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15th June 2016

Re: Submission to the Australian Competition Tribunal Consumer Consultation - South Australian Limited Merits Review

The Consumer Utilities Advocacy Centre (CUAC) is a specialist consumer organisation established in 2002 to represent Victorian energy and water consumers in policy and regulatory processes. As Australia's only consumer organisation focused specifically on the energy and water sectors, CUAC has developed an in-depth knowledge of the interests, experiences and needs of energy and water consumers.

While CUAC does not represent any consumers served by the South Australian Power Network (SAPN), the Tribunal's decision in this case is likely to set a precedent for distribution businesses in other jurisdictions, such as Victoria. CUAC has been actively involved in the Electricity Distribution Price Reset in Victoria, providing submissions both directly to the AER directly and as part of the Victorian Energy Consumer and User Alliance (VECUA).[1] Should the Tribunal find in SAPN's favour, this precedent may lead Victorian distribution businesses to embark on a Limited Merits Review for these same issues, with the possible outcome of higher distribution prices for Victorian consumers. It is therefore of material importance to Victorian consumers, and therefore to CUAC. In this submission, CUAC will outline a number of select issues raised by SAPN that have relevance to the Victorian distribution businesses.

The National Electricity 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 - **price**, quality, safety, reliability and security of supply of electricity…"[2]

CUAC would ask the Tribunal to consider that the price of electricity remains of primary concern for consumers, particularly given the lengthy revenue reset periods. Price pressures continue to be evident, for example:

- The most recent CHOICE Consumer Pulse survey data indicates an overwhelming majority of consumers (77%) view electricity prices as their number one cost concern.[3]
- According to the latest AER Performance of the Retail Energy Market report, "South Australia has a higher proportion of customers with [an electricity] debt than the other jurisdictions".[4]

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[1] Consumer Utilities Advocacy Centre, *AER Review of Victorian DNSPs' 2016–20 EDPR Revenue Proposals – submission,* 13 July 2015.; Victorian Energy Consumers and Users Alliance, *Submission to the AER: AER Preliminary2016-20 Revenue Determinations for the Victorian DNSPs,* 6 January 2016.

[2] As set out in the National Electricity Law, section 7

[3] Choice, *What do consumers need from the 2016 election?*, 2016. Available online at: https://www.choice.com.au/money/budget/consumer-pulse/articles/what-do-consumers-need-from-the-2016-election#fullpulse

[4]Australian Energy Retailer, *Annual Report on the Performance of the Retail Energy Market 2014-2015*, p. 3.

- The most recent Essential Services Commission Comparative Performance Report indicates that the disconnection rate of residential electricity customers in Victoria for not-payment remain at the near historic high of 2013-2014, with 34,418 residential customers disconnected in 2014-15.[5]

Gamma

CUAC supports the AER's decision in both the South Australian and Victorian EDPR determinations that the appropriate value for gamma is 0.4. In its application for Limited Merits Review, SAPN has argued that the appropriate value for gamma is 0.25, while the Victorian distributors have proposed the same value for gamma in their final proposals. The Standing Council on Energy and Resources statement of policy intent outlines that:

> "the long-term interests of consumers should be the **sole criterion** for determining the preferable decision, both at the initial decision-making stage and at merits review".[6]

The proposed value for gamma – as put forward by both SAPN and the Victorian distribution businesses - relies on a single methodology that produces statistically unstable results because it is highly sensitive to underlying assumptions.[7] CUAC would urge the Tribunal to consider whether it is in the best interests of consumers for the regulator to rely on this single measure and methodology, rather than considering a wider range of evidence drawn from different methodologies to produce a more robust value for gamma, as has been done by the AER in their guideline paper.

According to SAPN's own estimates, adopting SAPN's proposed value of gamma would cost $85.2 million over the 2015-2020 period.[8] CUAC would urge the Tribunal to consider that the changes to the National Electricity Law and National Gas Law were to:

> **"[ensure] consumers do not pay more than necessary** for the quality, safety, reliability and security of supply of electricity and natural gas under the national energy laws."[9]

The additional cost of $85.2 million over the 2015-2020 period will be passed through and borne entirely by consumers. It is difficult to see how this cost increase is in the interests of consumers.

Trailing Average

In its final South Australian decision, the AER rejected SAPN's proposed Hybrid Transition from an "on the day" approach to a trailing average approach to calculating the return on debt. Likewise, the AER rejected the Victorian distributors initial proposed Hybrid Transition, and the distribution businesses' subsequent proposal of an immediate transition to a trailing average, with the majority of service providers offering a second preferences a hybrid transition. CUAC supports the AER's decision that in both states, it is more appropriate to take a gradual transition, rather than adopting a methodology that potentially violates the zero net present value condition, particularly if this results in a wealth transfer from consumers to the networks.

There is little dispute that a 10 year trailing average has benefits to both consumers and distribution businesses. It will enable distribution businesses to smooth their costs over 10 years and in doing so, reduces the propensity for bill shocks to consumers. However, CUAC would urge the Tribunal to

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[5] Essential Services Commission, *Comparative Performance Report 2014-15 – Customer Service*, 5 May 2016, p. 40.
[6]Standing Council on Energy and Resources, *Regulation impact statement: Limited Merits Review of Decision- Making in the Electricity and Gas Regulatory Frameworks,* 6 June 2013, p. 10.
[7] Australian Energy Regulator, *Final Decision SA Power Networks determination 2015-2020: Attachment 4 - Value of imputation credit*, 29 October 2015, p. 204-30.
[8] South Australian Power Networks, *Amended Application for Leave and Application for Review by the Australian Competition Tribunal,* 11 May 2016, p. 63.
[9] Parliament of South Australia, *Statues Amendment (National Electricity and Gas Laws – Limited Merits Review) Bill – Second Reading*, 26 September 2013, p. 7172.

consider whether a Hybrid Transition or immediate transition to a trailing average is in the long term interests of consumers, particularly with regard to price. During the global financial crisis, distribution businesses were provided a return on debt that was commensurate with the then current market risk due to the "on the day" approach. By adopting the return on debt variables from these years into the trailing average, distribution businesses would receive "windfall gains", a by-product of altering the methodology rather than a service provider's efficient decision making.[10] As the AER has pointed out, this would reflect bias in the regulatory decision making, as it chooses an approach that uses historical data after the result of that data are already known.[11] Given the Tribunal is required to:

> "demonstrate that [it's decision] provides, compared to the original decision, a materially preferable outcome in the long term interests of consumers as set out in the NEO and NGO",[12]

CUAC would ask the Tribunal to consider whether providing networks with windfall gains based on chance and timing rather than networks own efficient pricing considerations meets the objectives of the NEO.

Opex – Forecast labour price growth

In both South Australian and Victorian determinations, the AER did not accept the networks' proposed opex increases due to labour price growth, and has developed its own labour price growth forecast instead. The AER's decision on labour price growth is lower than both SAPN's proposed labour price growth and the Victorian distribution businesses proposed labour price growth.

It is questionable whether any increases in real labour price growth are appropriate - and in the long term interests of consumers - without a corresponding increase in productivity growth. As stated by in the VECUA submission, "productivity and labour price increases are inextricably linked".[13] This is particularly pertinent given that the AER has accepted the networks in both states have proposed zero productivity growth (with the exception of Jemena in Victoria), despite the significant capital expenditure over the previous period. CUAC notes that SAPN proposed that the AER adopt negative productivity growth forecasts in its alternative estimate of opex.

The networks in both South Australia and Victoria have relied upon the Enterprise Bargaining Agreements for near term forecasts and to forecast future trends in their EBAs. As argued by the AER's Consumer Challenge Panel 3, "businesses are free to establish whatever EBA they believe is appropriate".[14] However, these costs should not simply be passed through to consumers. Instead they should reflect "pressure for improved productivity if wage increases are above the norm so the total wage bill (including contract labour) remains within the AER's forecast. This is no different from the wage negotiations occurring in competitive businesses where salary increases above CPI are offset by agreed productivity improvements".[15] To do otherwise would reward stagnant productivity and provides no incentive for increased efficiency at a higher cost to consumers.

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[10]Australian Energy Regulator, *Final Decision SA Power Networks determination 2015–20: Attachment 3 – Rate of return*, 29 October 2015, p. 3-166.
[11] ibid.
[12] Standing Council on Energy and Resources, *Regulation impact statement: Limited Merits Review of Decision- Making in the Electricity and Gas Regulatory Frameworks,* 6 June 2013.
[13] VECUA, *Submission to the AER*, 2016, p. 64.
[14] Consumer Challenge Panel 3, *Submission to the AER: An Overview — Response to AER Preliminary Decisions and revised proposals from Victorian electricity DNSPs for a revenue reset for the 2016– 2020 regulatory period*, 22 February 2016, p. 21.
[15] ibid.