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19 January 2021

Ms Kami Kaur
General Manager, A/g
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submitted via email to VIC2021-26@aer.gov.au

Dear Ms Kaur,

**Re: Victorian electricity distribution determination 2021 to 2026**

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to provide a submission to the Australian Energy Regulator's (AER) draft decision which applies to the Victorian Electricity Distribution Network Service Providers including AusNet Services, CitiPower, Jemena, Powercor and United Energy (collectively, the Victorian DNSPs) for their 2021-2026 regulatory period.

Red and Lumo have carefully reviewed the AER's draft decision and the resubmissions by the Victorian DNSPs in response to the draft decision. We consider that revenue caps deliver stable revenues across regulatory periods with smooth price paths. Further, we consider that customer choice is paramount, both in order to opt in and out of cost reflective tariffs, but also to ensure that customers who take up the Victorian Default Offer are placed on equivalent network tariffs. Our submission also notes that we consider that DNSP incentive schemes be abolished, except the capital expenditure sharing scheme (CESS) and the Efficiency Benefit Sharing Scheme (EBSS).

**Stable revenues across regulatory periods with smooth price paths**

In order to ensure a more measured customer experience is delivered to Victorian consumers, we consider that revenues from network determinations remain stable and that reductions in revenue are smoothed out across the regulatory periods. This is consistent with our customer's expectations.

We support the AER's draft decision which has delivered lower revenues for the Victorian DNSPs compared to the previous regulatory period. As a result, we also welcome the lower revenues included in the Victorian DNSPs re-submissions.

We acknowledge that the building blocks of a DNSP's revenue stream are subject to change over different regulatory periods. Our preference is that they remain stable to the extent possible as this is likely to provide stable tariffs to consumers in the long run.

In order to facilitate this outcome, we support:

- the parameters of the WACC being locked in over a 5 year regulatory period;
- stable expenditure allowances for capital and operational expenditure and depreciation over a regulatory year.

In order to maintain this stability across the regulatory period, we do not support the price cut to be fully applied in the first year of the regulatory period. The resubmissions made by Victorian DNSPs appear to have passed the price cuts associated with the revenue reductions through in the first year of the regulatory period. A more stable price path results in more stable prices across the regulatory period protecting consumers against sudden price movements. On this basis, we recommend that the Victorian DNSPs re-align their price path and smooth it out across the regulatory period.

**Customer choice is paramount**

Consumers must always have a choice on whether to opt in to cost reflective tariffs. Red and Lumo consider that consumers should be empowered to make informed decisions, based on their electricity usage profile in order to choose an appropriate tariff structure that delivers them the most benefit.

The Victorian DNSPs have mandated some time-of-use (TOU) tariffs charged to retailers for residential customers, with a peak charging window set as 3pm to 9pm and off-peak rates at all other times. These tariffs apply to new connections, customers who upgrade to three-phase power supply and customers who install solar PV.

Red and Lumo support the Victorian DNSP proposals that seek to align the TOU tariff charging windows for residential customers. The TOU tariff charging windows will apply with a peak period occurring between 3pm to 9pm local time all days and off peak applying at all other times. Aligning the tariff charging windows for TOU not only reduces the complexity, but also makes the TOU structures easier to communicate to all Victorians.

While we support the AER's draft decision to mandate cost reflective tariffs, customers must also have the right to opt out to flat tariffs, should they choose to. In their resubmissions, the Victorian DNSPs have maintained the option for customers to opt out of mandated cost reflective tariffs which we consider to be reasonable.

**VDO customers must not be assigned to cost reflective tariffs**

Under recent Victorian government policy, the Essential Services Commission now sets a flat Victorian Default Offer or maximum annual amount, which is available to all residential and small business customers irrespective of the underlying network tariff. The Victorian Default Offer is a standing offer, which retailers must make available to their small customers, upon request.

Retailers face financial exposure and risk where residential and small business customers who are subject to a cost reflective network tariff and choose to move onto the VDO. This is because retailers incur the underlying cost reflective network charges, while the same customers have chosen to take up the flat VDO standing offer.

We consider that it is fair that while retailers must offer a flat VDO standing offer to their customers, that the Victorian DNSPs make available an equivalent flat VDO tariff. This will allow retailers to place customers who take up the flat VDO standing offer, on the equivalent network tariff, reducing the risk to retailers. This will also ensure that the networks understand the amount of customers who chose to avoid the cost signals in their network tariff, and work with retailers to ensure that the cost reflective tariffs do not have an inherent customer detriment.

The AER does not appear to have addressed this matter in its draft decision, nor have the Victorian DNSPs. Given that this is a significant policy issue, it warrants being addressed as part of this regulatory pricing review. As such, we consider the AER should make a simple directive to the Victorian DNSPs to allow for re-assignment of flat VDO standing offer customers onto an equivalent flat network tariff.

**Incentive schemes outside of the CESS and EBSS not supported**

Red and Lumo note that the AER currently provides electricity distributors with incentives to reduce costs over time through the efficiency benefit sharing scheme (EBSS) and the capital expenditure sharing scheme (CESS). The Victorian DNSPs have accepted the draft decision related to the CESS and the EBSS as evidenced in their resubmissions. Red and Lumo support this outcome.

Unlike competitive businesses where consumers have a choice of provider, regulated monopolies have limited incentives to improve their customer service outcomes. Consistent with our previous submissions made to the AER, we consider that the delivery of high quality customer service outcomes for energy consumers are important. Requiring an incentive mechanism in order to deliver that outcome for consumers is not. We do not support any of the resubmissions that apply to the incentive schemes other than the CESS and the EBSS.

In the resubmissions made by the Victorian DNSPs, they have included allowances for incentive schemes that reflect the AER's draft decision, except for Citipower/Powercor that have made adjustments to the STPIS from the AER's draft decision. We do not consider that these incentive schemes are warranted as:

- CPI-X incentive regulation already provides incentives for DNSPs to implement solutions at costs below their benchmark expenditure allowances. By doing this, DNSPs are able to earn additional revenue via the efficiency carry over mechanism and share it with consumers. This allows efficient DNSPs outperform their regulated return raising doubts about whether other incentive schemes are necessary.

- Network planning solutions already require DNSPs to consider a range of investment options and determine the investment option that maximises the net market benefit to consumers under the Regulatory Investment Test - Distribution (RIT-D). As such, the existing regulatory arrangements already require DNSPs to consider alternatives investments to network solutions in the form demand side management. Hence, the introduction of a Demand Management Incentive Scheme (DMIS) that provides DNSPs additional financial incentives to invest in the demand side is unwarranted.

- Demand side solutions will be strengthened as DER integration improves. With improvements in the manner in which DER can be integrated into the system driven by the AER, there should be an increase in the supply of demand side solutions to the market. This raises further doubts on whether incentive schemes to incentivise the demand side are necessary.

- The Service Target Incentive Scheme (STPIS) is not required. The STPIS was introduced to address the risk that DNSPs would under-spend relative to their benchmark expenditure allowances over the regulatory period improving their profitability at the expense of reliability. In our view, it is not clear that a DNSP would erode the reliability of its network for short term profits. Such a strategy would risk the loss of its license in the long run.

We urge the AER to reconsider its draft decision to allow the Victorian DNSPs to receive additional incentives under these mechanisms at a cost to Victorian consumers. We acknowledge that largely these are intended to deliver efficiencies to the network business in order to offset the additional cost to consumers, however, as noted above the links between the two are tenuous. Furthermore, it is very difficult to accurately capture consumers' preferences and willingness to pay for specific services in these schemes. As a consequence, we are concerned that the additional costs to consumers will outweigh any potential benefits.

**About Red and Lumo**

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, South Australia, Queensland, and the ACT to over 1 million customers.

Should the AER wish to discuss or have any enquiries regarding this submission, please contact Con Noutso, Regulatory Manager on [redacted].

Yours sincerely,

[redacted]

**Ramy Soussou**
General Manager Regulatory Affairs & Stakeholder Relations
**Red Energy Pty Ltd**
**Lumo Energy (Australia) Pty Ltd**