31 May 2019

Mr Sebastian Roberts
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Email: EnergyQueensland2020@aer.gov.au

Dear Mr Roberts

RE: QLD REGULATORY PROPOSAL 2020-25

Origin Energy appreciates the opportunity to provide a submission to the Australian Energy Regulator's (AER) assessment of the regulatory revenue proposals submitted by the Queensland electricity distribution businesses for the period 2020 to 2025.

Origin acknowledges the significant expenditure reductions achieved by the Queensland distribution businesses over the current regulatory period and supports efforts for further reductions in the 2020-2025 period.

In terms of the proposed Tariff Structure Statements (TSS), we support the move towards cost reflective pricing and efforts to encourage efficient investment, particularly with respect to distributed energy. However, for these reforms to be successful customers must be able to understand their tariffs so that they can optimise their benefits or at least minimise negative impacts. The necessary preconditions for this are broad-based customer education and sufficient penetration of demand response technology. We strongly believe these pre-conditions must be delivered before the mandatory assignment to complex tariffs. Otherwise, we are concerned that this would compromise the ability of these reforms to be successful.

Furthermore, it is vitally important that tariff reform be cognisant of the interaction with other key retail tariff reforms such as the default market offer (DMO). It is essential that there is consistency in these reforms to ensure that each party in the supply chain has a reasonable opportunity to manage their financial risks.

We would also like to recognise the stakeholder engagement by the Queensland networks in the development of these regulatory proposals.

Origin's responses to specific issues are set out below.

Regulated Asset Base (RAB)

Origin agrees that the rate of increase in the RAB has been excessive for some time and a key driver of increased network costs and delivered energy prices. We welcome efforts to reduce the quantum and rate of growth in the RAB.

To the extent that the proposed tracking approach for regulatory depreciation provides a more accurate method for determining depreciation and reduces the rate of growth in the RAB, we are supportive of this approach.

We also support the proposal to transfer legacy ICT assets previously held by SPARQ to the network RAB in order to provide for greater transparency and comparability with peers. While we accept that this will result in an increase in the RAB, we would expect there to be a corresponding reduction in operating expenditure since there will no longer be an external service charge associated with these assets.

Capital expenditure

Origin welcomes the forecast reduction in capital expenditure over the forecast period. We note, however, that while non-network capital expenditure is forecast to decline over the period, the reduction is relatively minor. We encourage the AER to closely scrutinise non-network capital expenditure, particularly in relation to forecast fleet and equipment and property expenditure, and the application of capitalised indirect expenditure.

We note that the proportion of overheads capitalised appears relatively high in comparison to peer DNSPs. We encourage the AER to review the application of the approved cost allocation methodologies to determine the appropriateness of these allocations.

Operating expenditure

Origin supports the AER's use of industry benchmarks in determining efficient operating expenditure.

We are encouraged by the operating expenditure reductions in the current regulatory period and support further reductions in the forthcoming period. Origin supports the inclusion of productivity improvements to forecast operating expenditure and notes the forecast productivity improvements proposed over the period. However, we propose that the AER conduct a thorough assessment of forecast increases in input prices and output growth to determine if further reductions to operating expenditure are achievable.

Incentive schemes

We note that both networks are entitled to revenue increments in the 2020-25 regulatory period under the capital expenditure sharing scheme (CESS) and operating expenditure efficiency benefit sharing scheme (EBSS) for efficiencies achieved in the current 2015-20 regulatory period but are proposing not to claim these increments. We commend this proposal.

Tariff Structure Statements

Origin recognises the importance of network tariff reform and the consequent need to promote cost-reflectivity and efficient network utilisation and investment. However, we consider that a measured approach that retains simplicity in tariff design and is cognisant of the available technology is essential in achieving the desired outcomes. Origin is concerned that some proposed tariff structures are too complex for the vast majority of consumers to understand and therefore respond to. Further, it is critical that the interaction between network and retail tariffs be considered to ensure that the intended network pricing signals are passed on to customers.

In principle, Origin supports the adoption of an inclining block tariff for residential and small business customers as a means of promoting improved cost-reflectivity. However, we consider it important that any increase in block volume charges associated with additional consumption be mindful of the need to avoid price shocks for customers.

Origin considers that there are a number of issues associated with the proposed residential and small business demand tariff that render it impractical to effectively implement and are therefore not supportive of this tariff proposal. Specifically, the inclusion of two demand charges unnecessarily complicates the tariff. The proposed day demand charge could be eliminated, with associated costs spread between the evening demand charge and the volume charge.

Further, the option for a new customer to opt-out where it is determined they are financially worse off under the proposed demand tariff is problematic. Specifically, determining whether a customer is financially worse off is potentially unclear at the retail level. For example, with the application of the DMO and differing retail structures applied by retailers, year on year differences in the financial impact on customers could be due to the retail component of the end tariff rather than the network component, Accordingly, any assessment of financial impact should be determined at the network rather than retail level.

We consider that the proposed residential and small business capacity tariffs are not practical to implement at this stage. In particular, we consider that the tariffs are too complex and customers are not sufficiently educated to make informed decisions in relation to their application.

We believe there needs to be better education of customers before exposing them to tariffs they are unfamiliar with or are complex. This education must be consistent, simple, and broad-based; a responsibility beyond the scope of networks and retailers in isolation. In this regard, we agree with the views raised by the ACCC that there may be the need for government communication campaigns in conjunction with retailers and networks to provide consumers with information about the benefits of cost-reflective pricing and to explain to customers how they can manage the potential impacts of these reforms. The absence of a broad based and coordinated education campaign remains the largest impediment to the successful implementation of network tariff reform.

There also needs to be recognition that effective smart demand response technology that enables greater energy management is not yet sufficiently available or economic for the vast majority of residential customers. In the absence of a material penetration of appropriate technology in the correct network locations, the effectiveness of cost reflective tariffs will be muted. Under these conditions, we believe incentive-based demand management initiatives may provide a more effective outcome in the short-term.

We retain the view that tariff reform must be considered part of a suite of approaches to be used to reduce demand on the networks. These include controlled load and other demand management strategies.

With respect to alternative control services, we have some concerns in relation to a number of the proposed fee-based services. Specifically, it appears that the proposed fees for a number of services vary considerably between 2020-21 and the corresponding current fee for those services as set out in the AER approved 2019-20 Pricing Proposals (for example in relation to Connection Management Services (de-energisation/re-energisation) and Auxiliary Metering Services). The rationale for the variances has not been provided and we encourage the AER to examine the cost structures associated with these services to determine the validity of the proposed fees.

We also note that the service product codes for alternative control services set out in the Pricing Proposals have not been provided in the Tariff Structure Statements. This makes direct comparison of service charges between regulatory periods difficult. Accordingly, we request that product codes be incorporated in the TSS.

Closing

Origin supports the progress the network businesses have made in achieving more efficient expenditure levels during the current regulatory period and the ongoing commitment to further cost reductions.

We remain concerned about the approach to network tariff reform. While Origin supports the need for tariff reform to provide pricing signals to consumers regarding the costs of their usage, it is necessary that these reforms are underpinned by an education campaign that provides consumers with the understanding and tools they need to make fully informed decision.

Furthermore, it is vitally important that the AER consider the implications of how tariff reform interacts with other retail tariff reforms such as the DMO. It is essential that there is consistency in these reforms to ensure that each party in the supply chain has a reasonable opportunity to manage their financial risks.

We would also encourage the AER to scrutinise proposed costs associated with alternative control services to determine if these are appropriate.

If you have any questions regarding this submission, please contact [redacted] in the first instance at [redacted].

Yours sincerely

[redacted]

Sean Greenup
Group Manager Regulatory Policy
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