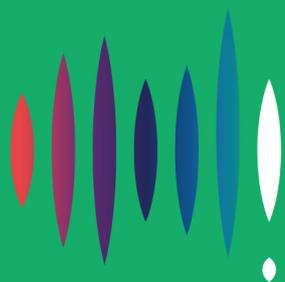
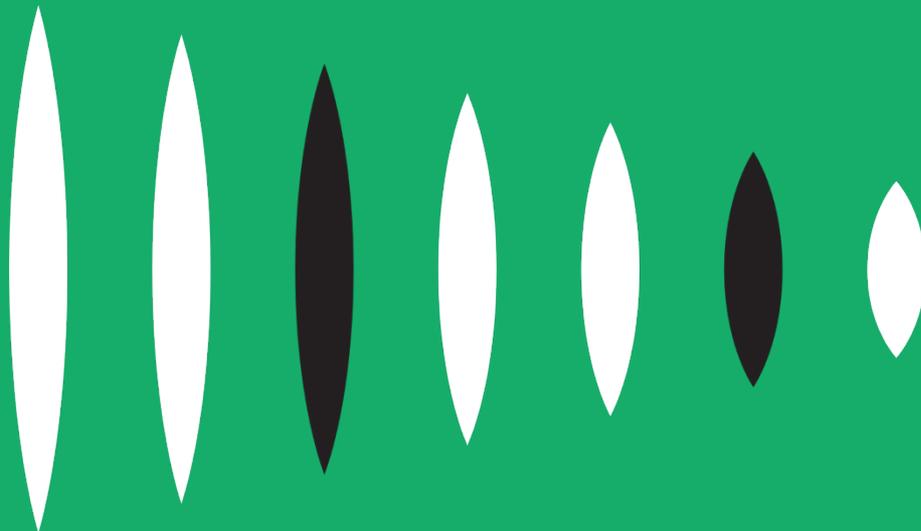


**AER Issues Paper:
QLD electricity distribution
determinations
Energex and Ergon Energy
2020 to 2025**

Submission
June 2019



**ENERGY
CONSUMERS
AUSTRALIA**

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Summary

Improving energy affordability through contemporary risk management practices and achieving further efficiencies to reduce network costs is a priority for energy consumers in Queensland.

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments Energy Council in 2015, our objective is to promote the long-term interests of energy consumers with respect to price, quality, reliability, safety and security of supply.

We appreciate the opportunity to respond to the Australian Energy Regulator (AER) on its *Issues Paper: QLD electricity distribution determinations – Energex and Ergon Energy 2020-2025*. In our response, we will comment on matters raised in the AER Issues Paper, as well as matters from Energy Queensland's Energex and Ergon Energy regulatory proposals (the Proposals). At this point we note that there is no Tariff Structure Statement (TSS) lodged with the AER (following the withdrawal of the previous TSS submitted in January 2019). We are conscious that the proposals have been developed at the same time as Energy Queensland has been settling its new organisational structure.

Affordability is a priority for households and small businesses and is Energy Consumers Australia's focus in applying the long-term interests of consumers test when reviewing network revenue proposals. Energex and Ergon Energy estimate that average household bills will fall by 8.3 per cent and 7.4 per cent respectively in the first year (2020-21) of the next regulatory period.

These price reductions in the first year would provide welcome relief for consumers. However, in the final four years of the period prices would trend back up – an outcome that is inconsistent with consumers general preference for price stability over time that allows them to plan and manage their own energy use.

We do not think this price path is acceptable when there appear to be opportunities for the businesses to more deeply embed contemporary risk management practices to secure greater efficiencies and further savings for consumers. We are keen to engage with Energy Queensland on these matters with a view to moving towards Proposals that are capable of acceptance.

Our analysis is informed by advice from the consulting firm Dynamic Analysis, who we engaged to provide a technical perspective on the Energy Queensland Proposals. We made a submission on Energy Queensland's

Draft Plan in October 2018 which included initial advice from Dynamic Analysis outlining strategic questions for the network.¹

Dynamic Analysis has undertaken further detailed analysis since Energy Queensland published its formal Proposals in January 2019 (**Attachment A**). This advice poses a series of questions about the proposals that we are keen to explore in the next phase of the process, including:

- Do operating and environmental factors justify the mid-range performance of both networks on AER benchmark models for operating expenditure (opex)?
- Are the businesses applying best practice risk-based asset management strategies and how is this informing the replacement capital expenditure (capex) proposals?
- Has Energy Queensland fully explored demand management opportunities with a view to deferring localised capex augmentation to reduce costs for consumers?
- How is Energy Queensland addressing the challenges associated with increasing levels of distributed energy resources (DER) on the network? In particular, how is it seeking to optimise network and consumer investments?
- Are there opportunities for property and fleet plans to be better prioritised?
- Have consumers benefited from historic information and communications technology (ICT) investments and do forward plans represent value for money?

What energy consumers in Queensland are telling us

Energy affordability remains a priority for households and small businesses in Queensland, after a ten-year period where prices increased substantially, driven by network costs in the first instance, and more recently wholesale costs. This is reflected in the latest results of our [Energy Consumer Sentiment Survey](#), which indicate that consumers are much more satisfied with electricity reliability (84 per cent), compared to value for money (51 per cent).²

As we outlined in [our submission](#) on the Draft Plan in October 2018, moves by the Queensland Government in the last two years to bring the costs of feed-in-tariffs on budget, and to issue directions to state-owned generators to modify their bidding behaviour, have reduced the pressure on energy bills. Scores on key indicators in the Energy Consumer Sentiment Survey have been steadily improving in Queensland, with satisfaction with value for money increasing by 16 per cent between December 2017 and December 2018.

While the costs of the Solar Bonus Scheme are being funded by the Queensland Government for three years from 2017-18, the scheme is

¹ <https://energyconsumersaustralia.com.au/publication/energy-queensland-energex-and-ergon-energy-our-draft-plans-2020-25-submission/>

² <https://energyconsumersaustralia.com.au/publication/energy-consumer-sentiment-survey-findings-december-2018/>

scheduled to run until 2028³. There is a question about how the scheme will be funded after the current network period which ends in June 2020. The Australian Competition and Consumer Commission (ACCC) found that environmental and other scheme costs were making a substantial contribution to consumer bills, and welcomed the move of the Queensland Government to fund the Solar Bonus Scheme itself (\$771m in its budget for three years), rather than have consumers fund the scheme through network costs. This saw average savings on electricity bills of around \$72 per customer in 2017-18⁴. We would be concerned about the consumer impacts of bringing this back onto bills.

Energy Consumers Australia is currently undertaking a national review of costs imposed on consumers through electricity bills that have not been subjected to the long-term interests of consumers test by the AER. Preliminary findings suggest that these costs nationally amount to hundreds of millions of dollars per annum.

As in other parts of the National Energy Market (NEM), consumers' confidence that the market will deliver value for money over the long-term remains very low at 32 per cent. Energy Queensland's decision to become a signatory of the Energy Charter, which was launched in January 2019, is a positive sign of its commitment to rebuilding trust and confidence and delivering better outcomes for consumers over the longer-term.



Our framing and approach

The objective – the long-term interests of energy consumers

Promoting the long-term interests of consumers means that current and future consumers pay no more than they need to for the quality of service they require. To put it in even simpler terms, not one dollar more is spent than necessary; not one day earlier than it is needed. This is an outcome that can best be achieved through a process of dialogue and alignment between network businesses and the consumers they serve. When this happens, businesses are demonstrably careful with consumers' money and investors are earning reasonable returns.

This does not happen when investors (or owners in the case of government owned assets) or managers are incentivised to follow a strategy that is distorted by objectives beyond the regulatory framework. In our assessment of regulatory proposals, we are guided by three principles to explore and understand the direction the business is taking.

1. The network business should be able to demonstrate that it has developed a deep understanding of the preferences of its consumers.
2. The business should be able to talk about its longer-term strategy and business plans to provide a context for the five-year revenue

³ ACCC, *Restoring electricity affordability and Australia's competitive advantage, Retail Electricity Pricing Inquiry – Final Report June 2018*, Table 9.1, page 214. Accessed from <https://www.accc.gov.au/publications/restoring-electricity-affordability-australias-competitive-advantage>

⁴ *Ibid*, page 219.

proposal under consideration, including a long-term price path expectation.

3. The business should be able to acknowledge the problems created by decisions made previously – comparatively less spending per se, is not enough. Consumers are looking for positive assurance that the spending proposed and approved is designed to meet the National Electricity Objective (NEO).

How we assess draft plans and regulatory proposals

We include Dynamic Analysis' detailed advice to support our submission (**Attachment A**) and as a shared resource for all stakeholders engaging with Energy Queensland as part of this process.

It is important to note that this advice does not reflect an Energy Consumers Australia final position. Rather, it is an input which informs our thinking and highlights areas for further exploration. We ask that network businesses and the AER consider the questions posed and issues raised in the advice, to help further public understanding of the network's strategy and reasoning for the revenue setting proposal.

When we engage with proposals, we hope to see proposals that successfully demonstrate the link between the business strategy and revenue proposal. In these documents, we look to see if the business has unpacked why the decisions being made (or proposed) are in the long-term interests of consumers. We seek evidence about the claims in the proposal and how they link back to consumer preferences and outcomes; and how informed consumer preferences have influenced decisions within the business.

Based on our experience in similar processes, we have also come to the position that if one party has information that would make the choice between two alternatives in a draft plan or revenue proposal clear, but will not provide the information, we will assume the information works against the proposed preferred option. Consequently:

- If we are not provided with the information we request, our position is that the expenditure is unjustified.
- If we cannot see evidence of consumer preferences, our position is that the expenditure is unjustified.
- If we cannot see clear evidence of ring-fencing integrity, our position is that the expenditure is unjustified.

Our observation is that different businesses are at different stages of maturity as we move away from the old way of making revenue determinations. Some businesses have taken us on the entire journey; some have willingly shared non-public information with us and our experts; and some re-started this journey with a clear and demonstrated commitment.

At the end of this process, we would ideally be in a position where we can confidently assure consumers that the very best use of their next \$1 is to

spend it with their local network to deliver the high-quality network services consumers have said they wanted.

We recognise that it is the responsibility of the AER to set the maximum revenues that networks are allowed to recover from consumers through network tariffs over the five-year regulatory period, based on its assessment of efficient costs and an informed view on expected electricity demand.

Consumer views and perspectives are integral to ensuring that the decisions made by the AER are in the long-term interest of consumers.

Our response

Engagement with stakeholders

In informing our views on this proposal, Energy Consumers Australia has had a laser like focus on affordability, which needs to be a constraint on all expenditure decisions of the business.

The energy system is undergoing a paradigm shift, driven by technological advances and consumers making new choices about how they meet their energy needs and participate in the energy market. The task of networks in this context is transitioning from supporting a system comprising a small number of large things, to supporting one comprised of a large number of small things.

The values, needs and preferences of consumers must shape decisions about the future. This is not just an engineering challenge – it is an extraordinary social and economic reshaping that demands new thinking, new frameworks and new tools. To meet this challenge, networks need to engage in a deep dialogue with consumers.

Energy Queensland adopted an innovative approach to the development of the revenue proposals for the 2020-25 period, publishing a draft plan in September 2018, ahead of its formal Proposals which it lodged with the AER in January 2019.

Energy Consumers Australia made a submission on this draft plan on 23 October 2018.⁵

Comparison to the Draft Plan

Energex and Ergon Energy both proposed overall reductions to revenue compared to the draft plan. For Ergon Energy, the reduction was \$353.8m, and for Energex the reduction was \$153.7m.

Analysis undertaken by Dynamic Analysis in Figures 1 and 2, compares the components of revenue between the draft plan and regulatory proposals for Ergon Energy and Energex respectively.

⁵ <https://energyconsumersaustralia.com.au/publication/energy-queensland-energex-and-ergon-energy-our-draft-plans-2020-25-submission/>

Figure 1: Drivers of revenue reduction from draft plan to regulatory proposal for Ergon Energy (\$m, real 2020)



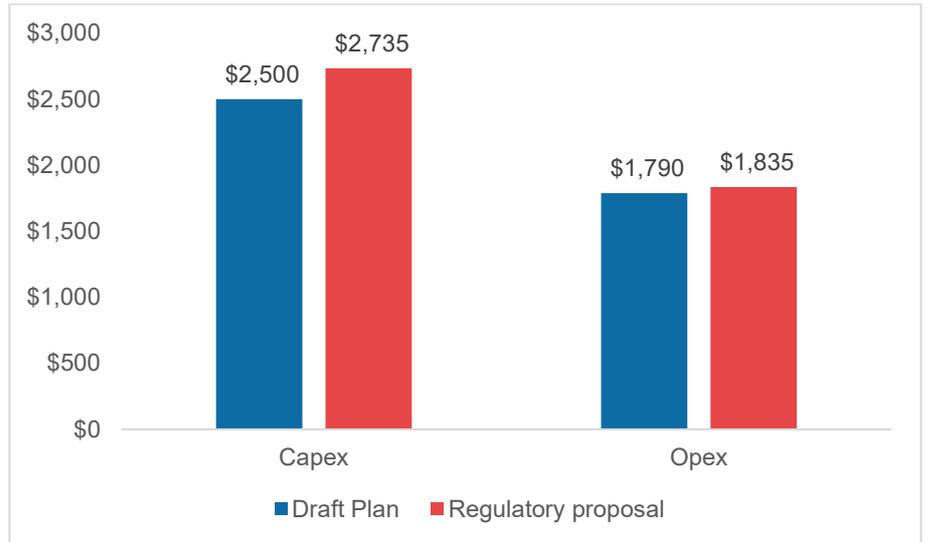
Figure 2: Drivers of revenue reduction from draft plan to regulatory proposal for Energex (\$m, real 2020)



We note that most of the revenue reductions are linked to a decision to not claim incentive payments.

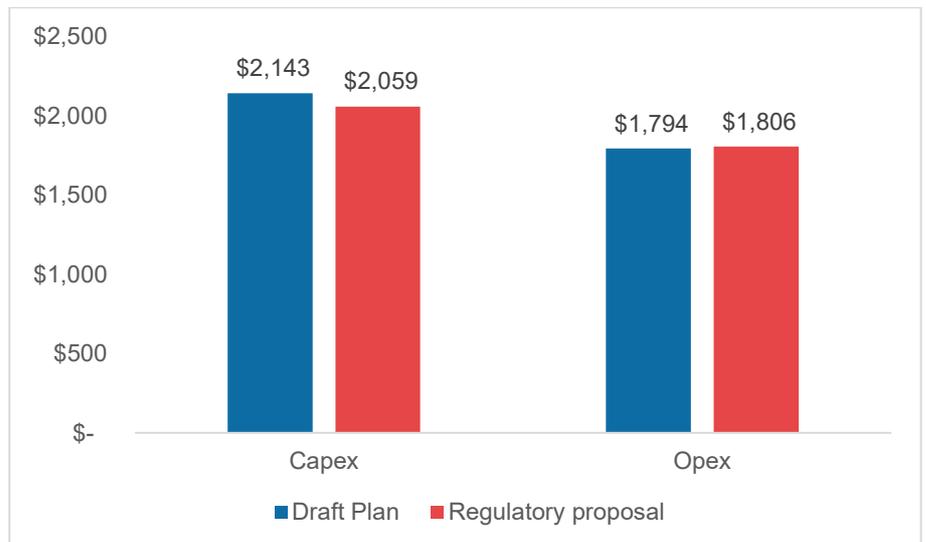
In terms of proposed expenditure, Ergon Energy has increased its net capex by \$234m relative to the draft plan, with most of this relating to new replacement capex (repex) programs (about \$214m). It has also sought an increase of \$45m for opex compared to the draft plan. The increase in expenditure since the draft plan is set out in Figure 3 below. Our draft submission had raised a number of concerns on the level of capex and opex being proposed by Ergon Energy, and these remain.

Figure 3: Ergon Energy change in capex and opex between draft plan and regulatory proposal (\$m, real 2020)



In contrast, Energex has reduced its net capex proposal by \$83m compared to the draft plan which is welcome given that our view in the submission on the draft plan was that minor reductions to repex and connections could be possible. However, there is no reduction in non-network capex, an area where we also raised concerns. Energex has increased its proposed opex by \$12 million since the draft plan. Figure 4 shows the difference for Energex.

Figure 4: Energex change in capex and opex between draft plan and regulatory proposal (\$m, real 2020)



Looking at the decision-as-a-whole, Dynamic Analysis’s advice to us is that:

Under Energy Queensland’s guidance, Energex and Ergon Energy have made significant inroads into improving their efficiency. They have put forward a proposal that lowers prices for Queensland customers in the 2020-25 regulatory period. Our review of the proposal suggests both networks can find a deeper level of cost savings without impacting safety or reliability of services. This includes reductions to base year operating expenditure and capital expenditure. We also seek more evidence to assure Queensland customers that they have not paid twice for past Information and Communication Technology assets in the Regulatory Asset Base.

Energy Consumers Australia is keen to engage with Energy Queensland on these issues with a view to working towards Proposals that are capable of acceptance. We highlight these matters in the following section, with supporting detail available in the Dynamic Analysis advice at **Attachment A**.

An area where we have engaged in depth with Energy Queensland is in relation to the pricing arrangements that will govern how it recovers revenues from consumers in the 2020-25 period – settings that are outlined as part of the TSS that accompanies the proposals.

One of the challenges we have faced in this engagement is that the shape of the tariff proposals have not been settled, and no revised TSSs have been submitted. In this context, our comments are both directed to the AER to support its decision making and to Energy Queensland.

The bottom line – costs to consumers

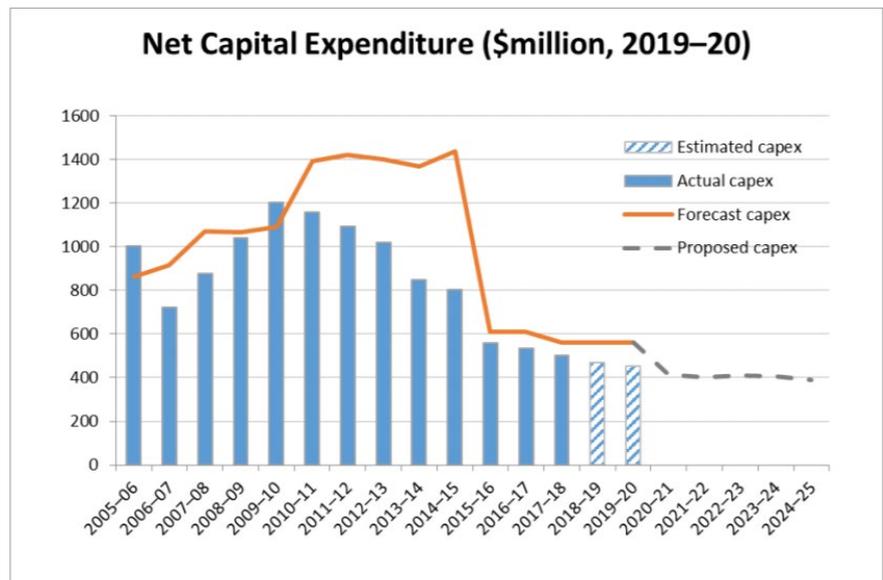
Energy Queensland has developed a proposal that would see average household bills fall by 8.3 per cent (Energex) and 7.4 per cent (Ergon Energy) in 2020-21, and then increase in the remaining four years of the period (see Table 1). On average over the period this would keep prices at current levels. We support a smoother revenue path as we view stable prices as a road to building consumer confidence and trust.

TABLE 1: PROPOSED PRICE PATH FOR AVERAGE HOUSEHOLD BILLS

	2020-21	2021-22	2022-23	2023-24	2024-25	Average 20 20-25
Energex	-8.3%	2.0%	2.5%	1.7%	1.9%	-0.1%
Ergon Energy	-7.4%	2.2%	2.2%	2.2%	2.2%	0.2%

These price outcomes reflect regulated revenues that are 9.4 per cent lower for Energex, and 5.4 per cent lower for Ergon Energy, for the next five years compared to the 2015-20 period⁶. For both networks these revenues are significantly lower than the peak that was reached in 2014-15, achieved principally through big reductions in annual capex – Energex proposes to spend 20 per cent less on capex in 2020-25 then in the previous period (see Figure 5)⁷.

Figure 5: Comparison of Energex’s past and forecast net capex



Source: AER analysis based on data from AER Final decision PTRM and RFM for 2015-20 regulatory period; Energex Regulatory Proposal PTRM and RFM for the 2020-25 regulatory period.

Note: Total proposed Capital expenditure is \$2020 million (\$2019-20). These amounts exclude Capcons.

The regulated asset base (RAB) legacy

A network business’s RAB is a significant factor in the affordability of the network, as (in simple terms) the higher the RAB per customer, the greater the overheads the network will recover from consumers and the greater the pressure on bills.

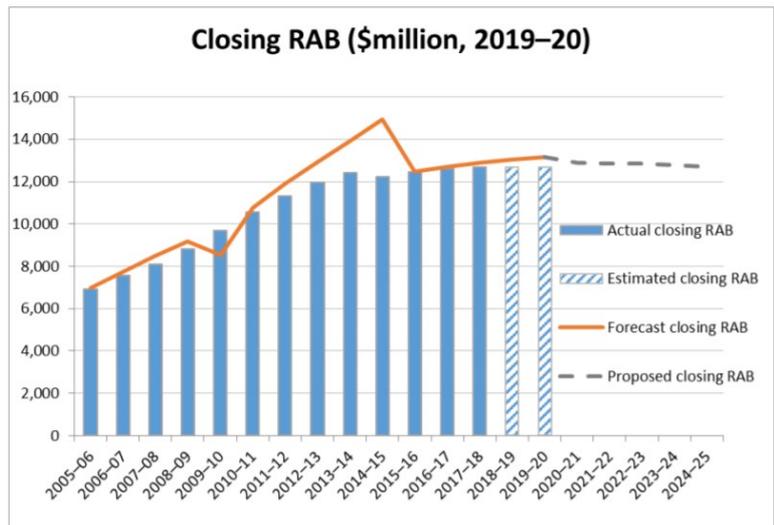
Despite Energy Queensland making these reductions and finding efficiencies in other areas, the legacy of previous high investment remains, with high RABs continuing to be a major factor for revenues and therefore energy bills over the next five years.

⁶ AER, *Issues Paper: Energex and Ergon Energy distribution determinations 2020-25*, pages 14 and 15 respectively. Accessed from <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/energex-determination-2020-25/proposal>.

⁷ *Ibid*, page 25.

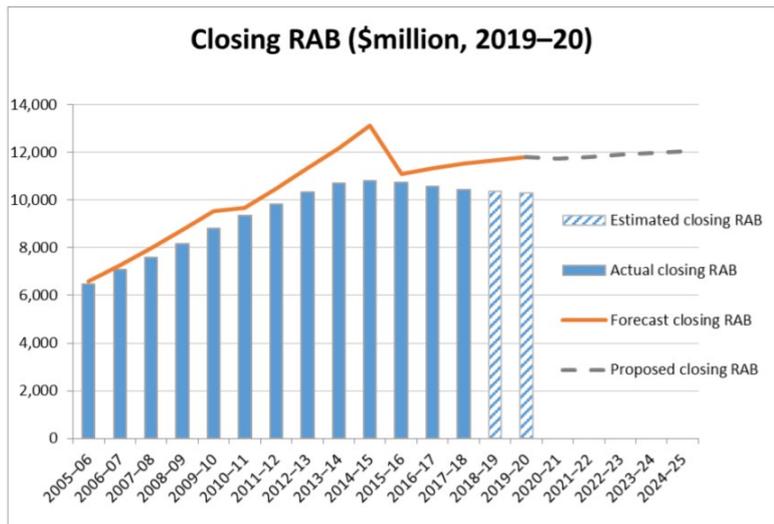
As figures 6 and 7 below show, the RABs for both networks will remain at high levels, reducing by one per cent in the case of Energex and increasing by three per cent in the case of Ergon Energy.

Figure 6: Energex’s RAB value over time (\$million, 2019/20)⁸



Source: AER analysis based on AER Final decision PTRM and RFM for 2010-15 and 2015-20 regulatory periods; Energex Regulatory Proposal PTRM and RFM for 2020-25 regulatory period, DNSP performance report.

Figure 7: Ergon Energy’s RAB value over time (\$million, 2019/20)⁹



Source: AER analysis based on AER Final decision PTRM and RFM for 2010-15 and 2015-20 regulatory periods; Ergon Energy Regulatory Proposal PTRM and RFM for 2020-25 regulatory period, DNSP performance report.

⁸ Ibid, Figure 9, page 24.

⁹ Ibid, Figure 14, page 36.

The ACCC estimated that recommended measures could reduce the contribution that network costs were making to the average bill for a household in south east Queensland by \$147 (Figure 8). This is significantly higher than the \$53 saving than is being proposed for the Energex region.

Figure 8: Achievable average annual residential bill savings by 2020-21¹⁰

Region	Achievable savings (\$ per annum)						2020-21 Bill	% Reduction
	2017-18 Bill	Networks	Wholesale	Enviro	Retail	Reduction		
Victoria	1457	39	192	34	26	291	1166	20
NSW	1607	174	155	47	77	400	1200	24
South east Queensland	1703	147	192	18	62	419	1284	25
South Australia	1727	13	227	89	42	371	1356	21
Tasmania	1979	113	226	75	—	414	1490	21

Comments on key components

The Energy Queensland Proposals incorporate material savings for consumers that lays a platform for improved consumer outcomes over the longer-term. Both Energex and Ergon Energy have reduced opex, constrained capex programs, embedded productivity and forgone incentives – efforts which help effect a course-correction following historic overinvestment in network capacity.

The Dynamic Analysis advice also indicates that Energy Queensland has provided clearer justification of its programs and revenue since its Draft Plan, which we welcome. However further substantiation is required in relation to several key elements of the Proposals. We provide a high-level summary of these issues below, with a more detailed discussion available in **Attachment A**.

Opex

Energex and Ergon Energy have achieved significant reductions in opex since 2015, when expenditure peaked, with further savings proposed through productivity commitments that go beyond the AER Guidelines in the 2020-25 period.

¹⁰ ACCC, *Restoring electricity affordability and Australia's competitive advantage, Retail Electricity Pricing Inquiry – Final Report June 2018*, Table A, page xv. Accessed from <https://www.accc.gov.au/publications/restoring-electricity-affordability-australias-competitive-advantage>

Energex proposes to spend \$1805.8m in opex over the period 2020-25, which represents a downward trend from current levels¹¹. Ergon Energy is also proposing a reduction in this element compared to current levels, with total opex over the period of \$1834.6m¹².

Dynamic Analysis has focused on how Energex and Ergon Energy have performed against the AER opex benchmarks, as well as evaluating the robustness of the starting point (the 'base year') that has been selected to calculate its performance on opex metrics.

The key question raised in this analysis is whether Energex and Ergon Energy's performance in the mid-range of the AER's opex benchmarks is justified, and whether consumers should expect the networks to achieve deeper efficiencies. Energy Queensland argues in the Proposals that this performance reflects the special environmental and operating context in these regions, but we are not yet convinced that these circumstances justify higher costs compared to networks that face similar challenges.

Based on this analysis, we are seeking further assurance of the justification for approximately \$98 million of Energex's proposed opex, and \$215 million of Ergon Energy's proposed opex.

Capex

As discussed above, both Energex and Ergon Energy are proposing to maintain lower levels of capex that each transitioned to in the 2015-2020 period following the elevated levels earlier in the decade.

Energex is proposing \$2.0bn in capex over the period, which is 20 per cent lower than the actual capex in 2015-20¹³. Ergon Energy is proposing \$2.7bn for the period, which is an increase of eight per cent compared to 2015-20¹⁴.

The Dynamic Analysis review has focused on high-level indicators – including, capex performance over the past ten years, age of the network, performance against AER benchmarks and reliability performance – to identify areas that require further review and assurance.

Replacement capex

Energex proposes \$643m in replacement capex or 'repex' during 2020-25 – 28 per cent of the total capex spend¹⁵. This figure for Ergon Energy is \$1094m which is 38 per cent of its overall capex budget¹⁶. Whereas Energex's repex is much lower (26 per cent lower) than the current period, Ergon Energy is proposing a significant increase in repex, being 23 per cent higher than 2015-20.

¹¹ AER, *Issues Paper: Energex and Ergon Energy distribution determinations 2020-25*, page 31. Accessed from <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/energex-determination-2020-25/proposal>

¹² Ibid, page 43.

¹³ Ibid, page 25.

¹⁴ Ibid, page 37.

¹⁵ Ibid, page 27.

¹⁶ Ibid, page 39.

As discussed earlier in this submission, the increase to Ergon Energy's repex since the Draft Plan was published in September 2018 is about \$214 million.

Given the significance of repex expenditure, in particular in the Ergon Energy network, we would like to hear from the business on its longer-term strategy and trajectory to provide a context for the five-year revenue proposal under consideration. We will continue to engage with Energy Queensland to better understand how the goals and key target areas in its *Summary of Energy Queensland Corporate Plan 2020-25*¹⁷ guides network investment in this period and the longer term.

Dynamic Analysis raises a question about whether Energex and Ergon Energy are taking an unduly conservative approach to managing their infrastructure. While Energy Queensland has one of the younger networks in the NEM, they appear to be replacing their assets earlier than their peers. Energy Consumers Australia needs to be assured that Energy Queensland is following good risk quantification and management practice that we are seeing elsewhere.

This analysis, which has also reviewed unit costs and failure rates for various asset categories, indicates that we need assurance on 20 per cent of the proposed repex for Ergon Energy and 15 per cent of the proposed repex for Energex.

Augmentation capex

Augmentation capex or 'augex' for both networks are a relatively small part of their overall capex budgets, with Energex proposing to spend \$301m (13 per cent of capex)¹⁸ and Ergon Energy \$249m (eight per cent of capex)¹⁹.

It is critical that networks partner with consumers, particularly by rewarding flexibility, to reduce the need to expand the network and keep costs down, as the energy system transforms. The Energy Queensland networks have been leaders in this area, through programs like PeakSmart, which rewards consumers for allowing their air conditioners to be managed in a more dynamic way, while maintaining comfort within the home.²⁰

¹⁷ Energy Queensland, Supporting documentation: *Summary of Energy Queensland Corporate Plan 2020-25*, January 2019. Accessed from <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ergon-energy-determination-2020-25/proposal>

¹⁸ AER, *Issues Paper: Energex and Ergon Energy distribution determinations 2020-25*, page 28. Accessed from <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/energex-determination-2020-25/proposal>.

¹⁹ Ibid, page40.

²⁰ <https://www.energex.com.au/home/control-your-energy/positive-payback-program/positive-payback-for-households/air-conditioning-rewards>

The results of the Energy Consumer Sentiment Survey indicate that there is a huge potential for networks to build on these initiatives, with more than 40 per cent of households in South East Queensland indicating that they would be willing to reduce their energy use during periods of very high demand.²¹

The Dynamic Analysis review indicates that Energy Queensland is shifting the focus of its augex away from traditional work to accommodate peak demand growth, to improving its ability to manage the network in a smarter way. Key here is upgrading the technology on its network to give it greater visibility about how electricity is moving around its low voltage network.

Both networks have historically spent less on augex than they sought in their revenue proposals, and we need to be assured that the approximate 15 per cent buffer that we have seen in earlier periods is not also built into the 2020-25 proposal. Dynamic Analysis explores issues associated with reinforcement programs, worst performing feeders and power quality programs in its advice which provide a basis for engagement on this element of the proposal in the next phase of the process.

Non-network capex

As the energy system transforms, networks will need to spend more (at least in proportional terms) on things other than the 'poles and wires' to play their role as the platform for new energy services – first and foremost here will be the ICT systems that will act as the brain for a much more sophisticated network.

Developing and rolling-out new ICT infrastructure is therefore critical, but it must be done in a systematic way that represents value for money for consumers. Energy Consumers Australia sees a need for networks, as well as regulators and consumer advocates, to increase capability and skills in ICT strategy, planning and procurement. Dr Rob Nicholls, an ICT expert with the University of NSW Business School, is working with Energy Consumers Australia on these issues and we will be facilitating a series of stakeholder webinars in the coming months that will provide an opportunity for dialogue between networks and consumer advocates on this key transformation issue.

Over the last decade Energex and Ergon Energy have spent almost \$1.2bn on ICT. Looking forward, the networks propose to spend \$350m and \$290m respectively on ICT capex over the 2020-25 period. Dynamic Analysis has reviewed the effectiveness of ICT investments to date, finding that Energex and Ergon Energy have not provided quantified evidence to show that consumers have benefited from this significant spend – approximately \$500 per household between 2011 and 2020. Better data platforms should create opportunities to defer capex and reduce maintenance costs, but this is not evident in the proposals.

²¹ ECA, *Energy Consumer Sentiment Survey*, December 2018, page 24. Accessed from <https://energyconsumersaustralia.com.au/wp-content/uploads/Energy-Consumer-Sentiment-Survey-Report-December-2018.pdf>.

Roll forward of previous ICT assets

Two strong themes we are hearing about ICT is lack of transparency and, subsequently, lack of trust, about what benefits consumers are receiving from the investment; and the risks of consumers paying twice for the same thing. The case for rolling forward the SPARQ assets into the RAB raises these two issues as we cannot see clear explanatory materials about how the value of the assets were derived and we are uncertain about whether consumers could potentially end up paying twice for the assets.

The advice provided by Dynamic Analysis is that there is little documentation or data to establish that the:

- written down value of the past ICT investments is correct; and
- forecast process for deriving opex and capex in the 2020-25 period reflects that Energex and Ergon Energy will no longer pay an annual service fee.

Dynamic Analysis suggests that a rough 'rule of thumb' guide about the written down value of the assets after an annual usage fee would be about \$100m instead of the \$147m and \$154m for Energex and Ergon Energy respectively²².

The technical report provided by Dynamic Analysis at **Attachment A** provides key questions for data for review, that supports the approach to the roll-forward of legacy ICT assets in the Proposals.

Property, fleet and plant

Energex is proposing \$182m for fleet and equipment, which is eight per cent lower than the current period²³; while Ergon Energy is proposing \$225m which is 12 per cent higher than the current period²⁴.

For property costs, Energex is proposing \$174m (11 per cent lower than the current period)²⁵; while Ergon Energy is proposing \$220m (five per cent higher than the current period).²⁶

The advice from Dynamic Analysis suggests that there might be other options for managing property, fleet and plant given the reduced workforce and the efficiencies driven by the creation of Energy Queensland.

²² Energy Queensland, Supporting Information – 8 – *Integration of Legacy ICT Assets 2020-25 January 2019*. Table 2, page 2. Accessed from <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/energex-determination-2020-25/proposal>

²³ AER, *Issues Paper: Energex and Ergon Energy distribution determinations 2020-25*, page 30. Accessed from <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/energex-determination-2020-25/proposal>

²⁴ Ibid, page 42.

²⁵ Ibid, page 30.

²⁶ Ibid, page 42.

The advice also highlights the different unit costs that Ergon Energy and Energex face for its fleet capex. We ask the AER and Energy Queensland to consider whether there are opportunities for Energy Queensland to use its buying power to obtain better pricing outcomes on its fleet expenditure.

Tax and depreciation

Tax allowance

Dynamic Analysis suggests that we would expect to see a reduction in the tax allowance for Ergon Energy and Energex due to the finalisation of the AER's tax review in December 2018. We defer to the AER's expertise on the calculation of the tax allowance for Ergon Energy and Energex however, Dynamic Analysis suggests that the tax allowance proposed by Ergon Energy and Energex could be reduced by a third.

Depreciation

Ergon Energy has proposed using the year by year tracking approach for the calculation of depreciation, which would result in an increase of 27 per cent on the current period²⁷.

Energex has also proposed moving from the Weighted Average Remaining Life (WARL) method to the year on year tracking approach for implementing straight line depreciation, which would see the depreciation allowance increase significantly by 55 per cent compared to the current period²⁸.

In its Issues Paper, the AER states that it has limited discretion in the methodology employed by businesses, as the year by year methodology satisfies the requirements in the National Electricity Rules for the matching of depreciation with the assets' underlying asset lives.

The technical report provided by Dynamic Analysis at **Attachment A** discusses the approach to calculating asset lives given assets are living longer than in the Post Tax Revenue Model.

The AER Issues Paper notes that most distribution network businesses apply the year on year methodology. We questioned the value of year on year over the WARL in [our submission](#) to the AER Issues Paper for the Ausgrid 2019-24 revenue determination, noting that it increases the amount of revenue collected from today's consumers, raising a question of intergenerational equity between today's and tomorrow's consumers.

The advice provided by Dynamic Analysis raises a similar point, in that the year on year methodology brings forward depreciation. This doesn't seem to be the only implication. There is the potential for the year on year methodology to result in a "cliff-face drop off in straight line depreciation" where the drop-off bears no relationship to the underlying costs of the network at the time.

²⁷ Ibid, page 36.

²⁸ Ibid, page 24.

We have seen the impact that volatile pricing has on consumers managing their energy costs and question whether the year on year approach to depreciation could have negative revenue and price implications for consumers in the longer term. In terms of meeting the NEO, does this approach meet the long-term interests of consumers test?

Tariff Structure Statement

The context

There is a renewed focus on tariff reform following the ACCC's Retail Electricity Pricing Inquiry, which found that progress in shifting to 'user pays' or 'cost reflective pricing' for the use of electricity distribution networks has been too slow. While we agree that this important reform project has not progressed as intended, we are concerned about approaches that simply mandate new network tariffs for all consumers with digital meters given the risk of unknown and unintended consequences around how these charges are passed through by retailers in their final energy bills. Moves by some retailers to limit choice, such as no longer offering 'flat rate' retail pricing following the implementation of cost reflective network tariffs, or see consumers experiencing bill shock from being charged peak rates, negatively impacts confidence and trust which is already low in this market.

Energy Consumers Australia is therefore interested in how the tariff proposals affect residential consumers, particularly those who face difficulties managing their energy bills; and small businesses, including agricultural enterprises in regional Queensland. We are also interested in the extent to which the tariff designs can unlock the potential flexibility in consumers' energy use over the longer-term. Tariff designs that facilitate 'demand side participation' help make the system more efficient and cheaper to run by reducing the need for expensive new infrastructure to be built.

However, changing the tariff structures can create risk for consumers that needs to be managed.

Firstly, the benefits of tariffs that better reflect the underlying costs of delivering the service will only be realised where consumers understand and can respond to new price signals. Without the right information and tools, a price signal can quickly become a penalty. Exposing consumers to the risk of higher bills – or the opportunity for lower bills – without ensuring they have the capacity to understand and respond is in stark contrast to the intention of the package of measures that have been recently introduced to improve consumer outcomes in retail energy markets.²⁹

Secondly, reviewing the merits of proposed changes to the design of electricity distribution network tariffs is difficult because only rarely is information provided about how these new prices will be passed through to consumers by retailers.

²⁹ This includes the default market offer
<https://www.energy.gov.au/publications/price-safety-net>

And finally, while governments can and are playing a role in providing a safety-net for consumers who might not be able to respond to new pricing, identifying who needs assistance can be challenging.

Our most recent Energy Consumers Sentiment Survey June 2019 report finds that there have been increases in the positive rankings for energy services in South East Queensland since the deregulation of electricity prices in July 2016. Overall satisfaction with energy services is now at 75% (up 4% in the last year) while the proportion reporting positively on value for money is now at 58% (up 8% in the last year) which is the highest level nationally.

In our view this demonstrates that a positive outcome is possible when significant changes to pricing are introduced alongside a targeted information campaign and assistance for low income consumers to understand and make choices about their energy use.

Response to tariff proposals

Energy Queensland is yet to provide revised TSSs to replace the TSSs that were part of the Energex and Ergon Energy's regulatory proposals submitted on 31 January 2019, and subsequently withdrawn.

Given the stage that we are at in the determination process, Energy Consumers Australia has provided comments on several aspects to assist the AER in its decision-making in relation to the possible tariff structures and pricing to be put forward by Energy Queensland.

In our view, the AER should progress to making its Draft Determination on its usual timetable, which we understand would be September 2019. A delay beyond that point only adds to the uncertainty for consumers, and an inability to plan for tariff changes that are scheduled to come into effect on 1 July 2020. In this regard, it may be that there is merit in the start date being delayed, until 1 July 2021. Such a delay should be to allow pricing and information to be communicated by retailers, and if necessary supporting measures by government, to support consumer decision-making. This means that Energy Queensland should aim to finalise their tariff structures, and pricing with a view to these being settled by the time of the Draft Determination.

The nature of the engagement with Energy Queensland on tariffs

Throughout the process, including the most recent intensive engagement with consumer groups since January 2019, Energy Queensland's approach has been at the inform end of the International Association for Public Participation (IAP2) spectrum, rather than consult, involve or collaborate.

It is disappointing that there have been information gaps and inaccurate information provided, and feedback from consumer groups has not been or only partially addressed. The result is that we are yet to arrive at a clear understanding of Energy Queensland's proposed tariffs and the overarching strategy.

The proposed tariff strategy

In our view no clear link has been established between the discussion of proposed tariffs and the known challenges that are facing Energex and Ergon Energy in adapting to a more decentralised energy system, driven by the need to lower emissions and facilitated by rapid technological change. Given the level of penetration and further growth in rooftop solar systems and expected uptake of both batteries and electrical vehicles, our expectation was that there would be discussion of what this means for tariffs that incentivise utilisation of the Queensland networks.

As we have seen in South Australia, the low levels of demand in the middle of the day are being addressed through time-of-use network tariffs that incentivise consumers to shift when they use power to utilise this available energy. At the same time, a ‘prosumer network tariff’ is designed to reward consumers for using energy in a more flexible way, assisted by technology (batteries, home energy management systems, etc). How to manage limits on the ‘hosting capacity’ of the network – particularly where electricity generated from rooftop solar systems is being injected into the grid is also being discussed.

The absence of a more joined-up discussion about these issues in Queensland, particularly as it has led the way in “automated” load management that has a high acceptance by consumers, is a significant missed opportunity.

We understand from the engagement with Energy Queensland that peak demand is no longer a driver of significant capital expenditure, although it is possible that there are parts of the network where there are locational constraints. As a result, the tariff strategy appears to be focussed on reallocating revenue recovery between different groups of consumers, rather than sending a price signal to reduce future network investment costs.

Our understanding is that the following are the proposed default tariffs that are to apply from 1 July 2020.

- All existing customers as at 1 July 2020 (regardless of their meter) will be assigned to an inclining block tariff, with the blocks increasing in 10,000-kilowatt hour increments for residential customers and 20,000-kilowatt hour increments for small business (noting that existing Ergon Energy customers have an inclining block tariff and Energex customers have a flat (or single) rate tariff;
- From 1 July 2020, customers who are supplied with a digital meter (new connections and replacement meters) will be assigned to a demand tariff that has morning and evening windows (at different rates) in addition to a fixed charge and a volume charge.

We note that where customers have a secondary tariff (i.e. have load control), that this usage is excluded from charging under the primary tariff.

Our understanding is that both existing customers and customers with digital meters can opt out from the assigned tariff – either the inclining block or the demand tariff – to what is described as the existing flat rate legacy tariff (Energex customers) or the existing inclining block tariff (Ergon Energy customers).

We also understand that all existing customers after 1 July 2020 can opt-in to a demand tariff if they choose, or a capacity tariff (which will be based on kilowatt bands), and presumably customers who have been assigned to a demand tariff can also opt-in to the proposed capacity tariff.

The demand and capacity tariffs proposed by Energy Queensland create specific challenges for retailers, and by extension consumers. They are not a familiar concept – unlike time-of-use pricing which is simpler and easier for consumers to understand and respond to. Where demand tariffs have been introduced by networks in other jurisdictions, such as in Victoria on an opt-in basis and in the ACT and in New South Wales on a default basis, it remains the case that consumers lack the information and tools they need to manage their energy use to respond to these tariffs. In this context, it is critical that consumers have the choice at the retail level, of a flat rate tariff so that they are not forced into managing the risk inherent in peak pricing.

We understand from the AER that both time-of use and demand tariffs can be cost-reflective, in signalling drivers of network costs. We would have preferred that the concerns raised by consumer advocates about demand tariffs had been addressed earlier, but at this late stage we place greater weight on the AER settling the choice of tariff structure as matter of urgency, rather than Energy Queensland going back to the drawing board.

Pricing and impact analysis

The tariffs proposed by Energy Queensland to take effect from 1 July 2020 are intended to increase the proportion of the revenue recovered from the following consumer groups, within the overall allowed revenue.

- Consumers with higher overall usage, compared with consumers with lower usage (below the threshold), which could include customers with medical or cooling needs, larger families and specific housing including residential villages, community housing and caravan parks.
- Consumers with higher peak usage, compared to consumers with flatter loads, which could negatively impact families with children and working families, who use air-conditioning and are not on load control.
- Consumers with rooftop solar systems compared to consumers without rooftop solar systems.

The impacts for consumers, compared with the current tariffs and pricing, depend on the overall revenue to be recovered and the pricing for each tariff, noting that the indicative pricing provided to consumer groups in recent engagement appears to be preliminary.

We are not yet able to accept the network tariff proposals being put forward by Energy Queensland, in advance of a TSS being submitted.

To move forward we are seeking further information to be made available, to enable impact analysis to be undertaken to identify which consumers are potentially at risk of higher bills, and to inform the development of measures to assist consumers to mitigate this risk. Our request is that Energy Queensland:

- within the TSS finalise the preferred network tariff structure as well as the indicative pricing of each of the proposed network tariffs, including the proposed fixed charges, the pricing for each parameter, the relative pricing between each of the tariff choices available to consumers, and the price path over the five years;
- make available a data set with load profiles, linked where possible to socio-demographic information (including solar versus non-solar) for households and also for small business to be made available publicly, including being accessible through the University of New South Wales Centre for Energy Environmental Markets Tariff Assessment Tool (available online [here](#)); and
- assist with the customer impact analysis, over the five years of the revenue determination not only the initial year.

Consumers able to understand and respond to retail pricing

Ultimately, it is the impact on consumers of retail pricing that is critical to ensuring a transition that is in line with community expectations. Consumers need to be able to understand and respond to the retail pricing offers available, in deciding whether a flat retail rate tariff or a retail peak pricing offer best meets their circumstances.

For retailers to have this in place for 1 July 2020, there needs to be certainty around the network tariff, clarity around how different groups are impacted and how any opt-out mechanism will work in practice.

Consumers should not be faced with a situation where the first time they learn about a demand tariff is when they get a higher bill. While many consumers could be better off – those that have flatter loads or can be flexible in how they manage their energy use – similar numbers of consumers could be worse off.

It should not be assumed that consumers with digital meters will be provided with the information on their energy use in such a way that enables them to make decisions to shift or reduce their use at peak times. There is a need for a whole of sector conversation in advance of the introduction of these tariffs on 1 July 2020 that addresses how consumers will be provided with information on their use that is meaningful, timely and actionable.

Energy Queensland is in a unique position to play a leadership role, in how network tariffs are translated into retail tariffs, with Ergon Retail as part of its corporate structure. There is an opportunity for Ergon Retail to lead the way in developing innovative energy services and accessible information to assist consumers in regional Queensland to achieve better bill outcomes at the same time as new network tariffs are introduced. Ergon Retail could play an active role in improving access to load control – for major electricity appliances – for renters and low-income households to help mitigate the potential impact of demand tariffs.

There are also important opportunities for the Queensland Government in:

- supporting the development of an information campaign, to be directed at households and small business, on the choices available for retail tariffs that are appropriate for their circumstances;

- encouraging retailers to improve access to the load control of major appliances for renters and low-income households; and
- tasking the Queensland Competition Authority, to take a more contemporary approach in its price setting approach to retail tariffs to apply from 1 July 2020.

Conclusion

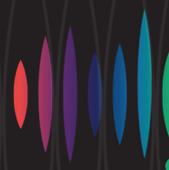
Energy Consumers Australia has appreciated the opportunity to comment on the Energy Queensland Proposals for 2020-25 and address issues raised in the AER Issue Paper.

If you have any questions about our comments in this submission, or require further detail, please contact Shelley Ashe, Associate Director – Networks, by email at shelley.ashe@energyconsumersaustralia.com.au or phone on 02 9220 5514.

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