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13 February 2015

Mr Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

by email: NSWACT@aer.gov.au

Dear Mr Anderson,

Re: NSW Electricity Distribution Network Determinations 2014-19: AER Draft Decisions and Revised Regulatory Proposals

AGL Energy Ltd (AGL) welcomes the opportunity to provide comments on the Australian Energy Regulator's (AER) Draft decisions for the New South Wales distribution networks determinations as well as the corresponding networks' Revised Regulatory Proposals.

AGL operates nationally across the energy supply chain and has investments in coal-fired, gas-fired, renewable and embedded electricity generation. AGL is Australia's largest private owner, operator and developer of renewable generation in Australia, and is also a significant retailer of energy with more than 3 million electricity and gas customers. As one of the largest energy retailers in Australia, AGL is well placed to comment on issues in the industry.

These are the first draft decisions made by the AER under the recent changes to the National Electricity Rules (NER) and National Electricity Law (NEL) and AGL is encouraged by the principles and approaches used by the AER in meeting the amended NER and NEL requirements. AGL supports

- the draft decisions taking an holistic view rather than forensic analysis of individual components whilst ensuring that the constituent components comply with the NER;
- determining the networks' capital costs that a prudent operator would require given realistic expectations of energy demand, changes in cost inputs and the current legal obligations of running a reliable and safe network;
- deriving the networks' operating expenditure allowance at the total level by benchmarking against an efficient base level of operating cost and making no decisions on how the businesses allocate this expenditure in running their networks;
- utilising its rate of return guideline to determine a rate of return that is commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk; and
- the AER's treatment of exit fees in its draft decisions which complement the national policy direction of introducing competition for metering and related services.

In its submission on the NSW networks' regulatory proposals, AGL considered that the initial proposals had not sufficiently taken into account changes to electricity consumption and peak demand forecasts, current financial market conditions or new reliability requirements as well as disregarding the inefficiencies revealed when benchmarking the NSW networks against other Australian network businesses.

AGL therefore considers that the AER draft decisions have more effectively accounted for these changes than the networks' regulatory proposals and is therefore more likely to provide a consistent and balanced framework that encourages efficiency in electricity networks for the long term interests of consumers.

In reviewing the NSW networks' revised regulatory proposals, AGL notes some of the networks' specific concerns that the AER should address in its Final decisions and these are highlighted below. However, AGL is surprised that the revised proposals fail to address the AER's primary concerns regarding efficiency of spend and an appropriate level of total revenue given prevailing market conditions and asset utilisation.

AGL believes these revised regulatory proposals remain heavily weighed to the benefit of the businesses with inadequate regard given to efficient investment, operation and use of electricity services for the long term interests of consumers. This gives the AER little choice but to maintain the positions it has posited in its draft decisions.

AGL would make the following comments regarding the constituent cost components in the draft decisions and revised regulatory proposals.

Capital Expenditure

The networks' revised regulatory proposals have largely rejected the AER's top down approach to assessing an appropriate level of capital expenditure and instead have made only minor reductions to the forecast capital spend.

As the NSW networks:

- spent well in excess of historical levels in the last regulatory period due to expected demand growth which did not eventuate; and
- are facing no demand or energy growth in the current regulatory period;

it is hard to justify that they require further high levels of capital investment in this regulatory period.

The AER has predominantly accepted the networks' capital spend for new customers so the focus on record levels of network asset replacement is inexplicable given the low levels of asset utilisation, forecast to decline further, the relatively young age of the networks and the poor efficiency of capital and regulatory asset base benchmarks compared to their peers.

AGL supports the AER draft decisions given that consumers are unlikely to derive any benefits from increase capital expenditure allowances, even if used, over this period.

Operating expenditure

AGL supports the AER's use of benchmarking to establish distribution networks' base operating expenditure noting that the AER was conservative in its benchmarking approach by providing additional allowance to cater for exogenous environmental differences and using the weighted average of relatively efficient networks rather than focussing on the most efficient provider.

AGL also agrees with the AER that it is not feasible to consider historical operating expenditure of the NSW networks as a basis for their future operating spend given they are shown to be clearly inefficient.

The NSW networks have made some nominal reductions to forecast operating expenditure in their revised regulatory proposals but continue to rely on recent historical spend in making their proposal and AGL believes this is untenable given the inefficiencies revealed through the benchmarking process.

The networks have identified some issues with the AER benchmarking and where material, AGL supports the correction of errors and enhancements to the AER benchmarking model be made before the AER's Final decisions are made. However, AGL does not believe there this is any justification for the AER to move away from benchmarking as the basis for determining the efficient operating spend for these networks.

AGL also supports the draft decisions that no expenditure will be subject to an Efficiency Benefits Sharing Scheme over the 2015–19 regulatory control period.

Transitional determination

The transitional regulatory control determination made for 2014–15 was to allow for an expedited transition to the new rules with the understanding that the placeholder revenue allowance for 2014-15 would later be 'trued-up' in the determination for the 2015–19 regulatory control period.

AGL understands that the ‘true-up’ is therefore measured as the difference between the placeholder revenue for 2014–15 and the notional annual revenue requirement for 2014-15 determined by the AER in its draft decision and that this revenue is returned to customers over the 2015–19 regulatory control period (adjusted for the time value of money).

AGL feels this mechanism is punitive to the NSW network businesses with regard to their 2014-15 operating expenditure. A true-up of all other revenue components such as capital expenditure, depreciation and rate of return is required but these businesses have little control over their 2014-15 operating expenditure at this point in time.

AGL opposes the AER allowing the NSW networks to transition to efficient levels of operating and capital expenditure over the forecast period and making NSW consumers pay the cost as they slowly improve efficiency. However, given this transition is rejected by the AER, AGL believes that operating expenditure should in principle be omitted from the 2014-15 true-up.

Rate of Return

AGL supports the AER’s use of its Rate of Return Guideline (Guideline) for determining a rate of return which balances the interests of the distributions networks and electricity consumers. Its draft decision estimate of 7.15 per cent (nominal vanilla) provide such a balance and meets the rate of return objective encompassed in the NER.

AGL again notes that the AER guidelines were extensively consulted upon and AGL considers the final decision a compromise. While AGL would argue on different input assumptions, the headline result attempted to provide an equitable balance between the interests of consumers and investors with the AER determining conservative estimates at the top end of the calculated range for most parameters.

Conversely, AGL does not believe the rate of return submitted by the NSW networks in their initial and revised regulatory proposals meets the objective as they are significantly higher than an efficient financing costs given the low levels of risk faced by these distribution networks.

AGL is surprised that the NSW networks have not adjusted the rate of return estimates in their revised proposals and encourages the AER to maintain its single definition of the benchmark efficient entity.

To do otherwise would require an inconsistent methodology with varied rates of returns for the different networks depending on past debt financing behaviour. Given the asymmetry inherent in such a method (i.e. no network will submit that its financing is lower than the benchmark efficient entity), the result of such an approach will be that electricity consumers will pay for a rate of return that, on average, will be greater than that achievable by a benchmark efficient entity. It would fail to meet the rate of return objective.

Alternate Services - Metering

AGL supports the AER’s treatment of exit fees in its draft decisions as it is in line with the policy direction and regulatory arrangements currently being developed to support the introduction of competition for metering and related services.

AGL also believe that the AER’s decision to move the cost of stranded metering assets to the Standard Control Services will further the National Electricity Objective as smart metering solutions will facilitate the move towards cost reflective tariffs which are fundamental to achieving efficient use of and investment in distribution networks.

AGL is concerned that the NSW Distribution networks in their revised regulatory proposals have requested the recovery of administration charges for customers who transfer to a third party meter provider in the range of $36-65 per meter removed.

We believe these charges as excessive for the function performed. AGL therefore:

- cannot support the introduction of what the revised proposals refer to as a 'meter transfer fee' or similar; and
- believe that support for exit fees, including administrative fees, as an Alternate Control Services charge, will result in a significant barrier to entry on the commercial deployment of smart meters (i.e. the Market Led approach).

Ancillary Network Services Fees

AGL is pleased to note that the proposed fees in the DNSPs revised regulatory proposals have generally decreased, however AGL considers that they are still high and out of alignment with other states in many instances. AGL continues to support Ausgrid's proposed special read and move in and move out fees.

In reviewing the networks' proposed fees there appear to be inconsistencies. AGL understands that a consistent methodology was applied in calculating the network fees so these variances raise questions as to whether the fees are truly cost reflective.

Table 1: Revised Disconnection/ Reconnection Fees

	Ausgrid	Endeavour	Essential Energy
Disconnection – Meterbox [failed]	$43.89	$75.52	$85.16
Disconnection/Reconnection – Completed [non-technical]	$143.44	$227.43	$113.68
Disconnection/Reconnection – Technical	$241.11	$275.18	$113.68
Disconnection/Reconnection - Pillar/Pole Completed	$767.24	$469.50	$419.15
Disconnection/Reconnection- Pillar/Pole [failed]	$319.82	$200.39	$85.16
Reconnection outside business hours	$98.77	$85.29	$112.51
Special Meter Reading	$10.08	$36.80	$75.02

The revised regulatory proposals outlines that travel time, locating adequate point to disconnect, negotiating with the customer and others inputs are used to calculate Reconnection/Disconnection fees. If these factors have been used by all networks it is unclear why:

- Essential Energy is the lowest failed disconnection fee when it is the most rural network and must factor in higher travel time;
- Endeavour's completed disconnections fees on the whole are much higher than the other networks when there is no clear differential;
- Ausgrid's fee for performing a disconnection/reconnection – pillar/pole is approximately $300 more than the other network' same service;
- longer travel times impact Essential Energy's special read fees (making them 7 times greater than Ausgrid's) but do not impact other services equally.

AGL supports the AER decision that the proposed labour rates are too high based on the Marsden Jacob analysis of networks' labour rates and on-costs. Networks NSW have argued that labour rates have been set by using actual information from their current Enterprise Bargaining Agreement 2012 and that these rates are cost reflective and efficient.

AGL queries whether these labour rates are efficient or even a current reflection of the NSW labour market. There is no justification provided as to why local market conditions require much higher labour rates than other states so the AER's benchmark of labour rates and on-costs against other states is appropriate.

Each network uses third party providers to perform services. The use of third parties to provide services should allow for more competitive efficient pricing but it is not clear when these services are used by each network. Service fees should reflect the efficient costs which are likely to be third party service provider rates.

If the networks are tied into inefficient collective bargaining agreements that are driving up the cost to perform these services then AGL suggest that some services, such as special meter reads, could be carried out by retailers or their appropriately accredited agents. Retailers operate in a competitive environment and have more incentive to operate efficiently and carry out services at lower costs to the advantage of the customer.

Disconnection and Reconnection fees

AGL encourages the AER to revisit their decision to not separate disconnection and reconnection fees.

AGL notes that Endeavour does not oppose the separation of disconnection and reconnection fees. Endeavour clarifies that it is rare for a new customer to reconnect after another customer has been disconnected for non-payment and so there is no disadvantage to customers. Endeavour also advises that they are willing to provide more detailed fee estimates if the separation of fees were to be considered further by the AER. Ausgrid and Essential Energy have not provided any view on the splitting of the service and fee in their revised proposals.

AGL found that 46 per cent of NSW electricity customers who were disconnected for debt in 2014 were reconnected by another retailer. Retailers are therefore absorbing significant fees which result in additional costs being spread across the industry and increasing the average costs for end use customers. When extrapolated, AGL estimates this issue results in misplaced fees to retailers of around $5.5 million per annum.

It therefore would seem more appropriate to split the disconnection and reconnection fees to ensure that the costs are paid by the relevant retailer and customer rather than averaged across all consumers.

Conclusion

AGL believes that the AER draft decisions on the NSW electricity distribution networks provides a greater balance between the efficient investment, operation and use of electricity services and the long term interests of NSW consumers.

The networks' Regulatory Proposals failed to provide such a balance and included revenue recovery that was greater than needed for efficient investment and operation of the network.

Unfortunately, the networks' revised regulatory proposals have made few material changes to moderate their proposed revenue requirements so AGL believes that the AER will have little choice but to maintain its draft decisions.

Yours sincerely

Elizabeth Molyneux
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Corporate Affairs