Submission to the remitted revenue determinations for NSW/ACT 2014-19 and Essential Energy proposal

6 March 2018

ENERGY CONSUMERS AUSTRALIA

1. Summary

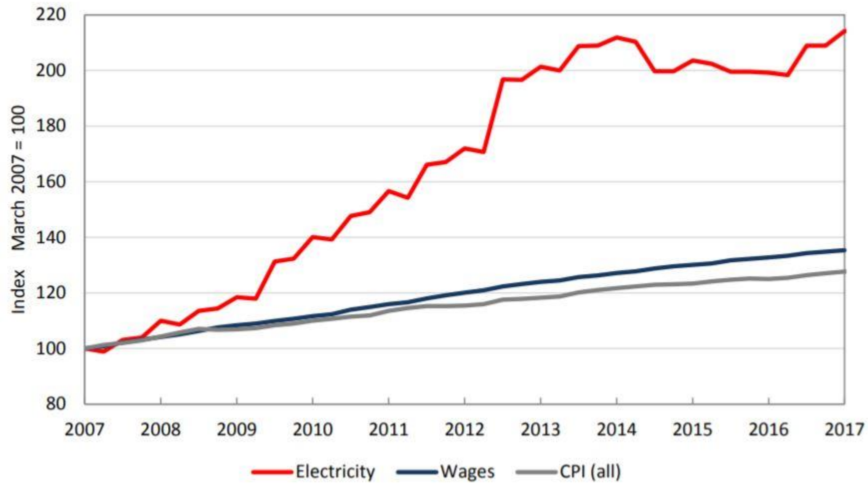
This submission responds to the Australian Energy Regulator's (AER) position paper, *Remitted debt decisions for NSW/ACT 2019-19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement* (the Position Paper). It also comments on Essential Energy's proposal to the AER regarding the remittal (the Essential Proposal).

Energy Consumers Australia supports the AER's proposed approach, which will see networks transitioned to a trailing average approach to calculating the cost of debt in a manner that will not result in any increase in overall revenue collected from consumers. As previously stated, Energy Consumers Australia also believes that the Essential proposal is in the long-term interest of consumers.

2. The network price imperative

The electricity affordability crisis in the National Electricity Market is well known. As shown in Figure 1, the Australian Competition and Consumer Commission (ACCC) recently reported that the electricity prices faced by many residential and small business users have increased by 80-90% above inflation since 2008.[1] These price rises have left many people unable to make their homes safe and comfortable. Electricity and gas prices are also hampering the competitiveness and viability of Australian business, small and large.

Figure 1: Increases in electricity prices compared to wages and overall Consumer Price Index



Source: ABS, Consumer Price Index 6401.0 and ABS, Wages Price index 6345.0, Australia.

1 ACCC, *Retail Electricity Pricing Inquiry – preliminary report*, 2017, 12. Available at: https://www.accc.gov.au/publications/accc-retail-electricity-pricing-inquiry-preliminary-report

Energy Consumers Australia's Energy Consumer Sentiment Survey consistently shows that consumers remain unhappy with the outcomes that the energy market is delivering. This result should be understood in the context of the ACCC finding that network cost increases made the greatest contribution to electricity price increases since 2008 (ahead of retail, generation and green scheme costs).[2]

This context emphasizes the importance that energy networks must plan and operate their businesses with affordability as a constraint. The achievement of the National Electricity Objective (NEO) and the promotion of the Long-Term Interests of Consumers requires that consumers must not pay one dollar more than is necessary for network services at the quality and reliability that they desire.

It is similarly vital that the AER effectively executes its responsibility to set network revenues and prices consistent with the NEO and to promote the Long-Term Interests of Consumers.

2. AER Position Paper – remittal of the cost of debt

2.1 Background

The Position Paper outlines the AER's proposed approach to setting the cost of debt for Ausgrid, Endeavour Energy, Essential Energy, ActewAGL Distribution and Jemena Gas Networks for the current regulatory control period. The AER made its original decisions for these networks almost three years ago, on 30 April 2015 or 3 June 2015. Appeals of the AER's debt decisions for all five networks were subsequently heard together by the Australian Competition Tribunal (the Tribunal) as part of *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016].

As shown in Table 1, the AER Position Paper states that the difference between the five network's revised proposals and the AER final decisions on the cost of debt is significant - $1.2 billion.[3]

Table 1: Differences between network revised proposal and AER final decision for the cost of debt ($million, nominal)

Network	Amount
Ausgrid (2014-19)	558.58
Endeavour Energy (2014-19)	227.12
Essential Energy (2014-19)	276.90
ActewAGL Distribution (2014-19)	44.18
Jemena Gas Network (2015-20)	92.07
TOTAL	**1,198.85**

2 Ibid, 34.

3 AER, *Remitted debt decisions for NSW/ACT 2019-19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement,* December 2017, 6-8. Available at: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/essential-energy-determination-2014-19-remittal

In its decision in the above matters, the Tribunal found that the AER had erred in finding that the benchmark efficient entity (BEE) to be used for calculating the return on debt was necessarily a regulated business. Nonetheless, the Tribunal's decision provided that in remaking its decision, the AER was to use a BEE with "a similar degree of risk as that which applies to the relevant [distribution network service provider] in respect of the provision of standard control services".[4]

Energy Consumers Australia agrees that in remaking its decision, it is open to the AER to arrive at the same end point for the cost of debt determination, while still complying with the parameters set out in the Tribunal's decision in *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016].

2.2 The AER's proposed approach

The key issue at stake in the remaking of the cost of debt decision relates to the method of transitioning the networks in question from the on-the-day approach to the trailing-average approach. The Position Paper states that the AER intends to "move the service providers to a trailing average and apply revenue neutral transitions in moving them to this methodology".[5] The AER acknowledges that its "approach is effectively a combination of the on-the-day methodology and trailing average methodology",[6] which, Energy Consumers Australia notes, bears some similarity to the ten-year transition contained in the AER's 2015 decisions.

The AER has since considered the approach to determining efficient debt financing costs, with the benefit of two subsequent decision by the Tribunal (in the cases of ActewAGL Distribution (Gas)[7] and Jemena Electricity Networks[8]), both of which affirmed the AER's initial determination. Rather than provide the full reasoning and result of this approach, the Position Paper refers stakeholders to Attachment 3 its recent APA VTS gas access arrangement 2018-22 Final Determination. In that decision, the AER states that a ten-year transition to the trailing average approach is appropriate because:

> current debt costs in the market reflect efficient financing costs and we consider correct compensation in a present value sense (or an allowance that meets the NPV=0 condition) is required to meet the [Allowed Rate of Return

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4 *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACmpT1 [913].

5 AER, above n 3, 12.

6 Ibid.

7 *Application of ActewAGl Distribution* [2016], ACompT6

8 *Application of Jemena Electricity Networks (Vic) Ltd* [2016], ACompT7

Objective] and to achieve the [National Electricity Objective]/[National Gas Objective].[9]

2.3 Energy Consumers Australia supports the proposed approach

Energy Consumers Australia takes the view that the AER's proposed approach is consistent with the relevant requirements contained in the decisions of both the Tribunal and the Full Federal Court in relation to *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016].

While the proposed approach does not include the immediate and full introduction of the ten-year trailing average for the return on debt, Energy Consumers Australia believes that it addresses the issues identified by the Tribunal in the NSW appeals. A gradual transition to the trailing average has been upheld twice by the Tribunal. Energy Consumers Australia further notes that, the Full Federal Court recently affirmed this approach to debt in its decision on SA Power Networks.

Finally, Energy Consumers Australia agrees with the AER that at this point in time and under current circumstances, the long-term interest of consumers will be given best effect by a remade approach to determining the cost of debt that is revenue neutral with the AER's 2015 approach. That is, there will be no increase in the revenue collected from consumers as a result of the remade decision on the cost of debt, compared to the original decision.

3. Essential Energy remitted determination

On 30 November, 2017, Essential Energy wrote to the AER with a proposal for how its 2014-19 revenue determination should be remade.[10] In essence, the Essential Proposal is that the business be allowed to retain $100 million in additional revenue from consumers as a result of the decisions of the Tribunal and Full Federal Court. Essential stated that it would be forgoing an additional $381m to which it was entitled under those decisions. In the letter, Essential also made certain commitments about elements of its 2019-24 initial regulatory proposal and sought a three-month extension to the deadline to submit that proposal.

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9 AER, *Final Decision: APA VTS gas access arrangement 2018 to 2022, Attachment 3 – Rate of Return,* November 2017, 103. Available at: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/apa-victorian-transmission-system-access-arrangement-2018-22/final-decision

10 Letter from John Cleland to Paula Conboy, 30 November, 2017, available at: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/essential-energy-determination-2014-19-remittal/proposal

Essential has since released a draft regulatory proposal that contains real price increases of 1.63% each year, for five years.[11] These sustained increases are despite notable (and proposed) reductions in both Essential's operating and capital expenditure per customer. The ongoing price increases are driven by the effect of Essential's large regulated asset base (RAB) and the weighted average cost of capital (WACC) that will apply under the AER's Rate of Return Guideline. Energy Consumers Australia is concerned that the RAB and WACC factors are driving ongoing price increases, despite the Essential's best efforts to achieve price reductions.

Having considered this issue carefully, Energy Consumers Australia believes that the AER needs to conduct a thorough review of the operation of the regulatory framework to understand how network revenue requirements continue to increase despite reductions in costs.

Nonetheless, Energy Consumers Australia supported, and continues to support, the remaking of Essential's 2014-19 revenue determination as proposed. On 27 November, 2017, Energy Consumers Australia wrote to Essential Energy to indicate this support, on the basis that the proposal was in the long-term interest of consumers.[12] Energy Consumers Australia took this view on the basis that under the Proposal, Essential will receive a maximum of $100m in additional revenue stemming from the Tribunal, and subsequent Federal Court, decisions. This amount represents 5.8% of the total amount Essential stated, in its initial applications to the Tribunal, that it had lost as a result of AER errors in the final 2015 determination.[13] ECA believes this is a reasonable outcome, given the costs associated with restructuring the Essential workforce to a more efficient level; one which means consumers are not paying any more than necessary for energy network services.

If you would like to discuss anything related to this issue further, please contact Oliver Derum, Associate Director of Advocacy and Communications, on (02) 9220 5514 or oliver.derum@energyconsumersaustralia.com.au.

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11 Essential Energy, *Empowering communities to share and use energy for a better tomorrow: Draft 2019-24 Regulatory Proposal*, February 2018, 6. Available at: http://www.woolcott.com.au/EssentialEnergy/

12 Letter from Rosemary Sinclair to Gary Humphries, 27 November, 2017, available at: https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/essential-energy-determination-2014-19-remittal/proposal

13 Essential Energy stated in their initial application to the Tribunal that the AER's errors had disallowed $1.716 billion in required revenue. See Essential Energy, *Application for leave and application for review*, 21 May 2015, [25], available at: http://www.competitiontribunal.gov.au/current-matters/tribunal-documents/act-7-2015

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