



public interest
ADVOCACY CENTRE

PIAC submission to Directlink 2020-25 revenue proposal

16 March 2019

About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney.

Established in 1982, PIAC tackles barriers to justice and fairness experienced by people who are vulnerable or facing disadvantage. We ensure basic rights are enjoyed across the community through legal assistance and strategic litigation, public policy development, communication and training.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives input from a community-based reference group whose members include:

- NSW Council of Social Service;
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- Physical Disability Council NSW;
- St Vincent de Paul NSW;
- Good Shepherd Microfinance;
- Affiliated Residential Park Residents Association NSW;
- Tenants Union;
- Solar Citizens; and
- The Sydney Alliance.

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The Public Interest Advocacy Centre office is located on the land of the Gadigal of the Eora Nation.

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Introduction

PIAC welcomes the opportunity to respond to the Australian Energy Regulator's (AER) issues paper and the regulatory proposal submitted by Directlink.

The context of these revenue determinations

Determining Directlink's revenue allowance for the 2020-25 period can only be made while cognisant of both the current state of the National Electricity Market (NEM) and the recent history of electricity network outcomes in NSW.

A combination of high wholesale electricity prices, high gas prices and long-term growth in the Regulated Asset Base (RAB) of network businesses has meant that consumers have faced unusually high bills in recent years. The ACCC noted that "high prices and bills have placed enormous strain on household budgets and business viability. The current situation is unacceptable and unsustainable."¹

Long-term affordability and efficiency are key priorities for consumers

The history of NSW electricity determinations also plays an important part in the affordability pressures faced by NSW consumers. NSW consumers pay extremely high prices for their networks. After a period of relatively stable electricity prices, the 2009-14 saw an unprecedented increase in network investment – primarily driven by distribution network investment. The ACCC have recently confirmed this to have been over-investment.²

We acknowledge that this strong uptick in network investment was not driven by Directlink.

Subsequent revenue determinations have helped put downward pressure on NSW network prices, and while it is clearly positive that this is coming down, it must be noted that it is coming down from a particularly high level. Further, falling prices are not enough – they must also be efficient and sustainable.

Given this, PIAC contends that efficiency and consumer preferences should be central drivers of decisions by the businesses and the AER.

Efficiency and consumer preferences must inform revenue determinations

Traditionally, revenue allowances in the NEM have been determined using a 'bottom-up' process, where a range of expenditure programs are covered by the building blocks in an AER determination. What is also required is a top-down view of the proposals, where investment is constrained by an explicit focus on what consumers are willing to pay for, not just which projects are efficient in and of themselves.

Also, given the recent high prices and long-term growth in RABs, network businesses must set clear expenditure targets to deliver lower prices – now and over time – and to prioritise their projects accordingly. They must do what needs be done and do it as efficiently as possible, not

¹ ACCC, [Restoring electricity affordability and Australia's competitive advantage](#), June 2018, iv.

² Ibid, ix.

do what is 'nice to do'. They must establish a capex program that recognises future changes, and not build in long-life assets that are at risk of being underutilised in the future. They must understand the trade-offs between capex for new assets and opex for maintaining existing assets. All of this must be done with the explicit purpose of lowering costs to a sustainable level.

Consumer engagement

Consumer engagement is a core responsibility of network service providers (NSPs) in the energy market. Being a natural monopoly providing an essential service, businesses like Directlink do not face these competitive pressures; consumers cannot choose a different set of poles or pipelines, nor can most cost-effectively remove themselves from the grid at this stage.

Today, NSPs need to implement formal consumer engagement programs. These programs ensure NSPs provide network services that meet the requirements and preferences of their customers.

It is no longer acceptable for network businesses to do engagement poorly and promise to 'do it better next time.'

To this end PIAC conducted its Network Engagement Evaluation project to transparently and robustly assess the effectiveness of the three NSW electricity distribution businesses' consumer engagement in the lead up to lodging their initial revenue proposals in 2018.³ Overall, we found there was a significant improvement in consumer engagement by the NSW distribution businesses compared with that done to support their 2014-19 proposals.

Engagement in developing the revenue proposal

Given the importance of robust and early consumer engagement in forming a strong and supportable revenue proposal, the level of consumer engagement conducted by Directlink thus far is not acceptable.

Directlink sought a series of one on one meetings prior to lodging the revenue proposal "to introduce Directlink to these stakeholders, brief them on the key issues being faced by Directlink."⁴ However, as noted in the revenue proposal "due to the proximity of the Christmas/New Year break mutually available times could not be co-ordinated or the key stakeholders were not available."⁵

The timing and conduct of this engagement were problematic:

- Held at a time when stakeholders are unlikely to be available (around the Christmas/New Year period).
- Too little time allowed for stakeholders to realistically consider and provide informed feedback on Directlink's revenue proposal.

³ PIAC, [PIAC Evaluation of Consumer Engagement by NSW DNSPs 2017-18](#), August 2018.

⁴ Directlink, *Directlink Revenue Proposal 2020-25*, January 2019, 28.

⁵ Ibid.

- Too late for Directlink to realistically incorporate any feedback from stakeholders into the proposal submitted to the AER in January.

PIAC expects NSPs to be engaging with consumers and stakeholders through deliberative processes which relate directly to the IAP2 Public Participation Spectrum.⁶ Deliberative processes are becoming the industry standard for engagement. As detailed in Figure 1, the spectrum measures public participation in decision-making from ‘Inform’ to ‘Empower’.

PIAC contends that any truly deliberative consumer engagement process should be at the ‘Collaborate’ level of this spectrum.

We consider that the engagement Directlink has conducted to date in their revenue proposal has been closer to the ‘Inform’ and ‘Consult’ level of the IAP2 spectrum.

| | | INCREASING IMPACT ON THE DECISION | | | | |
|---------------------------|-----------------------|--|--|---|--|--|
| | | INFORM | CONSULT | INVOLVE | COLLABORATE | EMPOWER |
| PUBLIC PARTICIPATION GOAL | | To provide the public with balanced and objective information to assist them in understanding the problem, alternatives, opportunities and/or solutions. | To obtain public feedback on analysis, alternatives and/or decisions. | To work directly with the public throughout the process to ensure that public concerns and aspirations are consistently understood and considered. | To partner with the public in each aspect of the decision including the development of alternatives and the identification of the preferred solution. | To place final decision making in the hands of the public. |
| | PROMISE TO THE PUBLIC | We will keep you informed. | We will keep you informed, listen to and acknowledge concerns and aspirations, and provide feedback on how public input influenced the decision. We will seek your feedback on drafts and proposals. | We will work with you to ensure that your concerns and aspirations are directly reflected in the alternatives developed and provide feedback on how public input influenced the decision. | We will work together with you to formulate solutions and incorporate your advice and recommendations into the decisions to the maximum extent possible. | We will implement what you decide. |

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Figure 1 IAP2 spectrum of public participation (Source: International Association for Public Participation)

⁶ International Association for Public Participation, [IAP2 Public Participation Spectrum](#), 2014.

Engagement after lodging the proposal

In late March Directlink held a workshop with consumer representatives and stakeholders on their revenue proposal. This provided additional time to discuss the revenue proposal as a whole as well as particular aspects of the proposal such as elements of the capex program. However, it is obviously too late for any feedback from participants to inform Directlink's proposal.

This still falls short of the mark of truly deliberative consumer engagement.

Engagement moving forward

We note the findings which Directlink has taken regarding their consumer engagement to date:

There have been three key takeaways by EII from our consumer engagement to date:

- There is strong support for improvement in this area from stakeholders contacted.
- In the future engagement needs to commence further in advance of the submission.
- There are a number of areas that stakeholders are keen to engage on which will benefit from that engagement even though the transmission determination process has commenced.

In response to this, EII is proposing to continue to implement its broader stakeholder engagement program in line with the recommendations from Newgate Research.

In recognition of the need to commence stakeholder engagement earlier and to build it into the decision making of the interconnector before a transmission determination period, the ongoing consultation during this transmission determination period will feed into the next Transmission Determination proposal from Directlink.⁷

Waiting for the next revenue proposal is too late. We urge Directlink to find opportunities to effectively engage within this revenue determination process and not wait for the next revenue determination for the 2025-30 period.

Furthermore, we strongly support Directlink – and indeed all NSPs – embedding robust, open and honest consumer engagement as part of its business and usual and not something to be conducted only when preparing a revenue proposal.

We expect NSPs to engage using strategy-driven processes, not process-driven strategies. This means that a pre-determined plan for engagement should not drive how a business engages with its consumers. Instead, NSPs should identify how they need consumers to influence outcomes (the *strategy*) and design flexible deliberative practices (the *process*) through which that engagement can be performed.

This approach to embedding consumer preferences into business decisions is reflected in the Energy Charter of which APA is a signatory.⁸ The Energy Charter is a principles-based disclosure regime that can be applied to all businesses across the energy supply chain focused on

⁷ Directlink, *Directlink Revenue Proposal 2020-25*, January 2019, 30.

⁸ <https://www.theenergycharter.com.au/>

embedding customer-centric culture and conduct in energy businesses to create real improvements in price and service delivery, through commitment to five key principles.

The first principle and the principle in action, shown in Figure 2, highlight the importance of implementing strategy-driven processes, not process-driven strategies.

The graphic is a dark blue rectangle. On the left side, there is a circular orange icon containing a white silhouette of a person's head and shoulders, with a hand reaching up towards the chin. To the right of the icon, the text is as follows:

ONE:
We will put customers at the centre of our business and the energy system

Having the right culture underpins the way we behave, the decisions we make and the outcomes we deliver. We recognise that getting the culture right for our customers is crucial not only to deliver on our customer commitments, but also to the long-term success of our businesses.

We will develop the culture within our businesses that puts the customer at the centre and will work together and with our stakeholders to deliver the safe, affordable, reliable and sustainable energy system the community expects.

Principle in action

To fulfil this principle energy businesses should:

- 1.1** Have a Board that actively oversees the business's culture so as to be aligned with Energy Charter Principles.
- 1.2** Have management operationally accountable for embedding a 'customer at the centre' culture.
- 1.3** Ensure their work force is engaged and incentives are aligned to drive positive customer outcomes.
- 1.4** Have robust processes to determine customer and community needs and be accountable on how feedback has been considered and incorporated into decision making.
- 1.5** Demonstrate a culture of innovation and collaboration for positive customer outcomes, including through the sharing of insights with government, research institutions and across the supply chain, as well as joint advocacy on regulatory, policy and operational issues.

Figure 2 Energy Charter Principle 1: putting the customer at the centre (Source: The Energy Charter, 2019)

We strongly encourage Directlink to view this as an opportunity to improve rather than purely as an obligation to meet a regulatory requirement. We look forward to continuing to work with Directlink alongside other consumer representatives and stakeholders in developing and implementing a robust engagement program.

Long-term sustainability delivered by the revenue proposal overall

PIAC maintains its earlier position from the revenue determinations for the NSW DNSPs that we will neither support proposals that will increase distribution charges over the 2019-24 RCP nor support expenditure programs that result in continued RAB growth.⁹

Network businesses should be proposing, and AER approving, real price decreases in order to address the current affordability and cost of living pressures on consumers who are already struggling.

Total revenue allowance

PIAC is concerned that Directlink is proposing an increase to its 2015-20 revenue allowance as shown in Figure 3.

While we can appreciate the challenge of finding further efficiencies in Directlink's expenditure, it is, nonetheless imperative that these are found to deliver real price reductions to consumers. Therefore, we do not support the overall revenue allowance proposed.

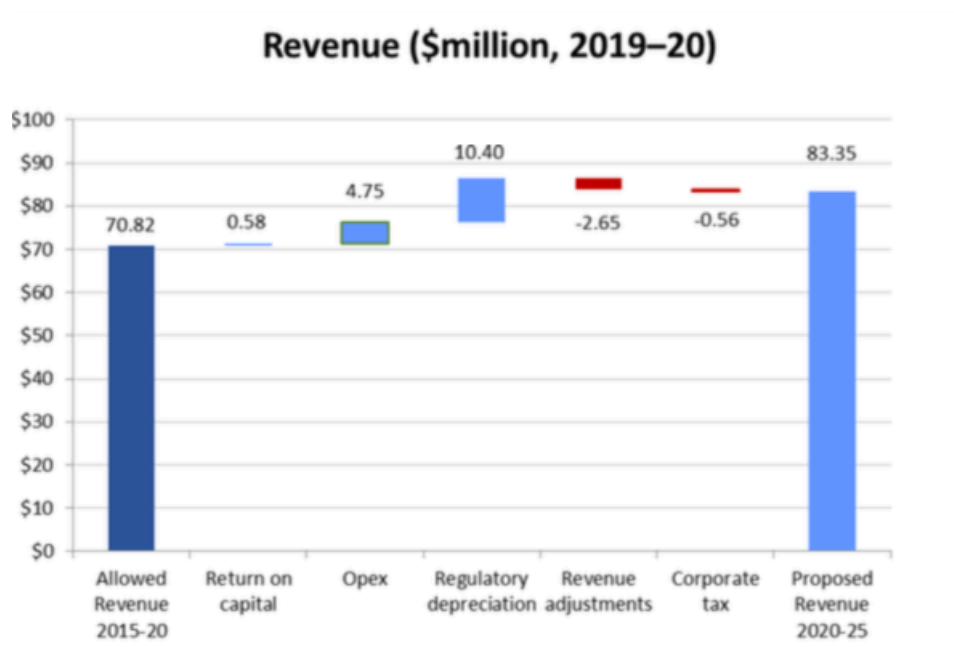


Figure 3 Proposed change in total revenue allowance for the 2015-20 period compared to the 2020-25 proposal (Source: AER Issues Paper)

⁹ PIAC, [PIAC submission to the AER's draft determinations and the NSW DNSPs' 2019-24 revised proposals, August 2018](#), 2.

Regulated Asset Base

While recent revenue determinations have reduced network expenditure, under the current regulatory framework, this does not address the impact of earlier network investment. Rather, the historical increases of the RAB will continue to place upward pressure on consumers' prices for decades to come.

As noted earlier, we consider that network businesses should be proposing, and AER approving, real price decreases in order to address the current affordability crisis and cost of living pressures on consumers who are already struggling. Halting, and indeed reversing, RAB growth is, perhaps, even more important than short-term price paths. Expenditure allocated to the RAB results in higher prices paid by consumers for the life of the relevant asset, through higher return on capital and regulatory depreciation allowances.

Inflation and cost of capital are at historically low levels. Given that cost of capital is a key driver of network prices, it does not bode well for the future that electricity prices are unsustainably high even when this input is at historic lows. If or when the cost of capital increases, a second round of affordability crises will arise – absent genuine reforms to the underlying business operations.

Given this, we are concerned that, under the 2020-25 revenue proposal, Directlink's RAB is expected to grow as shown in Figure 4. PIAC does not support the proposed impact on RAB.

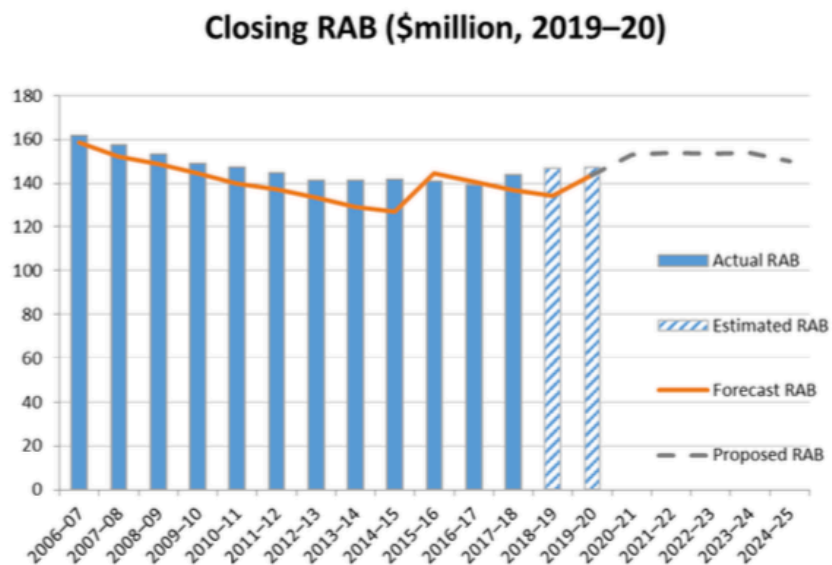


Figure 4 Proposed change in Directlink Regulated Asset Base (RAB) from 2020-25 revenue proposal (Source: AER issues paper)

Capex proposal

Given the importance of affordability and managing RABs described above, PIAC is looking for clear evidence that significant efforts have been made to reduce capex and reign in the RAB growth through the proposals.

IGBT replacement

The proposed replacement of Insulated-Gate Bipolar Transistors (IGBTs) forms a significant portion of Directlink's capex proposal. PIAC supports the range of options Directlink has put forward as potential solutions. We cannot at this time, comment on which may be the most appropriate solution to pursue. However, we support Directlink continuing to investigate these options in further detail as well as assessing other potential solutions including through the RIT-T process.

Reliability upgrade

Directlink has proposed a capex project to improve its reliability. PIAC doubts whether the potential benefit to NSW and Queensland consumers from any increase in reliability is worth the additional cost or whether it reflects consumer preferences regarding price and reliability.¹⁰ In light of the pressing needs of delivering affordability described earlier, whether maintaining existing levels of reliability for Directlink would not be more preferable.

These concerns are further heightened as significant upgrades to the Queensland-NSW Interconnector (QNI) have been flagged in AEMO's Integrated System Plan and the RIT-T for the first upgrade has already commenced.

Land rectification and restoration

PIAC supports the intent of the proposal to set aside an annual amount to cover the cost of land rectification and restoration after Directlink reaches the end of its regulatory life in 2041/42. Annualising the cost of this would be a prudent way of preventing bill shock to customers at end-of-life and is consistent with the beneficiary pays principle where the costs are recovered from those customers who are currently deriving benefit from Directlink.

However, PIAC has a number of concerns with the proposal, noting that this is an unusual item in a capex proposal and there are limited details of the proposed mechanism for tracking and using the amount set aside. We also note that the AER's decision in this matter may set a precedent for future network proposals.

PIAC's concerns include:

- Has the cost of decommissioning and land restoration already been included in the RAB value of Directlink? If this is the case, consumers would already have been paying for these costs in existing network prices and this additional capex item would be double-dipping.

¹⁰ Bearing in mind that the level of reliability experienced by the majority of consumers are far more strongly influenced by outage rates in the distribution network rather than transmission-level reliability or security issues which any upgrade to Directlink would affect.

- Is the annual amount proposed to be put aside prudent and efficient for the expected rectification and restoration costs? Factors to consider include the salvage value from materials in decommissioning Directlink assets and the extent of remediation work which will be required (for instance, could some concrete be left in situ rather than being removed).
- What happens if Directlink’s life is extended?
- What happens with any over- or under-spend once the actual costs of land rectification and restoration are revealed?

Opex proposal

While the opex allowance proposed is relatively minor, PIAC is concerned that it still represents a noticeable step increase from the current regulatory period’s allowance. We also note that no output or productivity growth was included in the proposal. We question whether further opex efficiencies could not be found.

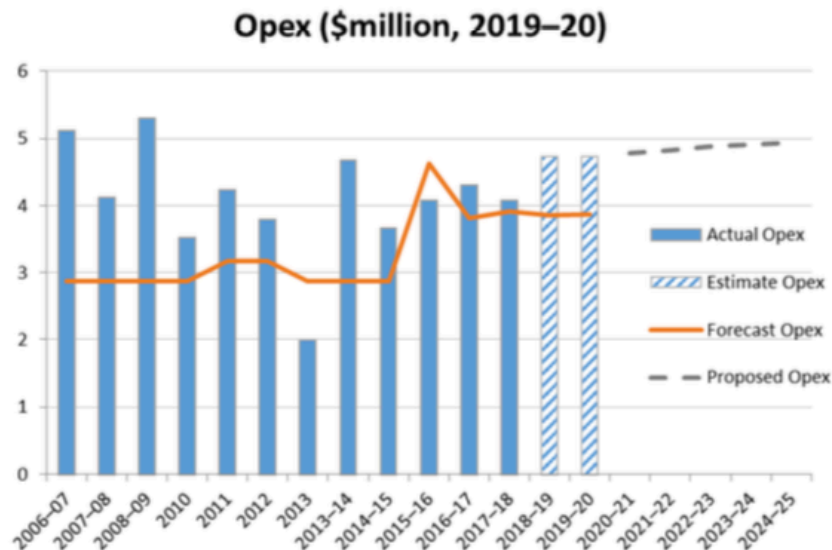


Figure 5 Proposed change in Directlink operating expenditure (opex) in 2020-25 revenue proposal (Source: AER issues paper)