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Warwick Anderson
General Manager, Networks Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Lodged electronically: EnergyQueensland2020@aer.gov.au

EnergyAustralia Pty Ltd
ABN 99 086 014 968
Level 33
385 Bourke Street
Melbourne Victoria 3000

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

Energex's regulatory proposal for the 2020-25 regulatory control period

EnergyAustralia welcomes the opportunity to make this submission to the AER's consultation on Energex's 2020-25 determination.

EnergyAustralia is one of Australia's largest energy companies with around 2.6 million electricity and gas accounts across eastern Australia. We also own, operate and contract an energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 4,500MW of generation capacity.

Expected price impacts for customers should be stated consistently

As the AER is aware, significant reforms are about to take effect to ensure customers receive consistent and accurate information on electricity prices. The contribution of network and other costs to retail bills is also the subject of ongoing scrutiny by the ACCC and a range of other energy market bodies.

We consider that further work could be done in conjunction with network service providers (NSPs) to ensure the price impact of regulatory proposals and the AER's decisions are consistently quantified.

In the materials published by the AER we have found several expressions of the price impact of Energex's proposal:

- Energy Queensland committed to reducing network charges by at least 10% in its draft plans and delivered even further benefits for customers in its regulatory proposals.[1]
- Energex's main proposal document notes a headline 10.3% real reduction in distribution charges for the average residential customer from July 2020.[2]
- Energex's indicative bill impact calculation (reproduced in the AER's issues paper[3]) suggests residential customers would receive an 8.3% reduction to the network component of their average bill.[4]

A Queensland Government media release regarding Ergon and Energex's proposals states that "(h)ousehold charges would reduce by around 10 per cent".[5]

[1]https://www.aer.gov.au/system/files/Energy%20Queensland%20-%20Presentation%20-%20Public%20Forum%20-%209%20April%202019_0.pdf
[2] Energex, *Regulatory Proposal 2020-25*, January 2019, p. 13.
[3] AER, *Issues paper QLD electricity distribution determinations 2020 to 2025*, March 2019, p. 12.
[4] Energex, *17.052 – Indicative Bill Impact RIN template*, January 2019.
[5] Minister for Natural Resources, Mines and Energy, The Honourable Dr Anthony Lynham, *Qld power savings continue to flow*, Media Release, 31 January 2019.

Our own calculations suggest that a residential customer on Energex's default flat tariff would see a reduction of 4% to the network component of their bill from July 2020 under its regulatory proposal, with the usage rate reducing by 6%.[6]

All of these figures would be reconcilable with a full examination of assumptions, and our observations are not a criticism of the AER or Energex. Where network prices are reducing, however, NSPs may tend to publicise reductions at the higher end of possible estimates. This can generate unreasonable expectations of what retailers can pass onto customers. It is in the interests of all stakeholders to ensure transparency and consistency in expected price changes, particularly where policy-makers can now take action against retailers on the basis of broadly-defined prohibited conduct around setting prices relative to costs.[7] At a minimum we would recommend use of nominal price or bill changes in any headline stakeholder communications. There may also be scope to align assumptions in price calculations, for example, consumption benchmarks that form part of retail price regulation from 1 July 2019.

It is difficult to determine whether price reductions reflect genuine efficiency gains

Energex's proposed P0 adjustment is a 10.25% reduction in 2020-21 with X factors of zero thereafter. In nominal terms this translates into smoothed revenues that decrease by 9% in 2020-21 then increase at the rate of inflation thereafter.

The AER should validate Energex's statements that this outcome reflects genuine efficiency gains in the business. Almost all of Energex's proposed P0 reduction reflects the foregoing of incentive payments arising from the 2015-20 period, as well as changes to benchmark cost of capital parameters from those determined at the commencement of that period. The other main drivers of proposed revenues are expenditures that would decline from current levels, offset by a significant increase in regulatory depreciation.

Many stakeholders in network price reviews have limited time and capacity to examine regulatory proposals in detail, and would benefit from a succinct "outputs" measurement framework that indicates, at a high level, the overall value for money in forecast expenditures. The AER's total factor productivity data are a useful historic starting point in this regard, showing that Energex's productivity is currently 5th highest among 13 Australian comparators, and appears to have improved in absolute terms since 2015.[8] It would be useful to reconcile these or similar types of productivity measures to forecasts including Energex's targeted 9% productivity assumption on operating expenditure (opex)[9] and other metrics listed in its proposal. We expect the AER has a full range of these measures within its datasets and can undertake these types of assessments on behalf of customers.

Measures of asset utilisation should also be considered to understand how Energex is challenged by, but also managing, the legacy of capital expenditure (capex) and costs associated with maintaining assets that were installed to meet government security and reliability standards that have since been relaxed.

We note that Energex's asset base and proposed depreciation allowances have been materially affected by the rolling in of short-lived IT assets previously owned by SPARQ. We expect this to result in a net present value reduction in the overall cost of service provision across Ergon's and Energex's revenue requirements, as per the business case that would have supported this change i.e. in the form of re-allocating overhead costs and various efficiency gains by having

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[6] Prices sourced from Energex's 2019-20 approved tariffs and 2020-25 TSS, for tariff 8400 based on a residential customer with no controlled load and an annual consumption of 4600 kWh as the benchmarks associated with the DMO for the Energex region.
[7] See Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018, s. 153E.
[8] AER, *Annual Benchmarking Report, Electricity distribution network service providers*, November 2018, page iii & iv
[9] Energex, *Regulatory Proposal 2020-25*, January 2019, p. 53.

better managed IT assets.[10] The large proposed amounts of expenditure on IT for both Ergon and Energex, in the name of delivering efficiency gains, warrants considering IT service delivery on an holistic basis from the perspective of a prudent service provider, and should not be artificially partitioned between capex and opex, nor limited to the forthcoming regulatory control period, as per the NER constituent decisions or the AER's expenditure assessment frameworks.

Efficiency incentive payments should not be presented as an ultimatum for customers

We note both Energex and Ergon have presented customers an ultimatum in the form of foregoing carryovers under the capex and opex incentive schemes if their regulatory proposals are accepted. We are interested in the prospect of NSPs presenting options to customers and the regulator in terms of holistic service-price offerings, and incentives to submit better quality and compliant proposals that minimise the need for costly and forensic regulatory reviews. We note the ESC introduced the fast-tracking of regulatory proposals for water businesses under its PREMO framework and this is likely to be investigated by other regulators.[11] However in this case, Ergon and Energex appear to have offered the regulator and customers potential price increases unless the AER accepts all elements of their proposals as submitted. While the foregoing of price increases is welcome for customers, we do not consider this to be compliant with the NEL and NER, and offering this ultimatum is not in the spirit of promoting customer interests. In the likely event the AER finds some reason (and is thereby legally compelled) to not accept even a minor element of Ergon and Energex's proposals, we would be disappointed if the foregone incentive payments (equating to approximately 4% of proposed revenue requirements) were introduced in revised proposals.

Expenditure associated with distributed energy resources (DER)

Energex is proposing $42.4 million of augmentation capex under its Power Quality and Solar Program, to deal with power quality issues caused in part by increasing solar PV penetration and further customer investments in battery and other technologies. We note Energex's objectives to enhance its capabilities in data monitoring and analytics of the LV network via continued installation of Energy Queensland devices, with potential third-party involvement subject to future cost benefit assessment.[12]

While the AER does not approve individual projects associated expenditures, we consider that it give further consideration to how Energex's activities best accommodate the role of retailers and other market participants in delivering optimal DER solutions and services. Specifically, the AER and Energex should have a view beyond the value of DER arising from the customer-distributor relationship. Optimal DER solutions will be customer-led rather than imposed via solutions that are limited to solving network operational problems. Similar to our comments on SAPN's corresponding efforts to manage DER, this is a broader issue affecting all DNSPs and we expect there would be benefits from a shared effort in examining technical and well as regulatory solutions that promote the long-term interests of consumers.

If you would like to discuss this submission, please contact [redacted] on [redacted] or [redacted].

Yours sincerely

Sarah Ogilvie

Industry Regulation Leader

[10] Energex, *Regulatory Proposal 2020-25*, January 2019, pp. 77-8.
[11] https://www.esc.vic.gov.au/water/how-we-regulate-water-sector/premo-water-pricing-framework
[12] Energy Queensland, *7.047 - Customer Quality of Supply*, January 2019, p. 16.