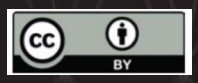
Ausgrid
Regulatory proposal 2019-24
Submission to the AER Issues Paper
August 2018

ENERGY CONSUMERS AUSTRALIA



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Introduction

Energy Consumers Australia considers that the long-term interests of consumers are served when current and future consumers pay no more than they need to for the services they prefer.

Consumers are looking to Ausgrid to provide high quality services, at affordable prices. In return, they accept that investors should earn a fair return for their long-term investment in these regulated assets. We are looking to Ausgrid to adopt long-term strategies, and revenue proposals that align the interests of their shareholders with the interests of their customers.

Energy Consumers Australia is the national voice for residential and small business energy consumers. Established by the Council of Australian Governments Energy Council (the 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 provided by the Australian Energy Regulator (AER) to respond to the Issues Paper. In our response, we have taken into account relevant developments including:

- the subsequent decisions of the AER in accepting the remittal proposals submitted by Essential Energy and Endeavour Energy;
- ongoing engagement with Endeavour Energy to refine its 2019-24 proposal as submitted;
- ongoing engagement with Ausgrid, in relation to both its remittal proposal for 2014-19 which has not yet been submitted and the 2019-24 proposal.

In this submission we are responding to the revenue proposal submitted by Ausgrid and the associated issues raised by the AER in its Issues Paper on the NSW electricity distribution determinations 2019-24.

We understand that the final outcome for consumers of Ausgrid's 2019-24 proposal, when combined with the return of revenue to consumers from the remaking of the 2014-9 decisions by the AER, is expected to be decreases in real terms in average annual network prices for households and small businesses.

Further, we expect that the application of the 2018 Rate of Return Guideline (which is currently under review) could put further downward pressure on network prices charged by Ausgrid.

However, in our view there remain significant outstanding issues with the Ausgrid proposal, in particular significant capital expenditures and a worsening of capacity utilisation, combined with a significant regulatory asset base of over $16 billion at the end of the period, which if accepted would lead to poorer outcomes for consumers.

We consider that Ausgrid's approach in its proposal is one of risk avoidance by building and replacing primary assets and not one of risk management where there is a combination of primary asset works, secondary systems and operational measures that can manage the risk for a much lower total cost to customers.

Energy Consumers Australia needs assurance about a number of matters before the Ausgrid proposal is capable of acceptance

While the revenue proposal as submitted foreshadows real price reductions, we are not convinced on the information made available to us that the expenditures are warranted or that the price reductions are sufficient.

Energy Consumers Australia has not been able to obtain the necessary assurance from Ausgrid about a number of matters that are core to demonstrating that Ausgrid's proposal is consistent with the regulatory framework – particularly the requirement in the National Electricity Law to comply with the National Electricity Objective, including ensuring that regulatory proposals are in the long-term interests of consumers.

Given the matters that are unresolved because Ausgrid was unable to arrange a response, and based on our thorough review of the proposal and the expert advice provided to us, we consider that the AER would be justified and should determine an allowed revenue for the period 2019-24 that is $1 billion lower than the proposal submitted by Ausgrid of $7,971.9 million.

Our framing and approach

Energy Consumers Australia considers that the long-term interests of consumers are served when current and future consumers pay no more than they need to for the services they prefer.

Central to achieving this objective is the development of effective competition in markets where competition is viable, and best practice regulation of natural monopoly services where competition is not viable. Our model of network regulation is designed to provide incentives to networks to improve their performance, while constraining their prices within an efficient cost of service envelope.

Consumers are looking to Ausgrid to provide high quality services, at affordable prices. In return, they accept that investors should earn a fair return for their long-term investment in these regulated assets.

The proposal from Ausgrid is made at a time when capital market conditions are favourable, there is availability of capital seeking to finance quality assets, and new shareholders and management teams are bringing greater discipline to these processes.

For these reasons, Energy Consumers Australia is looking to Ausgrid to adopt long-term strategies, and revenue proposals that align the interests of their shareholders with the interests of their customers. It is time that we move on from the adversarial processes of the past and move the consideration of these revenue proposals from the courts to the boardroom.

In this context, we consider that the AER should engage directly with the Board of Ausgrid. This will serve to emphasise directly the importance of achieving efficient cost network services for consumers that are consistent with networks investing not one more dollar than necessary, one day earlier than necessary.

Our response

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 interests of consumers.

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

Engagement with stakeholders

Energy Consumers Australia has attempted to engage with Ausgrid throughout the process of the development of their proposal.

We acknowledge that there has been some improvement in the way in which engagement with consumers and other stakeholders has been undertaken, compared with the previous period, but from a low bar.

However, we agree with the assessment of the Public Interest Advocacy Centre (PIAC) that Ausgrid's engagement with consumers sought to enlist consumers to support Ausgrid's pre-set positions which were primarily beneficial to it.

We consider that there is clearly further work needed by the senior management team in Ausgrid to develop a culture which supports authentic engagement over time.

The context of this proposal included new owners, sale expectations, time pressures, and an unfinalised remittal proposal.

These have all contributed to a genuine concern held by Energy Consumers Australia and we understand by PIAC that the consultation did not focus on identifying and addressing consumer needs and preferences and concerns with proposed actions.

Rather, we consider that Ausgrid's process was intended to and did present company preferences and obtain endorsement from consumer bodies based on inadequate time or resources for consumer advocates to fully consider and respond to the matters under consideration.

There needs to be more time allowed for reflection on the proposal as a whole

There needs to be more time allowed for reflection by consumer advocates and Ausgrid on the proposal as a whole. Ausgrid's approach of dividing the task into focused elements meant that the benefit of holistic integrated thinking by consumers about preference and investment alternatives was lost.

During the finalisation of this submission, Energy Consumers Australia sought engagement with Ausgrid on specific matters that remained of concern, based on expert advice.

The list of these specific matters is included in the Appendix, and many are referenced throughout this submission. Despite agreement from Ausgrid at the most senior level that experts would be made available to address these matters, before our submission was lodged, this did not eventuate.

For these reasons, we consider that the AER cannot be satisfied that making a determination in accordance with Ausgrid's proposal would be reasonable in the long-term interests of consumers with respect to price, quality, safety, reliability and security of supply and the reliability, safety and security of the national electricity system.

Significant increases in capital expenditure over the last decade have resulted in regulatory asset bases that are too high

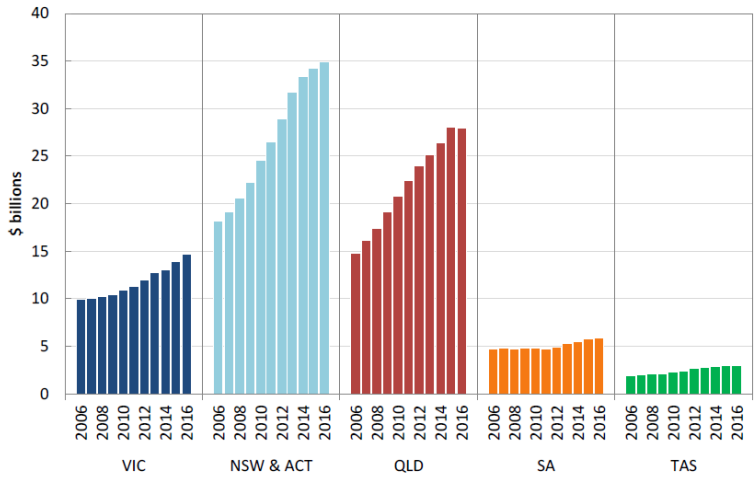
Accordingly, we do consider that by making a determination which in effect accepts Ausgrid's proposal the AER would not be acting reasonably in accordance with its statutory duty to perform or exercise its economic regulatory functions in a manner which will or is likely to contribute to the achievement of the national electricity objective.[1]

Growth in the regulated asset base

Across all three businesses in NSW we have seen significant increases in capital expenditure over the last decade. These have resulted in combined regulatory asset bases that are too high as shown in Figure 1 (which is from the Australian Competition and Consumer Commission's Retail Electricity Pricing Inquiry, Preliminary Report).[2]

[1] *National Electricity Law,* s16(1)(a)
[2] ACCC Retail Electricity Pricing Inquiry, Preliminary Report, page 63

Figure 1: Regulatory asset bases (real $2015-16) across the NEM



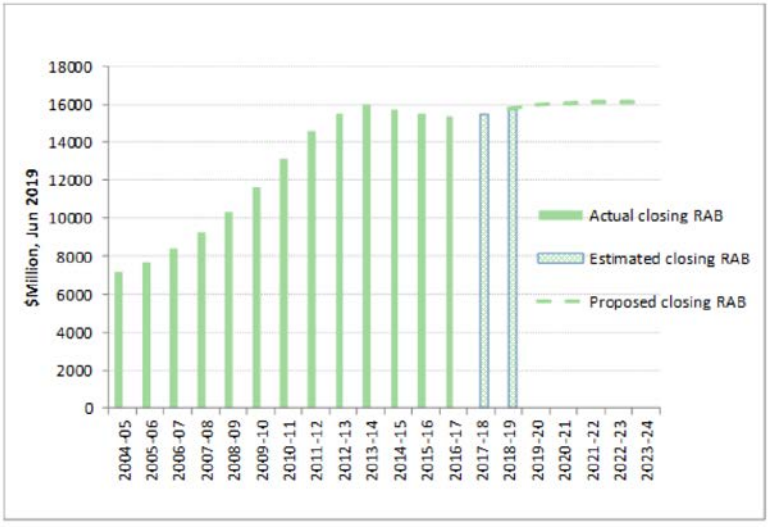
Source: AER economic benchmarking, Regulatory Information Notice responses.

Given the size of these regulated asset bases, we believe that the circumstances and the outcomes for consumers of already incurred capital expenditure needs to be carefully scrutinised, as consumers are yet to receive a dividend from the increased capacity and improvements in reliability that this investment was intended to deliver.

The growth in Ausgrid's regulatory asset base since 2004-05 is shown in Figure 2.

While growth has stabilised (a 2.6% increase over 2019-24) it remains at a high level, the costs of which need to be recovered from consumers.

Figure 2: Growth in Ausgrid RAB ($million, 2018-19)

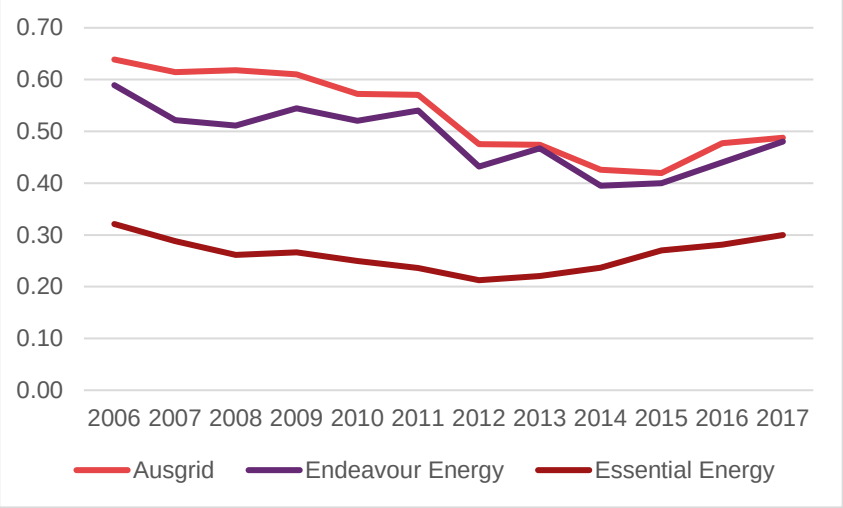


Source: AER Issues Paper, *NSW electricity distribution determinations: Ausgrid, Endeavour Energy, Essential Energy, 2019 to 2024*

Capacity utilisation

While the regulatory asset base has grown, capacity utilisation rates on the Ausgrid network fell significantly.

Figure 3: Capacity utilisation rates (RIN data)



This is an unacceptable level of capacity utilisation and Ausgrid has neglected to address it in their proposal

Capacity utilisation fell from 64% in 2006, to a low of 42% in 2015 and has since recovered somewhat to be 49% in 2017 (see Figure 3). It appears that the main reason for the recent improvement in utilisation is the retirement of some 33/11kV transformers.

This is an unacceptable level of capacity utilisation and Ausgrid has neglected to address it in their proposal. For this reason, Energy Consumers Australia considers that capex in the period 2019-24 should be kept very modest, with a target of restoring utilisation of substations and other assets back to in the order of 60% plus.

In this context there is little, or no, detail provided by Ausgrid in their proposal as to how capacity utilisation might be improved in the future, to bring down unit network costs for consumers.

Without a strong focus on capacity utilisation, there remains a greater risk that consumers will be responding to distorted price signals when deciding to invest in distributed generation assets to reduce their use of the network.

This investment in distributed generation increases the costs for the customers who remain on the network, and who do not, or often cannot, make these investments. Economists could point to this outcome as a dramatic example of the loss of dynamic efficiency that can be caused by allowed revenues being too high.

Comments on key components

The key components of Ausgrid's revenue proposal are summarised in Table 1.

We have focussed our comments principally on capital expenditure, and to a lesser extent changes in operating expenditure. We have not commented on the application of incentive schemes to Ausgrid.

Table 1: Key components of the proposals

2019-24 SUMMARY	AUSGRID
Revenue ($2018-19m) unsmoothed	$7,971.9
RAB June 2019 ($m)	$15,716
RAB June 2024 ($m)	$16,127
% change in RAB	2.6%
CAPEX	$3,083.7
OPEX	$2,402

Rate of return

The AER notes in its Issues Paper that Ausgrid has adopted the approach to setting the allowed rate of return set out in the 2013 Rate of Return Guideline and subsequent determinations. They go on to say that should the revised 2018 guideline be released by the end of the year and be binding on the distribution businesses as proposed by the COAG Energy Council, it would apply to the 2019-24 final determinations for the three NSW businesses.

Ausgrid has made a submission on the application of the 2013 Guideline as part of its proposal. As the 2013 Rate of Return Guideline does not consider debt and equity raising costs. Ausgrid has proposed its estimates in its revenue proposal, to arrive at an overall allowed rate of return of 6.33% for the first year, to be updated annually.

In support of its proposal Ausgrid submitted a report by Frontier Economics that provided advice on the determination of the following aspects of the allowed rate of return for Ausgrid's 2019-24 regulatory control period:

- the equity beta;
- the low-beta bias problem;
- the market risk premium (MRP);
- gamma; and
- the return on debt.

In response to the Frontier Economics Report, Energy Consumers Australia commissioned the South Australian Centre for Economic Studies (SACES) to prepare a short expert report on matters raised in the Frontier study (see Attachment). This SACES report has been prepared by Mr Jim Hancock, Deputy Director.

The SACES Report draws on the evidence presented to the Concurrent Expert Evidence session conducted by the AER as part of the current review of the Guideline.

In the event that the legislation does not come into effect, we submit that the allowed rate of return should be calculated using the parameters and approaches proposed by the AER in its 2018 Final Guideline.

The current Draft Guideline, on which the AER is currently consulting, includes the following parameters:

- a benchmark gearing ratio of 60% for the allowed return on debt;
- the risk-free rate estimated based on an average of the yield on 10-year Commonwealth Government Bonds (CGS) over an averaging period of between 20 and 60 business days;
- a market risk premium of 6%;
- an equity beta of 0.6;
- an allowed return on debt determined on the basis of the revenue neutral transitional arrangements that AER recently determined for each service provider to move from an 'on-the-day' approach to a 10-year trailing average approach;
- the benchmark for estimating return on debt is the yield on debt instruments issued at a BBB+ investment grade rating; and
- a value for imputation credits (gamma) of 0.5.

Energy Consumers Australia is considering whether some of these parameter choices could be revised to apply a lower rate of return, in its forthcoming submission on the Draft Guideline.

Depreciation

According to the AER's Issues Paper regulatory depreciation is provided so investors can recover their investment over the economic life of the asset.

While the AER's preferred approach is that businesses adopt a weighted average remaining life approach (WARL) to calculating straight line-depreciation, it has on occasion accepted period-by-period tracking as consistent with the National Electricity Rules (NER).

Our concern with this approach is that while it doesn't increase the overall investment recovered overall (in a net present value sense) it does increase the amount of network revenue recovered from today's consumers.

As Engineroom Infrastructure Consulting explained in its work on accelerated depreciation:

> *The difference in the United Energy decision between the WARL approach and year-by-year tracking for the 2016-2020 regulatory control period was $106.5 million, and the year-by-year tracking approach was about 34 per cent more than the WARL approach.*[3]

We acknowledge and support Ausgrid's decision not to proceed with period-by-period tracking after seeking the views of stakeholders

We acknowledge and support Ausgrid's decision not to proceed with period-by-period tracking after seeking the views of stakeholders.

Capital expenditure (capex)

Affordability needs to be an overarching constraint on all future network investment decisions.

In relation to proposed growth in capex we are concerned that businesses remain locked into past practices in relation to risk. While Ausgrid is now using probabilistic planning, and in the previous regulatory period became subject to the Service Target Performance Incentive Scheme, it appears to us that conservative failure rates and times to repair are being adopted.

The result of this approach to risk management is large proposed capex. It is noteworthy that in its Draft Rate of Return Guideline the AER consumers may be willing to bear a higher risk to reliability in return for lower bills.[4]

There is also a significant missed opportunity to reduce future network capital expenditure through rewarding consumers for flexibility in their energy use – through demand response and network price signals

There is also a significant missed opportunity for Ausgrid, as with other NSW businesses, to reduce future network capex through rewarding consumers for flexibility in their energy use – through demand response and network price signals.

In this context, Ausgrid has proposed capex of $3,083.7 million ($2018-19m) in the 2019-24 period, which is made up of:

- growth expenditure of $241.3 million (8%);
- replacement expenditure of $1,673.1 million (54%)
- non-network expenditure of $548 million (18%); and
- capitalised overheads of $621.3 million (20%).

Growth capex

In our view Ausgrid's approach in its proposal is one of risk avoidance by building (and replacing) primary assets and not one of risk management where there is a combination of primary asset works, secondary systems and operational measures that can manage the risk for a much lower total cost to customers.

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[3] Engineroom Infrastructure Consulting, An evaluation of the role of accelerated depreciation in the regulation of electricity and gas networks, April 2017, page 14, available https://energyconsumersaustralia.worldsecuresystems.com/grant-archive/807-research-advocacy-accelerated-depreciation

[4] AER Draft Rate of Return Guideline: Explanatory Statement, 10 July 2018, page 28

During 2014-19, the risk of underperformance in the quality of supply measures reduced dramatically with little growth in load at the same time as over 4,000MVA of zone substation transformers being installed. This must create opportunities to defer capex but there appears to be little recognition and action on this front within the proposal.

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Ausgrid has proposed growth capex of $241.3 million, on the basis that it is required around major infrastructure loads in the Sydney region. In other areas growth in demand will be supported by existing capacity.

We are seeking further information from Ausgrid in relation to their key growth capex projects -at Macquarie Park, Rozelle, Alexandria, White Bay and Pyrmont – and more details on the reliability expenditure and opportunities for better management given the reduction in reliability (growing length of outages on the network).

Replacement capex

Given that there were more stringent planning standards in place in the previous period than will apply in 2019-24, and the significantly lower demand forecasts for this period, our expectation is that Ausgrid is in a position to manage parts of the network as "run-to-fail" without impacting customer service or reliability.

Figure 4: Ausgrid Overview

Capital Replacement Expenditure Overview*

Replacement Expenditure (FY20-24) in FY19 Real $	Asset Life Extension	Major Projects	Planned Programs	Conditional Programs	Reactive Programs	Total
Sub-transmission Substations	$13m	$41m	$23m	$3m	$17m	**$98m**
Sub-transmission Power Lines • UG Cables - Oil/Gas ($231m) – e.g. Castle Cove – Mosman Feeders ($34m)	$35m	$245m	$10m	$2m	$18m	**$310m**
Zone Substation • Switchboards ($185m) – e.g. Concord Zone ($18m)	$61m	$211m	$46m		$36m	**$355m**
HV Power Lines • OH Conductors – Steel/ACSR ($38m)		$59m	$45m	$16m	$58m	**$177m**
Distribution Substations • Fuse Switches & CBD Swgr & Txs ($102m)	$20m	$2m	$198m	$19m	$37m	**$276m**
LV Power Lines • UG Cables – Consac/HDPE ($111m) • OH Conductors – LV Reconfiguration ($43m)	$16m	$5m	$173m	$23m	$47m	**$264m**
Poles	$6m			$143m		**$149m**
Service Connections • OH Services – Bare/PVC ($52m)				$52m	$1m	**$53m**
Monitoring & Control Systems • ADMS Continued Implementation ($41m)		$47m	$10m			**$57m**
Total	**$151m**	**$611m**	**$505m**	**$258m**	**$214m**	**$1,738m**

* - All numbers are draft and subject to validation

Ausgrid could significantly reduce the planned programs and major projects categories of replacement capex

This means that Ausgrid could significantly reduce the planned programs and major projects categories of replacement capex, which are shown in the capital replacement expenditure overview provided by Ausgrid at the replacement capex workshop (Figure 4).

One particular concern is with the relationship between Transgrid and Ausgrid's expenditures. We know that the TransGrid 2018-23 Revenue Determination included capex for the Powering Sydney's Future (PSF) project which includes the retirement of 8 off 132kV cables in the Sydney CBD and surrounds. This moves network capability and growth in the regulated asset base from Ausgrid to TransGrid.

When we look at the detail of the proposal (Section 3.6 of the Ausgrid document *5.14.2 Subtransmission Cable Replacement)* it lists 13 cables, of 122km combined length) that will be decommissioned as part of PSF.

We recognise that with more replacement capex moved into the "reactive" category where assets are replaced on failure, there is a need for rapid response plans, and safety mitigation plans to manage risk

The replacement cost of these cables on a like-for-like basis is somewhere between $250m and $1,000m using the rates for other cable replacements in the same document. We would expect that replacement expenditure would be reduced significantly with the retirement of these cables. There also appears to be an inconsistency in the information provided by Ausgrid and the information in the RIT-T for the PSF.

By way of further examples, Ausgrid has not provided significant justification for their replacement expenditures.

- Attachment 5.13.D - Project justifications for underground cables replacement programs. Ausgrid does not take a risk-based approach to the justification to spend $104.2 million on low voltage cable replacements. The justification is qualitative and does not assess value of risks and any mitigation programs that can be used.
- Attachment 5.14.1 – Project justification for 11kV switchgear replacements.
  - Our advice is that the retirement of two zone substations (City East and Dalley Street) and the transfer of their load to other zone substations without the need for any capacity augmentation, but enabled by 11kV switchgear replacements, is unusual. It would appear that this is a consequence of the past-overbuild of the CBD network.
  - The need to replace the 11kV switchgear at Mascot zone substation (pages 8 to 12) has led Ausgrid to the preferred option of retiring the 33/11kV zone substations and establishing a new 132/11kV zone substations at a different site at a forecast cost of $51 million capex and $50 million opex in the form of demand management. It is not apparent that Ausgrid has considered lower cost options for example by mitigating the risk to reduce the likelihood (e.g. temporary switchboard or maintenance) or consequence by automating feeder isolation and transfer to other healthy feeders or having extra resourcing to rapidly restore operations.

We are seeking information from Ausgrid on the potential impacts on reliability and safety if the planned programs and major project budget for 2019-24 was halved, saving $500 million during the period.

We recognise that with more replacement capex moved into the "reactive" category where assets are replaced on failure, there is a need for rapid response plans, and safety mitigation plans to manage risk. We are seeking information from Ausgrid on their rapid response and safety mitigation plans.

Non-network expenditure capex

Ausgrid is proposing significant expenditure on non-network costs which include information and communications technology (ICT), property, fleet and plant.

It is unclear that there are tangible benefits from this expenditure, and we are seeking further information from Ausgrid on the benefits and costs

In relation to ICT Ausgrid has spent considerably more on ICT in the previous period than was determined in the AER decision (an overspend of $75 million) and proposes to maintain this high level of expenditure throughout the next period. We consider that these expenditures need to be scrutinized carefully.

Of the proposed expenditure on ICT of $216 million, around $90 million is associated with the Advanced Distribution Management System (ADMS) and Network Innovation programs.

It is unclear that there are tangible benefits from this expenditure, and we are seeking further information from Ausgrid on the benefits and costs, including:

- in relation specifically to the *Project Justifications for operational technology and innovation programs* – April 2018, this appears to be a "shopping list" for $102 million of equipment with very little justification and no evidence or forecast of savings. The list includes completing the Advanced Distribution Management System for $42 million with the justification being an unsatisfactory qualitative assessment of three options; and
- in relation to the $43 million expenditure on network innovation, which includes developing a high voltage micro-grid at $17.5 million and $1.2 million for an EV charging system, there is significant experience with both these technologies now and there does not appear to be a need to add capex for these devices because they should be applied to reduce capex in the network.

The proposed property capex program is high at $208 million. It is not apparent why this expenditure could not be spread over two regulatory periods, rather than in 2019-24

The proposed property capex program is high at $208 million. It is not apparent why this expenditure could not be spread over two regulatory periods, rather than in 2019-24. In relation to this, we note that there is a depot rebuild at Homebush to cost $65m on existing property. We are seeking further information from Ausgrid to understand the nature of these costs and where they can be deferred.

Ausgrid is also proposing to increase its fleet expenditure compared with the previous period, on the basis that the expenditure will reduce life cycle costs and provide the right resource base for the field. We are seeking further information from Ausgrid on the potential savings in opex to be achieved from this program.

Capitalised overheads

Ausgrid's proposed expenditures on capitalised overheads of 20% are high by comparison with businesses in other jurisdictions and are therefore unlikely to be considered efficient. As there are economies of scale for a larger business such as Ausgrid it is not clear why this should be so high.

In our view there should be a trend of reducing capitalized overheads as a percentage of capex over the period to recognize productivity improvements.

Operating expenditure (opex)

In relation to opex, it is only now that we are seeing more efficient performance in these NSW businesses that will benefit consumers in the next five years. It is difficult for consumers to accept that these businesses should not be subject to a productivity dividend, at a time when costs of living are rising and wages growth is flat.

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The issue of how output growth and productivity forecasts should be treated by the AER has been raised in the context of both the Evoenergy and NSW electricity distribution determinations, and in particular by the Consumer Challenge Panel 10 (CCP 10) in its submissions on the AER's framework and approach.

Energy Consumers Australia's view is that the approach for forecasting output growth and productivity growth should be set in advance as it is for the rate of return, rather than on a case by case basis.

In relation to the consideration of Ausgrid's proposal, Energy Consumers Australia supports the view of the CCP 10 that the AER should consider reviewing its approach to considering efficiency and trend productivity.

Pricing Directions

Energy Consumers Australia contributed to the development of the *Pricing Directions* paper (the Paper), together with the CCP 10, Total Environment Centre and the Public Interest Advocacy Centre (PIAC). Our purpose in contributing to the Paper was to have a shared perspective between these groups in engaging with the three NSW electricity distribution businesses on the outcomes for consumers of the direction and the pace of change in the structure of network charges.

Our overarching principle is that consumers should have the opportunity in energy markets to be rewarded for flexibility in their energy use. In this context, ensuring that retailers are exposed to the price signal for the use of the network at peak times just as they are exposed to movements in the wholesale price of electricity is critical.

We note that the Australian Competition Commission has taken a similar view in its recommendations in the Final report of the Retail Electricity Pricing Inquiry, where it proposes that accelerating the shift to cost-reflective network pricing requires:

- an appropriate tariff for addressing the nature of peak demand on the network, such as demand tariffs;
- mandatory assignment of cost-reflective network pricing on retailers, for all consumers with a digital meter (smart meters, interval meters) and an end to opt-in and opt-out arrangements;
- retailers not be obligated to reflect the cost-reflective network tariff structure in their customers' retail tariffs, but should be free to innovate in the packaging of the network tariff as part of their retail offer;

- measures to mitigate potential bill shock, ensuring there is transitional assistance is provided for residential and small business customers, and that customers have the opportunity to mitigate the impacts through behaviour change, including:
  - a compulsory 'data sampling period' for consumers following installation of a smart meter;
  - a requirement for retailers to provide a retail offer using a flat rate structure;
  - communication campaigns (funded by government) around the benefits of cost-reflective pricing and smart meters to build community acceptance and awareness of individual and community wide benefits, as well as customer awareness of their rights.[5]

We support these recommendations, and the AER's consideration of the NSW electricity distribution businesses tariff structure proposals should be assessed in the light of these recommendations and the Pricing Directions paper. Our views on the specific tariff structures proposed by Ausgrid, and the other electricity distribution businesses are aligned with the detailed comments provided by PIAC in their submission.

Energy Consumers Australia, along with other stakeholders, have a number of specific concerns with the Ausgrid proposal to significantly increase fixed charges

In the context of the Ausgrid proposal we are particularly concerned with the proposed changes to fixed charges, and the future direction this is expected to take in subsequent regulatory periods. Our view, and this is supported by the ACCC, is that increasing fixed charges as a means of recovering residual (sunk costs) is not appropriate. Work by The Brattle Group for the Australian Energy Market Commission (AEMC) identified alternative mechanisms for recovery of residual costs, rather than falling back on what might be seen as the orthodoxy.[6]

Energy Consumers Australia, along with other stakeholders, have a number of specific concerns with the Ausgrid proposal to significantly increase fixed charges.

- Consumers have greater potential benefit from flexibility in their energy use – by shifting use or reducing use at peak times – when the proportion of the network costs recovered through fixed charges is low.
- Ausgrid has sought to justify the increase in fixed charges as in response to positive consumer views, which raises questions for us about the quality of the engagement.
- Allowing a significant increase in fixed charges, after a significant period of capex investment that has led to reduced capacity utilisation on the network, is to "doubly penalise" consumers on the Ausgrid network.
- The proposal for fixed charges includes a carve out for consumers with low usage, and significantly higher charges for small businesses, neither of which can be supported. We understand from our engagement with small business representatives that they are concerned at the impact of

[5] ACCC Retail Electricity Pricing Inquiry, page xix
[6] The Brattle Group, *Structure of Electricity Distribution Network Tariffs: Recovery of Residual Costs,* https://www.aemc.gov.au/sites/default/files/content/2a6444dc-2eca-468a-89bb-5d6c05f88402/The-Brattle-Group-%E2%80%93-Recovery-of-residual-costs.PDF

these fixed charges on the competitiveness of small businesses and the lack of a rationale from Ausgrid as to the basis for this proposal.

In our view, it is important to consumer confidence and trust that consumers continue to have a choice of retail tariff, who will have different preferences for assuming the risk of being exposed to peak wholesale and network prices.

In this context, the way in which retailer offers are expected to evolve away from the almost universal current flat rate energy-based tariffs is also important. Through the Energy Consumers Australia Retail Choice project we are compiling a comprehensive set of information regarding retailer pricing strategies, with a focus on their modification of network price signals, and the impacts of these modifications on customer bills and overall system efficiency.

Concluding comments

Energy Consumers Australia has appreciated the opportunity to comment on the Ausgrid revenue proposal for 2019-24 and address the issues raised in the AER's Issues Paper, including the issues concerning Ausgrid's Tariff Structure proposals. We have separately provided submissions to the AER for Endeavour Energy and Essential Energy.

In 2012, the Australian Energy Market Commission (AEMC) changed the rules governing how the AER determines the total amount of revenue for each electricity and gas network business. One key focus of the AEMC's rule changes and the related government reforms was improving the electricity and gas network businesses engagement with their consumers. In support, the AER developed the Consumer Engagement Guideline for Network Service Providers (the Guideline) and the accompanying explanatory statement.

Our expectations of consumer engagement are that through engagement the network businesses will develop a genuine alignment with the needs of their customers, build trust and create creating new value for customers. As the AER has stated:

> *Consumer engagement is about working openly and collaboratively with consumers and providing opportunities for their views and preferences to be heard and to influence service providers' decisions.*

In our view further work is needed by Ausgrid to develop a culture which supports authentic engagement over time., that will achieve better outcomes for the consumers served by Ausgrid's network.

There needs to be more time allowed for reflection by consumer advocates and Ausgrid on the proposal as a whole. Ausgrid's approach of dividing the task into focused elements meant that the benefit of holistic integrated thinking by consumers about preference and investment alternatives was lost.

During the finalisation of this submission, Energy Consumers Australia sought engagement with Ausgrid on specific matters that remained of concern, based on expert advice.

We consider that the AER cannot be satisfied that making a determination in accordance with Ausgrid's proposal would be reasonable in the long-term interests of consumers with respect to price, quality, safety, reliability and security of supply and the reliability, safety and security of the national electricity system.

Accordingly, we do consider that by making a determination which in effect accepts Ausgrid's proposal the AER would not be acting reasonably in accordance with its statutory duty to perform or exercise its economic regulatory functions in a manner which will or is likely to contribute to the achievement of the national electricity objective.

If you have any questions in relation to our comments in this submission, or require further detail, please contact Lynne Gallagher on 9220 5500 or by email lynne.gallagher@energyconsumersaustralia.com.au.

Appendix

The following questions on specific matters remain to be answered by Ausgrid.

Approaches

1. What method has been used to verify the modelled future failure rates of equipment against historic performance? In the Powering Sydney's Future work with TransGrid and the DPAR for "Addressing reliability requirements in the Inner West", Ausgrid provided very good reports on the failure rates of 132kV and 33kV cables but these have not been provided for feeder and transformer failure rates. Can Ausgrid provide more details on what is used in the business cases and regulatory investment tests?

2. How have the depot sites been optimised to reduce the outage times for forced outages by ensuring staff have access to equipment and depot facilities to respond to system outages?

3. What is the strategy for 11kV feeder fault segmentation, automatic isolation and re-energisation from adjacent feeders? That is, what is Ausgrid's strategy and design for the Distribution Feeder Automation program?

Replacement expenditure

4. The Concord Zone full 11kV board replacement is listed as being $20m. This appears to be very expensive. Can Ausgrid comment on what makes this such an expensive project?

5. The previous levels of augmentation and replacement capex, particularly in 2009-14, were targeting a more stringent planning standard than the current one and with a higher demand forecast than the current view. This means that there must be parts of the network that can run-to-fail without actually impacting customer service and security for the network. This should reduce the planned programs and major projects categories of replacement capex however those categories account for 64% of the replacement capex in the figures presented during the workshops. What would be the impact in reliability and safety outcomes if the planned programs and major project budget for 2019-24 was halved thereby saving $500m during the period?

6. The TransGrid 2018-23 Revenue Determination included capex for the Powering Sydney's Future (PSF) project which includes the retirement of 8 off 132kV cables in the Sydney CBD and surrounds. This moves network capability and RAB from Ausgrid to TransGrid. Section 3.6 of the Ausgrid document 5.14.2 Sub-transmission Cable Replacement lists 13 cables, of 122km combined length, that will be decommissioned as part of PSF. The replacement cost of these cables on a like-for-like basis is somewhere between $250m and $1,000m using the rates for other cable replacements in the same document. Why has the repex

not reduced significantly with the retirement of these cables and why is the information different to the RIT-T for PSF?

7. The justifications in the Ausgrid document 5.14.2 Subtransmission Cable Replacement do not cost any of the options except the preferred option and in most cases the preferred option is replacing the cable while also putting in duct work for a future cable. Can Ausgrid comment on the driver for this being the preferred way forward?

8. The justification for much of the replacement work is condition but particularly condition leading to safety outcomes. There is no cost/benefit analysis done for these programs or projects and the decision making appears to be quite subjective. There are a number of safety mitigation plans that can be put into place to manage the risk while reducing the rate of repex expenditure. Can Ausgrid show how these mitigation plans have been used for the major programs in the proposal?

Growth expenditure (augex)

9. Augex has been spent to meet a demand level that is now not expected for many years and with a lower reliability standard and yet the current proposal has $417m of augex forecast. This does not appear logical. The argument that the past augex may have been placed in the wrong areas and therefore there are still local geographic areas that need augex is not satisfactory given the impact on the RAB and pricing. The end result is that the underutilisation of assets gets worse. Can Ausgrid comment on this aspect of the proposal?

10. Can Ausgrid provide the justification (even if it is just showing that the forecast is equal to historic levels) for the Distribution augmentation and Distribution reliability categories of the augex spend as they make up $115m or about half the augex amount?

11. The Macquarie Park STS major project does not have a well-developed justification. Att 5.16 gives it a probability of proceeding at 75% and yet it needs to be built by 2022/23 with spending in 2018/19. We assume a RIT-D will be prepared. There appears to be significant spare capacity in the surrounding zone substations but the document doesn't provide a load forecast to enable any assessment. Can Ausgrid provide more information?

12. The 2 major projects Rozelle 132/33kV STS and Alexandria STS are linked but the justification is not sufficient. There does not appear to need an extra transformer at Alexandria as non-spot load growth is low to negative. Can Ausgrid provide an explanation of the meaning of the following sttaement:

    a. *Statement page 11 of Att 5.16 – Augmentation major projects: "This project is treated as a conditional project but has been allocated a probability of 100% of proceeding based on the status of development and customer connection* requirements."?

13. The White Bay zone sub-station does not appear justified, as there should be an opportunity to supply from capacity elsewhere. We note that it is also close to Rozelle STS and related to its development, and has a 10% probability of proceeding. Can Ausgrid provide comment?

14. The Pyrmont STS project looks like a marginal project for which there has been very little assessment of cost/benefit and the loading is only at the N-2 level without load switching. This is given a 50% probability weighting on the capital. Can Ausgrid indicate whether there is any other justification for this project?

Non-network projects

15. Why is a depot rebuild at Homebush to cost $65m on existing property? What is the scope and rough cost breakdown of the scope of the project.

16. The ADMS and Network Innovation programs have around $90m of capital expenditure associated with them but no real tangible benefits. Have there been any examples where recent developments in this area have actually allowed changes in the distribution planning and design standards so that the benefits can be delivered through lower capex? For example, the design of 11kV feeders assumes 4.5kVA ADMD for each household and a standard rating of 4.5MVA for the feeder allowing around 1000 homes to be connected to a feeder. Small improvements in any of these parameters can have a large impact on further costs. Can Ausgrid cite any such changes made in recent years to the planning and design standards?

17. For the fleet and plant capex, the justification is to reduce life cycle costs and provide the right resource base for the field. Can you please show the expected opex savings to be delivered with the current plan?

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