Energy Queensland 2020-2025 Draft Plan

Submission

October 2018

ENERGY CONSUMERS AUSTRALIA

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Version history

VERSION	DATE	COMMENTS
1	23 October 2018	Final

Introduction

The long-term interests of consumers are served when current and future consumers pay no more than they need for the quality of service they require.

We are looking to Energy Queensland to set out its long-term strategy for its networks. This will help consumers understand how efficiencies gained from network transformation activities will be measured and the benefits passed back to consumers. We are also looking for Energy Queensland to provide more information on its long-term strategy for reducing network costs. For example, how it will continue to decrease the value of the Regulated Asset Base (RAB); increase capacity utilisation; and actively seek savings from network transformation activities that will be passed on to consumers in Queensland.

Summary

Energy affordability is a prominent issue in Queensland and the Draft Plan communicates this clearly.

On the day before the launch of the Draft Plan, the Queensland Government reiterated its goal for affordable energy and made reference to its 2017 Affordable Energy Plan and its direction to Queensland networks to reduce network costs.

The Queensland Competition Authority (QCA) reports that recent reductions in electricity costs are largely a result of a decline in network costs and, to a lesser extent, wholesale costs. The benefit of network savings has been partially offset by higher Renewable Energy Target costs. We note that the Queensland Government's removal of the Solar Bonus Scheme costs from network prices would have contributed to the downward pressure on network costs.

The Australian Competition and Consumer Commission's (ACCC) Restoring electricity affordability & Australia's competitive advantage report unpacks the cost stack for Queensland consumers, using south east Queensland as an example. Table 1 below demonstrates the potential savings for consumers across the entire cost stack through implementation of the ACCC's recommendations. In particular, savings in network costs by 2020-21 would be $147.

Table 1: Achievable average annual residential bill savings by 2020-21

	Achievable savings ($ per annum)							
Region	2017–18 Bill	Networks	Wholesale	Enviro	Retail	Reduction	2020–21 Bill	% Reduction
Victoria	1457	39	192	34	26	291	1166	20
NSW	1697	174	155	43	37	409	1288	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

Source: Table A, ACCC: Restoring electricity affordability & Australia's competitive advantage

Energy Consumers Australia is aware of Energy Queensland's positive contribution as a foundation member of the Energy Charter and is looking to Energy Queensland to:

- begin incorporating the spirit of the five principles outlined in the draft Energy Charter that it is helping to develop:
    - Principle One: we will put customers at the centre of our business and the energy system
    - Principle Two: we will improve energy affordability for customers
    - Principle Three: we will provide energy reliability, safely and sustainably
    - Principle Four: we will improve the customer experience
    - Principle Five: we will support customers in vulnerable circumstances.
- Indicate how it will manage the long-term health and performance of the network, in a way that is financially sustainable
- Indicate how Energy Queensland will pursue productivity improvements in both its capital and operating expenditure programs
- Provide more explanation on the proposed new capital expenditure (capex) programs
- Provide more explanation on the proposed new capex for Information Communication Technology (ICT). We recognise that ICT is a transformation enabler however, we seek more information to show:
    - the benefits that will be delivered to consumers; and

- the pay-offs from the investment (for example, the operational productivity and efficiencies that will flow from this investment).

- Provide a deeper understanding of the reason for changing the depreciation methodology for Energex, noting the upward pressure it is expected to place on Queensland network costs.

What consumers are telling us

Queensland consumer respondents to our June 2018 Energy Consumer Sentiment Survey indicate that overall, only 45 per cent of consumers are satisfied with value for money of their electricity services, while satisfaction with reliability (72 per cent) and faults (68 per cent) is significantly higher.

There is a high penetration of traditional energy appliances in Queensland (71 per cent of homes have air conditioning for heating and cooling, while 65 per cent of homes have a dishwasher). However, there is also a high penetration of rooftop solar (45 per cent of homes).

Energy savings is a key theme, both in terms of energy efficient practices (including access to off-peak benefits) and appliances; and energy savings measures. The survey results could also indicate that affordability remains a key issue for Queensland consumers:

- 91 per cent of household consumers switch off lighting and appliances when not in use
- 51 per cent of respondents say they have switched appliance use to off-peak times
- 67 per cent of respondents use appliances less frequently; and
- 51 per cent of respondents said they were considering purchasing energy efficient appliances, but only eight per cent plan to do so in the next 12 months.

There are even more opportunities for a dynamic partnership between Energy Queensland and its consumers. 21 per cent of consumers have a smart meter however, only six per cent use the smart meter for controlling their energy costs. This could be because not all “smart” meters in the field have enabled communications. However, we would ask Energy Queensland to further investigate this non-network solution for managing network costs.

Queensland consumers are also looking towards the future. In response to the survey, consumers indicated that they are considering purchasing the following technologies (although not necessarily immediately):

- Energy efficient appliances (41 per cent of homes)
- Battery storage systems (27 per cent of homes)
- Rooftop solar panels (22 per cent of homes)
- Solar hot water (16 per cent of homes).

Our survey results indicate that there are ongoing opportunities for Energy Queensland's long-term strategy to create a more dynamic network by partnering with consumers. This could help to provide a more secure and reliable network in the longer term. The challenge for Energy Queensland, like other networks, is to develop a strategy that responds to the direction consumers are taking the market, empowers consumers and delivers affordable solutions.

To do this, Energy Queensland, like the sector more generally, will need to move beyond the 'trilemma' framing that for example, tends to focus organisations on big capital-intensive solutions to reliability challenges where a cheaper, more modular, risk-based solution may have emerged.

We have alternative framing that prioritises three objectives – a framing that informs our assessment of Energy Queensland's proposal:

1. *Affordability* must be a constraint on investment and decisions about energy – an explicit criterion in decision making up and down the supply chain.
2. Energy services must be built around *individuals* to reflect their unique circumstances, enabling people to easily manage their own use and costs – whether that is innovating and engaged consumers, the majority of consumers who are focussed on affordability and costs, and consumers with vulnerabilities.
3. Investment in the power system – networks, generation and retail – must be *optimised* based on consumers' demands that not a dollar more is spent a day earlier than is necessary.

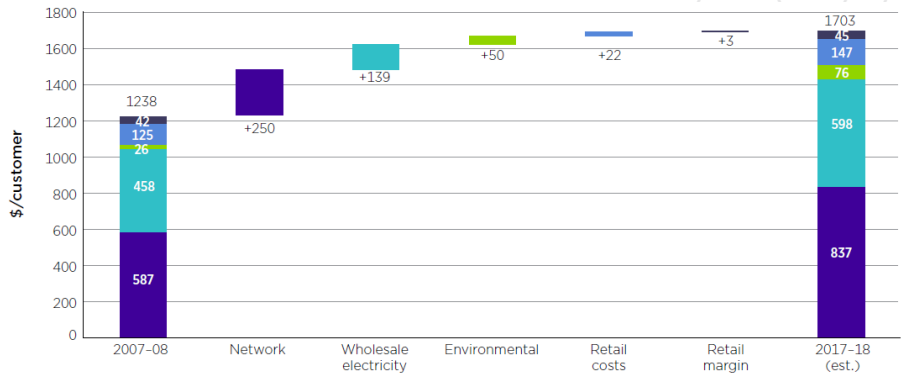
Critical context: network costs and high prices

The need for affordability to be an explicit constraint on all network decisions recognises that overall bills for Energy Queensland consumers have steadily increased over the last ten years and network costs have helped drive increases.

Figure 1 below illustrates the impacts of the cost components of a retail bill for consumers in south east Queensland, in the Energex network area.

We note that the Queensland Government's "Powering Queensland Plan" provided funding of $771 million to stabilise prices for consumers. This funded the removal of the costs of the Solar Bonus Scheme from electricity prices for three years from 1 July 2017 and directed Energy Queensland to remove these costs from its network charges. We are eager to see how the Solar Bonus Scheme costs will be treated in the 2020-25 period and beyond. On page 16, the Draft Plans tells us that the distribution network forecasts exclude the Solar Bonus Scheme. As the scheme will continue until 2028, we are yet to see how the scheme costs will be recovered after 2020.

Figure 1: Change in average south east Queensland residential bill per customer from 2007-08 to 2017-18, $ per customer, real $2016-17, excluding GST



Source: Figure 1.1, ACCC: Restoring electricity affordability & Australia's competitive advantage

The QCA continues to regulate retail prices for regional Queensland in the Ergon network area (that is, notified pricing). In its Final Determination: regulated retail electricity prices for 2018-19, the QCA explains the impact of the Queensland Government's Uniform Tariff Policy (UTP).

To give effect to this policy, the QCA uses a network cost plus retail costs methodology (N+R) to determine the cost supply. The Queensland Government then subsidises the difference to bring prices in line with south east Queensland. Regional Queensland consumers will generally face higher electricity costs due to the need to recover the costs of a large network from fewer consumers. The UTP means that customers in regional Queensland pay no more for electricity that their south east counterparts.

In its 2018-19 report, the QCA finds that lower network prices have helped to mitigate price increases in other parts of the retail cost stack.

According to Figure 4.1 in the Australian Energy Market Commission's (AEMC) 2017 Residential Electricity Price Trends data spreadsheet, average consumers in Queensland are paying around 12.84 cents per kilowatt hour (c/kWh) for network costs. Network costs across the National Electricity Market (NEM) range from 7.46 c/kWh (in the Australian Capital Territory) 14.44 c/kWh (in New South Wales).

Our framing and approach

We have engaged network revenue experts, Dynamic Analysis, as part of our assessment of Energy Queensland's Draft Plans. This assessment has sought to understand the journey that Energy Queensland and the households and small businesses it serves are on, and consequently, how this relates to its immediate and longer-term strategy.

In doing so, the assessment focuses on three key issues for consumers:

1. The need to place significant downward pressure on long-term RAB. This includes its approach to capex such as replacement; connections; and information and communication technology capex.
2. How the business is driving efficiency and productivity in operational expenditure (opex). This includes base year trends and productivity trends.
3. The revenue reward for the Capital Expenditure Sharing Scheme (CESS).

More information about the key issues is at Attachment A.

Our response

The AER is responsible for setting the maximum revenues that networks can recover from consumers through network tariffs over the five-year regulatory period. We understand that the AER must base its assessment on efficient costs and an informed view of expected electricity demand.

The Draft Plans are the first step in the revenue determination process, reflecting and gathering stakeholder feedback to inform Energy Queensland's revenue proposal to the AER.

Through five-yearly determination processes, the AER authorises the transfer of dollars from the consumer's pocket to the distribution network. This is money that the consumer would otherwise have been able to spend at their own discretion. Instead, it is turned into a guaranteed income for the distribution network in exchange for the safe and reliable delivery of electricity.

This means that consumers need to be absolutely confident that the decisions driving network investment are in their long-term interests.

Engaging with customers

We recognise that Energy Queensland has consulted with customer groups, published information on its Talking Energy website and shared the Draft Plans ahead of the formal revenue setting process. At the launch of the Draft Plans on 5 September 2018, we observed two key messages from participating stakeholders:

1. There were "no surprises" in the Draft Plans. This demonstrates early communication between Energy Queensland and stakeholder representatives to date.
2. Don't stop now. Energy Queensland has delivered savings in its Draft Plans which will see a one-off 10 per cent reduction in 2020. However, it must maintain this momentum and demonstrate that it is refining the proposal based on feedback from consumers.

Energy Consumers Australia is participating in this process with a view to finding alignment between Energy Queensland's strategy and the long-term interests of energy consumers with respect to price, quality, safety, reliability and security. We bring insights from participating in network determination

processes across the NEM, as well as information about Queensland consumers gleaned from our six-monthly Energy Consumer Sentiment Survey.

We continue to engage with Energy Queensland to find out more about the underlying drivers of its Draft Plan and provide feedback through the Regulatory Proposal and Tariff Structure Statement Working Group.

Through our grants function, we are funding the Queensland Council of Social Service (QCOSS) to participate in the determination process. We understand that QCOSS is also engaging with the Energy Queensland Tariff Structure Statement process.

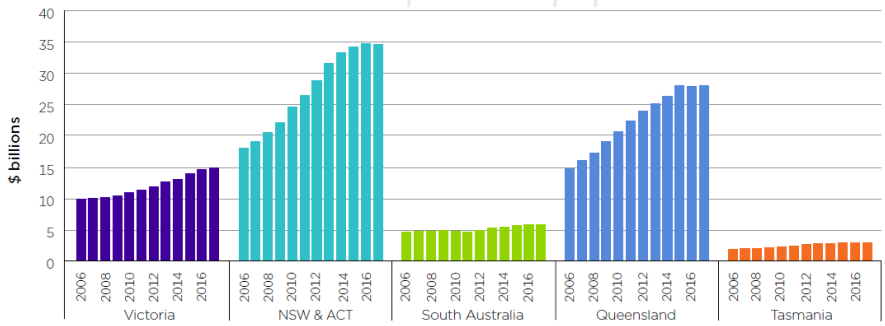
Downward pressure on the long-term RAB

Combined, the Queensland networks saw significant RAB growth from 2006-2017 (see Figure 2). Energex and Ergon Energy have high RAB values (normalised for customer numbers and size of network) compared to Victorian and South Australian networks.

Investment in the Queensland networks more closely resembles the New South Wales networks. The ACCC's final report Restoring electricity affordability & Australia's competitive advantage suggested that over-investment in the Queensland networks has resulted in consumers paying billions of dollars in extra revenue more than necessary.

We are pleased to see that Energy Queensland has reduced its RAB. However, we would like to see how Energy Queensland plans to better utilise the available capacity in its network. Data published by the AER from networks' Regulatory Information Notices (RIN) indicates that the average network's capacity utilisation in the NEM in 2017 was 0.41. RIN data indicates that both Energy Queensland businesses sit below the average NEM rate with Ergon Energy at 0.39 and Energex at 0.27.

Figure 2: RAB from 2006 to 2017, by NEM regional, real $2016-17



Source: ACCC, Restoring electricity affordability & Australia's competitive advantage

Capex

The key to affordability in the long-term is to ensure the RAB declines over time. Keeping a lid on capex provides the best means of reducing the RAB over the medium term. The 10 per cent one-off saving for Queensland consumers is welcome and stems mostly from the merger of Energex and Ergon Energy. Energy Queensland's factsheet Savings against the 2015-2020 AER allowance indicates that the savings in 2015-20 from the merger of the two businesses have largely flowed through to capex. The factsheet indicates that savings in capex will continue into the 2020-25 period when the RAB will be lower than it otherwise would have been and prices will be set based on the lower cost base.

It appears that the proposed savings stem from a commitment to reduce costs due to the merger of the two businesses, rather than through more efficient operation of the network and planned initiatives. To help us understand Energy Queensland's journey of continuous improvement, we would like to see more information about how the network is better utilising the assets it already has, and future plans for continued efficiencies across the network.

Figures 3 and 4 outline the proposed capex for 2020-25 and actual spend in the 2015-20 (current) period.

Figure 3: Ergon Energy capex trends

Real $2020	2010-2015 Actuals	2015-2020 Allowance	2015-2020 Forecast	2020-2025 Forecast
Replacement	932.38	812.83	916.01	880.00
Connections	679.29	447.75	392.08	305.90
Augmentation (incl Reliability)	908.10	562.47	301.61	257.12
Escalation	N/A	N/A	N/A	10.66
Capitalised Overheads	1,404.17	1,069.07	865.92	572.95
Total System	**3,923.94**	**2,892.12**	**2,475.62**	**2,026.63**
ICT	-	28.13	17.67	226.18
Fleet & Equipment	229.06	174.69	159.80	161.54
Property	299.41	218.65	165.14	125.46
Total Non-network	**528.47**	**421.47**	**342.61**	**513.18**
Total capex	**4,452.41**	**3,313.59**	**2,818.23**	**2,539.81**

Totals may not add due to rounding. Note: due to changes in treatment capitalised overheads and ICT cannot be compared over periods on a like-for-like basis.

Source: Energy Queensland, Our Draft Plans

Figure 4: Energex capex trends

Real $2020	2010-2015 Actuals	2015-2020 Allowance	2015-2020 Forecast	2020-2025 Forecast
Replacement	882.71	1,083.99	869.76	665.11
Connections	751.52	501.96	521.76	485.49
Augmentation (incl Reliability)	1,561.47	445.19	423.71	279.21
Escalation	N/A	N/A	N/A	9.37
Capitalised Overheads	1,381.43	926.87	783.16	517.19
Total System	**4,577.13**	**2,958.01**	**2,598.39**	**1,956.38**
ICT	-	9.61	7.96	234.46
Fleet & Equipment	214.27	163.34	122.30	109.37
Property	242.71	92.56	114.34	82.86
Total Non-network	**456.98**	**265.51**	**244.60**	**426.69**
Total Capex	**5,034.11**	**3,223.52**	**2,842.99**	**2,383.07**

Totals may not add due to rounding. Note: due to changes in treatment capitalised overheads and ICT cannot be compared over periods on a like-for-like basis.

Source: Energy Queensland, Our Draft Plans

When compared to other networks in the NEM, Energex has a very young network, while Ergon Energy's network is an average age. Energy Consumers Australia would like to understand more about how Energy Queensland plans to ensure that utilisation of the network increases, where possible, and other capex projects are deferred if not required.

Given the level of legacy inefficiencies, we believe there are still more opportunities for savings to be made for consumers.

Replacement capex (repex)

Repex is forecast to be $665.11 million for Energex (that is, 28 per cent of Energex's capex total); and $800.00 million for Ergon Energy (that is, 35 per cent of Ergon Energy's capex total).

In September 2018, we attended the AER's public forum on its Industry practice application note for asset replacement planning. The application note is being developed to help network businesses adopt best practice asset replacement planning. We would like to understand how Energy Queensland assesses repex and considers alternatives to replacing like with like; and options for pursuing non-network solutions including demand management and distributed energy resources. There may be opportunities for Energy Queensland's overall network strategy to identify synergies across a number of network areas including repex, augmentation capex and network transformation activities.

We are interested in whether Energy Queensland has considered other options such as whether it can continue to safely extend the life of the asset and therefore defer unnecessary repex spend; and other options that are open to the business for shrinking (that is, transforming) the network other than replacement.

We would also like to see Energex and Ergon Energy consider whether they can deliver projects for a lower price. Recent AER draft decisions have used benchmark unit rates to test the efficiency of a network's replacement forecast. We encourage Energex and Ergon Energy to examine the data

available on unit costs of other networks and propose efficiency targets in areas where efficiency can be targeted.

Connections capex

Connections capex is also another large part of the capex forecast. For Energex, this is $485.49 million (that is, 20 per cent of Energex's total capex); and for Ergon Energy, this is $305.90 million (that is, 12 per cent of Ergon Energy's total capex).

We would like to understand more about the impact of the connections policy and the consumers' experience. The Draft Plans indicate that the connections policy has an impact on forecast capex. After reviewing the Connections Policy Factsheet, it is unclear how the policy impacts connections capex, and we seek more information on this matter. We also seek more information on to what extent any changes to the connections policy will impact consumers.

Information and Communication Technology (ICT) capex

The ICT capex being proposed is significantly higher than in the current 2015-2020 period:

- Energex: $234.46 million in 2020-25, up from $7.96 million (an increase of $226.5 million)
- Ergon Energy: $226.18 million in 2020-25, up from $17.67 million (an increase of $208.52 million).

We understand that transformation of the network will likely involve increased expenditure in non-traditional revenue areas. Network transformation appears to be a growing area of concern for networks, as flagged in their draft plans.

For example, on page 6 of the SA Power Networks Draft Plan 2020-25, SA Power Networks indicated that it will seek $37 million to:

- Continue to adapt its network to support consumers increasing uptake of distributed energy resources like solar and battery storage
- Undertake activities to ensure security and reliability of the network
- Provide a platform for consumers to access new energy products and services and have more choice in how they buy, use and trade their energy.

Without commenting specifically on the SA Power Network's proposal, we would generally prefer to see small, demonstrator projects trialled before agreeing to consumers funding high cost new technology and services. Alternatively, networks may prefer to fund unproven projects out of their own pockets, with the option for consumers to choose to pay to access the service, if it is sure they will deliver benefits to networks and consumers.

To better understand Ergon Energy and Energex's transformation journey, we seek more information on how the proposed expenditure will help meet

the long-term interests of consumers and how consumers will benefit from this expenditure.

We also seek a greater understanding of what ICT projects will be delivered during the 2020-25 period and whether this is the beginning of the transformation journey for the businesses or completes it. What benefit will consumers see from the proposed ICT capex and how will these funds be used to better enable consumers to use the network differently, in a way that they want to?

We would also expect to see efficiencies stemming from this investment and we ask Energy Queensland to further articulate what the trade-offs in the business will look like, and how consumers will see the benefit of these trade-offs.

Depreciation

The Draft Plans propose moving Energex from the Weighted Average Remaining Life (WARL) methodology to the straight-line tracking method (also known as period by period tracking). If Energex continued to apply the WARL methodology, the forecast decrease in revenue in the 2020-25 period would have been around one per cent greater.

Energy Consumers Australia seeks more information around the modelled impacts of various depreciation methodologies.

We do not seek to prescribe a particular depreciation methodology. However, as mentioned previously, affordability should be a constraint on network costs. We would like to see Energy Queensland better articulate what the benefits to consumers will be, if not in the short term, then in the long term.

Driving efficiency and productivity in opex

The AER's 2017 Annual Benchmarking Report for distribution networks indicates that there may still be some opportunities for Ergon Energy and Energex to pursue greater efficiencies. A number of metrics suggest Ergon Energy and Energex are performing in the mid-range of networks on the AER benchmarks of opex, such as multi-factor productivity.

In this light, we would like to see Ergon Energy and Energex pursue greater, more ambitious productivity savings above 0.6 per cent per year.

Capital Expenditure Sharing Scheme (CESS)

To provide an incentive for networks to apply effort to being more efficient in their use of capex, the revenue determination process allows networks to retain some of the benefit of efficiency savings. In the ordinary course of events this would occur because the revenue allowance would include return of and for the capital that was not spent.

The CESS operates to normalise this incentive so the benefit to the network is the same for a capex saving irrespective of the year in the period it is made, and to equivalize the incentive to that for opex (that is, 30 per cent of the benefit is retained by the network assuming a 6 per cent rate of return).

The arrangement works equally as a normaliser of over-expenditure through inefficiency.

We support initiatives that ensure that investment is optimised based on consumers' expectations that not one more dollar is spent than is required and new investments are not made one day earlier than is necessary. We also strongly support incentives for networks to deliver projects at a lower cost.

The incentive is intended to reward efficiency improvements; delivering the same projects at lower cost. We are concerned that the capex forecasts put forward by Ergon Energy and Energex for 2010-15 and 2015-20 were unrealistic and represented an inefficient capital program. We are encouraged that the organisations took positive measures to ensure that not one more dollar was spent than required. However, a network should not be rewarded for spending less than an inefficient forecast or for deferral through lack of demand.

We would like to see more information on whether Ergon Energy and Energex will propose a reward for underspending capex. The reward should only be provided for cost efficiency in delivery, rather than forecasting inaccuracy.

Concluding comments

We appreciate Energy Queensland's willingness to continue the conversation with us in the lead up to finalising its revenue proposal.

Shortly before lodging this submission we spoke with key personnel from Energy Queensland to gain a deeper understanding of some of the underlying drivers of the strategy in the Draft Plan. We were encouraged by what we heard about the future network and Energy Queensland undertook to provide us with more information on ICT capex and depreciation.

We will be providing future comments on the proposed tariff structure statements in this engagement.

We believe that Energy Queensland is in a unique position to take advantage of opportunities for greater efficiency and productivity across its operational and capital expenditure programs. As energy affordability is important to consumers supplied by Energy Queensland, it is also a key concern for the Queensland Government and it is keen to deliver results. In addition to its instruction to Energy Queensland to deliver savings to consumers in the current regulatory period (from which the 10 per cent one-off reduction in the next regulatory period stems), in Parliament on 4 September 2018 Queensland Premier, the Hon. Annastacia Palaszczuk, stated that "Queenslanders cannot afford to wait for the federal government, so my government will get on with the job of delivering cheaper, more reliable power for Queenslanders".

We look forward to seeing how Energy Queensland incorporates consumer and other stakeholder feedback into its proposals.

If you have any questions about our comments in this submission, please contact Shelley Ashe, Associate Director Advocacy and Communications on 02 9220 5514 or by email at shelley.ashe@energyconsumersaustralia.com.au.

A Suite 2, Level 14, 1 Castlereagh Street, Sydney NSW 2000
T 02 9220 5500
W energyconsumersaustralia.com.au

@energyvoiceau
in /energyconsumersaustralia
f /energyconsumersaustralia

ABN 96 603 931 326

ENERGY CONSUMERS AUSTRALIA