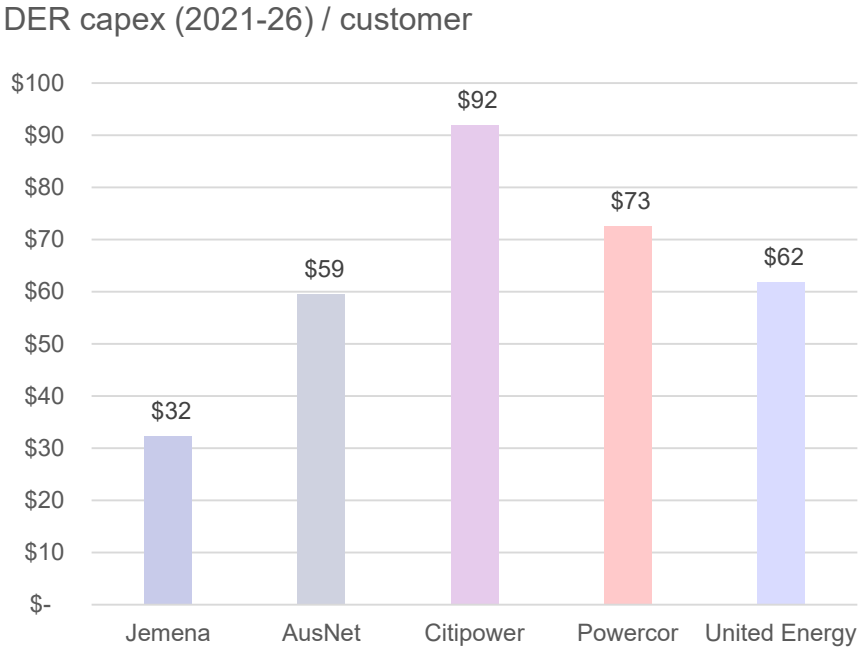
Distributed Energy Resources
Network Transformation

- ~ 30% of Victorian customers will have PV by 2026.
- All customers will pay $32-$92 each for DER. (Note: This is consistent with Vic Govt policy intent of solar homes rebate funded by Vic tax payers)

- Costs are linked to forecasts of PV. Economic recession could slow uptake and push out constraint timing.

- Unclear that businesses have fully taken account of future business benefits of improved LV visibility that could offset costs (as has been the case with AMI data).

AER should confirm costs are based on efficient past costs.



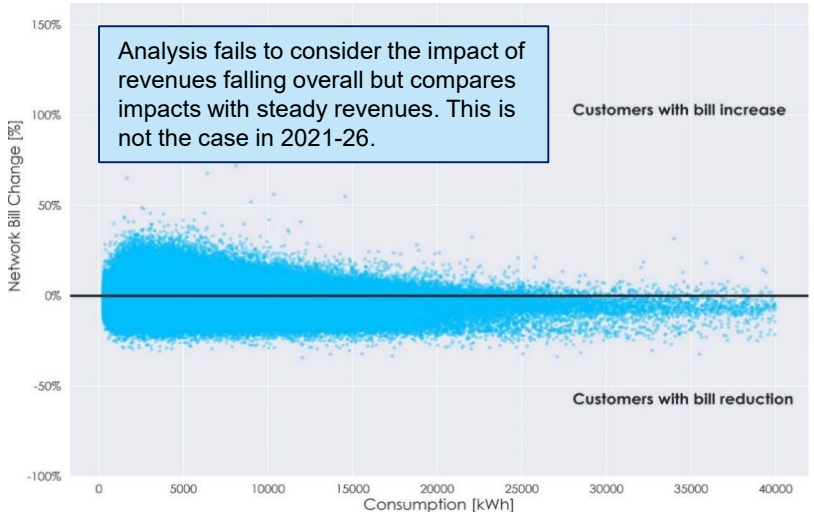
DER is a reality for the Grid driven by economics and politics. It must be leveraged to deliver as many benefits to customers as possible

Tariffs
A lost opportunity

- 2021 Tariff Proposals are a lost opportunity – A declining revenue scenario is a once-off opportunity to undertake broad based tariff reform with very few 'losers'.
- Victorian ToU tariff proposals lack ambition and focus on new and upgrade connections, and customers with solar or EV with "opt in" for everyone else.
- This is a slow track, and with universal smart meters there is an opportunity for an innovative tariff to incentivise demand flexibility

Benefits of AMI roll-out 10 years ago continue to accrue to businesses rather than to the customers that paid for them.

Figure 22 Victorian bill impacts of a move of all single-rate customers to our new ToU tariff (%), Powercor TSS, p42.



EVs
Uncertain timing of uptake

- AEMO's forecasts suggests that EVs consumption share of operational demand in Victoria will be about 13% by 2040 under a neutral scenario and 15% under a faster uptake scenario.

- All businesses have used a pass-through event to cater for uncertainty of uptake and uncertainty of network impact.

We consider this is to be a reasonable approach for this period given the uncertainty up take-up, particularly in the current economic circumstances