Minutes of the South Australian public forum on ETSA Utilities' draft distribution determination (1 July 2010 to 30 June 2015)

Location:	**Stamford Plaza Hotel** **150 North Terrace, Adelaide**
Date:	**9 December 2009**
Forum Chair:	**Steve Edwell**
Attendees:	**(see appendix 1)**

Summary of Discussion

1. Opening remarks by Steve Edwell (Chair, AER)

Steve Edwell opened the forum. He stated that:

- the purpose of the forum was to outline the AER's draft distribution determination for ETSA Utilities for the 2010-2015 regulatory control period
- the forum would focus on key aspects of the draft determination
- for the purposes of the National Electricity Rules (Rules), questions and comments made during the forum would be treated as 'oral submissions' and will be taken into account in the AER's final determination
- a brief record of the conference proceedings will be made available and published on the AER's website.

Steve Edwell gave an overview of the AER's draft decision. The overview presentation covered the key areas of the AER's process, allowed capital and operating expenditures, expenditure drivers, allowed revenues, the cost of capital and indicative price impacts.

A copy of the AER's presentation is available on the AER's website at: http://www.aer.gov.au/content/index.phtml?itemId=733070

Comments and questions on the opening remarks

John Pike – ECCSA, Observed recent market data from Credit Suisse, noting the favourable outcome for ETSA Utilities' parent company regarding the AER determination on WACC of 10.02%, given Credit Suisse's initial estimate of 9.2%. Mr Pike believed that the AER's decisions on a BBB+ credit rating and a 10 year term of debt were unusual, as he would have expected a credit rating of A- and a shorter term of debt. As such, Mr Pike questioned whether the AER's draft decision on the WACC was actually based on reality rather than just theory. Mr Pike encouraged the AER to be mindful of any increases in

ETSA Utilities' revenue allowance from the draft decision to the final and hoped that the AER would stand firm on its draft decision.

Steve Edwell responded that these issues were analysed in detail in the AER's WACC review. He noted that originally the AER had proposed a 5 year term of debt and an A– credit rating. However, the regulated businesses responded with compelling arguments, some of it confidential and as a result the AER considered a more conservative approach was warranted. Mr Edwell noted that the AER sets a WACC according to a benchmark and not a firm-specific approach, and that it is up to the businesses to respond accordingly.

Mr Edwell highlighted that the AER's role in setting of WACC parameters largely involves looking at the most recent data and applying a set formula consistent with the WACC review. Some of these parameters are defined in Rules, while others allow certain discretion to the AER.

Mr Edwell also stated that the AER intends the draft decision to be as close as possible to its final decision and it is incumbent on ETSA Utilities to come back with persuasive arguments in order to justify any changes in the final decision.

Bob Lim - on behalf of the ECCSA noted that AER had chosen a term of debt of 10 years when it had indicated that there was evidence that a reasonable term of debt would be 7.8 years. As such, Mr Lim questioned why 10 years was chosen, given that any rounding should have put the figure at 7 rather than 10 years. Mr Lim also noted that the AER took a holistic rather than a conservative approach to its WACC review and as such, a term of debt of 7 years appears to be more consistent with a holistic approach.

Steve Edwell responded that the AER would take the WACC comments on notice and noted that there had been much debate on the subject as part of the WACC review.

Ariel Liebman – EUAA, commented that the chair had spoken briefly about the Efficiency Benefit Sharing Scheme, noting that it applies mainly to opex but that there were incentives with regard to capex. Mr Liebman requested more detail on the incentives with regard to capex.

Steve Edwell responded by noting that the framework for capex is that if the business spends less than its allowance, it gets to keep the return on and of capital. Mr Edwell noted that this framework could create an incentive to compromise reliability, but that this incentive was offset by the AER's Service Target Performance Incentive Scheme. He noted that this is first time that the AER has gone through this process with ETSA Utilities, and that the framework will be monitored.

Chris Pattas – AER, added that the capex incentive exists because a profit-maximising business will aim not to spend all of its allowance when it is allowed to keep the difference, which will reveal the firms' efficient expenditure. He said that this was the framework that the AER is required to consider under the Rules.

Bob Lim responded that this observation was true for a profit-maximising business, but not necessarily for a regulated business, so the framework is wrong.

Steve Edwell stated that if the framework was wrong in some way then that is an issue for the rule makers and not the AER.

2. Detailed presentation of the AER's draft determination for ETSA Utilities

Mr Edwell progressed through a more detailed presentation on the draft determination for ETSA Utilities in the areas of demand forecasts, the opening regulatory asset base, capex, opex, building block components and alternative control services.

3. Presentation by the EUAA - Ariel Liebman

Ariel Liebman noted that the views to be presented were preliminary as the EUAA had only a week to digest the draft determination of the AER. In particular the EUAA:

- considered the reductions in opex to be limited
- was disappointed with the AER's response on benchmarking
- expected a more aggressive approach on demand management and believe insufficient priority is being given to this area.
- raised the issue of pricing transparency, and stated that the AER should report average annual increases for DNSPs and that prices should not be presented as total bill impacts using assumptions about distribution costs being a percentage of total costs
- raised the differences in the rates of returns allowed by the AER and those allowed by Ofgem in the UK. The AER has approved a real WACC of 7.6% compared with Ofgem's 4.75%.

A copy of the EUAA presentation delivered by Ariel Liebman is available on the AER's website: http://www.aer.gov.au/content/index.phtml?itemId=733070

4. Presentation by Bruce Mountain (Carbon Market Economics)

Bruce Mountain presented a critique of the AER's benchmarking and a description of the benchmarking approach used by Ofgem. His critique of the AER's benchmarking focused on the scope of the benchmarking undertaken and the method used. In this latter regard, Mr Mountain considered that the 'line of best fit' – the least squares fit that the AER had drawn should not intersect the X-axis as the AER's line does. He developed two regressions which distinguished between publicly and privately owned distributors. In terms of scope, Mr Mountain noted that Ofgem benchmarked both capex and opex and that benchmarks were used directly to set the allowed expenditure for around 66 per cent of total expenditure costs. He noted that Ofgem had refined its approach to benchmarking over four regulatory resets.

Carbon Market Economics' presentation slides are available of the AER website: http://www.aer.gov.au/content/index.phtml?itemId=733070

5. Questions and comments on all presentations

Steve Edwell responded to the presentations from the EUAA and Carbon Market Economics. Mr Edwell stated that with regard to demand management, it is not the AER's role to impose spending decisions upon businesses. Mr Edwell noted that the questions the AER asked its consultants were whether ETSA Utilities were undertaking efficient options analysis, including the consideration of demand management rather than network augmentation. Mr Edwell noted that the AER was in turn satisfied that demand management alternatives were being considered as a matter of course by ETSA Utilities.

Mr Edwell noted on the issue of benchmarking that it could prove to be a useful tool for the AER going forward. In response to the EUAA's observation of Ofgem's experience in the use of benchmarking, Mr Edwell noted that Ofgem's experience largely relates to the fact that it has now completed four or five regulatory resets for all its distribution businesses. This is in contrast to the AER which only received jurisdiction over distribution networks in 2008. Nevertheless, Mr Edwell stated that the AER would be happy to engage with the EUAA on benchmarking.

Mr Edwell also commented that there were issues of data availability, and that given the current data showing ETSA Utilities appearing to be an efficient firm according to the AER's opex benchmarking graph (which was commented on by Mr Mountain), based on Mr Mountain's proposition, the AER would have had to allow all of ETSA Utilities' proposed opex. As such, Mr Edwell questioned whether Mr Mountain's conclusion supported his arguments.

Bruce Mountain of CME clarified he was not drawing conclusions or proposing what ETSA's expenditure allowance should be on the basis of benchmarking. However, Mr Mountain noted that the AER had benchmarked ETSA's 2007/08 expenditure, and if the AER allowed this level of operating expenditure on the basis of its benchmarking, then this would mean than the AER would allow ETSA less expenditure than it has in the draft decision.

Ariel Liebman commented that the EUAA was not arguing that the AER's attempt should be taken as benchmarking and applied. He commented that Mr Mountain's observations demonstrate that the AER has not undertaken benchmarking of sufficient robustness to comply with the rules.

Bob Lim pointed out that the ECCSA had previously drawn attention to ETSA Utilities' large capex proposal, particularly the asset replacement claims. Mr Lim noted that ETSA Utilities had proposed similar claims in the previous determination to ESCOSA, and that these were subsequently rejected. As such Mr Lim thought it unusual that ETSA Utilities had still managed to underspend its allowance. Mr Lim questioned whether this was an issue of regulatory gaming on the part of the business, or whether there is actually a serious asset replacement issue? On a related matter, Mr Lim also noted ECCSA support for the AER's draft decision in adopting a condition based assessment of asset replacement requirements.

Mr Lim stated that the ECCSA believes that many of the cost pass throughs in NSW were inefficient and asked the AER to pay particular attention to this matter in South Australia.

With regard to pricing, Mr Lim noted that some of the ECCSA's members were unable to replicate the pricing examples provided by the AER, and would appreciate more transparency on pricing matters. Further, Mr Lim suggested that the lead times between ETSA Utilities' pricing decisions and the start of the new regulatory period were too short.

Steve Edwell responded by noting that the AER has encouraged ETSA Utilities to engage early with users and user groups, to ensure adequate and timely visibility of pricing outcomes. He also noted that there is a general recognition that this process can be handled better.

Andrew Nance, on behalf of SACOSS noted that with more assets and a larger RAB, consumers will continue to pay for this in future years. Mr Nance noted that ETSA Utilities has much experience in the trialling of demand management yet has proposed very little in its regulatory proposal. Mr Nance suggested that the AER was unsure of the role it had to play in the demand management arena, and that the $3 million allowance for demand management was far too small, given an overall determination of $3 billion.

Steve Edwell reiterated that the AER's role is not one of imposing demand management solutions on the businesses. He noted that the allowance under the demand management incentive scheme was largely an allowance for research and development.

Mr Edwell noted that the draft decision had drawn attention to the AEMC's ongoing review of demand side management responses in the National Electricity Market and the potential for changes to the regulatory framework as it pertains to demand management.

Andrew Nance questioned why the number was three million, not three and a half, six or 20 as it was in the last determination for ETSA Utilities.

Steve Edwell noted that the size of the allowance had been considered previously in detail, and that an amount greater than three million for research and development was not justified at this time.

Ariel Liebman asked Mr Edwell to comment on why there was not a NSW type of D factor scheme in SA.

Steve Edwell noted that the D-factor scheme was inherited in NSW as part of the transitional arrangements and that evidence thus far was showing limited success.

Chris Pattas added that the demand management incentive scheme (DMIS) for South Australia is not limited to the $3 million under the Part A – Demand management innovation allowance component of the DMIS. Mr Pattas noted that the DMIS also includes a Part B – Foregone revenue component, similar to the D-Factor scheme.

John Pike complimented the EUAA on their presentation, but asked whether based on the EUAA's analysis, there was an appropriate number that the EUAA could suggest on the basis of a benchmarking exercise.

Ariel Liebman suggested that he did not have a number, and that the EUAA could not undertake such an exercise with its limited resources. Mr Liebman suggested that there are academics who are qualified in the area of benchmarking and could assist the AER.

Bruce Mountain commented, in response to John Pike's question, that he does not believe that the data available to the AER is sufficiently robust to use international benchmarking to set ETSA's expenditure allowance, but suggested that this does not mean that benchmarking should not be explored further by the AER. He also drew attention to a soon to be released paper he has authored, comparing NSW distribution businesses with counterparts in Victoria and the United Kingdom.

John Pike questioned why data from Ofgem's last 4 to 5 resets could not be utilised for this purpose.

Bruce Mountain responded that there was probably not sufficient time at the moment to undertake robust analysis, but there was scope for such work in the future.

Mark Henley, of UnitingCare Wesley stated that energy costs were on the rise and this was of concern to consumers. Mr Henley questioned how network charges would be allocated between customer classes, and what the AER's role on this matter would be?

Steve Edwell responded that the AER's mandate on pricing matters is very limited under the Rules for ensuring compliance with the pricing principles. He suggested to Mr Henley that he could contact the AER after the public forum to obtain further information on the AER's role in regard to ETSA Utilities' pricing proposal.

6. Concluding comments

Steve Edwell outlined the remaining process and timetable up to the AER's final decision and approval of prices.

Mark Henley enquired as to the possibility of commencing discussions on the pricing proposals before the 30 April.

Steve Edwell suggested that the best approach would be for the user groups to engage directly with ETSA Utilities, and that the AER could try to assist in arranging such engagement if necessary.

Lew Owens of ETSA Utilities noted to Mr Henley that discussions with consumer groups would be arranged with regard to providing transparency and visibility on pricing matters.

Steve Edwell thanked attendees for their participation and closed the public forum at 11:30 am.

Appendix 1 – List of Attendees

Organisation	Attendees
Department for Transport, Energy and Infrastructure	Marino Bolzon, Jinny Pavanello, Ron Williams
ESCOSA	Bob Burgstad, Natasha Cheshire, Stuart McPherson
Philip Cheesman & Associated	Philip Cheesman
Business SA	Anthony Clarke
UnitingCare Wesley	Mark Henley
ElectraNet	Bill Jackson
SP AusNet	Kate Jdanova
SA Water	Rebecca Knights
Envestra	Craig De Laine
Energy Users Association of Australia	Ariel Liebman,
Bob Lim & Co (for Energy Consumer's Coalition of South Australia)	Bob Lim
AGL	Nicole Wallis, David Sita
CityPower/Powercor Australia	Stephanie McDougall, Renate Tirpcou
Carbon Market Economics (for EUAA)	Bruce Mountain
St Kitts Associates (for SA Council of Social Services)	Andrew Nance
Parsons Brinckerhoff	Victor Petrovski, John Thompson, Ashley Manna
COTA Seniors Voice	Ian Yates
Energy Consumer's Coaliton of South Australia	John Pike
ETSA Utilities	P Roberts, Lew Owens, Patrick Makinson
South Australian Farmers Federation	Heather I'Anson