The South Australian Council of Social Service (SACOSS)

Submission to the AER:

ETSA Utilities 2010-2015 Distribution Price Review

Part II: Draft Determination and Revised Regulatory Proposal

February 2010
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<tr>
<th>Acronym</th>
<th>Description</th>
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<tr>
<td>AEMC</td>
<td>Australian Energy Market Commission</td>
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<td>AEMO</td>
<td>Australian Energy Market Operator</td>
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<td>AER</td>
<td>Australian Energy Regulator</td>
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<tr>
<td>DMIA</td>
<td>Demand Management Incentive Allowance</td>
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<td>DMIS</td>
<td>Demand Management Incentive Scheme</td>
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<tr>
<td>DNSP</td>
<td>Distribution Network Service Provider</td>
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<tr>
<td>DUoS</td>
<td>Distribution Use of System</td>
</tr>
<tr>
<td>EDPR</td>
<td>ETSA (Utilities) Distribution Price Review</td>
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<tr>
<td>ESCOSA</td>
<td>Essential Services Commission of South Australia</td>
</tr>
<tr>
<td>MMA</td>
<td>MacLennan Magasanik Associates</td>
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<tr>
<td>NIEIR</td>
<td>National Institute for Economic and Industry Research</td>
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<tr>
<td>PTRM</td>
<td>Post Tax Revenue Model</td>
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<tr>
<td>RAB</td>
<td>Regulated Asset Base</td>
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<tr>
<td>RET</td>
<td>Renewable Energy Target</td>
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<tr>
<td>SACOSS</td>
<td>South Australian Council of Social Service</td>
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<tr>
<td>TNSP</td>
<td>Transmission Network Service Provider</td>
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<tr>
<td>TUoS</td>
<td>Transmission Use of System</td>
</tr>
<tr>
<td>WACC</td>
<td>Weighted Average Cost of Capital</td>
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Executive Summary

The sole South Australian Distribution Network Service Provider (DNSP), ETSA Utilities, provided a Proposal for the 2010-2015 regulatory period to the Australian Energy Regulator (AER) for its consideration in July 2009. SACOSS subsequently provided a submission to the AER in August 2009. The AER considered the ETSA Utilities proposal and the submissions it received and released its Draft Determination in November 2009.

This submission has been prepared by SACOSS in response to the AER Draft Determination and ETSA Utilities’ Revised Proposal, submitted in January 2010. SACOSS has prepared this submission in the knowledge that the Proposal and the attendant review process is of vital importance in setting the price for South Australian electricity consumers throughout 2010-15, and beyond.

This submission has also been prepared based on the understanding that the AER will not deviate from its Draft Determination unless it is presented with fresh evidence or substantially new arguments.

In preparing its original submission, SACOSS posed the following questions (Nance and Stead, 2009):

1. Has ETSA Utilities fulfilled its duties under the 2005-2010 regulatory decision, and how is this evaluated?
2. How has ETSA responded to the incentives embedded in the regulatory framework, and are these responses reasonable?
3. Does the Proposal fulfil ETSA Utilities’ responsibilities under the National Electricity Objective?
4. Is the cost recovery fair and equitable, and is it based on sound data and analysis?
5. Can consumers afford the proposed cost recovery?

The SACOSS analysis of the original ETSA Utilities Proposal arrived at the following answers to these important questions:

1. The current regulatory framework does not allow for the evaluation of the current regulatory period and therefore fails to provide a sufficient contextual basis for the Proposal.

2. The regulatory framework incentivises the maximisation of the RAB and the minimisation of consumption forecasts to allow for greater cost recovery through DuOS charges. ETSA Utilities has responded to these incentives in its Proposal, in part by proposing questionable changes to the RAB and WACC parameters.

3. SACOSS argues that ETSA Utilities has failed in its Proposal to prioritise the management of peak demand, and that this not only fails consumers but also the National Electricity Objective. Issues around large air conditioning units, and the lack of pricing for their use which conveys the upstream effects, remain unresolved.

4. The Proposal outlines cost recovery mechanisms, which SACOSS finds are based on flawed residential consumption forecasts that other sources dispute. Additional cost burdens outlined in the Proposal fail to recognise the inelasticities in swathes of the residential market, and are therefore unrealistic for many and ultimately inequitable in the light of point 3 above.

5. Many low income and vulnerable consumers will be unable to afford the proposed cost increases. SACOSS analysis shows that the $25 per year additional cost cited in the
Proposal will actually be closer to $50 per year for households unable to reduce consumption. Given that people on low incomes already pay more for electricity as a proportion of their income than those on higher incomes, they are likely to be further disadvantaged by this Proposal.

The Draft Determination from the AER only addressed some of these issues and the subsequently Revised Regulatory Proposal from ETSA Utilities is not materially different in the context of these issues. Hence this submission reiterates the important issues and questions raised in SACOSS’ original submission.

SACOSS has long accepted that these regulatory processes provide two distinct phases:

- The first phase, where all consumers have a common interest, ensures that the regulated entity is allowed sufficient revenue to ensure the efficient operation and maintenance of the infrastructure to ensure a reliable and adequate capacity.

- The second phase, the allocation of the collection of this revenue to each class of customers, is of course where the interests of different consumer classes diverge and is equally important to SACOSS and the low income and disadvantaged consumers it represents.

SACOSS acknowledges and appreciates the offer from ETSA Utilities to participate, once this current process determines their overall revenue allowances, in further consultation with regards to the price setting details that will follow. ETSA Utilities is scheduled to submit its pricing proposal to the AER by June 1st, 2010.

This second submission from SACOSS will not raise new issues but will however provide further argument for the consideration of the points raised previously. Specifically, it calls into question the retail sales forecasts used by ETSA Utilities to form part of the basis for its Revised Proposal, as well as reinforcing SACOSS’ position that Demand Management represents a preferable alternative to network augmentation that should be pursued more vigorously.
Scope of interest

The South Australian Council of Social Service (SACOSS) is the peak body for social services in South Australia, and is an independent non-government organisation with a proud sixty-year history of advocating for disadvantaged and vulnerable South Australians. SACOSS is a not-for-profit independent organisation whose members represent a wide range of interests in social welfare, health and community services. SACOSS is part of a national network assisting low income and disadvantaged people, and shares with its members the vision of justice, opportunity and shared wealth for all South Australians.

In its role as a peak body for community services in South Australia, SACOSS covers a broad range of policy areas including the impacts of disadvantage on the most vulnerable South Australians. In recent years SACOSS has led or participated in debate and advocacy in the areas of consumer credit, electricity and gas, telecommunications, financial counselling, payday lenders, food security and gambling.

SACOSS welcomes the opportunity to continue its participation in the ETSA Utilities Distribution Price Review (EDPR) for the 2010-2015 regulatory period. This submission is part of the Consumer Advocacy Panel-funded National Energy Market Reform Advocacy Capacity Building Project – South Australia. SACOSS’ interest in the EDPR is based on the needs of vulnerable consumers and the implications embedded in the ETSA Utilities Regulatory Proposal and Revised Regulatory Proposal for the 2010-2015 regulatory period. It is SACOSS’ firm belief that all South Australian electricity consumers have an interest in the regulation of distribution services and that any price impacts embedded in the proposal and in the final decision will ultimately affect low income and vulnerable consumers disproportionately.

Ultimately SACOSS recognises the importance of the current review in terms of the 5-year period that the final decision will encompass, and views its role as one of ensuring that the best available evidence is used to arrive at reasonable and equitable distribution pricing outcomes.
Introduction

This submission is delivered from the perspective of the vulnerable household electricity consumer. From this perspective, the ETSA Utilities Revised Regulatory Proposal (ETSA Utilities, 2010 – the ‘Proposal’) represents a substantial increase in charges in each of the next five years, and a cumulative effect that will be borne with difficulty by many consumers. Residential customer charges for Distribution Use of System (DUoS) and Transmission Use of System (TUoS) combined already represent between 45 and 50% of the typical pre-GST electricity bill. While all electricity consumers have an interest in ensuring that network services are provided as efficiently and effectively as possible, the Proposal outlines an expenditure program that will see typical residential DUoS charges increase by 50% in real terms by the end of the regulatory period.

The AER’s Draft Determination (AER, 2009b) summarises the Revenue Allowances proposed by ETSA Utilities in Table 13 of the Executive Summary, and their conclusion in Table 14. ETSA Utilities revised proposal is summarised in their document in Table 16.4. All figures in nominal $m:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>ETSA Utilities Initial Proposal</td>
<td>591.6</td>
<td>673.0</td>
<td>745.4</td>
<td>821.1</td>
<td>889.4</td>
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<td>AER Draft Determination</td>
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<td>658.6</td>
<td>708.0</td>
<td>760.3</td>
<td>811.3</td>
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<tr>
<td>ETSA Utilities Revised Proposal</td>
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<td>699.1</td>
<td>757.3</td>
<td>819.2</td>
<td>874.7</td>
</tr>
</tbody>
</table>

Of particular interest to SACOSS is the cumulative projected impact on small customer bills. The original ETSA Utilities Regulatory proposal is replicated here:

And the Revised Proposal is replicated here:

<table>
<thead>
<tr>
<th>Customer type</th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
<th>2014/15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>$372</td>
<td>$397</td>
<td>$422</td>
<td>$447</td>
<td>$472</td>
<td>$497</td>
</tr>
<tr>
<td>Small business</td>
<td>$747</td>
<td>$812</td>
<td>$904</td>
<td>$995</td>
<td>$1,094</td>
<td>$1,203</td>
</tr>
</tbody>
</table>

It is hoped that the AER has already noted that the projections have INCREASED. The reasons for this are not entirely clear as the increase in the proportion of revenue from the residential sector has increased disproportionately to other customer classes.

It is significant that the time period of the review, 2010-2015, is also the period where Wholesale Electricity Charges are expected to increase as a result of an expanded Renewable Energy Target (RET) and an emissions trading scheme in some form. The full impact on electricity prices for residential consumers over this period, and the value of any Commonwealth compensation arrangements, is unclear at this point. Economic recovery over this period is also a subject of some debate. The ETSA Utilities spending proposal appears extravagant against this background and, to preserve affordability for vulnerable consumers, must be pared back to only what is essential spending in order to maintain service standards.
The comments made in the original SACOSS submission stand. However, there are two matters where it is felt that further information is relevant: Customer Sales forecasts and Demand Management. These will be discussed in turn.
Customer Sales Forecasts

The AER agreed with the concerns raised by SACOSS and others about the rather optimistic impacts of energy efficiency and price elasticity on residential demand. However the AEMO work used as the basis for the AER Draft Determination has been subjected to extensive scrutiny by ETSA Utilities and its consultants.

The chart below (Figure 1) illustrates the range of values put forward at different times. Of particular note is the disparity between ETSA Utilities’ own consultant’s report (NIEIR 2010 Table 5.3, page 61) – for some reason the figures in each year are 100GWh lower in the ETSA Utilities Revised Proposal and the Post Tax Revenue Model than in the consultant’s modelling results. ETSA Utilities must be asked to explain this.

![Customer Sales Forecasts Chart](image)

It is understood that the projections in each case are based on a ‘business as usual’ (or ‘current initiatives’) trajectory from which ‘Post-model-adjustments’ are made to reflect the impacts of measures not reflected in the past trajectory. This then opens up two areas of conjecture:

- Firstly, the ‘business as usual’ trajectory includes the impact of future prices on demand ‘the price elasticity of demand’.
- Secondly, the number, nature and impact of the various future initiatives to reduce demand.

It is noted that the various critiques of the models employed (NIEIR and AEMO) do not include a look back to see how well the models have forecast changes. The recent history of the South Australian Energy Market has included some significant price rises on which to assess residential elasticity, and the use of the -0.33 figure by ETSA Utilities does not reproduce past results. The AEMO stated in their report to the AER for the Draft Determination (AEMO, 2009, p. 41) that, “Price elasticity changes with the price level and varies between -0.185 and -0.364 for the data set used to estimate the model. The elasticity estimated at the sample median is -0.236.”
These are extremely influential assumptions yet neither the AEMO, NIEIR, Frontier or MMA work seems to test whether these figures have proved correct in recent years (particularly over the FRC introduction in January 2003). As noted in our original submission (see chart at Figure 2 of ESCOSA data reproduced below), the average demand by households seems to bear little correlation to price in the medium term.

![Figure 2 – Residential Consumption and Prices 1999/2000 to 2007/2008 sourced from ESCOSA Annual Performance Reports](image)

In the end, it appears to come down to academic arguments between consultants that are not particularly useful when there is no reconciliation to the simple observations available.

The second area of interest is the ‘post-model-adjustments’ arguments put forward by both sides.

The work by ETSA Utilities and its consultants relies very heavily on the work of George Wilkenfeld and Associates. It is curious as to why Wilkenfeld has not been consulted directly on the validity of the interpretation of his work.

Of particular interest to SACOSS was the work of MMA in estimating the overlap of price and policy effects. The regularly quoted Wilkenfeld (2009) report “Prevention is Cheaper than Cure – Projected Impacts of the Energy Efficiency Program to 2020” projects impacts based on the combined effect of policy measures and the influence of steadily increasing prices (around 20-26% by 2020). The MMA analysis of this overlap (MMA 2009 p15 and Appendix 3, p85) is very interesting and just a little hard to understand. SACOSS has not been able to reproduce the results for “Overlap between price and policy effects” (MMA, 2009 Appendix 3, p85-86) and is concerned that a reputable consultant such as MMA can arrive at a precise overlap figure of, for example, 0.2kWh for 2011 considering their rather imprecise basis that “…we have relied upon Wilkenfeld’s estimate of a 15% reduction in electricity use by appliances by 2020... “.
Surely the most relevant comparative analysis is between the base-cases of the ETSA Utilities / NIEIR work and the Wilkenfeld work – only once this has been established should the appropriate use of post-model adjustments be considered.

What has been presented is guesswork and some creative use of disparate data to form a conclusion that is highly sensitive to the original, unacknowledged assumptions. A sensitivity analysis on the results of the MMA analysis, for example, would most likely yield an uncomfortable result for ETSA Utilities.

Ultimately SACOSS offers the view that, in the absence of more reliable data, should the benefit of the doubt go in favour of consumers or the business? If the final consumption figures are too high and ETSA Utilities have set the prices too low to meet their revenue targets, they can make it up in the next year. If on the other hand, the consumption figures used for price setting are too low ETSA Utilities ends up over-collecting revenue from consumers. Not surprisingly, SACOSS strongly urges the AER to ensure the benefit of the doubt falls on consumers, particular as we believe that the consumers represented in this submission have quite inelastic consumption anyway.

In the midst of such uncertainty it may just be prudent to assume that residential consumption will remain static at weather corrected per customer averages over the last X years and share the risk more evenly.
Demand Management

In its previous submission, SACOSS (Nance and Stead, 2009, pp. 3-4) stated:

The regulatory approach appears to absolve ETSA Utilities from any material responsibilities to manage South Australia’s growing peak demand and worsening network utilisation.

The Demand Management Incentive Scheme (DMIS), Part A (AER, 2008) – Incentive Allowance (DMIA) of $3m proposed by the AER over the five years of 2010-15 seems extraordinarily disproportionate. It equates to a financial incentive of $3m to avoid having to build infrastructure while the business collects over $3bn in revenue and the RAB increases by $1.5bn over the same period.

ETSA Utilities is clearly ready in this next regulatory period to go beyond ‘trials’ (the envisaged purpose of Part A) and deliver significant, broad-based peak demand reduction solutions. Trials may well be the appropriate activity in other jurisdictions but not in South Australia. Moreover, any revenue lost due to the efficacy of trials under the DMIA is recoverable under Part B of the DMIS.

The implications of not satisfactorily addressing peak demand in South Australia are manifest in the capital expenditure program proposed by ETSA Utilities. The AER must revisit its October 2008 decision regarding the DMIS to apply in this case.

5.1 Demand management
– Why this proposal fails consumers and the National Electricity Objective:

The National Electricity Objective (from the National Electricity Law) (Parliament of South Australia, 2009, p. 30) states:

7 – National electricity objective

The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to –

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system.

It is impossible to conclude that the treatment of this issue within the Distribution Price Review regulatory approach does anything but fail this objective, as it is clear that the ‘long term’ interests of consumers will not be met under the Proposal. The issue of peak demand in South Australia not only has a detrimental effect on the price and reliability of supply of electricity but also the reliability, and hence safety, of the national electricity system.

Failing to meet the demand management needs of the network, ETSA Utilities instead proposes an arrangement by which its capital expenditure program focuses on very expensive, under-utilised infrastructure. In terms of overall economic efficiency, SACOSS contends that the electricity distribution network is only one of many parts of the South Australian economy that would benefit from an additional $1bn over the next five years — many of which would be of greater benefit to consumers.
The AER did not accept this reasoning. In its Draft Determination it stated (AER, 2009b):

(p230-231) The AER considers the regulatory framework in general, and the NER in particular, does not absolve ETSA Utilities from having to consider demand management solutions to South Australia’s electricity demand profile. The regulatory framework requires ETSA Utilities to make provision for efficient demand management solutions. The AER, however, considers that it is not in a position to enforce the uptake of demand management projects by ETSA Utilities. It is the DNSPs responsibility to determine an efficient demand management project while it is the AER’s responsibility to assess the prudence and efficiency of the proposed costs.

(page 386) The AER does not agree with SACOSS’ submission that the regulatory approach absolves ETSA Utilities from any responsibilities in the area of demand management.

Further, in response to a SACOSS question at the December 2009 pre-determination conference in Adelaide:

**Steve Edwell** reiterated that the AER’s role is not one of imposing demand management solutions on the businesses. He noted that the allowance under the demand management incentive scheme was largely an allowance for research and development.

Mr Edwell noted that the draft decision had drawn attention to the AEMC’s ongoing review of demand side management responses in the National Electricity Market and the potential for changes to the regulatory framework as it pertains to demand management.

In a recent submission to the AEMC review mentioned by Mr. Edwell, the AER (AER, 2009a, p. 2) stated:

“The AER considers that implementing cost-reflective pricing and improving consumers abilities to respond to the improved price signals represents a superior solution to promoting efficient consumption decisions.”

And,

“... anecdotal evidence from the AERs various DMIS consultation processes indicate that efficient DSP responses to network constraints arising during a regulatory control period are not necessarily being acted on by DNSPs.

“... Once more data is available, the AER will be better able to consider the need for and design of a national DMIS for DNSPs, as well as barriers created by the regulatory framework.” [emphasis added]

SACOSS feels a need to respond further to the AER statements: as the issue of peak demand in South Australia continues to be a key driver of the cost of providing distribution services, the AER seems to take a ‘wait and see’ approach. The AEMC seem to have expressed similar sentiment to SACOSS regarding the somewhat arbitrary $3m in the DMIA. In the AEMC’s Final Report to Stage 2 of the Review of Demand-side Participation in the NEM (AEMC, 2009) it stated (page 26):

“In a period of significant change in the energy sector, customers may be better off in the longer term if network owners were to take on greater levels of expenditure and risk in respect of innovation.
“The AER, under the DMIA, has developed innovation schemes for distribution businesses in the NEM. According to the AER, the purpose of the scheme is to provide incentives for DNSPs to conduct research and investigation into innovative techniques for managing demand. Through this, the AER considers that DSP projects may be increasingly identified as viable alternatives to network augmentation.

“...The majority of submissions indicated that innovation funding for DSP was important for encouraging efficient DSP outcomes. However, submissions indicated that the existing DMIA is not effective in overcoming the barriers to innovation for distribution businesses. In particular, submissions were of the view that the amount of money available from the AER was insufficient to prove beneficial.” [emphasis added]

SACOSS can only hope that the subsequent rule changes proposed by the AEMC’s final report will lead to a more effective response to South Australia’s worsening peak demand issues.

A recent analysis of ETSA Utilities’ Direct Load Control (DLC) trials (Johnston, 2010) has stated that while these trials have not significantly impacted on customer bills, the potential for the reduction of network augmentation is clear. This shows that a bigger trial of DLC technology is warranted, and that together with improved Community Service Obligations (CSOs), DLC can have a significant impact on the need to undertake costly network augmentation. Ultimately, this will benefit consumers through DUoS charges that are less than they otherwise would have been, while ensuring that the ‘lights won’t go out’.

The above-referenced report also reports the observations of ETSA Utilities that education about maintenance and use of airconditioners has a role to play in the future as well. This highlights the difference between ‘projects’ and ‘programs’ in relation to peak demand management in the residential sector. While existing requirements ensure that ETSA Utilities consider individual DM projects when considering a specific network upgrade, these same requirements do not ensure the provision of ongoing, broader reaching programs that deliver long term benefits to consumers.

It is also disappointing that the 2010-15 regulatory period will have no commitment to a formal review of the benefits or otherwise of the $20m program conducted over the 2005-10 regulatory period. Surely a mechanism that ensured that this experience is not lost is of benefit to consumers.

In conclusion, SACOSS stands by its previous statements in relation to the National Electricity Objective. Framed another way, it is clear to us that declining utilisation of very expensive infrastructure is testament to a failure of the market to deliver on the NEO. The consumers we represent don’t care if it’s the MCE failing to prioritise the policy issues, the AEMC failing to implement rule changes or the AER failing to enforce them – in the end they are being asked to pay more and more while being encouraged to use less and less.
Summary

SACOSS finds the ETSA Utilities Revised Proposal flawed in a number of ways. By responding to the incentives embedded in the regulatory framework to maximise the RAB and minimise consumption forecasts, our sole distributor has proposed a cost recovery response that is unreasonable and inequitable. South Australian consumers – particularly those on low and fixed incomes – simply cannot afford constantly increasing prices for essential services. Not only does ETSA Utilities propose questionable changes to the RAB and WACC parameters, but goes further by making use of consumption forecasting that is not backed up by transparent evidence.

Additionally, the current DLC trials represent a means by which Demand Management can move forward, easing the pressure on the distribution network during peak load times and consequently easing the pressure on the capex component of any Regulatory Proposals. It is SACOSS’ position that the AEMC and AER need to support DLC and Demand Management in general in order to achieve outcomes for all consumers.

The approach to Distribution Price Reviews in the NEM has a long road of reform ahead before consumers will feel that they are truly participating. SACOSS will continue to scrutinise the process and advocate for change.

SACOSS intends to play an active role in the allocation of costs to the various customer classes and welcomes the invitation from ETSA Utilities to participate further even though it is not obliged under the rules to do so.
References


NIEIR (2010) Electrical energy projections for ETSA Utilities in South Australia to 2019-20, National Institute of Economic and Industry Research, January 2010 Provided as Attachment E.7 to the ETSA Utilities Revised Regulatory Proposal (on Supporting Documentation CD)
