11 Feburary 2010

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email:aerinquiry@aer.gov.au

Dear Mr Pattas,

**RE: VICTORIAN DNSP REGULATORY PROPOSALS**

As a major retailer in Victoria, Origin appreciates the opportunity to provide comment on the regulatory proposals of the Victorian distribution network service providers (DNSPs), the first provided in Victoria under the new framework, covering the period calendar years 2011 to 2015.

*1. Classification of services*

Origin made an earlier submission to the Australian Energy Regulator's (AER) draft *Framework and Approach* on classification, and the following should be read in the context of that earlier submission.

Origin notes that the DNSPs propose classifications for new connections and augmentations that differ from the classification proposed by the Australian Energy Regulatory (AER) in its final *Framework and Approach*. This reflects the reported preference of the Victorian Government that *Guideline 14* should continue to apply to the calculation of fees charged for new connections and augmentations in Victoria.[1]

Powercor (PCR), Citipower (CPR) and United Energy (UE) propose to classify connection services as standard direct control, with Guideline 14 used as the basis to determine the proportion of the cost attributable to the individual customer. Jemena (JEN) also proposes that connection services be classified as standard direct control, but proposes a schedule of prices to determine the customer contribution for routine connection services. Finally, SPAusnet (SPA) proposes to classify routine connection services as alternative direct control services and non-routine connection services as standard direct control.

Origin is not opposed in principal to a DNSP spreading a portion of the cost of a new connection across the customer base through use-of-system charges, provided the proportional contribution is calculated in a cost-reflective manner. Origin is more concerned, however, with the precedent set by *Guideline 14* continuing to operate as a

[1] Under Guideline 14, a party initiating a new connection or augmentation may be required to make a contribution towards the cost, but this contribution is limited to any shortfall between the incremental revenue expected to flow from the connection and the connection's incremental cost.



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core instrument in the determination of DNSP revenue in Victoria, post 2011. In Origin's view it would be better to work towards modifying and adapting the framework for capital contributions within the national rules, rather than relying on *Guideline 14*. The requirements of the NER and Victorian Guideline 14 are difficult to integrate:

- While the standard direct control classification may allow the DNSP to earn a return on capital, the classification is inappropriate under the NER, since the service is directly attributable to an individual user and is rendered contestable by a requirement to tender.

- The approach proposed by JEN to setting the value of customer contributions for routine new connections via a schedule is difficult to reconcile with the NER, since it is unclear on what basis the AER should approve a schedule of prices when 6.2.6(a) of the NER requires the control mechanism for standard direct control services to be of the CPI-X form within the price cap.

Origin notes the AER's comments in its *Final Framework and Approach*:

*the National Electricity Rules (NER) do not provide a derogation to allow the existing Victorian (ESCV Guideline 14) capital contribution arrangements to continue in their current form. As these arrangements deal with service pricing, which in Victoria will be regulated under chapter 6 of the NER from 1 January 2011, they would not apply to new works and augmentations in the 2011-15 regulatory control period.*[2]

Where the regulator is required to integrate jurisdictional codes and guidelines as supplements to the national rules in each jurisdiction this generates problems. It would be preferable if either the Guideline ceased to apply. Or, if aspects of the Guideline are to be incorporated into the rules, then these should apply to all jurisdictions.

## 2. *Demand and consumption forecasts*

Origin notes that all five DNSPs forecast growth in peak demand accompanied by minimal or negative growth in volumes of energy consumed. The DNPS recognise **a range of factors driving peak demand**, including: increased penetration of air conditioners and an increasing frequency of above-average hot days. Among **drivers of reductions in consumption identified** are: the impacts of periods of below trend economic growth, the introduction of smart meters and a range of other Government policies designed to reduce energy usage, most notably changes to energy standards for lighting and AMI.

In principle it is not unrealistic that volumes of energy consumption could drop while peak demand continues to grow. In the case of air conditioning, for example, demand on extreme temperatures can be highly inelastic to price even when consumption at other times is shrinking. However, the downturn in consumption seems overstated when compared to credible forecasts such as the Australian Energy Market Operator's (AEMO) *Electricity Statement of Opportunities* (SOO).[3]

In this context, Origin is concerned that the assumptions about the relative changes in growth in volumes and peak demand have not been made sufficiently explicit, and it is

[2] AER, Framework and approach paper for Victorian electricity distribution regulation, Final, May 2009, p.38.
[3] 2009 Electricity Statement of Opportunities, chapter 3, pp.3-4, 3-15.

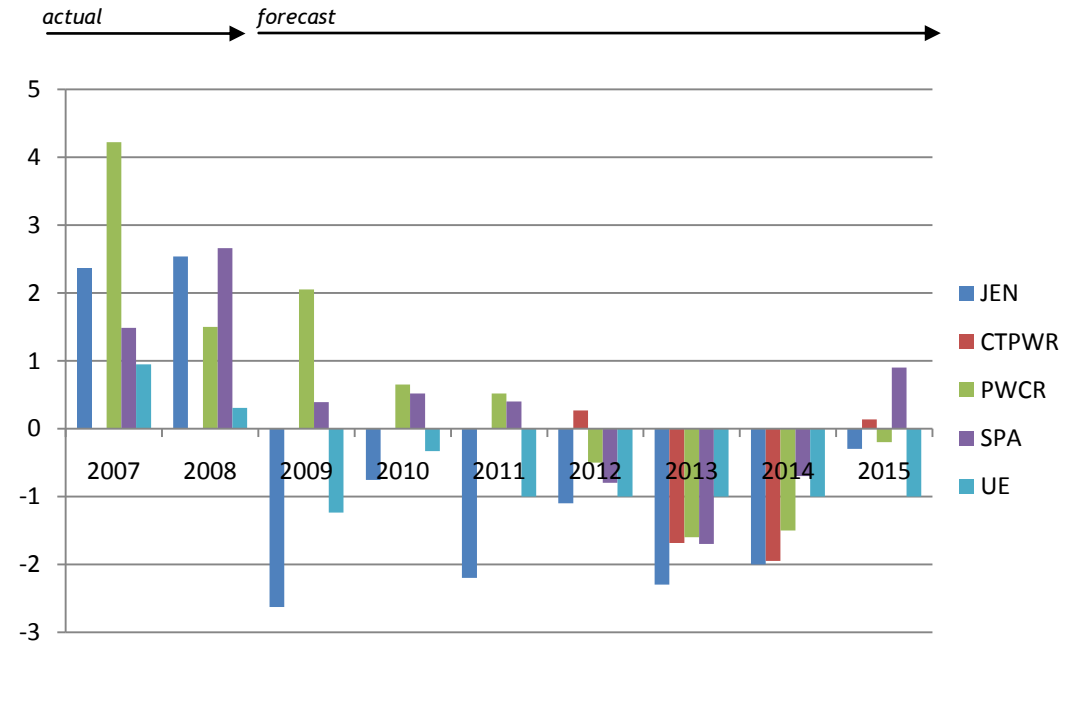
not clear why the DNSP forecasts should differ from those in SOO. Origin draws attention to the issue because if peak demand does grow as volumes drop this implies increases in capex spread over fewer sales, resulting in persistent network price increases for customers. Furthermore, if consumption forecasts are understated compared to demand prices will be set too high and DNSPs will over-recover.

### *2.1 Importance of historic data on consumption*

Information on consumption in the current period is an important input when considering the reliability of consumption forecasts. Citipower relies on historic consumption information that it has provided to the National Institute of Economic and Industry Research (NIEIR), but does not make this data available, nor has it released the NIEIR report. It would be helpful if Citipower could provide its historic consumption data, as distributors have done in all other jurisdictions. It would also be helpful if Powercor could provide its historic consumption data in its submission, instead of relying on data tabled in various appendices to the NIEIR report.

Of the four DNSPS that have provided historical consumption data, Origin would note that all recorded positive growth in consumption in 2007 and 2008 (these two growth figures cover the three years of actual consumption data available, CY2006-08). In all cases but UE, this growth was above 1 percent. However, from 2009 the forecast data shows growth in consumption dropping rapidly away, before turning negative for all DNSPs in 2013 and 2014 (Figure 1).

**Figure 1. Growth in energy consumption, Victorian DNSPs Actual (2008-09) and forecast (2009-2015), percent**




As illustrated in Figure 1, DNSPs are proposing a significant shift in consumption trends in the forecast years compared to the period for which actual data is available.

Origin would highlight a number of important drivers of consumption in the residential sector, including some that have shown growth above the rate of growth in the economy. These include increases in:

- population,
- the dwelling stock,
- the average size of house,
- the number and diversity of electrical appliances,
- standby energy consumption,
- the intensity of lighting and
- the number of computers and other home entertainment items.

In some of the proposals these drivers are discussed in relation to peak demand but not in relation to volumes. It would be helpful if DNSPs could be explicit about the assumptions made by the NIEIR in relation to the impact of these drivers on consumption. Further, CTPWR and PWCR both cite NIEIR forecasts for population growth to decrease in Victoria, but do not explain the basis for these, given consistent population growth in the state in recent years.

In relation to government policies that will drive reductions in consumption in the period, the DNSPs identify as most important:

- changes in minimum efficiency standards for lighting and
- the Advanced Metering Infrastructure (AMI) roll-out.

Of these, Origin seeks more detail around the assumptions related to the AMI roll-out, as outlined below.

### *2.2 The impact of AMI*

There is little evidence in the Australia context of significant reductions in energy consumption resulting from the move to interval meters. It is uncertain whether the meters will lead to a sustained reduction in consumption and, if so, over what period. SPA notes:

*Even after assessing overseas studies, it is clear that there is no correct or common 'point estimate' in relation to the impact that these* [TOU] *tariffs will have on the amount of energy that customers consume.*[4]

Advanced metering is most often directed to achieve behavioural changes leading to peak load reduction, rather than reductions in total energy use, so there is more evidence of the impact of AMI on peak demand. However, despite this, UE acknowledges that DNSPs can be reluctant to factor in the impact of AMI on peak demand:

*At present, there is a perception among network businesses that the price signals from time-variant tariff models are an inadequate means of achieving a curtailment of demand during heat wave conditions. This view may be a shibboleth which will be refuted by research. However, if peak period demand is price inelastic, such that network businesses cannot rely on customers to curb their consumption in response to price signals, then TOU tariffs, and, by extension a CPP regime, cannot be used as a substitute for network augmentation.*[5]

[4] SPA's Regulatory Proposal 2011-2015, p.93.
[5] UE's Regulatory Proposal 2011-2015, p.204.

It would be of significant concern if the impact of AMI on peak demand was assumed to be minimal or doubtful until proven otherwise, yet the impact on volumes was fully factored in – even where evidence is scarce. The two impacts will be strongly correlated, in Origin's view, and to the extent they are not proportionate, this should be based on rigorous assumptions. As an example, JEN projects that AMI will deliver an average annual impact on peak summer demand of -0.21 percent, but will have an average annual on consumption of -0.55 percent, or close to three times the impact on demand. In the case of Powercor, the average annual impact on demand will be -0.17 percent, but -0.50 percent on volumes.

It is worth noting in this context that a number of the Victorian DNSPs' tariffs appear targeted primarily to peak demand reduction, ahead of volume reduction. For example, SPA proposes a time of use tariff for residential customers where the price per kWh between 4 pm and 6 pm in the summer months (and March) is 14 times the off peak rate (or 46 cents in peak and 3 cents respectively).[6] The price signal here is clearly designed to encourage customers to shift some their load to the off-peak time. If such a significant price signal has a limited impact on peak demand it seems equally unlikely to affect consumption.

In light of this, it would be helpful if each DNSP could provide a clear assessment of the following assumptions in relation to the AMI roll out:

- Assumptions about broad impacts of AMI on prices. It is important to note that prices will not increase uniformly for all customers as a result of the move to more cost-reflective pricing. Also, the extent to which retailers can pass on network price signals will depend on the structure of the tariffs adopted by the distributor.

- Assumptions on demand elasticity. The rollout is scheduled to be completed only by the end of 2013. Even in the most optimistic scenario – whereby customers enthusiastically embrace the new technology and seek to modify their behaviour accordingly – energy consumption is still likely to be less elastic to price in the short run, as certain drivers of customer energy use (such as their appliance mix) cannot be changed immediately. Of the five DNPSs, only SPA provides an estimate of its assumptions in relation to price elasticity.

If this information was provided in a concise manner it would aid comparison across the five DNSPs and between projections for demand and for consumption.

## 3. Capital expenditure

JEN has proposed an increase in capex on the current period of around 80 percent, from $372 million in 2006-10 to $669 million in 2011-15 (all in $2010). This follows an increase from 2001-05 to 2006-10 of 74 percent. This means that expenditure was averaging $35 million per annum in 2001-05, $75 million per annum in 2006-10 and will average $130 per annum in 2011-15. Replacement capex is proposed to increase from a ten-year average to 2010 of $11.73 million per annum to an average of $34.7 million per annum for the next regulatory period.

[6] SPA's Regulatory Proposal 2011-2015, p.336.

In its independent review of Jemena's capital expenditure completed by GHD it was noted that:

*The large increase in expenditure in Replacement and Augmentation Capex compared with historical expenditure trends, in GHD's judgement, requires Jemena to provide justification for the trend, as, taking the capital expenditure criteria relating to trend forecasts and expenditure on its own, the proposed capital expenditure are inconsistent with the presumption of a smooth trend in expenditure over time.*

GHD notes a shift from condition-based replacement trends to forecast age-based replacement profiles. JEN has invested significantly in replacement in the current period, exceeding the ESC approved capex level by over 30 percent.[7] In the next regulatory period a growing proportion of JEN's assets will exceed 50 years in age, so it is vital that JEN adopts a rigorous approach to assessing the condition of its assets. Origin seeks assurance that the move to a focus on age-based replacement will not result in over-investment in the network, noting that the approach must examine both the *age* and the *condition* of the asset.

Origin notes that all DNSPs propose increases in capital expenditure, with increases ranging from 37 to 81 percent. The primary driver of these increases appears to be the ageing of the network. Yet only JEN makes public the expert assessment of the reasonableness of its capex proposal. Origin urges the AER to apply careful scrutiny to the reasonableness of these capex proposals and the expert opinions provided in this context, an approach endorsed above by GHD.

## 4. X factors

All four DNSPs have adopted an approach whereby the increase in the first year of the period (Po) is significantly greater than the X factors in subsequent years. While this approach is not inconsistent per se with the requirements of the NER, Origin questions its suitability, since a function of the X factor is to smooth prices over the period (with a neutral impact on the NPV of revenues), not to create a dramatic increase in one year followed by only minor increases in other years – particularly in the context of the increasingly widespread implementation of time-of-use style tariffs which will also impact significantly on some customers' bills.

## 5. Tariff strategy

Origin notes UE's proposals in relation to new and innovative tariffs and is concerned about a number of the tariff and proposals outlined. Specifically, Origin is concerned that:

- Some tariffs are too complex for retailers to bill for small customers, such as the Summer Demand Incentive Charge, and so cannot be passed on to customers or provide an effective price signal. The result is that retailers are left unable to recoup network charges and are forced to spread these across the customer base at large. If there are a multitude of complex network tariffs across five DNPSs

[7] JEN Regulatory Proposal, p.56. Note that JEN's capex in the current period exceeded amounts approved by the ESC by over 30 percent.

this drives system costs, as different retail tariffs have to be created to accommodate these, while having minimal impact on actual customer demand.

- Tariffs that involve the packaging of services such as load control seem to imply some sort of marketing relationship between UE and its customer base, with some services falling outside the minimum funded by DUoS. Origin seeks further detail on how customers would elect to receive these services from their distributor and whether this would occur via a market contract with their retailer.
- Tariffs that provide a premium service delivered via enhanced supply reliability and services imply that UE would lower the level of service to the general customer base in order to segment its customer base (it being a zero sum game with respect to the revenue/price caps). This approach seems at odds with the more general objectives and requirements of Chapter 6 of the National Electricity Rules.

Origin notes that NSW DNSPs will be required to demonstrate the appropriateness of their tariff structures against clauses 6.18.2(b) and 6.18.5(b) of chapter 6 of the NER as part of their annual price approval process. We consider this a useful basis for considering tariff structures for the Victorian DNSPs.

6. Tariff re-assignment

Clause 6.12.1(17) of the NER requires the AER to make a decision on procedures for assigning customers to tariff classes as part of its distribution determination. Requirements for a distributor to communicate with a customer when re-assigning them them in Victoria are currently found in the ESC's *Electricity Price Distribution Price Review 2006-10* (EDPR), with some requirements also found in the *Electricity Distribution Code* ('the Code'*)*.

In May 2009 the AER made amendments to the Code in its decision on *Interval Meter Reassignment Requirements*, specifically in relation to the Victorian AMI roll-out. These changes created an obligation for a DNSP to communicate with a customer twice in the process of re-assigning that customer to a time-of-use tariff. When the current EDPR concludes at the end of 2010, these requirements in the Code will remain in place, to govern communications in the AMI context. Origin seeks clarification on whether the requirements in the AER's decision of May 2009 will also extend beyond the conclusion of the 2006-10 EDPR, given that the AER's decision was in response to requirements in the 2006-10 EDPR.

The Code requirements do not cover re-assignment between tariffs outside the context of the AMI roll-out (for example, when a customer on a smart meter is re-assigned from one time-of-use tariff to another). Any requirements for a distributor to communicate with a customer in this instance will presumably be a feature of the AER's Final revenue Determination for Victoria. (While re-assignments resulting from meter exchange will account for the bulk of re-assignments in Victoria in the period 20011-15, there will also be re-assignment initiated by DNSPs for other reasons.)

PWCR and CTPWR have proposed that the requirements in the most recent NSW DNSP Distribution Determination (FY2010-14, 'NSW Determination') should be largely appropriate for tariff re-assignment in Victoria. Origin notes that the requirements in NSW require that:
*A NSW DNSP must notify the customer concerned in writing of the tariff class to which the customer has been assigned or reassigned by the DNSP, prior to the assignment or*

*reassignment occurring. If the DNSP does not know the identity of the customer then it must notify the customer's retailer instead.*[8]

Origin supports a requirement for the DNSP to communicate with the retailer about tariff changes. Indeed, Origin believes that the DNSP should be required to inform the retailer not just when the DNSP does not have the customer's details, but prior to *all* tariff re-assignments. This communication should come at least 20 business days prior to the proposed re-assignment. If a requirement for the DNSP to communicate in this way is not included as part of the Victorian Determination (in response to cl.6.12.1(17)) then it should be included elsewhere in the regulatory framework, to ensure that retailers are able to pass on network costs in their entirety.

While Origin supports the requirement for DNSPs to communicate with retailers about tariff re-assignment, Origin is unclear on the full implications of the NSW decision for retailers. In the NSW model the DNSP must communicate the tariff change to the retailer when it does not have the customer's details. It is unclear whether this implies that, in these instances, the retailer must inform the customer of the re-assignment *on the DNSP's behalf*. That such a requirement exists could be inferred, since under the NSW Determination *all* customers have an opportunity to challenge a tariff re-assignment, which presupposes that all customers are notified of tariff re-assignments – even where the DNSP notifies the retailer only.

If such a requirement is implicit in the NSW Determination, Origin does not think this should be replicated in the Victorian Determination, which should stipulate that retailers are not *required* to initiate a communication with customers about network tariff re-assignment on the behalf of DNSPs. Specifically:

- In the context of AMI re-assignments, the AER's amendments to Code in 2009 should be adequate to ensure customers are informed.

- For re-assignment of customers outside the context of AMI: a separate communication on tariff re-assignment should be unnecessary. Customers can at any time contact their retailer to discuss changes in their billing and the retailer can at that time explain the impact of a change in network tariff.

In light of this, Origin would like to confirm that – whatever the procedures for tariff reassignment adopted in the Victorian context – they should not mandate how retailers communicate with customers about changes in network tariffs. Any ambiguity about the retailers' roll should be removed.

As a final point on tariff reassignment, we refer again to the proposal by UE and commented on above. If the determination allows the DNSP to provide various services as part of a tariff (premium service, load control etc) then for these network tariffs there can be no mandatory assignment of customers. In fact, the full range of processes and procedures among distributor, retailer and customer require further examination. For instance, Origin as a retailer cannot accept credit risk (which we currently do on existing network charges) for such an "enhanced product", and should not be liable to the distribution business unless the customer has paid the retailer for the service.

[8] NSW New South Wales distribution determination 2009–10 to 2013–14 Final Determination, Appendix A, p.407.

If you have any questions in relation to this submission please contact Steven Macmillan on (03) 8665 7155 in the first instance.

Yours sincerely

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