

Energy Consumers Coalition of South Australia

AER Review

ETSA Revenue and Pricing Reset

Application Presentation Forum

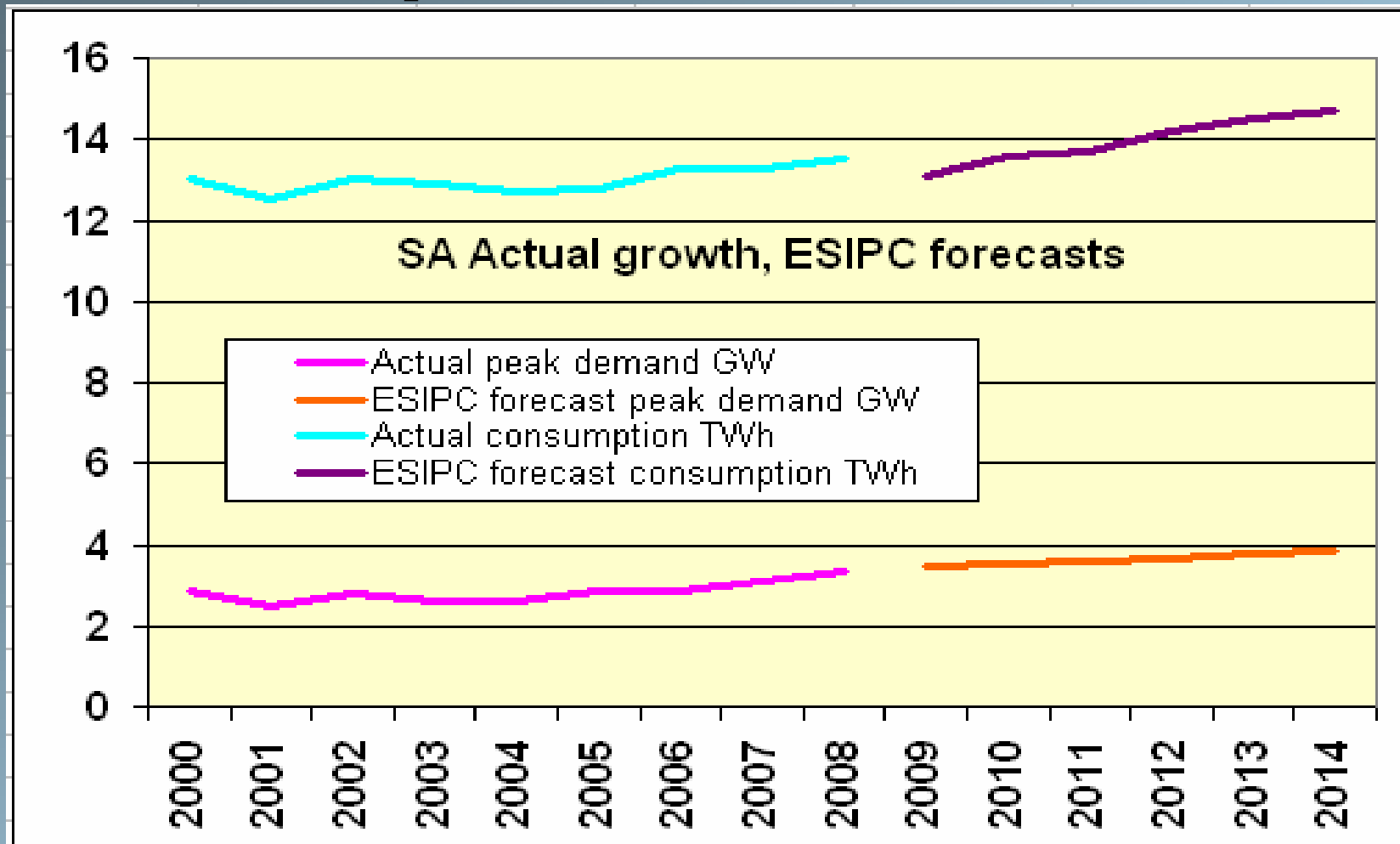
**ECCSA presentation by
David Headberry on behalf of
John Pike (ECCSA Chair)**

6 August 2009

Setting the scene in SA

- SA has consistently had the highest power prices in the NEM, and recent generator activity has ensured that power prices will stay high
- SA retail power prices for large users have shown >50% increase in the last 2-3 years
- ElectraNet charges are doubling over 10 years since deregulation (ETSA wants a 50% increase in five years)
- The global financial crisis has caused many businesses to cut back on costs severely to remain viable
- As the GFC recedes large power users will be hit by the impact of CPRS and xRET
- This continuing pressure on power costs has flagged concerns by many large power users
- SACoSS has recently issued a cost of living report indicating
 - the lowest income quintile of small users SA are already having trouble paying energy costs as electricity spend is 8% of income
 - electricity spend for the lowest income quintile in SA is >40% more than the average
 - SA electricity spend by small users is the second highest in Australia

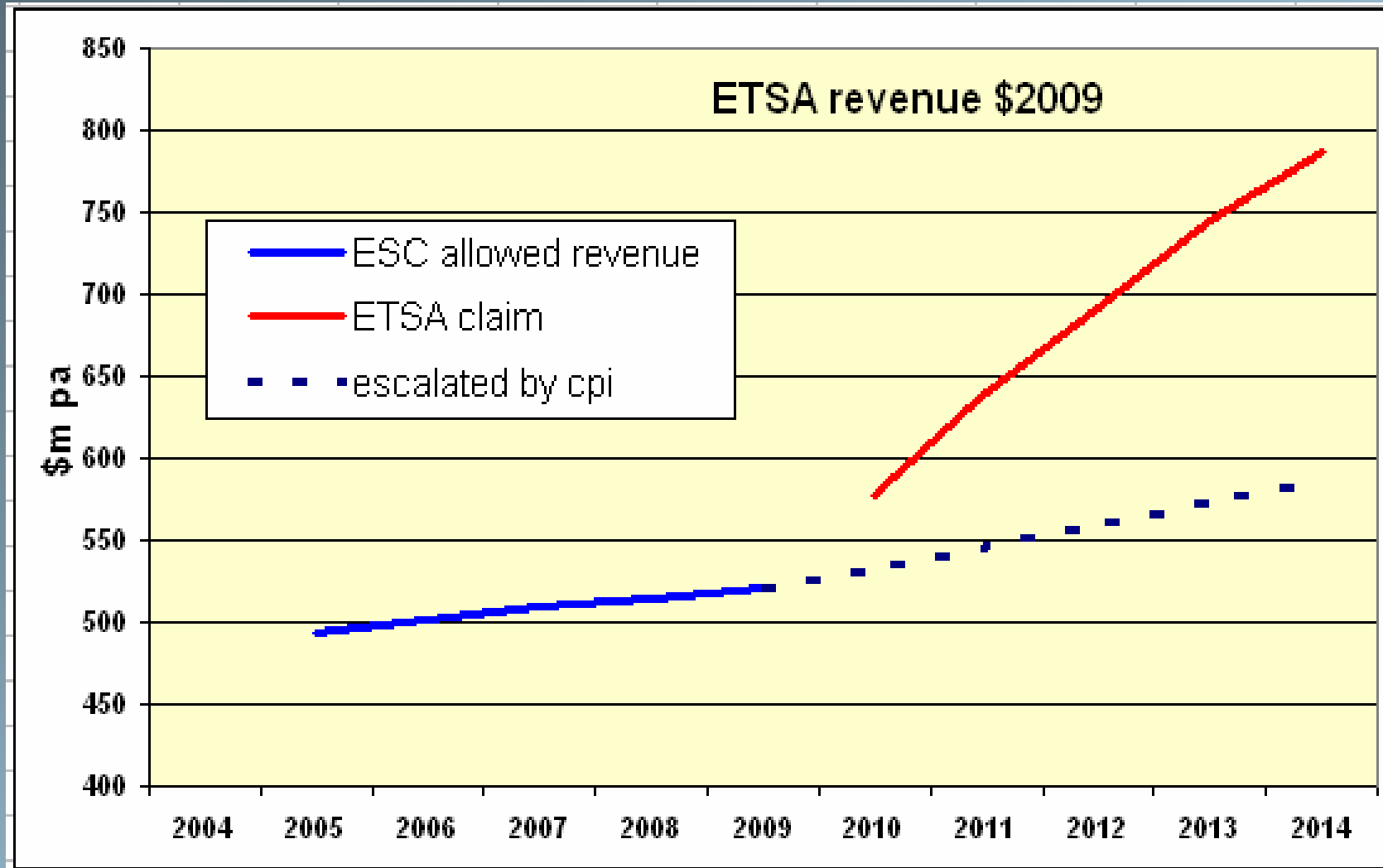
Growth in consumption and peak demand



What are the changes that drive the ETSA revenue

- CPI has been assumed by ETSA to be 2.47% pa for the next five years but CPI for the past five years has averaged 3.3% pa
- Consumption growth for the past years has averaged 0.8% but peak demand has averaged 2.9%
- For the next five years ESIPC has forecast consumption growth to be 1.5% pa and peak demand growth of 2.6% yet ETSA indicates higher growth in demand of >3% pa
- So overall, the ESIPC forecast growths for the next period are less than the last period and growth forecasts are relatively flat
- This growth in electricity usage assumes that large businesses in SA will continue their operations

ETSA revenue claim



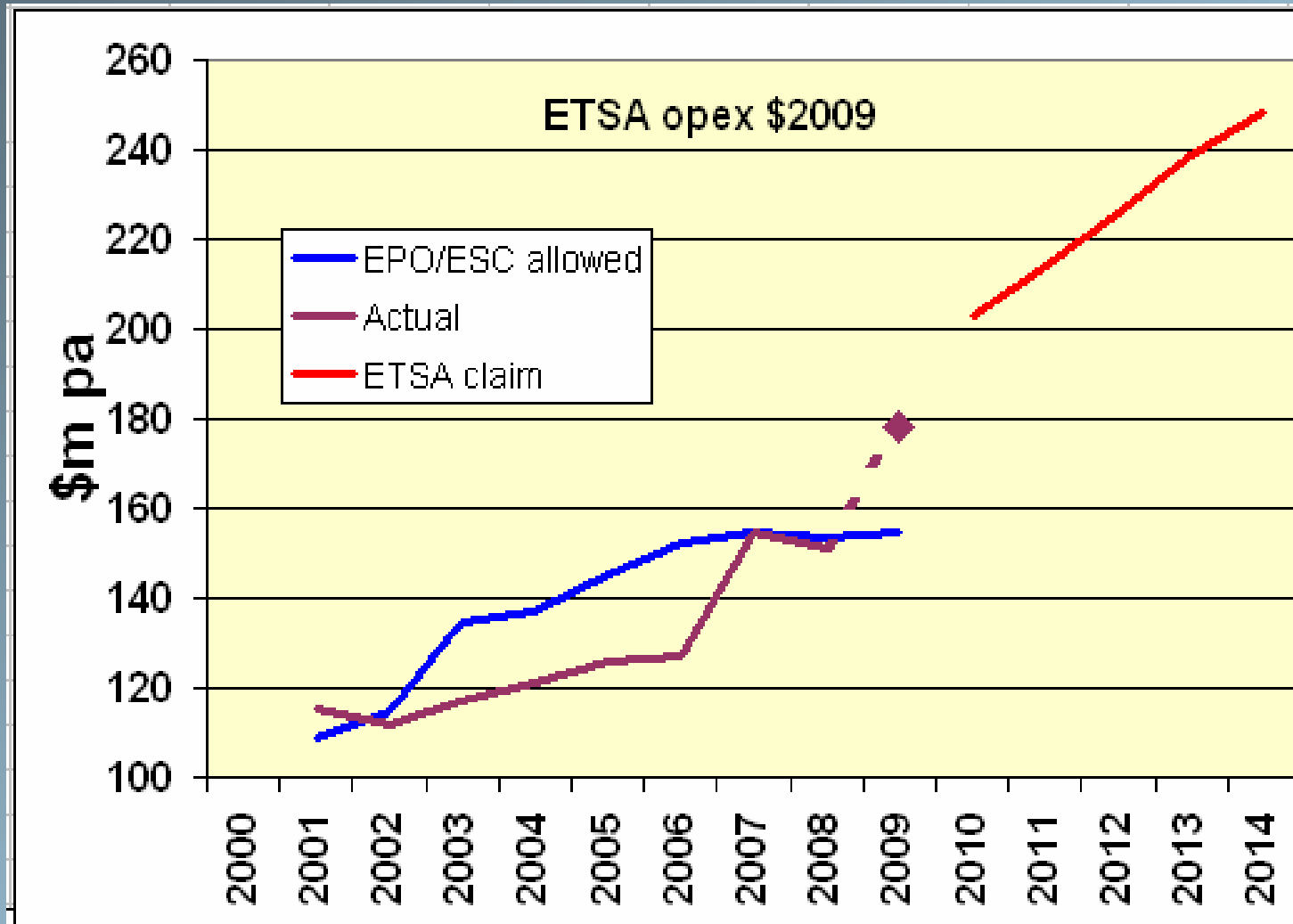
ETSA Revenue

- ETSA is seeking a massive increase in revenue
- Related to consumption growth this means that costs for consumers will increase from \$39/MWh by about 8% pa in real terms up to \$54/MWh in real terms
- ETSA requests that the X factor needs to be -10% for each year of the next period ie delivering real increases of 10% pa after allowing for the Q adjustment pay back
- As justification, it points out that consumers want better service, but at what cost? The SACoSS cost of living report seems to disagree with ETSA
- Certainly the AER have granted large revenue increases to every electricity network (transmission and distribution) that they have reviewed compared to the changes the ACCC and jurisdictional regulators allowed
- The increases are much more than governments allowed their vertically owned electricity utilities when they directly controlled these businesses

Some curious outcomes from the NSW distribution pricing review

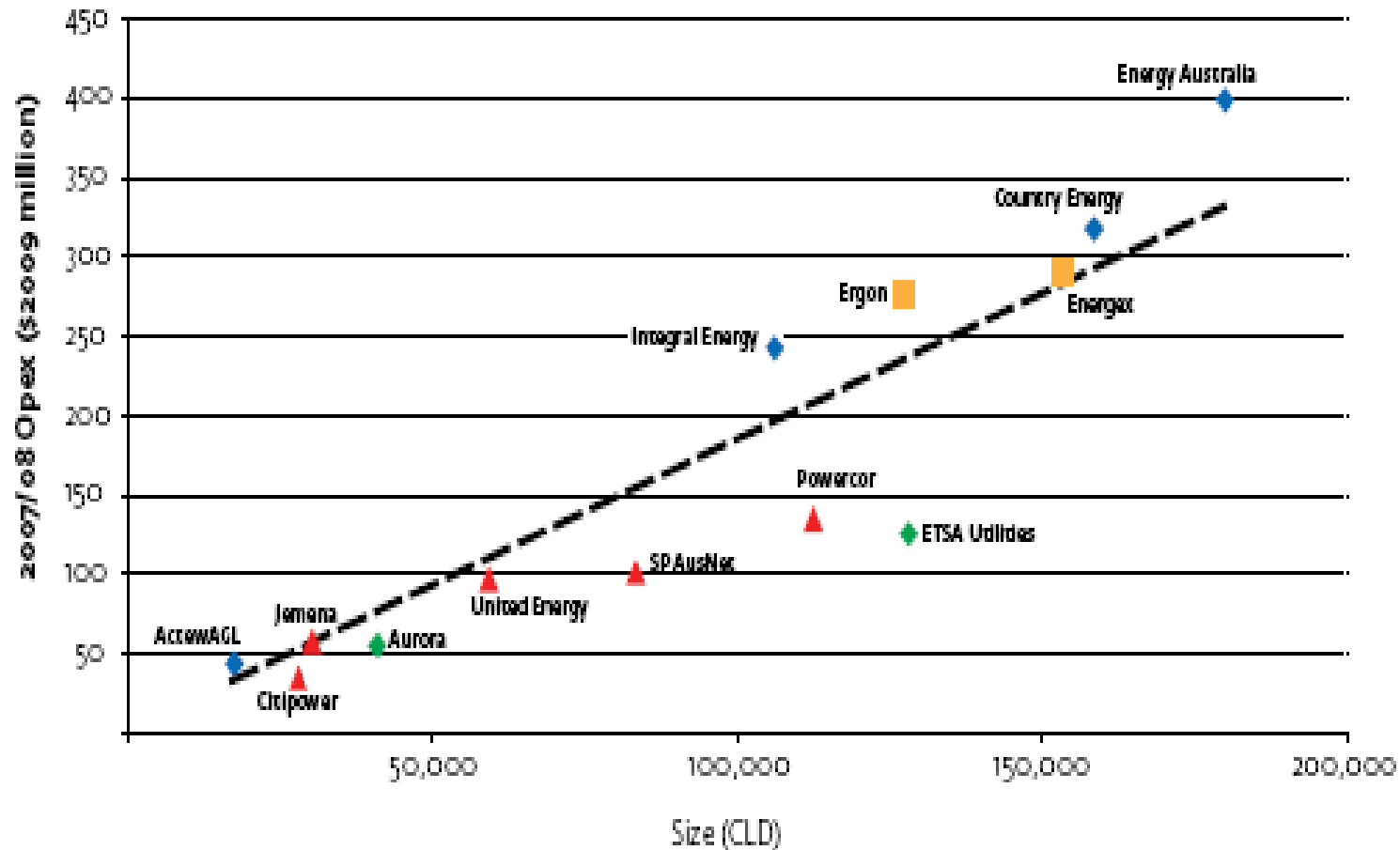
- Step increases in revenue of 12.58% were allowed one business by the AER
- Yet consumption increases of 0.7% and peak demand of over 3% pa were identified
- NSW businesses affiliated with ECCSA have seen step increases of 30-50% in distribution network charges from 08/09 to 09/10
- The AER allowed the TNSP an increase in revenue of 1.8% between 08/09 to 09/10, but a DNSP passed through an increase of 26.2%
- The AER should have better assessed the pricing approaches and models in the final determination
- The businesses affected have to carry this cost while their revenues are flat or falling

Change in Opex over time



Benchmarking opex

Figure 7.3: Comparative analysis of operating expenditure versus size (from Wilson Cook & Co)



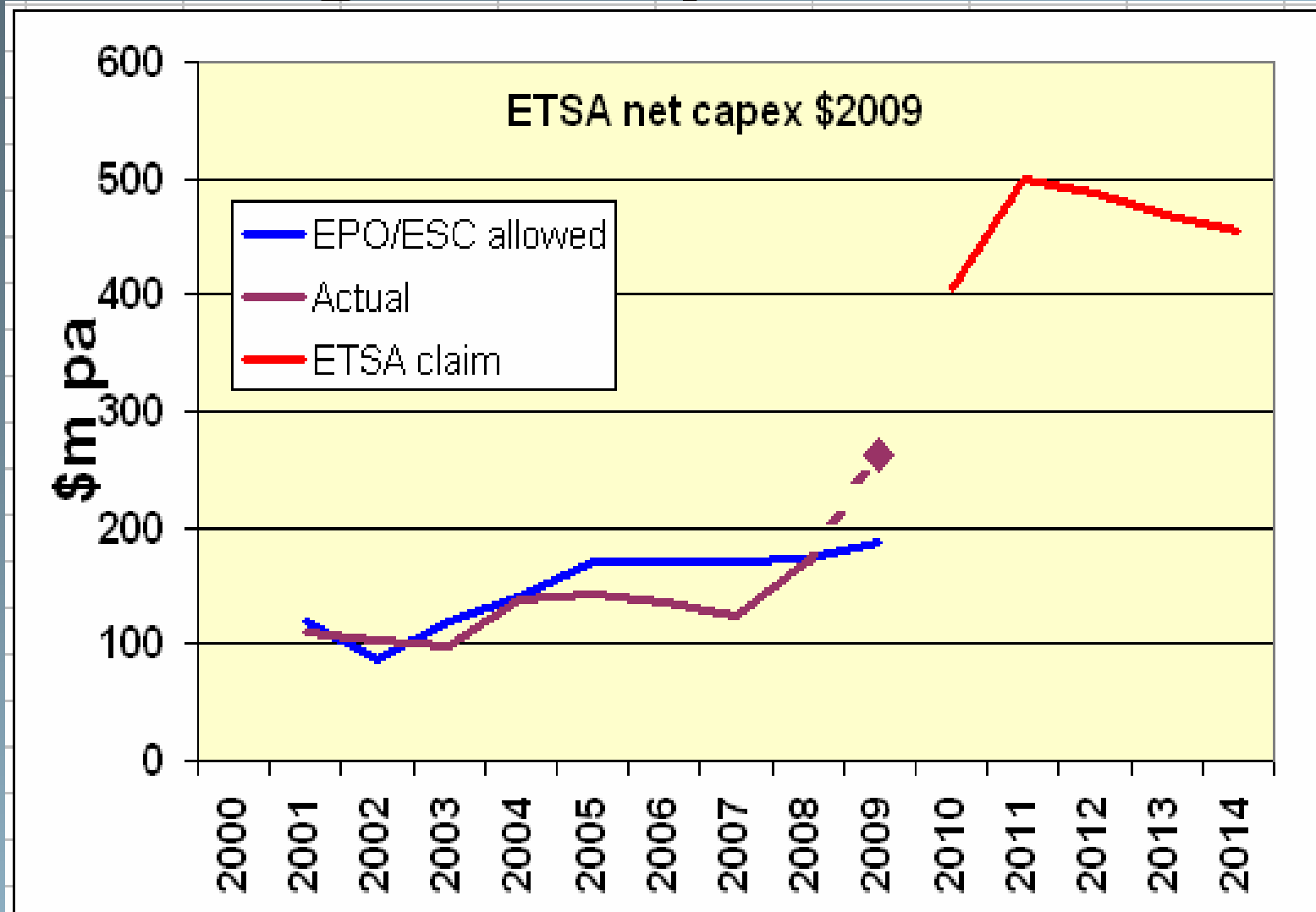
Points of interest in relation to opex

- The chart shows opex allowed, actual and sought in the same constant dollar terms as the ETSA application
- The data was accessed with some difficulty from ESCoSA determinations and ETSA applications
- It shows that consistently ETSA has under-used the opex allowance
- The recent rise in opex neatly matches the year ETSA knew the AER would set for its benchmark opex
- ETSA has forecast a large increase in opex for 09/10 but this cannot be tested so it should be discarded
- Despite the benchmark year opex being inflated compared to previous years, there is still a massive 34% step increase in opex followed by annual increases of another 6% pa
- ETSA provides some benchmarking data indicating it is in the low opex range but the chart is now skewed by the high opex granted in NSW

Stated causes for opex growth from the “efficient” base

- **Scope - increase** for Customer and community expectations; The condition of the distribution network; Legal and regulatory obligations; Government policy; The natural environment; The size and profile of ETSA Utilities’ workforce; and Prevailing economic conditions.
- **Scale - increase for** *Network growth*: growth in the size of the distribution network; *Work volume*: changes in the volume of capital and maintenance work taking place on the network; *Workforce size*: changes in the size of the workforce; and *Customer growth*: growth in customer numbers.
- **Input cost escalation - increase** for cost increases due to the economic environment
- **Compare these to the pressures on business in a competitive environment to actually reduce its unit costs despite these various factors**

Change in capex over time



Points of interest in relation to capex

- The chart shows capex allowed, actual and sought in the same constant dollar terms as the ETSA application
- The data was accessed with some difficulty from ESCoSA determinations and ETSA applications
- It shows that consistently ETSA has about matched or just under-run the capex allowance
- The recent rise in capex neatly matches the year ETSA knew the AER would set for its benchmark opex
- ETSA has forecast a large increase in capex for 09/10 but this cannot be tested so it should be discarded
- Despite the benchmark year opex being inflated compared to previous years, there is still a massive 140% step increase in capex followed by increases of another 10-20% above this value in the following years
- ETSA provides some observations pointing out that it needs such a large capex program to meet growth and replacement needs and comments that their capex is much less than EA and Ergon capex programs

Stated causes for capex increases from current base

- Average new capex is \$463m pa up from an average of \$168m pa or \$295m pa (175% more)
- Increase in spatial growth – demand, regulatory obligations, service standards, input costs
 - Eg labour input costs were 4.2% pa in current period but expected to be 3.3% pa but this causes 15% of the capex increase embedded in other elements
- Increase in capacity growth – 40% of capex increase
- Increase in quality, security, reliability – 33% of capex increase
- Increase in safety/environmental requirements – 10% of capex increase
- Servicing the increases in staffing, capex – 10% of capex increase
- These raise a fundamental question – are they really step increases? – the numbers do not support such a view

The impact of aged assets

- ETSA makes much of its view that it needs to spend significantly on replacement of aged assets due to years of neglect
- The SA government has operated the network for ~70 years up to the late 1990s
- They ensured that there was adequate reliability but also maintained much lower electricity costs and through periods of massive expansion
- Why is it that modern DNSPs are less able to manage the reliability/service/cost balance than the supposedly less competent government entity?
- Why do assets have to be replaced at the end of notional economic life when they can operate reliably for many years longer?
- We see that this might result in gold plating and over investment

The drivers of DNSP profit

- Depreciation and opex, are recovered on a cost basis and theoretically have no profit attached to them
- Pass throughs have no profit for a DNSP attached to them
- Efficiency carry over has no profit attached to it and declines over time
- Achieving performance standards has a profit element but is not a secure source of profit
- The bulk of a DNSP profit comes from the WACC which is a return on assets
- Therefore a DNSP is actively incentivised to increase the asset value of the network for two reasons
 - To increase its profits through the WACC on a larger asset base
 - To justify a larger opex to manage the greater amount of assets

and this is what ETSA has effectively detailed in its application

ECCSA Conclusions

- **ETSA has proposed large increases in opex and capex, yet the growth forecasts do not support the extent of the increases**
- **Average tariffs will rise by at least 40% in real terms and implemented by a 10% real increase yearly**
- **Opex is well above the “ETSA” benchmark**
- **Capex nearly triples yet ETSA only just spent its allowances in the current period with under-spending in the early years**
- **Opex and capex have been inflated for expected cost input inflation above CPI yet the real cost increases are expected to be less than in the current period**
- **Growth forecasts don’t support the argument to increase the capex or the opex**
- **Where are the justifying step changes to warrant the increases?**
- **Can consumers withstand such increases in the current economic climate?**
- **If large consumers get off the networks due to large cost increases, who will pay the revenue allowed but lost?**

And there are a number of companies in SA already considering this option