

*Submission on ETSA Utilities  
Regulatory Proposal 2010-15  
to the Australian Energy Regulator*

28 August 2009



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## Overview

Business SA is the State's leading business organisation, representing many thousands of businesses ranging in size from sole proprietors to large multinationals spanning across all industry sectors.

Our interest in the ETSA Utilities Regulatory Proposal (RP) for the 2010-15 period stems from the fact that all of these businesses use electricity and some are very large consumers of electricity. It is vital that businesses have access to a secure and reliable supply of electricity at prices that maintain their competitiveness both within Australia and internationally.

With regards to the operation of the distribution network, this means that whatever investments are necessary to ensure an acceptable standard of electricity supply, with minimal disruptions, should be pursued. Investments over and above that level would risk raising electricity prices too rapidly for no material benefits and could result in reduced economic activity and job losses as businesses struggle with higher costs.

Business SA is particularly concerned that the 10 percent a year real increase in electricity bills indicated for small businesses for the 2010-15 period may be excessive and unduly impose on these businesses.

It also necessary that ETSA receives sufficient revenues from its operations to cover costs, including vital capital and operating expenditures, and maintain profitability. Weighing up all of these interests is a fine balancing act.

Business SA believes that the Australian Energy Regulator (AER) must focus on the following issues in its determination:

1. the scope for reducing the price increases proposed in the RP
2. the potential impact on businesses if the proposed price increases are approved, in conjunction with increases in electricity prices that are expected to flow from the generation, wholesale, transmission and retail segments of the electricity industry, as well as climate change policies such as the Carbon Pollution Reduction Scheme and Renewable Energy Target
3. the necessity of the capital expenditures proposed
4. the necessity of the operating expenditures proposed
5. the scope for reducing expenditures, while still maintaining a secure and reliable supply of electricity
6. the scope for increased demand side management initiatives as a way of reducing future supply related capital expenditures
7. the likelihood of the forecasts in the RP being correct, particularly regarding future demand or sales and cost escalations

## Electricity price increases

Electricity distribution prices have been fairly stable in real terms over the last few years. However, the RP indicates that this will change over the next five years.

The following table replicates and adds to parts of Tables 16.10 and 16.11 in the RP.

Tariff (\$/MWh)	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	% rise
Major business	\$6.20	\$6.40	\$6.80	\$7.20	\$7.90	\$8.60	38.7
High voltage business	\$22.70	\$24.50	\$26.90	\$29.60	\$32.40	\$35.60	56.8
Low voltage business and unmetered supplies	\$46.90	\$50.50	\$54.60	\$59.90	\$65.80	\$72.30	54.2
Controlled load	\$18.10	\$20.00	\$21.90	\$24.10	\$26.50	\$29.20	61.3
Metering provisions	\$19.72	\$21.40	\$23.20	\$25.20	\$27.30	\$29.60	50.1
Small business bills*	\$747	\$822	\$904	\$995	\$1094	\$1203	61.0

\* \$ per annum

Business SA is concerned that, for all business categories, the increases in tariffs are large and have the potential to result in reduced economic activity and job losses as businesses struggle with higher costs. This is particularly the case for small businesses, that account for over 95 percent of businesses in South Australia, whose electricity bills are indicated to rise by 10 percent a year in real terms.

Business SA is also concerned that the AER's Service Target Performance Incentive Scheme (STPIS) has the potential to inflate prices even further. The STPIS provides for a "reward" of an increase of up to 5 percent in revenue if service levels are improved and a "penalty" of a decrease of up to 5 percent in revenue if service levels deteriorate.

This could result in targeted investments in areas where improvements in services that may not be required can be achieved cheaply, increasing average service levels and resulting in price increases that may not be justified.

While the regulatory determination process of the AER will necessarily focus on ETSA's RP and price increases to energy users from higher distribution related charges, Business SA urges the AER to keep in mind that increases to electricity prices are likely to come from other sources as well. Increases in electricity prices are expected to flow from the generation, wholesale, transmission and retail segments of the electricity industry, as well as climate change policies such as the Carbon Pollution Reduction Scheme (CPRS) and Renewable Energy Target (RET).

Wholesale electricity prices on the National Electricity Market have increased sharply in the last three years in South Australia (2006-07, 2007-08 and 2008-09), averaging \$58.7 per MWh compared to \$36.2 per MWh in the three years prior to that. The average price for the last three years is between 8 percent (Tasmania) and 26-27 percent (New South Wales and Queensland) higher than other States. This has flowed through to higher retail prices. Transmission related charges have also increased.

The Australian Energy Market Agreement was also recently amended to specify that, where retail prices are regulated, energy costs associated with the CPRS and RET are to be passed through to end use consumers.

The combined influence of all of these forces in the form of higher electricity prices could have a significant impact on business costs and lead to reduced profitability, job losses and lower economic activity. Interstate and international competitiveness are vital for the viability of businesses in South Australia.

While it is important that electricity prices rise to encourage the necessary investments in infrastructure to ensure a reliable supply of electricity, improvements in energy efficiency and reductions in greenhouse gas emissions, it is imperative that higher costs to energy consumers do not result in job losses and the closure of efficient businesses.

Higher energy costs are more of a concern to businesses than energy availability and security. A recent survey by Business SA found that electricity costs were a major concern for 46 percent of businesses. This compares to 25 percent of businesses citing energy availability and security as a major concern.

With regards to pricing structures, Business SA supports ETSA's proposal to introduce more cost reflective tariffs, as this should encourage more efficient use of energy and will enable ETSA to achieve an appropriate return on its investment.

Business SA is also supportive of the relativities in the tariff pricing structure by type of customer for distribution standard control services, given their differing load factors and therefore influence on the need for capital investment.

## Capital and operating expenditure

The RP proposes significant increases in both capital and operating expenditure for the 2010-15 period:

- Capital expenditure is forecast to increase 128 percent compared to the current regulatory period (2005-10) to around \$2.77 billion.
- Operating expenditure is forecast to increase 62 percent to \$1131 million.

These massive increases in spending will be accompanied by an increase in staff numbers of around 500 people and result in an increase in ETSA's Regulated Asset Base (RAB) from around \$3 billion to \$4.9 billion over the period.

Given the impact that these higher expenditures are estimated to have on distribution tariffs and electricity bills, it is imperative that the AER analyses the necessity of each capital investment in the RP. Lowest priority should be given to investments where the electricity supply is already reliable and secure. Highest priority should be given to the CBD related investments involving the City West connection point and the CBD aged asset replacement program. Priority should also be given to the connection of new major projects and development initiatives. However, if any projects are considered unlikely to occur in the 2010-15 period, the allowance for the relevant project should be removed from ETSA's proposed capital expenditure and a corresponding decrease in distribution tariffs and electricity bills is recommended.

In addition, the cost of each capital investment needs to be analysed, to ensure that there is no overestimation, which would lead to a higher RAB than necessary and higher prices than necessary.

There is a reliance on historic unit costs to justify costing estimates. Most companies become more efficient through time, such as through learning by doing and technology improvements, so a declining scale should be applied to the historic unit costs for the forecasts.

The condition monitoring based approach to decide which ageing assets to replace or upgrade is supported, as this will minimise costs to ETSA and result in price increases that are lower than would otherwise be the case. That said, an almost tripling of asset replacement expenditure requires analysis to determine whether all of that expenditure is really necessary. This is also the case with safety related expenditures, which are forecast to increase more than seven fold.

Business SA's other primary concern regarding both capital and operating expenditures relates to the labour cost escalation used in the RP. This is discussed in the "Issues with forecasts" section of this submission.

## **Demand side management**

Demand side management is a particularly important issue in South Australia because of the peaky nature of demand and the more rapid growth of peak demand for electricity than average demand.

Effective demand side management would reduce both peak demand and peak demand growth and result in lower levels of capital expenditure in the distribution network. This would flow through to smaller increases in both tariffs and electricity bills, which would benefit businesses considerably. The lower consumption of energy would also cut costs for businesses.

ETSA conducted a number of demand management trials during the 2005-10 regulatory period, but plans to reduce these initiatives in the 2010-15 regulatory period. Business SA believes that this is due to a number of factors:

- the lack of direct benefits to ETSA, even though there are significant “societal” benefits
- the relatively limited scope and incomplete measurement of the trials
- weak signals from both regulators and the South Australian Government regarding the importance of demand side management and the roll out of technologies (such as smart meters and direct load control), that would assist in reducing peak demand.

The Essential Services Commission of South Australia made provision for \$20 million to be spent on demand side management in the 2005-10 regulatory period. ETSA intends to spend just \$6 million during the 2010-15 regulatory period.

While the AER may not have the authority to enforce greater demand side management activities on ETSA, Business SA urges the AER to analyse the scope for reducing capital expenditures on the distribution network by swapping increased demand management projects in their place.

Encouragement for demand side management initiatives should also be provided wherever possible. Increasing the Demand Management Incentive Scheme (DMIS) allowance of \$3 million is one option.

Another option worth considering would be partnerships between ETSA and companies interested in demand side management, where both parties share the costs of installing appropriate technologies as well as the benefits of lower demand. Any South Australian Government funding or rebates to assist such partnerships would be greatly welcomed.

## Issues with forecasts

### Sales forecasts

Business SA is sceptical about the energy consumption forecasts in the RP.

The latest *Energy Update*, released in August 2009, by the Australian Bureau of Agricultural and Resource Economics, indicates that annual growth in electricity consumption in South Australia has been just over 2 percent since the National Electricity Market commenced at the end of 1998.

ETSA's own electricity sales have increased by 1.1 percent annually throughout this decade.

Given this recent history in electricity consumption growth, the RP's forecast of a 1 percent annual decline in energy consumption between 2009 and 2015 seems unlikely to come to fruition, even taking account of climate change policies and higher electricity prices that will encourage more efficient use of energy.

Regarding residential electricity sales, peak demand growth in new houses because of air conditioning is very strong and this trend is expected to continue. This is acknowledged by the ETSA commissioned MMA modelling, but does not appear to have been given enough weight by ETSA itself.

Electricity sales associated with the supply of hot water will fall as a result of the banning of replacement electric hot water storage systems. However, the tapering of these sales in Figure 5.9 of the RP appears overly optimistic. Most households will be inclined to only replace their electric hot water storage systems when they break. Therefore it is unlikely that electricity sales associated with these systems will halve over the next five years. Given that this decline accounts for the majority of the forecast decline in residential electricity sales, applying a more conservative assumption for the replacement of hot water storage systems would yield a more realistic electricity sales forecast.

Projections for customer sales in the Electricity Supply Industry Planning Council's (ESIPC) *2009 Annual Planning Report* indicate base case growth of 1.8 percent a year to 2018-19, with a low case growth of 1.5 percent a year and a high case growth of a very strong 4.8 percent a year.

Business SA is aware that electricity sales associated with mining is included in the ESIPC projections, but not included in the ETSA forecast of energy consumption. However, it is unlikely that mining activity growth to 2015, while expected to be significant, could account for the total difference of 2.8 percent in the two electricity sales growth numbers.



If energy consumption growth is higher than forecast in the RP, electricity bills for small businesses will rise by even more than the already high 10 percent a year during the 2010-15 period. This is a major concern for Business SA and more accurate indications of increases in bills is necessary.

#### Labour cost escalations

Business SA understands there is strong competition for the engineering and trade skills that ETSA requires in its workforce and that labour costs, as a result, may increase more rapidly than the national average. However, the forecast real wage increases in the RP of an average of 3.3 percent annually appear higher than can be justified.

A number of ABS statistics reflect this:

- Real unit labour costs have not increased nationally over the last five years, according to the national accounts (ABS 5206)
- The nominal labour price index in the electricity, gas and water supply industries increased nationally by 5 percent, 4.1 percent and 4 percent in 2006-07, 2007-08 and 2008-09, respectively (ABS 6345)
- The nominal labour price index in South Australia increased by 3.9 percent, 4.7 percent and 3.9 percent in 2006-07, 2007-08 and 2008-09, respectively (ABS 6345)

Given these statistics, Business SA believes that the real labour cost escalation needs to be substantially reduced, perhaps to the forecast growth in real Average Weekly Ordinary Time Earnings from BIS Shrapnel in Table 6.7 of the RP (1.7 percent average annual growth).

Applying a more realistic labour cost escalation will reduce the capital and operating expenditures required to maintain secure and reliable electricity supplies. This, in turn, will reduce the price increases indicated in the RP and reduce the burden of higher electricity costs on businesses.