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Gavin Fox  
General Manager  
Australian Energy Regulator  
GPO Box 3131  
Canberra ACT 2601

Email: [energyqueensland2025@aer.gov.au](mailto:energyqueensland2025@aer.gov.au), [SAPN2025@aer.gov.au](mailto:SAPN2025@aer.gov.au)

Dear Mr Fox,

**RE: Submission to the Energex, Ergon Energy and SA Power Networks regulatory proposals**

Origin Energy (Origin) appreciates the opportunity to provide a response to the regulatory proposals lodged by Energex, Ergon Energy and SA Power Networks for their electricity distribution networks for the period from 1 July 2025 to 30 June 2030 and the accompanying AER Issues Paper.

Origin supports prudent network expenditure that strikes a balance between maintaining the safety and reliability of the networks while supporting the energy transition and changing energy consumption patterns. With current cost of living pressures, it is critical that network businesses and the AER ensure that these objectives are met at least-cost.

Energex, Ergon Energy (Ergon) and SA Power Networks (SA Power) propose substantial real increases in revenue compared to the current 2020–25 period (19.1 per cent, 16 per cent and 7.5 per cent respectively). While increased interest rates and inflation forecasts are a significant contributor to the revenue increase, capital expenditure (capex) overspends in the current regulatory period and further forecast capex increases substantially increase the regulatory asset base and associated AER return on capital allowance. We support the AER's proposed detailed interrogation of forecast capex.

We are concerned with the forecast significant capex overspend for Ergon during the 2020-25 regulatory period (74 per cent higher than the AER's 2020–25 final decision forecast). We support the AER's proposed ex-post review of Ergon's capex and seek to understand Ergon's forecasting methodology and the AER's assessment approach for the 2020-25 capex forecasts, particularly in relation to replacement expenditure.

We support proposed tariff reform aimed at promoting cost reflectivity and accommodating the development of consumer energy resources. However, we strongly oppose the Energex and Ergon proposal to adopt demand tariffs as the default residential customer tariff. Demand tariffs are too complex for customers to understand and are not provided for in the AER's Default Market Offer (DMO) framework.

Ultimately, the decision to apply cost reflective tariffs to end customers rests with retailers. It is the role of the retailer to balance considerations, including simplicity, customer impact and the management of financial risk. It is critical that retailers retain the flexibility to package their offers to suit their customer requirements.

Finally, Origin acknowledges the customer engagement process undertaken by the electricity networks to inform their proposals and the ongoing effort to incorporate the long-term interest of customers in their forward planning.

Further details on these matters are provided at Attachment A.

If you have any questions regarding this submission, please contact me in the first instance at

[REDACTED]

Yours sincerely

[REDACTED]

Gary Davies  
Manager Regulatory Policy

[REDACTED]

## Attachment A

### Capital expenditure

Ergon anticipates a significant capex overspend in the current (2020-25) regulatory period compared to forecast expenditure (expected to be \$2,057 million (74 per cent) above forecast). Ergon indicates that replacement capex (repex) accounts for over 90 percent of the expected overspend.

Ergon expects to overspend its repex forecast for the 2020–25 period by \$1,273 million (or 118 per cent). The key driver of the overspend is increased pole replacements. In addition, increased pole replacements have driven an increase in replacements of assets attached to the pole such as crossarms, switches and transformers. Ergon indicated that increasing pole failures and improvements in the inspection process (identifying an increased number of poles requiring replacement) necessitated an acceleration of pole replacements in the period.

Ergon also expects a significant overspend in its overhead lines' clearance to ground and clearance to structure program. Ergon indicates that improvements to the process for identifying breaches in the clearance program resulted in a significant increase in the identification of breaches resulting in increased expenditure on the clearance program.

We are concerned that Ergon failed to previously identify such a significant amount of (apparently) required expenditure. Ergon's previous asset management strategy clearly failed to identify the increased safety risks and compliance breaches which Ergon is now addressing via the significant current period overspend and a further step-up in capex in the forthcoming period. We support the AER's ex-post review of past capex but encourage the AER to not only consider the prudence and efficiency of the expenditure but also whether Ergon rather than customers should fund all/part of the expenditure given Ergon's own processes failed to adequately address its safety and compliance obligations.

We also seek a better understanding of how the AER determined Ergon's 2020-25 approved repex allowance and how safety and compliance obligations were considered within this process. Given the proposed significant shortfall in required expenditure we question whether the AER's process requires refinement going-forward to ensure the allowed expenditure better reflects actual requirements particularly where these address safety and compliance obligations.

We note that all three network providers forecast significant uplifts in capex in the 2025-30 regulatory period compared to allowed current period capex (20 per cent Ergon and 21 per cent for Energex and SA Power). Networks argue the increased capex is required in response to increased demand and to maintain the safety, reliability, quality, and security of the networks. Given the significant impact on customer tariffs, we support the AER's proposed detailed assessment of the capex proposals, particularly the prudence and efficiency of expenditure and whether appropriate risk profiles have been applied. We also request that the AER examine whether the asset management practices and risk profile underpinning the forecasts increase in capex in the 2025-30 period are appropriate, particularly in relation to Ergon's (largely rural and regional) network.

### Productivity measures

We support the Energex and Ergon proposals to apply an annual opex productivity of 1 per cent (above the AER mandated 0.5 per cent) and a 1 per cent productivity factor for capitalised overheads. In addition, we support Ergon's proposal to self-fund \$121.3 million of current period Information and Communications Technology capex that exceeded the AER allowance.

Similarly, we support SA Power's proposal to apply an annual opex productivity factor of 0.5 per cent (consistent with the AER's mandated requirement).

### Legacy metering

We support the proposal from all three networks to classify legacy metering as standard control rather than as alternative control services to reduce the cost burden on remaining customers through the transition to

smart meters. Similarly, we support the recovery of legacy metering costs from all small low voltage customers and consider this represents a fair and equitable charging arrangement.

### **Tariff reform**

Tariff reform represents a significant component of the Energy Queensland (Energex and Ergon) and SA Power regulatory proposals. Key reforms include:

- Further development and refinements of cost-reflective tariffs, including Energy Queensland's proposal to assign new residential customers to residential time-of-use (TOU) demand and energy tariffs with plans to move to demand or capacity charges only over time.
- Changes to charging structures and charging windows (peak, off-peak, solar sponge) in response to changing consumption patterns/changing peak demand.
- The introduction of export tariffs, including a basic (free) export level, a modest export charge and a reward/rebate component during peak import periods.

Comments on the proposed reforms are provided below.

#### *Cost-reflective tariffs*

The principles of cost reflective tariffs are well understood – charges recovered from a customer should reflect the cost to serve that customer. Cost-reflective tariffs encourage customers to shift their usage from peak times (or discourage exports when the network is overloaded). This can reduce the need for network augmentation, reducing costs for all customers and provide flexibility for those customers who are able and willing to respond to the tariff signals to lower their energy costs.

Origin recognises the importance of reforming network tariffs. By sending clearer signals to consumers about the cost of supplying electricity, consumers will be better placed to make more efficient decisions about how much electricity they use and when to use it. This will remove cross-subsidies and result in more efficient future network expenditure.

While the theoretical underpinnings of cost reflective pricing are well established, it is important that customer implications are also considered. The ability and willingness of consumers to adjust consumption in response to cost reflective tariff structures and thus maximise their benefits is critical. In many cases customers are either unable to effectively modify consumption patterns or simply do not sufficiently understand the tariff structures in order to take advantage. Where customers do not respond to cost reflective tariffs or are adversely impacted the benefits of cost reflective tariffs are not fully realised.

For successful tariff reform, customers must be able to understand their tariffs so that they can optimise their benefits or at least minimise negative impacts. The necessary preconditions for this are broad-based customer education and sufficient penetration of demand response technology. We strongly believe these pre-conditions must be provided to help deliver the benefits of cost reflective pricing.

Cost reflectivity operates on a spectrum, for example, the widespread use of postage stamp pricing rather than locational pricing, suggests that pure cost reflectivity is not necessarily feasible or desirable – a degree of cross-subsidy is acceptable. Similarly, the objective of cost reflective tariffs should be to encourage a change in consumer behaviour in a way that improves network efficiency, but not at any cost. As the AER demonstrated in its recent DMO draft determination, customer considerations need to be balanced against theoretical objectives (e.g. promotion of retail competition). We suggest that the AER apply a similar approach in considering cost reflective tariff options, particularly the proposed introduction of demand tariffs.

We do not support Energy Queensland's proposal to adopt demand tariffs as the default residential customer tariff and the increasing reliance on the demand charging component of these tariffs. The application of a demand tariff across all residential customers suggests there are (or will be) capacity constraints across the entire Queensland network. While we accept that there are parts of the network that are constrained, it is highly unlikely that the entire network is constrained. There are simpler and more

targeted ways to relieve pressure on congested parts of the distribution network other than a broad-based demand tariff including, for example, battery solutions. These solutions do not unnecessarily impact other residential customers in uncongested parts of the network. We consider that further analysis is required to support any application of residential demand tariffs, including the network constraints that are being targeted and an assessment of alternative options.

Notwithstanding the above, demand tariffs are a difficult concept for customers to understand and respond to. It is questionable whether customers have the capacity and/or motivation to manually respond to demand tariffs in an optimal way.<sup>1</sup> As a result, the potential for adverse customer impacts is heightened. We note that, in response to stakeholder feedback that demand tariffs are difficult to understand, SA Power closed its residential prosumer demand tariff and created a time-of-use energy prosumer tariff. In proposing the introduction of default demand tariffs, we are concerned that the needs of the Queensland network businesses are being prioritised over those of customers. We consider there needs to be an appropriate balance between network objectives of addressing peak demand issues and the wider customer implications.

We note also that the AER's DMO does not provide for the application of demand tariffs. Demand tariffs present a range of issues including significant variability meaning there is no practical means of applying the DMO to demand tariff offers. We question the proposed introduction of default residential demand tariffs where these cannot be accommodated within the DMO framework. We seek the AER's feedback on this issue.

Retailers are the 'customer-facing' component of the energy supply chain. The retail offer encompasses all elements of the energy supply chain, including volatile and unpredictable wholesale energy costs as well as the network cost component. Ultimately, it is up to the retailer to decide how to reflect price signals in their retail offers. How the retailer packages its retail offers reflects a number of considerations, including simplicity, customer understanding, anticipated uptake of offers and the management of financial risk.

The decision to pass-through cost reflective network tariffs often reflects the complexity of the tariff and the perceived ability of the customer to measure and respond to the price signal. For example, we consider that demand charges are difficult to explain to residential customers and customers typically cannot easily measure their demand and respond to these charges. For these reasons we are generally reluctant to pass through demand charges to customers. This position may change as effective smart demand response technology that enables greater energy management is available or economic for the vast majority of residential customers. We consider that retaining the flexibility for retailers to package their offers to suit their customer requirements is critical.

Energex and Ergon identify significant bill increases (averaging 13 per cent in the first year) for customers moving from the residential transitional demand tariff to the default TOU demand and energy tariff. We request that Energex and Ergon clarify how they propose to manage these residential bill impacts.

#### *Export tariffs*

Origin supports export pricing that efficiently reflects the cost imposed on networks by exporters, minimising the need for network augmentation, while incentivising exports where these provide benefits to the network. We appreciate that the proposed export tariffs are relatively basic and are largely intended to introduce customers to the concept of export tariffs. We would expect export tariffs to be refined over time.

Implementing export charges will incur additional costs for retailers, for example to change billing systems. These costs are typically passed on to customers through retail tariffs. To be worthwhile for customers, the uptake of export tariffs and the customer benefits need to be sufficient to offset the additional cost of retailer implementation.

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<sup>1</sup> Asset orchestration services can assist in this area, but these remain in the early stages of development and application.

Based on our preliminary analysis, we consider that a significant proportion of customers are likely to exceed the basic export limit and thus incur additional costs. We seek further information on export tariff bill impacts, including the assumed average solar system size, volume of exports and assumed customer utilisation of export rewards.

We recognise that the application of export charges is likely to encounter some resistance, especially from existing solar customers who may be unable to adjust their behaviour to respond to the new charges. Accordingly, it is essential that the introduction of export charges be accompanied by a comprehensive customer education campaign that clearly explains the rationale and benefits of applying export charges. We consider that both state governments and network businesses should have a central role in providing information to customers. We request that the AER clarify how and by whom any education campaign should be delivered.