Submission to

The Australian Energy Regulator (AER)

Response to Electricity Distribution Business Regulatory Proposals for 2015-20, from SA Power Networks, Electricity Distribution Business

From UnitingCare Australia

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## UnitingCare Australia

UnitingCare Australia is the national body for the UnitingCare Network, one of the largest providers of community services in Australia. With over 1,600 sites, the network employs 39,000 staff and is supported by the work of over 28,000 volunteers. We provide services to children, young people and families, Indigenous Australians, people with disabilities, the poor and disadvantaged, people from culturally diverse backgrounds and older Australians in urban, rural and remote communities.

UnitingCare Australia works with and on behalf of the UnitingCare Network to advocate for policies and programs that will improve people’s quality of life. UnitingCare Australia is committed to speaking with and on behalf of those who are the most vulnerable and disadvantaged, for the common good.

## Our Observations

In energy policy discussions, Uniting Care Australia’s main objective is to ensure that energy prices experienced by consumers are fair and reasonable and that any regulatory proposals ease cost pressures on lower income and disadvantaged people. UnitingCare Australia sees this as central to the National Energy Objective.

## National Energy Objective

The starting point for both network businesses lodging their regulatory proposals and for the Australian Energy regulator (AER) must be the National Electricity Objective as set out in the National Electricity Law. The Objective , 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"

The application of this objective is crucial because of the financial pressure on households from current high energy costs and because it is unlikely that widespread amelioration of lower income household bills will come from any other source, including concessions.

Over the last six years, electricity prices have been rising, doubling in real terms for many households whose incomes have declined. Figure 1 shows the electricity price rises for Australian jurisdictions. Total annual energy costs for lower income households, as a proportion of household income, is the second highest for all Australian jurisdictions in South Australia; this is shown in Figure 2. The ABS household expenditure survey reports that average household expenditure on electricity Australia-wide is 2.3% of income. So SA lower income households are paying two and half times the national average electricity cost. We also know from our financial counselling, emergency relief and other services, that there are also households paying dramatically more than these average expenditure levels.

Figure 1: Electricity price indexes for Australian jurisdictions, 1990-91 = 100  
Source: Australian Energy Regulator, State of the Energy Market report, 2014

Figure 2: Modest Income Households, average electricity expenditure as a share of income, 2013, 14  
Source: Australian Energy Regulator, Annual Report on the performance of the retail energy market, 2013-14

# Consumer behaviour in the energy market

This section provides an overview response to both the questions from the Issues Paper:

*Do you think that SA Power Networks' capital expenditure proposal is adequately justified? Page 11*

*Is SA Power Networks' operating expenditure proposal adequately justified? Page 17*

SA Power Networks state that they are engaging with consumers, who they say are happy with the reliability of their electricity supply. They conclude that their costs are efficient, and propose an increase in capex of about 50% and an opex increase of about 33% over the 2015-20 period.

Our experience and evidence about what consumers are doing in response to higher electricity prices is quite different:

* More people are being disconnected from supply
* Growing numbers of consumers are installing solar PV to avoid network costs
* Households report increasing energy stress, with more people affected by rising prices, and a ‘deepening’ of energy stress for some groups of consumers.
* Growing numbers of customers are on hardship programs
* There are more complaints from energy consumers; and
* People are using less energy.

We now consider each of these behaviours in turn.

## More people being disconnected from Supply

Figure 3 shows reported disconnections due to inability to pay. While disconnections data is likely to be variable over time, due to different collections processes employed by businesses, and other varying factors, the trend for electricity disconnections is rising in all mainland states. In these jurisdictions, more people were disconnected for inability to pay in each year of the most recent distribution regulatory periods.

Figure 3 shows that South Australia has the highest rate of disconnections in the NEM and has had either the highest or second highest rate of disconnections for the last 7 years. Figure 3a provides the SA only disconnections data and shows that high numbers of households have been disconnected: over 10,000 per year for the last two years.

Figure 3: Disconnections due to inability to pay, jurisdictions, time series  
Source: Australian Energy Regulator, State of the Energy Market report, 2014

Figure 3a: Disconnections due to inability to pay, SA  
Source: Australian Energy Regulator, State of the Energy Market report, 2014

## Many more people installing solar PV to avoid network costs

About 23% of South Australian households now have solar photovoltaics (PV) on their rooves. From 2012/13 to 2013/14 there was an increase of 1.8% in the proportion of SA households with PV.

We recognise that there are many reasons for the rapid uptake of PV systems in Australia. Generous initial government incentive grants and guaranteed feed-in tariffs have certainly contributed to the initial uptake being beyond initial expectations. These have now largely concluded with market based feed-in tariffs all that remain. There was also an initial enthusiasm among people concerned about the environment and regarded personal PV as a means of reducing carbon footprints. These views remain; however, the current political context is quite dismissive of climate change and responses to it. The number of people installing solar PV is much greater than the number of Greens voters and certainly larger than membership of environmental groups, so we suggest that there is another major reason for the rapid and continuing uptake of solar PV.

UnitingCare Australia believes that a main reason for continuing PV uptake is that rapidly rising energy prices are pushing people to seek alternative means to manage their rising costs, particularly the network costs: households are wanting to ‘future proof’ their energy costs. This is evidenced by both the continuing installation of new PV systems, but also by the growing size of new installations, rising from a typical 1.5kW system about five years ago to an average of 4kW for each installation today. There is good evidence that the households most actively installing PV are lower-middle and middle income households, roughly deciles 3 to 7 from income distribution data sets, with households approaching retirement being significant installers.

UnitingCare Australia believes this trend reflects the desire of households to reduce their dependence on electricity networks and to give a degree of certainly about future electricity costs. This is evidence of the impact of cost pressures on households. While there are many advantages of domestic PV, we are also concerned because many low income households lack the capital, or lack control over their residential building, to respond to rising energy prices in this way.

## Increasing energy stress

The number of people who are unable to pay their utility bills on time is substantial, as shown in figure 4, using Financial Stress data taken from the ABS General Social Survey. Just over one in eight Australian households are unable to pay utility bills, mainly electricity, on time, but for the poorest 40% of Australians, close to one in five households can’t pay their bills on time.

Figure 4: Inability to pay utility bills on time  
Source: ABS, General Social Survey, 2012

This situation needs to be understood in the context of priority given to paying on time by consumers. Uniting Care Australia has sought to clarify this situation and has commissioned research surveying consumers about how they manage their energy bills. We have asked about the priority given to households in paying their energy bills on time, through 3 separate surveys each sampling about 1500 people. The results for each survey are almost identical, with the results for our most recent completed survey shown in figure 5. We have classified respondents into 3 income bands; low - less than $40,000 annual income, medium income – $40,000 to $80,000pa and high – more than $80,000 per annum.

The survey results show that all households place a high priority on paying utility bills on time, but the lowest income households put greatest priority on this: 41% of lower income rate it as a high priority, while only 3% give electricity bill paying a low priority. This evidence certainly contradicts the occasional argument that households who don’t pay their bills on time are ‘won’t payers’ rather than ‘can’t payers’. Indeed, paying energy bills on time ranks second highest priority for many households, with only rent / mortgage payment rating higher.

Figure 5: Priority given to paying electricity bills on time  
Source: Survey for UnitingCare Australia, undertaken by The Australia Institute

In the same survey mentioned above, we have asked about the impact of electricity prices doubling over the next five years, given that this has been the reality for a number of people over the last six years.

Figure 6 shows the impact of electricity prices doubling, for the low income band, over three surveys during 2010 and 2011. The predicted impacts increased over the period of the surveys. Of particular concern is that, by September 2011, about a third of households were reporting that continuation of electricity bill increases would reduce visits to doctors and ability to buy medications. Over half of respondents reported that they were cutting back on buying fresh food, and we hear, through our welfare services, stories about ‘two minute noodles’ being all that families are able to afford to eat. Increasing electricity bills are having health impacts, not just because people get too hot or too cold, but because they can’t afford to buy healthy food and because they cut back on doctor visits and medications.



Figure 6: Impact of electricity prices doubling  
Source: Survey for UnitingCare Australia, undertaken by The Australia Institute

Also of concern to us is that the data show about 40% of low income households would cut back on self education and training as a result of rapidly electricity price rises.

In figure 7 we show the impacts of electricity prices doubling for each of the income bands. The impacts for all income bands tracked each other relatively closely. Even moderately high income earners expect to cut back on a number of spending areas with rapid electricity price rises. Note too that the doctor visit reduction and medications decline are higher for the middle income band than the lowest income group. The impacts of large electricity price rises will be felt across the community, not just by poorer people, though poorer families will certainly be hit harder by the effects.

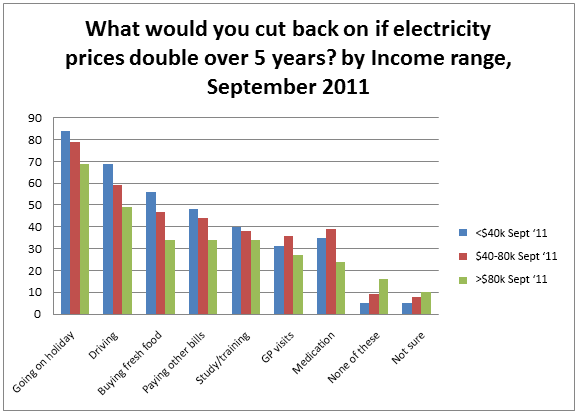


Figure 7: Impact of electricity prices doubling, by income band  
Source: Surveys for Uniting Care Australia, undertaken by The Australia Institute

Our view is that electricity costs are too high for a significant number of people to be able to pay. UnitingCare Australia contends that this places the National Electricity Objective in jeopardy. We contend that a supply is not efficient if low income people can’t afford to pay for this essential service.

## Mike, Zahra, Candice & John and Jarred

The UnitingCare network regularly assists families experiencing energy stress. Here are several examples of cases our network has encountered. Some are from South Australia, others are typical of the situations that UnitingCare agency financial counsellors deal with on a daily basis in South Australia.

**Mike**

Mike is nearing retirement age and works part-time as an after-hours caretaker. Both Mike and his wife are proud of the fact that they have paid off their own home, have modest savings for retirement and have done everything that they can keep their energy and wateruse efficient. “I spent a small fortune on energy efficient light globes when they first became available”, says Mike, “and they have no doubt reduced our energy use a little bit, but the bills keep going up.”

These days, Mike and his wife dread the arrival of their utility bills, both because the bills are more expensive each time no matter how little energy they use, and also because the stress of not being able to pay, on time, is “gut wrenching” for them.

“For the first time in our lives, we had to ask for extensions to pay our electricity bills last year, and now we are having to use some of our limited savings to be able to pay our bills, and this is after we have done everything we can, to be energy efficient” says Mike.

Their most recent gas bill was a modest $80.00, but what frustrates them is that nearly $60 of that was for the supply charge, which Mike does not regarded as fair or reasonable – “we must have bought half the network over the past 40 years” suggests Mike. The most recent electricity bill, after a mild summer in Adelaide, was $397.00, nearly double what it was three years ago, and with lower use.

“We are really worried that we just won't be able to afford to pay energy and water bills once we retire - already we are having to use our savings just keep head above water” says Mike. “I didn’t work all my life to not be able to afford electricity when I retire.”

**Zahra**

Zahra is an Africa-born woman with 5 daughters, the two eldest being at university, and the younger 3 in secondary school. She is very proud of her girls and the opportunities they have in Australia. “They study very hard” she says. Her husband was killed in her homeland, a reason for coming to Australia as a refugee.

“We all share a small house, we all work hard and we get by, but with only my low income and the little the girls can add from casual work, it’s the electricity bills that I dread the most,” she says. “But we use as little as possible. The girls need computers to study, I suppose that is our luxury.”

**Candice & John**

Have recently purchased a house in Sydney’s western suburbs. Having no real knowledge of energy efficient design, the ongoing and increasing energy costs were not taken into consideration at the time of purchase. Once they had moved into the house they discovered that it was extremely hot as there were a number of windows in the living areas exposed to the sun during the afternoon.

The couple purchased and installed a reverse cycle split system believing they were getting something that was efficient to run based on the information the salesperson had given them about the “Energy Star Ratings.” Their electricity bill almost doubled over the first billing period with the air conditioner. At the same time Candice was due to give birth to their first child and had to give up work earlier than expected due to health issues.

With only one wage coming in and having accumulated a large energy bill, the couple are in financial distress.

**Jarred**

Jarred lives in the western suburbs of Melbourne where he had been living with his wife and two daughters both below school age. Until recently, they had been getting by with one full time and one part time wage coming in, however approximately six months ago, Jared’s wife left him and the two children, along with a number of unpaid bills.

With no family support locally, Jarred has had to give up work to look after the children and is struggling to balance the payment of increasing energy costs and overdue bills. He has been unable to afford the cost of running and registering a vehicle and has sold it to collect some money to pay bills.

With limited monies available and limited mobility, the family has tended to remain home more often, resulting in increased energy bills. Energy Efficiency workers have been able to provide information for Jarred on ways to reduce the need for added cooling and reduce their energy consumption in general, but still the bills rise, and the income doesn’t.

These short stories are indicative of the thousands that we hear annually. High energy costs are having real, adverse impacts on the daily lives of too many people.

## Growing numbers of hardship customers

An important aspect of the National Energy Customer Framework (NECF) has been the requirement that all retailers offer an AER-approved hardship program. The number of people gaining access to hardship programs has been increasing substantially, albeit from a low base for some retailers. While UnitingCare Australia welcomes the operation of hardship programs, the demand for them is an indicator of the broader problem of growing numbers of people simply unable to pay for their basic electricity needs.

Of concern is the data in figure 8 which shows that South Australia has the highest proportion in the NEM of residential customers on a retailer hardship program.

Figure 8: Numbers of people in Hardship programs, by jurisdictions  
Source: Australian Energy Regulator, Annual Report on the performance of the retail energy market, 2013-14

## Complaints

The number of complaints about electricity bills, contracts and related issues to Ombudsman schemes and to energy companies has increased during the most recent network regulatory period, as shown in figure 9. The level of complaints has increased for all jurisdictions except ACT and Tasmania, and South Australia has the second highest rate of complaints in the nation (though we understand that there was a small decline in total complaints during 2013/14). Complaints about electricity supply have increased dramatically over the last 5 years.

Growing levels of complaints are an indicator that the current arrangements are not working for consumers. UnitingCare Australia contends that complaints arise from inefficient, disorganised markets, not from efficient, transparent and well-administered ones.



Figure 9: Retail customer complaints  
Source: Australian Energy Regulator, State of the Energy Markets report, 2013

The number of complaints about electricity bills, contracts and related issues, to the SA energy and Water Industry Ombudsman scheme is shown in chart 1.

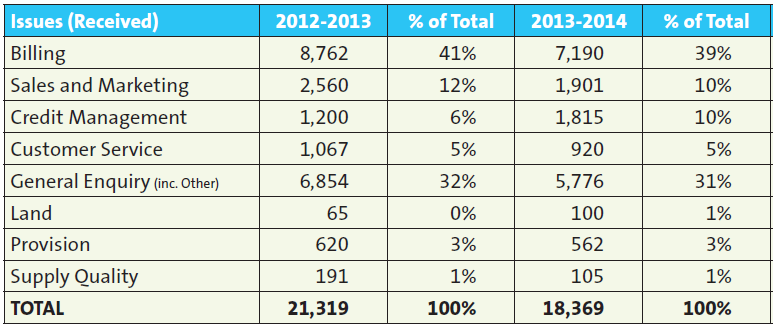


Chart 1 Retail Consumer complaints, electricity, SA  
Source: Energy and Water Ombudsman, SA, Annual Report 2014

## People are using less energy

The trends described in figure 10 are well known to energy companies and regulators. After an extended period of steady increase in annual demand for energy and more recently a more rapid growth in peak demand, demand is falling, in aggregate and at peak levels.



Figure 10: Declining energy use  
Source: Australian Energy Regulator, State of the Energy Markets report, 2013

Factors influencing declining demand include shifts in industry consumption, more consumer awareness and so increased demand management, more energy efficient appliances, the impacts of solar PV installation, higher prices leading to lower consumption, and poorer people being too worried about bills to use the electricity that they need to keep them healthy.

Each of the factors listed above indicate that consumers are leaving or reducing their use of electricity networks, by conscious decision making or by being forced to by disconnection or the threat of disconnection, real or perceived.

# Consumer behaviour and the National Electricity Objective

The behaviour of Australian electricity consumers, now and during the most recent regulatory period, has demonstrated that the market is not meeting their needs. Chart 2 summarises current electricity market performance against the specific measures to which the NEO must have regard.

|  |  |  |
| --- | --- | --- |
| NEO: regard to - | Being met currently? | Evidence |
| Price | No | High prices push the rapid uptake of solar PV as network alternative. |
| Quality | Don’t know | Evidence in this paper does not generally pertain to quality (as distinct from reliability). |
| Safety | No | Health risk to some vulnerable groups due to inability to pay for electricity for heating / cooling in extreme weather conditions. High energy prices leading to poorer health outcomes due to priority in household budget to electricity over healthy food and medical care. |
| Reliability | No | Disconnections due to inability to pay.  Increasing complaints.  Self restriction of use for fear of future bills. |
| Security of supply | No | Disconnections due to inability to pay.  Increasing complaints.  Self restriction of use for fear of future bills. |

Chart 2 Factors to be considered in meeting the NEO  
Source: Compiled by UnitingCare Australia

UnitingCare Australia draws attention to the issues of safety and reliability in our considerations of opex. The emphasis under safety discussions is usually on technical safety and on the likelihood of outages, particularly unplanned outages. However, from a low-to-middle income consumer point of view, the detrimental health effects of high electricity costs or disconnection, and the possibility of unreliability due to disconnection or denial of service, are just as important. UnitingCare Australia asks the AER to ensure that these dimensions of safety and reliability are given as much weight as the more technical ones.

With the high costs of electricity and failure to meet other criteria specified in the National Energy Objective, we conclude that there has not been efficient investment in, or efficient operation of, electricity services in South Australia over recent years, so the long term interests of consumers have not been met.

A market cannot be considered to be efficient if consumers are being forced from it and growing numbers are actively seeking to reduce their dependence upon it.

We now consider the questions from the Issues Paper, in turn.

# CAPEX

*Do you think that SA Power Networks' capital expenditure proposal is adequately justified? page 11(AER Issues Paper)*

The AER discussion paper also asks:

*“We note the scale of SA Power Networks' proposed capex program for the 2015–20 period, representing an increase of more than 50 per cent compared to the current period. At issue is whether this expenditure program is justified given SA Power Networks' forecasts ongoing flat demand.”*



Figure 11 SAPN capex, past regulatory period and proposed  
Source: AER Issues paper, SAPN regulatory proposal, 2014

SAPN has proposed to increase its capex by more than 50% over the next regulatory period, from base year 2013-14. The bid for renewal and replacement capex is dramatically higher than for 2010-15, yet the size of the network is not growing significantly as shown in figure 12 below. From 2006 to now there has been very modest growth in the network length, however capacity utilisation has fallen significantly, see figure 13. This data is indicative of over-capitalisation, and so no need for significant new capital expenditure.



Figure 12 SAPN length and nature of network  
Source: AER Issue paper, SAPN regulatory proposal, 2014



Figure 13 SAPN network capacity utilisation.  
Source: AER Issue paper, SAPN regulatory proposal, 2014

SAPN has claimed that significant increases are needed for replacement expenditure, yet a feature of the SAPN network is the ‘long’ sections of SWER (Single Wire, Earth Return) lines which were developed as a low cost and reliable network component to serve the needs of small rural communities that are some distance from centres with more intensive energy infrastructure. We understand that these are low cost components of the SAPN network do not require the higher maintenance costs per kilometre that are associated with network elements in large cities.

The matter of ageing assets is raised by SAPN in their proposal, but we understand that some assets, eg stobie poles, will have a much longer life, particularly in the generally dry South Australian climate, than a timber pole in a wetter, tropical location. Age of asset alone is not a particularly useful justification for the replacement of a class of assets.

The evidence shows that network growth is minimal, while utilisation is declining and demand is also falling. There is no reasonable justification for significant renewal or replacement expenditure increases, certainly not the 94% increase from 2010-15 expenditure in this category.

The one third of network augmentation for ‘safety’ reasons is not justified; refer to our comments about safety in the next section.

While time and resource constraints limit a more comprehensive analysis of SAPN capex proposals, we wish to raise the Strategic Project relating to replacement of the undersea cable to Kangaroo Island. We agree with the objective of having reliable electricity supply for Kangaroo Island (KI) households and businesses; however we are unconvinced by the evidence base to support the current proposed solution.

There does not appear to be evidence that SAPN have considered the range of options for KI electricity supply, or engaged with the range of KI consumers about options. For example, we note that KI has excellent wind resources and conditions to utilise solar PV, and that SAPN’s proposal does not address the scope for alternatives to undersea connection.

UnitingCare Australia recommends that the network, retailers and the regulator consider using deliberative consumer engagement[[1]](#footnote-2) to work with the KI community to consider the choices, and develop a picture of the community’s views on the issue. A deliberative process would involve people being presented with all sides and aspects of a problem and deliberating to reach a solution. We are convinced that a deliberative process involving KI community and business interests, together with the other stakeholders, would be able to recommend a possible solution.,

## Regulated Asset Base (RAB)

The Regulated Asset base is a significant component in determining the allowed revenue for a network business and the amount that consumers end up paying for electricity. Figure 14 shows SAPN’s RAB over the last 2 regulatory periods and the increase proposed for 2015-20, a 47 per cent increase over the 5 years to 2020 and a near doubling over the decade from 2010.



Figure 14 SAPN RAB, past regulatory periods and proposed  
Source: AER Issue paper, SAPN regulatory proposal 2014

We can find no justification for an increase in the RAB anywhere near the magnitude being proposed by SAPN, during a period of declining demand and at a time when network utilisation is declining.

Of further concern is that increases in the RAB are maintained into future regulatory periods, so consumers keep paying for the current period’s RAB increases well into the future. This is quite contrary to the long term interests for consumers.

## Demand Management

With the augex (augmentation expenditure) proposal up by about a half and repex (replacement expenditure) nearly doubled there is a serious need to consider demand management alternatives. The SAPN augex plans, in particular, have not seriously considered non-network alternatives.

The past 2 revenue allowances for SAPN have provided allowances for Demand Management trials and experiments. SAPN was a leader in exploring direct load control for domestic air conditioning, an initiative that SA based Uniting Communities supported. This proposal does not report on the outcomes of those trials, nor give consumers any advice about lessons that SAPN has learnt from spending customer money on these trials.

The failure of SAPN to actively explore demand management alternatives to their capex bid is very disappointing and an omission that we expect the AER to consider very closely when looking at the SAPN capex proposal and the substantial increases.

The question that this section has considered is:

Do you think that SA Power Networks' capital expenditure proposal is adequately justified?

Our answer is “No” and we urge the AER to reject the massive capex bid and associated RAB expansion that SAPN has proposed for 2015-20. The SAPN capex bid allowances should be in line with linear extrapolation of 2005-10 capex allowances and give much greater attention to alternatives to capital intensive solutions for network augmentation, replacement and expansion.

# Opex

*Is SA Power Networks' operating expenditure proposal adequately justified? Page 17*

SAPN has proposed an increase of about 33% over the next 5 years, which we say is excessive.

## Safety

A broad theme that runs throughout the SAPN proposal is that of “safety.” The whole of chapter 11 of the SAPN proposal is dedicated to “safety”. By way of example, SAPN state: *“Safety of the community is of paramount importance to SA Power Networks. We are committed to achieving the highest standards of safety for all our customers, employees and contractors, and the community.”* UnitingCare Australia agrees that safety is vital, however this ‘commitment to safety’ is used to justify considerable expenditure in OPEX (and CAPEX) components of the proposal that we consider to be too high for many consumers.

There is no argument about the importance of safety and no one is going to argue the merits of ‘less safety’. However, the claims and budgets related to ‘safety’ made by SAPN need close scrutiny. We suggest that there are a number of aspects of safety performance that are not explained, or considered by the SAPN proposal:

1. Safety of customers who cannot afford higher prices
2. Whether more spending actually improves safety?
3. Who else has relevant safety responsibilities?
4. Alternative, lower cost safety strategies.

## Safety of customers who cannot afford higher prices

We observe that SAPN in considering safety fails to consider the safety impacts on consumers of rising energy costs. Uniting Care agencies, along with community service organisations more broadly, have been confronted with the reality over recent summers that on very hot days we need to make public comments to urge low income and disadvantaged people to use air conditioning, where this is available, to maintain a degree of personal safety. Many households, particularly aged pensioners are extremely reticent to use air conditioning because of the electricity costs and fear of unpayable bills as a consequence.

The following graphic represents a perspective from low income customers who respond to rising energy costs by using candles and relatively unsafe options for lighting; options that provide greater risk of house fires. This graphic was produced as part of a project that asked low and average income energy consumers to respond to the question of impacts on them and their households of rising electricity costs (see Appendix 1 for details). This photo is one from that exhibition and reinforces the safety risk to consumers of rising energy costs. 

Photo 1; Source: Uniting Communities, Uni SA and SACOSS PhotoVoice exhibition

We do not consider that SAPN has considered the safety of its customers, and particularly lower income customers, who are forced to use less safe lighting and heating options in the face of escalating electricity prices. It is crucial that considerations of safety balance safety standards, responsibilities of network companies and safety of end consumers in coming up with budgets for expenditure on safety related matters. Striking this balance is the responsibility of the regulator, and we urge the AER to consider safety impacts for lower energy consumers along with the safety considerations that SAPN has proposed in its regulatory proposal.

We also note that SAPN has successfully operated for many years under established State and National safety provisions. We do not believe there is any substantial risk that they will change, to operate at below accepted safety standards and practice, if the cost increases that are claimed to be ‘safety related’ are not approved.

## Does more spending actually improve safety?

While the SAPN proposal has argued for increased expenditure across the business on ‘safety’, the unproved assumption is that more spending will improve safety.

Scant attention is given to better management practices that could also improve safety, SAPN says that the safety of their staff (and contractors) is a priority, and we do not doubt this. What is less evident is proof that SAPN management regularly engage with staff (and contractors) seeking advice about approaches that can improve safety. We refer a little later to the application of the International Association of Public Participation (IAP2) spectrum for consumer engagement, which starts with “Inform” approaches at the least engaged level of the spectrum, while approaches that “empower” are at the most engaged end of the spectrum. The exact same spectrum of engagement could be applied to engaging with staff and contractors, regarding safety. We read little evidence of such ‘safety first’ strategies being applied or proposed by SAPN.

There are other approaches to improving safety performance without simply increasing expenditure; the increased expenditure proposed may do little to actually improve safety.

## Who else has relevant safety responsibilities?

The SAPN regulatory proposal raises a number of areas where they argue, they should increase safety related spending. These include reducing bushfire risk and moving stobie poles on roads with higher levels of vehicle accidents.

In these situations, there are also other agencies with responsibilities in these areas, yet we are not made aware of their roles and how SAPN works with them. For example, regarding bushfire management, South Australians pay an emergency service levy, which has risen quite substantially this year. The emergency services, particularly the Country Fire Services, local government and residents in bushfire prone areas all have responsibilities to reduce bush fire risk; the dedicated emergency services levy supports some of these costs.

With regard to stobie poles located near roads with higher rates of vehicle accidents, there is a national ‘black spots’ funding program from government to make these locations safer.

We do not consider that the SAPN proposal adequately recognises other agencies and their budgets, with safety responsibilities in areas where they are proposing increased safety related expenditure. The SAPN regulatory proposal has failed to discuss their role in public safety in concert with other agencies with safety responsibilities.

## Alternative, lower cost safety strategies

SAPN has not adequately considered alternative lower cost options to stobie pole relocation. These could include increased signage or ‘traffic calming’ options including speed humps, ‘rumble strips’ or slow points. Each of these options could also have road safety benefits beyond those achieved only by power line realignment, and might be delivered at lower cost. We do not see much evidence that SAPN have consulted with traffic engineers, transport authorities or communities with a view to considering the range of options (and shared payment responsibilities) that could be applied to improve road safety.

The SAPN proposals for increased ‘safety’ related expenditure have not adequately considered the safety impacts for consumers seeking less safe energy options due to rising electricity costs. SAPN has not adequately considered lower cost options, nor have they actively engaged with other agencies with shared or related public safety responsibilities. We urge the AER to very closely review all expenditure claims linked to increased safety, against these concerns. Consumers will also need to be convinced that any increases spending on safety, will significantly improve safety outcomes.

## Other OPEX considerations

As with capex proposals, SAPN has proposed a considerable increase in opex expenditure compared with previous regulatory periods: 33% increase for the coming regulatory period. The opex proposal and past opex experience is shown in figure 15.



Figure 15 Opex spending comparisons, over time  
Source: AER Issue paper

It is difficult to comprehend why SAPN has bid for such substantial increases in both capex and opex while demand is falling. A dramatic increase in capex would be expected to be at least partially offset by a decline in opex since the marginal productivity of capital is normally regarded to be a substitute for the marginal productivity of labour, a key element of opex. Stable or declining demand should generally result in stable or declining opex.

We consider some of the elements given by SAPN for opex growth:

* Labour cost escalation. The SA labour market is characterised by higher than national rates of unemployment, extremely high levels of underemployment (employed part time, wanting more hours), a persistently lower than national rate for participation in the labour market, due in part to significant numbers of discouraged job seekers and the minimum wage, as determined by Fair Work Australia barely keeps up with the CPI, currently below 3%. These settings for the labour market would suggest that wages growth is going to be modest in nominal terms and flat or declining in real terms, yet SAPN proposes an increase to labour costs of $57.1million (in 2014-15 dollars). SAPN is effectively saying that many SA consumers who are experiencing declining or steady real incomes should by paying more in their electricity bills so that SAPN can pay significant increases to their staff. We consider this proposition to be unreasonable.

This increase in labour costs is completely inconsistent with prevailing labour market conditions in SA and the level of proposed increase unacceptable.

* Output Growth. The increase claimed, in 2014-15 dollars for the 2015-20 period is $46.7 million, when demand is falling or at best steady while network capacity utilisation is falling. There is no justification for the increased opex claimed for ‘output growth’.
* IT and telecommunications. We accept the importance of effective IT systems, which should be about increasing network efficiency and business productivity. In short, there should be a much greater return to consumers from any substantial increase in IT and telecommunications spending.
* Asset Inspections. We do not accept the magnitude of this increase
* Demand Side Participation. It is frustrating that the main mention of “Demand Management” in this proposal is with regard to metering and new charging arrangements, without much apparently coming back to consumers. Demand side participation should be about more efficient alternatives to high cost capex and opex options. To label new charging arrangements for customers as demand management misses the point completely. If new charging arrangements are to be introduced, they should only be introduced if they lower costs for consumers, they should not be a reason to be increasing charges to households and small business.
* Vegetation Management. The claim for an additional $31.9 million for vegetation management on top of the significant increased for the 2010-15 period is excessive.

We regard the opex increases proposed by SAPN to be an unsubstantiated ambit claim that fails to address the best interests of consumers.

# Rate of Return

*Do you consider any departures from the Rate of Return Guideline are justified? Page 24*

The key rate of return parameters proposed by SAPN are given in chart 3.

|  |  |
| --- | --- |
| Overall WACC | 7.62 |
| Return on equity | 10.45 |
| Return on debt | 5.74 |
| Gearing | 60 per cent |
| Value of imputation credits | 0.25 |

Chart 3SA Power Networks' proposed rate of return.

Source: SA Power Networks, Regulatory proposal, p. 342.

These proposals from the SAPN regulatory proposal for 2015-20 need to be put in context, and that context is that this regulatory proposal is lodged in a very different economic climate to that which existed in 2008-10 when the previous regulatory proposal was being developed. At that time, the Global Financial Crisis was at the forefront of thinking with expectations of high interest rates on global capital markets for the foreseeable future. Energy network businesses are capital intensive and borrow on global capital markets.

Figure 16 shows official interest rates for the G3 from 2004. Two realities emerge with regard to SAPN. The first is that interest rates fell much more quickly following the GFC than was expected. As a result, for the past regulatory period, SAPN has had capital raising allowances from the regulator much greater than the actual costs that new capital raisings would have been experiencing. Meanwhile, the electricity bills paid by consumers have risen sharply. SAPN will have been able to benefit from the interest rate arbitrage that they have enjoyed.

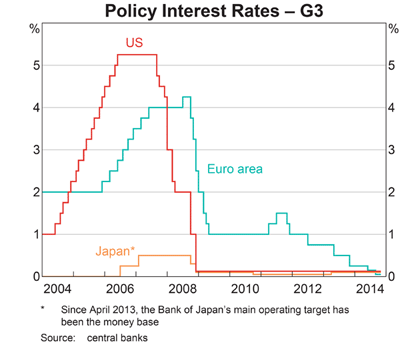
[](http://www.rba.gov.au/chart-pack/interest-rates.html)

Figure 16. Official interest rates, G3, over time  
Source: Reserve Bank of Australia, slide pack

The second reality of global interest rates is that they are now very low, and expected to remain low. The risk free rate for example has plummeted since the period immediately after the GFC. This new financial reality must be reflected in the AER’s determination for 2015-20.

The regulatory period 2010-15 must be regarded as ‘exceptional circumstances’, with the more useful reference point for 2015-20 regulation being the period up to 2010, with modest projection of costs for the business from this period as the basis for 2015-20.

Despite this low cost of capital environment, SAPN have proposed a WACC, net of risk free rate, higher than the WACC that applies to the current regulatory period. This is shown in figure 4.



Chart 4 WACC comparisons, current period and proposed  
Source: Consumer Challenge Panel, Presentation to AER forum, 10th December

Chart 5 tabulates three rate of return parameters for the most recent UK distribution determinations, the AER’s draft determination for NSW and the SAPN proposal. All SAPN proposed parameter are dramatically higher than for the UK, where distribution businesses seek capital on the same global capital markets as SAPN. WACC and cost of equity proposals from SAPN are higher than the draft NSW determination while the nominal debt proposal from SAPN is lower than the NSW draft determination, but still 220 basis points higher than for the UK. We therefore believe that SAPN proposals are too high.



Chart 5 WACC comparisons, current period and proposed  
Source: Consumer Challenge Panel, Presentation to AER forum, 10th December

## Rate of return – 2015-20 regulatory proposal

The DNSP proposals, in particular for the key parameters Weighted Average Cost of Capital (WACC) and equity beta (β), are proposal aspects where we believe the AER should reach a conclusion different to that set out by the networks. All four DNSPs have proposed WACC and β parameters that are beyond levels set out in the 2013 AER Rate of Return guidelines. Their rate of return proposals suggest risk levels at or beyond those that applied at the height of the Global Financial Crisis. They do not reflect current capital markets. Australian regulated electricity network businesses are low risk businesses, and global capital markets are actively seeking to invest in such businesses at rates of return to investors much lower than at GFC levels.

During recent discussions about the rate of return, a number of models were considered, and UnitingCare Australia understood that there was agreement that the Sharp-Lintner CAPM would be the base model. This is widely used in regulatory processes around the world, it is able to be applied and there is experience in using this approach. We do not believe that there has been sufficient new and persuasive evidence of circumstances that warrant change from the guideline position.

The Sharpe-Lintner capital asset pricing model (CAPM) states that the expected rate of return on an investment is determined by the risk free interest rate (RFR) and a risk premium, which is the product of beta, (a measure of sensitivity of expected excess returns on an asset compared with the expected excess returns for the market) and the market risk premium (MRP):

Sharpe-Lintner CAPM: Expected return = RFR + β \* MRP

In applying the Sharpe-Lintner CAPM to the 2014-19 regulatory proposals UnitingCare Australia recommends that the AER apply the guideline in determining the risk free rate, using the most recent data available at the time that the AER Board is finalising its draft determination.

## Market Risk Premium (MRP)

We recognise that market risk can be determined less precisely than the risk free rate, so ranges for risk related parameters are determined and a point estimate chosen within the range. In the guidelines, an MRP range of 5.3 – 7.5% is specified, with values in the range all giving investors an adequate through to generous return.

The possible values for the MRP lie on a continuum. Low figures produce lower prices that are in the interests of consumers, while figures at the higher end of the range reflect primarily the interests of investors and owners of the network businesses.

We have argued that the best interests of consumers are not currently being served by high prices for consumers and high returns for DNSP owners. The application of the NEO by the AER must give priority to the long-term interests of consumers. In selecting a point estimate for the MRP we believe that the AER should choose a value at the bottom of the range specified in the guidelines.

## Equity Beta (β)

As with MRP, we recognise that there is no precisely correct value for β, and that a point estimate is chosen by the regulator from within a range. The 2013 guidelines recommended a range for β of 0.4 – 0.7. We are disappointed that the DNSPs are proposing a β of over 0.8, outside the guideline.

Subsequent to the rate of return guidelines being published, a report commissioned by the AER has been released, undertaken by Olan Henry from the University of Liverpool.[[2]](#footnote-3) Henry’s work served both to respond to some of the debate around the issue of assessing β,[[3]](#footnote-4) to test the robustness and optimal approach to determining β, and to provide some indication of where an appropriate value might lie. Henry argued that the approaches to analysis that produced the most reliable results used the longest available data series, tested at weekly intervals, and considered the market data using either equal weighting or value weighting of the portfolio (tables 2, 14 and 16) (p. 63). A majority of Henry’s estimates were in the range 0.3 - 0.5, and the medians in the tables that he identified as providing the most robust results lay between 0.4 and 0.5.

As with MRP, we believe that the range in values for β lie on a continuum between low figures that serve the best interests of consumers, and higher figures that will serve the best interests of investors and owners, but that will come at the expense of affordability. Again, we recommend that the AER act in the best interests of consumers and select at the lower end of the range, 0.4. Such a choice would be consistent with relatively low risk businesses in a relatively benign capital market, which is the current situation.

## WACC and RAB

For the reasons outlined above, UnitingCare Australia is opposed to the high values of WACC that are proposed by the network businesses. We believe that they are inconsistent with current global capital markets and contrary to the best interests of consumers. The proposed WACC values are too high and apply to regulated asset bases (RAB) that have grown substantially over the course of the most recent regulatory period.

UnitingCare Australia believes that this determination presents an opportunity to benchmark network expenditure, domestically and internationally. It is anticipated that the AER will find that current RAB values are too high and will adjust accordingly. We also expect that the AER will lower the WACC, to be more in keeping with the rate of return levels proposed above.

## Departure from Guidelines

UnitingCare Australia was actively involved in the AER’s “Better Regulation” program undertaken throughout 2013. We are well aware of the extensive and inclusive processes that were undertaken to consider and develop the various guidelines, including the rate of return guidelines. This process actively involved network businesses, who were heavily involved in each stage in the development of the guidelines.

We remain convinced that all of the guidelines, including the rate of return guideline were rigorously developed, with extensive network business involvement. We cannot identify any reason for departure from the rate of return guideline, particularly within a year of its finalisation. We strongly encourage the AER to adhere to application of the rate of return guideline in considering the SA regulatory proposal.

# Consumer Engagement

*Do you consider SA Power Networks has adopted our consumer engagement guideline to build genuine consumer engagement across all business activities? Page 29*

*Do you consider that SA Power networks’ proposals reflect the engagement it had with you and the issues you raised? If SA Power networks did not agree with consumer views, did they explain why?*

*Did SA Power Networks provide you with options and scenarios for service and price trade-offs?*

UnitingCare Australia has a strong interest in approaches to and application of consumer engagement. We were amongst the first to provide input into the AER’s 2013 process to develop guidelines for Consumer Engagement. We repeat comments we made in a submission to the Better Regulation consumer engagement process:

1. In seeking to better understand “consumer engagement” we consider a selection of concepts, from different disciplines, that we suggest all inform the current use of the term “consumer engagement”.
2. Community Engagement (From Community Work)
3. Most Uniting Care agencies apply “community engagement” principles to their work, and for this paper, we consider the term “community development” to mean the same thing as “community engagement”(recognising that this is somewhat controversial for some practitioners). We understand communities to be groups of consumers, so the concept is not so different from “consumer engagement”.
4. The Canadian Tamarack Centre for Community Engagement[[4]](#footnote-5) is recognised as a leader in developing and documenting “Community Engagement” practice; they define the term:
5. *Community engagement is “people working collaboratively, through inspired action and learning, to create and realize bold visions for their common future.” (Tamarack, 2003)*
6. While the Queensland government has been using the following definition for a decade
7. *“Community engagement refers to arrangements for citizens and communities to participate in the processes used to make good policy and to deliver on programs and services.”*
8. Sovereign Consumer (from Economics)
9. Consumer Sovereignty
10. It is the idea that consumers influence the production decisions of (efficient) firms by voting with their spending, the idea that ‘the consumer is king’ and so makes the decisions for the market, which then competes to deliver what the consumer wants at the best cost and quality.
11. So consumer engagement here means that individual consumers know what they want, are fully informed about market choices, and are able to get what they want by actively engaging in the market through their spending decisions.
12. Public Participation (from Urban Planning)
13. The International Association of Public Participation (IAP2) defines Public Participation as:
14. *“public participation is a process to make better decisions that incorporate the interests and concerns of all affected stakeholders and meet the needs of the decision-making body.”*

Consumer engagement is a dynamic and interactive process, with interested parties working together to seek solutions. We recognise that consumer engagement can mean different things to different people and that invariably there is no single ‘right’ way to conduct consumer engagement.

We make these comments as a basis for considering the engagement that has been undertaken by SAPN as well as by other network businesses.

We are encouraged that the DNSPs are making efforts to engage with consumers, and we recognise the methodological validity of approaches that they have taken. This engagement has been one aspect of a broad range of consumer input that SAPN have received, from various sources.

UnitingCare Australia believes there needs to be greater depth to utilities’ consumer engagement. SAPN have stated that they are committed to the IAP2 public participation spectrum, but have also said that the spectrum level of consumer “empowerment” is not possible for energy issues, in part because this is against the rules. UnitingCare Australia believes this is not correct, and that there is scope for consumer empowerment in energy regulation and pricing. There are unrealised opportunities for network businesses to participate in more effective consumer engagement.

SAPN has used a fairly narrow range of consumer engagement processes, some of which represent market research rather than consumer engagement.

UnitingCare Australia is concerned that there was little engagement with consumers on any of the major elements of return to businesses, including rate of return methodology, RAB values, WACC, and parameters β and γ. Yet these are the areas where consumers are most impacted by the bills that they end up paying. These aspects of the regulatory proposal have substantial impacts on network charges, yet to the best of our knowledge were not discussed in forums with consumers.

A third concern that we have is that SAPN can make use of consumer information and voices other than those specifically undertaken for the company itself. There is substantial other consumer input that SAPN could recognise and consider. These could include the approximately 10,000 consumers who were disconnected from supply, the over 18,000 who made formal complaints, mainly about costs of their bills, the large numbers of consumers who are having payment difficulties and the increasing number of customers going onto retailer hardship programs. These customer voices were not recognised by SAPN, yet we expect that very few of these customers would support increased levels of SAPN spending.

A fourth concern is the lack of any evidence to indicate that lower cost alternatives have been explored with consumers, particularly in respect of the substantial proposed capex and opex increases.

Our main concern with the SAPN consumer engagement is that we cannot see how they have concluded that consumers will support a capex increase of over 50% and an opex increase of over 33% over the 2015-20 regulatory period, with minimal evidence to link consumer preferences to the quantum of the cost of their bid.

As we said in our submission to the Better Regulation consumer engagement guideline, we are committed to developing appropriate and effective approaches to consumer engagement related to energy regulation. We welcome the opportunity to cooperate with energy network businesses to advance their consumer engagement techniques.

# Building Blocks

*“How should we balance the interrelationships between building block components when making our decision on SA Power Networks' proposal?”*

Revenue

Actual revenue and associated profits, we suggest, is a useful ‘reasonableness test’ that can be applied to regulated monopolies to test reasonableness of outcome against consumer sentiment.

Figure 17 shows that SAPN revenue jumped considerably during 2011-15, compared to the previous regulatory period, a curious situation given that actual demand was falling for much of this period. The data also shows that SAPN’s actual revenue exceeded allowed revenue over the period, so consumers have overpaid for network costs in SA.

Of concern is that revenue sought for 2015-20 is even higher than the over allowance revenue for 2010-15.



Figure 17. SAPN Revenue  
Source: Consumer Challenge Panel, AER forum, 10th December 2014

In 2012 the regulated business of UK Power Networks, which is majority owned by SAPN co-owners CKI, achieved profit before interest and taxes (PBIT) of £711m for delivering electricity to around 8 million connections, giving a PBIT per connection of $161 per connection, adjusted to Australian dollars. In 2012/13 SAPNs’ distribution business achieved PBIT of $595m for delivering electricity to 838 000 connections, resulting in a PBIT margin of $710 per connection.

After adjustment for financing costs, SAPN’s regulated distribution business still seems to deliver a pre-tax profit, per connection, about 4 times higher than for its UK cousin.

These results suggest to us that applying a ‘reasonableness test’ to SAPN revenue and profit levels leads to the conclusion that consumers have paid too much SAPN services. This needs to be taken into account for the 2015-20 regulatory determination. Our view is that the step in end costs for consumers for this next regulatory period must be a step down in SAPN revenue and a reduction in costs for consumers.

# Summary

This submission deals with higher order issues arising from the 2014-19 regulatory proposals for SA Power Networks. We have focussed our consideration on the question of whether the NEO is currently being met. We argue that it is not, largely because very large price increases for consumers over the most recent regulatory period have lead to a range of actions and behaviours that have seen significant numbers of consumers leaving the networks, or reducing their use of them, either forced by disconnection or hardship or by choice through the rapid uptake of PV installation. We have shown that high and continuing high prices are continuing to have real and adverse impacts on large numbers of low and modest income households. This shows that the efficiency objective of the NEO is not being met and consequently that high prices have lead to the best interests of consumers not being met.

We also contend strongly that there is no justification for an increase in capex, and certainly not of the order of a 50% increase over the regulatory period. Similarly we do not accept that there is a need for operating costs to increase, and certainly not by 33%.

Attention has also been given to the rate of return and we observe that the WACC proposals from the distribution businesses are too high. We recommend application of the rate of return guideline from 2013, using the Sharp-Lintner CAPM model and adopting Market Risk Premium and β point estimates that reflect the best interests of consumers.

The regulator and SAPN need to understand that ongoing price increases for this essential service are contributing to growing levels of financial stress. A very profitable business needs to be cognisant of this reality for the communities in which it works and to adjust its action accordingly. Network prices in SA must come down significantly.

# Appendix 1

UnitingCare Australia is particularly interested in and committed to processes that best engage with consumers in determining their experience and what they regard as being in their best interest.

The PhotoVoice process simply loans a digital camera for a couple of weeks to a range of people who are asked to respond to a question of interest, with photos, from their life experience. During 2014, Uniting Communities, a South Australian member of the UnitingCare Australia network, lead a PhotoVoice project with Dr Janine Pierce from the University of SA and SACOSS. Twelve people from different income and employment experiences, including a couple of financial counselling clients as well as full time employed people, were asked to answer the question of the impact on rising electricity prices on them. The photos were collated into an exhibition that was staged in the SA Public Library during December 2014 and into January 2015. The process is empowering since the consumer, the person with the camera, is not required to be seen or to speak; they can present their experience anonymously if they wish, while their photos are real to their experience.

UnitingCare Australia has found that this process is a valuable way of engaging with a diversity of people, without intruding on their lives, beyond what they are comfortable with. It is a process that warrants wider application.

1. Our paper on deliberative processes is available at [http://www.unitingcare.org.au/images/stories/publications/2014/140912\_pub\_dis\_deliberative\_democracy \_discussion\_paper.pdf](http://www.unitingcare.org.au/images/stories/publications/2014/140912_pub_dis_deliberative_democracy%20_discussion_paper.pdf) [↑](#footnote-ref-2)
2. Olan Henry; [Estimating β: An update](http://www.aer.gov.au/sites/default/files/D14%2052760%20%20Estimating%20Beta_%20An%20update%20Olan%20T%20Henry%20April%202014.pdf), April 2014. [↑](#footnote-ref-3)
3. In particular, Competition Economists Group, [AER equity beta issues paper: international comparators](https://www.aer.gov.au/sites/default/files/ActewAGL%20-%20E8%20CEG%20-%20Equity%20beta%20-%20International%20comparators%20-%2028%20October%202013.pdf), October 2013. [↑](#footnote-ref-4)
4. http://tamarackcommunity.ca/ [↑](#footnote-ref-5)