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14 August 2014

Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email: NSWACTelectricity@aer.gov.au

Dear Mr Anderson

**RE: NSW electricity distribution regulatory proposals 2014-15 to 2018-19: Issues paper**

Thank you for the opportunity to respond to the Issues Paper (the paper) for the New South Wales 2014-15 to 2018-19 revenue reset.

Simply Energy is a leading energy retailer with customers across the National Electricity Market, including in New South Wales.

We encourage the AER to ensure that distributors' proposals are only approved when they support competitive market outcomes and reasonable prices, both of which will lead to the best outcomes for customers.

## Distributors' DUOS revenue proposals

Page 10 of the paper identifies how circumstances have changed since the last revenue reset and makes a request: "We seek guidance from consumers and stakeholders as to whether the distributors' expenditure proposals reflect these changed circumstances in which they operate."

The changed circumstances that are identified include the following:

- Reductions in the costs of finance since the global financial crisis
- Less onerous network planning standards
- Weakening demand.

Given that much of the revenue obtained by distributors is related to the costs of financing previous investments, Simply Energy is surprised that the AER states (on page 10 of the paper) that if it were to accept the distributors' proposals without change then prices would remain around current levels.

The competitive parts of the electricity supply industry are under intense scrutiny by government and regulators to ensure that savings due to reduced wholesale electricity costs (from the carbon tax repeal and reducing consumption) are reflected in the prices paid by consumers.

The distributors' proposals suggest that savings expected from their changed operating conditions are not reflected in lower expected prices for consumers. This is a particular concern given that prices increased by between 50% and over 100% from 2008-09 to 2012-13 (as shown by Figure 1 in the paper). The proposals are locking in the steep price increases that consumers faced during the last regulatory period, rather than seeking to reduce prices to reasonable levels.

We consider that the following will benefit consumers by leading to more reasonable network prices:

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- The change from price cap to revenue cap regulation, identified by the AER. We agree that the theoretical price cap benefit of more efficient pricing structures has not been seen, but the drawback of higher prices than needed to provide the services has been very visible.
- Further scrutiny by the AER of appropriate rates of return for distribution businesses. 8.83% seems very high given that the owners of these monopoly businesses receive guaranteed revenues. Also, the attempt by distributors to include (in the rate of return assessment) returns obtained by apparently similar businesses in the United States of America is inappropriate given the different regulatory and other conditions present in Australia.
- Further scrutiny by the AER of the operating expenditure proposals, which are flat or increasing. The proposals do not reflect the savings consumers would expect to see from less onerous standards and from businesses that no longer have to manage in circumstances where the demand for their services is constantly growing.
- Increased use of benchmarking by the AER. Benchmarking is one of the ways that the AER can address the information asymmetry whereby the distributors have greater access to information about their businesses than the AER. If unaddressed, information asymmetry leads to higher prices for consumers, as regulated businesses may not make information available when it does not support their regulatory proposals.
- Increased use of total factor productivity approaches by the AER. This is another approach that addresses information asymmetry and provides a way that consumers can benefit from productive gains made in the industry.

## Metering charges and exit fees proposed

Some of the metering exit fees proposed appear excessive and will stifle competition for the provision of metering services.

Ausgrid's proposed fees, in particular, seem extremely high in comparison with the exit fees proposed by the other distributors, and in comparison with Ausgrid's proposed annual metering charges.

For example, Ausgrid's FY18 proposed exit fee is $210.49, compared with Essential Energy's at $116.06 and Endeavour Energy's at $62.06. Similarly, Ausgrid's FY16 exit fee of $195.24 is 5.62 times its FY16 Type 6 residential metering charge of $34.71.

Additionally, Ausgrid's proposed exit fees increase during the regulatory period (from $195.24 in FY16 to $204.67 in FY19), which is in contrast to the other distributors' proposals that decrease during the same period (Essential Energy's, for example, decreases from $131.57 in FY15 to $109.21 in FY19). We cannot understand how a distributor's exit fee can increase during a period when the value of the metering assets that the exit fee applies to should be reducing due to depreciation.

An exit fee that increases over time would have the effect of increasing the barriers to metering competition over time. This is exactly the opposite of what is required to enable customers to benefit from growth in smart metering and the scale benefits that will be obtained as more customers are provided with smart metering.

There are other anomalies in the distributors' proposals for metering exist fees and metering charges. For example, Endeavour Energy's FY15 exit fee of $67.39 is 38% of the annual charge for Type 5 metering of $175.72. This contrasts strongly with the situation for Type 6 meters, where the exit fee is 144% of the annual charge. This creates what appears to be the perverse outcome that the incentives are lowest for replacing the meters with the least functions.

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Simply Energy urges the AER to consider alternative ways that metering exit fees can be determined, including the following:

- Determining a number of exit fees for each distributor, which correspond to the different annual metering charges proposed, such as separate exit fees for Type 5 and type 6 metering.
- Recovery of administrative costs from DUOS charges instead of metering exit fees. This is appropriate because all customers are expected to benefit from the increased efficiency of the industry that will follow from smart metering. For example, all customers will benefit from increased utilisation of networks at off-peak times, which will be facilitated by smart metering.
- Ensure that the stranded asset costs recovered through exit fees comprise only the metering assets that are being removed. Specifically, it is not appropriate that exit fees include recovery of capitalised overheads and IT system costs.
    - Exit fees will have a big impact on the scope of competition for smart metering services and the scope of smart metering roll outs; high exit fees will reduce the scope and the potential benefits. Including capitalised overheads and IT system costs in exit fees means that the potential benefits of smart metering are materially affected by the accounting treatment of overheads and IT costs that a distributor has decided to use.
    - The AER should consider looking behind the different accounting policies used by distributors to understand the substance of the operating and capital expenditure that has taken place. This will enable the AER to ensure that any recovery of stranded asset costs only relates to the actual costs of these assets themselves, and does not include distribution business overheads that should be recovered in other ways.

Please don’t hesitate to contact James Barton, Regulatory Policy Manager, if you wish to discuss this submission further.

Yours sincerely

Dianne Shields
Senior Regulatory Manager