



28 April 2020

Mr Warwick Anderson
General Manager
Network Finance and Reporting
Australian Energy Regulator

Via Email: AERInquiry@aer.gov.au
CC: Esmond Smith - esmond.smith@aer.gov.au

Dear Mr Anderson

RE: Submission – Impact on consumers of a delay to the Ergon Network 2020-2025 Determination

The Queensland Electricity Users Network (QEUN) appreciates the opportunity to provide a consumer perspective to the proposed delay in publishing the Final Ergon Network 2020-25 Determination from 30 April 2020 to late May 2020.

The QEUN is a consumer advocate representing small business and residential consumers with a particular emphasis on regional consumers. We advocate for affordable and reliable electricity from a resilient national electricity system where the pace of the transition to a renewable energy future is not at the expense of the economy, jobs or reasonable living standards.

Consumer Input Limitation

A potential delay in publishing the Ergon Network 2020-25 Determination will impact on the retail prices of over 765,000 consumers connected to the Ergon network in regional Queensland, in particular on 710,000 consumers captive to regulated retail prices set by the Queensland Competition Authority.

In April 2020 the Queensland Electricity Users Network applied to Energy Consumers Australia for a CEO Grant to provide a submission to the Queensland Competition Authority (QCA) on the 2020-21 regulated retail electricity prices for regional Queensland. We were verbally informed by ECA that our application did not qualify for a CEO Grant as the setting of regulated retail prices is a regular process on a known timeline and as such QEUN should have applied for an advocacy grant in October 2019. The CEO Grant application was refused citing “it did not provide enough information to show that it satisfies the Grants Program criteria, in particular on what analysis would be undertaken through the grant funding”.

In addition, a previous application to Energy Consumers Australia for an advocacy grant which included participation in the 2020-2025 network determination for the past two years was also unsuccessful. With no funding to support QEUN’s advocacy during the Ergon and Energex 2020-25 network determinations, QEUN were forced to participate for two years with no funding for network determinations.

Similarly, this submission which involves aspects of Ergon Network’s 2020-25 determination and QCA’s 2020-21 regulated retail prices is being provided for free by QEUN due to no funding from Energy Consumers Australia.

Recommendation 1

If the Final Ergon Network 2020-25 Determination is delayed from 30 April 2020 to late May 2020 we recommend that Ergon Network and/or the Queensland Competition Authority publicly announce on 30 April the decision of the Australian Energy Regulator to accept or reject Ergon Network’s 2020-25 Tariff Structure Statement.

Reason for recommendation 1

A public announcement will allow consumers, particularly business consumers, to constructively engage with the Queensland Competition Authority on the setting of 2020-21 regulated retail prices for regional Queensland. The QCA have scheduled virtual workshops for early May and submissions to QCA on 2020-21 regulated retail prices for regional Queensland close on 13 May 2020.



The network component of a retail power bill is the largest or second largest component of a retail tariff therefore network tariffs are pivotal to whether a business or residential consumer can afford the 2020-21 regulated retail prices set by QCA for regional Queensland (see Figures 1, 2 and 3).

For the last few years the Delegation from the Queensland Energy Minister has stated that the draft regulated retail prices must be published by 28 February and the final regulated retail prices by 31 May.

In the Ministerial Delegation of 9 December 2019, the Queensland Energy Minister stated:

- The QCA must publish the draft price determination on regulated retail electricity tariffs, and this should occur in February 2020, but no later than March 2020
- The QCA must publish the final price determination on regulated retail electricity tariffs for the 2020-21 tariff year, and it should have the retail tariffs gazetted by 31 May, but not later than 26 June 2020

The delay was announced prior to COVID19 therefore the publishing date for final retail prices by 26 June 2020 has no bearing on the AER's proposed delay of Ergon Network's 2020-25 Determination. The pandemic was declared by the World Health Organisation on 12 March 2020.

In previous retail price determinations, under the QCA's methodology of N+R (where N is the network component and R the retail component), the QCA used the network prices and tariffs approved by the AER. However, because Ergon Network in its Tariff Structure Statement has proposed to retire most of the network tariffs that underpin the existing retail tariffs, the QCA in their draft 2020-21 determination proposed an alternative approach of price indexation. This approach uses 2019-20 network costs as starting points, which are then adjusted using the AER's nominal X-factors.

Ergon Network has raised concerns to QCA about using an indexation based approach to determine the network component including that it will require transition paths for *small* customers in future years to 'rebase' regulated retail tariffs to the true 'N'. The QCA maintain the indexation approach is necessary given the uncertainty of ongoing network tariff reforms.

For large business customers the QCA propose to apply the standard N+R approach, this approach will pass through the 2020-21 network prices determined by the AER. In QCA's draft determination QCA have used the 2020-21 network prices that Ergon Network submitted to the AER as part of its revised regulatory proposal and Tariff Structure Statement in December 2019. For their final determination the QCA intend to use the updated pricing approved by the AER on 30 April.

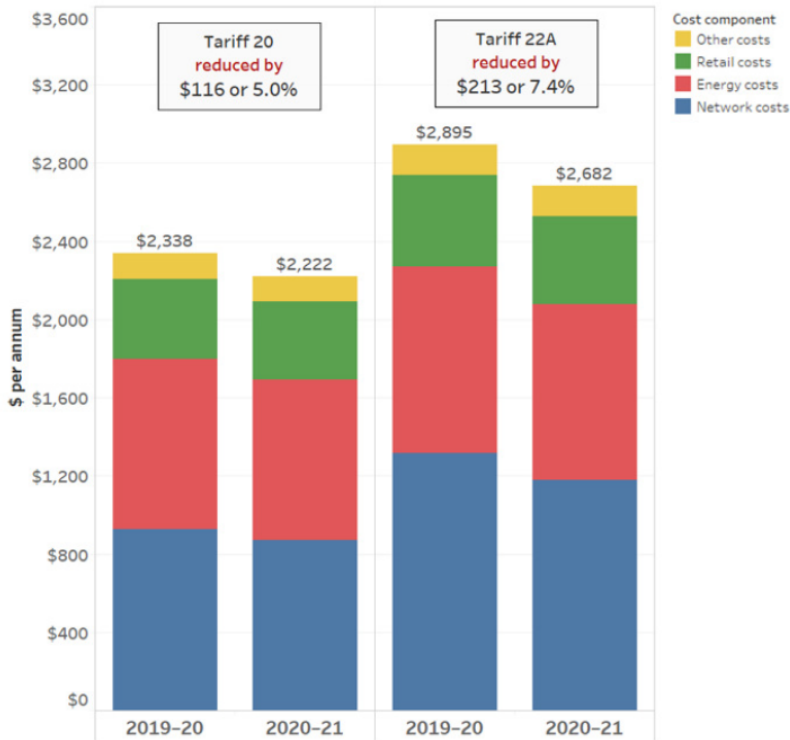
Should the AER on 30 April 2020 only provide a final determination on Year 1 revenue and whether it has accepted or rejected Ergon Network's proposed Tariff Structure Statement, we believe Ergon Network and QCA can incorporate the AER's TSS and Year 1 revenue determination into the 2020-21 regulated retail prices due to be gazetted by 26 June 2020. We understand that although Ergon Network and QCA are under no legal obligation to inform consumers as to whether the AER has accepted or rejected the Tariff Structure Statement it is critical to consumers that the AER's decision is made public on 30 April 2020.

The approval of the Tariff Structure Statement impacts on all business and residential consumers. However, the TSS has a particular impact on a group of large regional manufacturers who without tariff reform will have serious viability issues.

Regional Queensland was in a parlous state prior to COVID19 - a parlous position which can be directly attributed to exorbitant network and retail electricity tariffs paid to Ergon Network and Ergon Retail.

The parlous state is best illustrated by the poor population growth in regional Queensland compared to South East Queensland (see Table 1 and Figure 4 and 5). People only go where there are jobs and job prospects. For a strong post COVID19 recovery regional Queensland needs jobs. To employ people and to thrive not merely survive, businesses need cheaper electricity which means cheaper network and retail prices.

Figure 1 Residential power bills in regional Queensland based on QCA’s Draft 2020-21 regulated retail prices



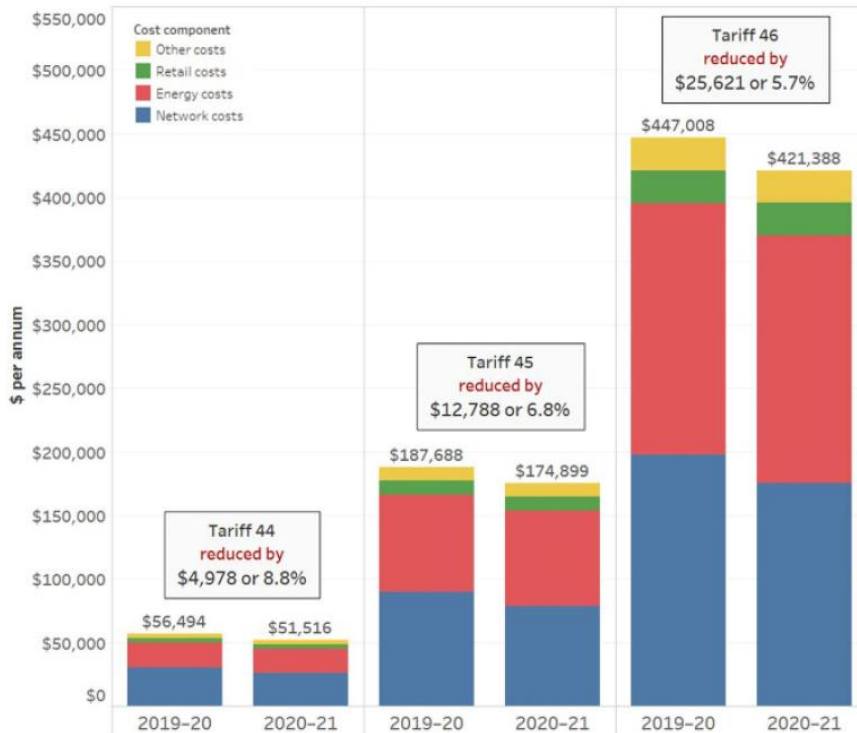
Source: Queensland Competition Authority 2020-21 Draft Determination, 31 March 2020

Figure 2 Small business power bills in regional Queensland based on QCA’s Draft 2020-21 regulated retail prices



Source: Queensland Competition Authority 2020-21 Draft Determination, 31 March 2020

Figure 3 Large business power bills in regional Queensland based on QCA’s Draft 2020-21 regulated retail prices

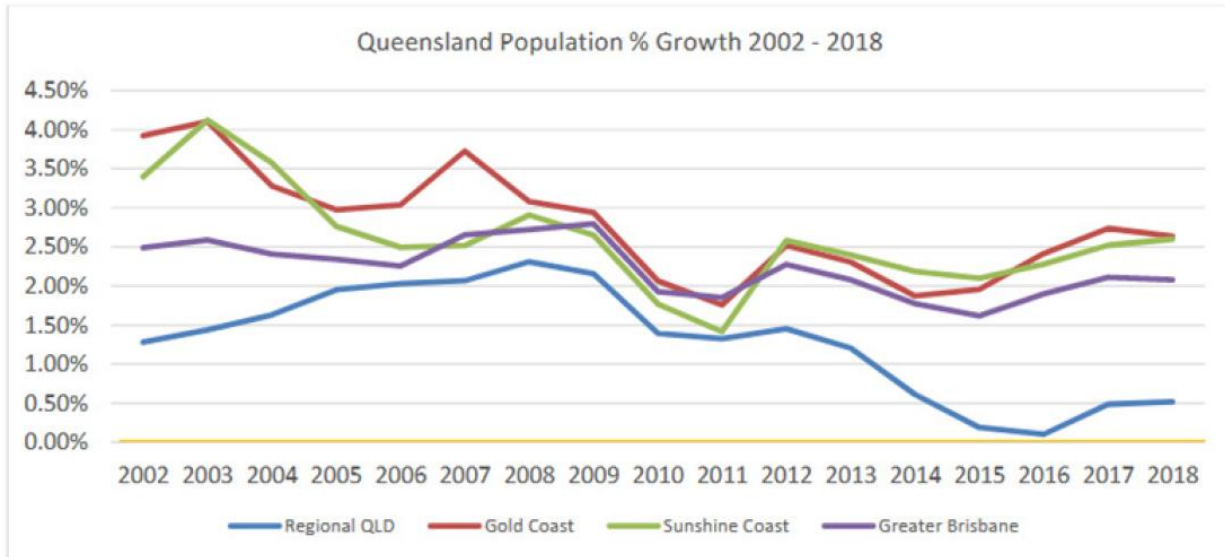


Source: Queensland Competition Authority 2020-21 Draft Determination, 31 March 2020

Table 1: Residential population growth in major northern regions, 2018-19

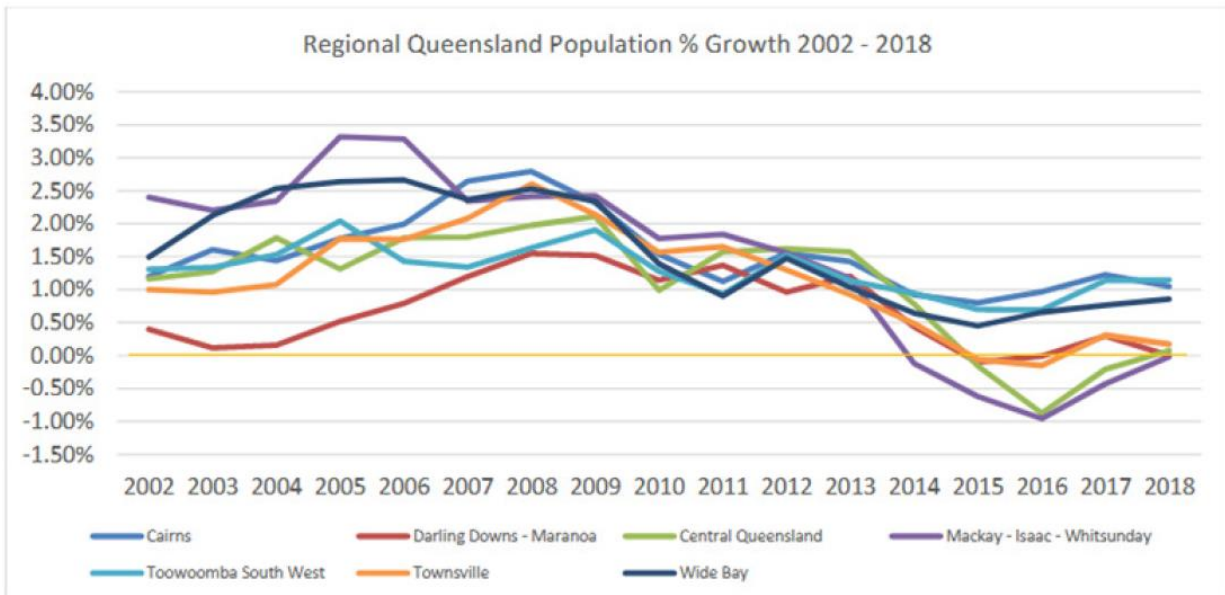
Major northern regions	Population 2018-19 No.	Growth 2018-19 No.	Growth 2018-19 %
Cairns TNQ Region	295,346	2570	0.9%
Cairns City LGA	166,862	1400	0.8%
Townsville/ North West Region	261,840	416	0.2%
Townsville City LGA	195,032	1013	0.5%
Northern Territory	245,929	(-1129)	(-0.5%)
Darwin City LGA	82,886	(-1614)	(-1.9%)
Central Qld Region	226,811	1306	0.6%
Rockhampton LGA	81,512	461	0.6%
Mackay Region	173,066	525	0.3%
Mackay City LGA	116,763	249	0.2%

Figure 4: Queensland population % growth 2001-02 to 2017-18



Source: Australian Bureau Statistics Cat. No. 3218.0 – Regional Population Growth, Australia

Figure 5: Regional Queensland population % growth 2001-02 to 2017-18



Source: Australian Bureau Statistics Cat. No. 3218.0 – Regional Population Growth, Australia

Recommendation 2

The Australian Energy Regulator quantifies the cost or benefit to consumers of a reduced inflation rate, in particular the impact of a reduced inflation rate on Ergon Network’s allowed revenue and Regulatory Asset Base over the 2020-25 regulatory period.

Reason for recommendation 2

It’s not clear how a delay to accommodate the Reserve Bank of Australia’s updated inflation rate will impact Ergon Network and consequently consumers.

Due to COVID19 the RBA’s inflation rate on 8 May 2020 will be lower than the RBA’s February 2020 inflation rate used by the AER to date in its revenue and Regulated Asset Base (RAB) calculations for Ergon Network’s 2020-25 Determination.

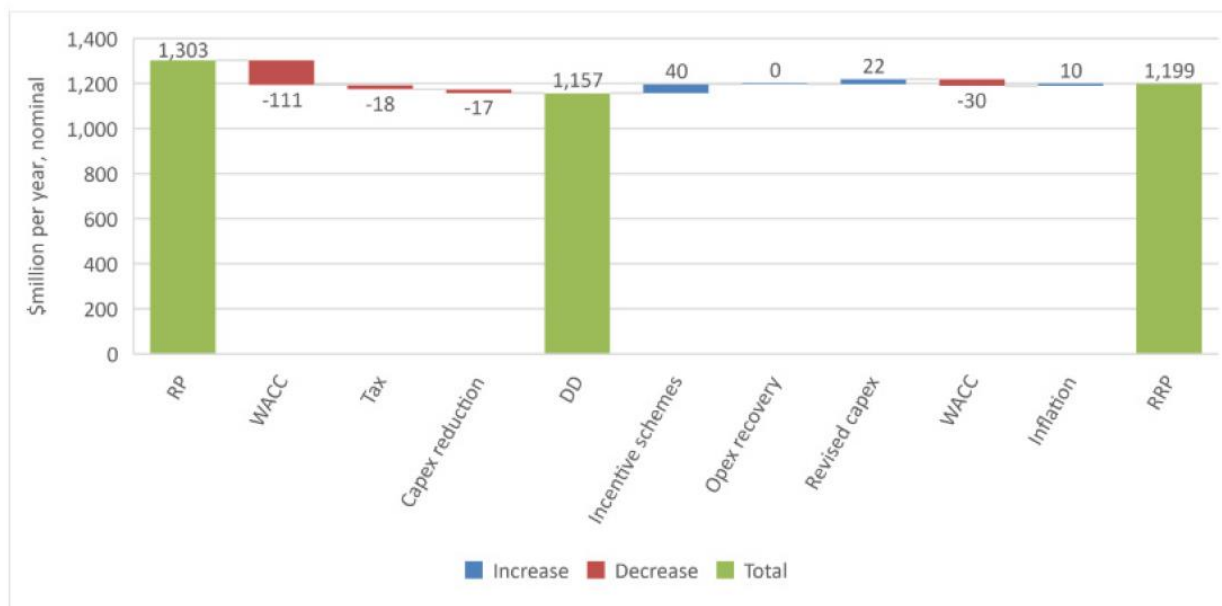
In February 2020, prior to COVID19, the RBA forecast an inflation rate of 1.6% for December Quarter 2020, 1.9% for June Quarter 2021 and December Quarter 2021 and 2.0% for June Quarter 2022.

The RBA’s inflation rate in February 2020 is substantially lower than the 2.37% in Ergon Network’s revised regulatory proposal submitted in December 2019 and lower than the 2.42% in its regulatory proposal submitted in January 2019.

This is because Ergon Network use the method adopted by the AER to forecast inflation. The AER methodology uses the RBA’s forecasts for the forthcoming two years (first two years of the five year reset ie to June Quarter 2022), then assumes actual inflation will be 2.5% every year for the following eight years then computes the geometric mean for the 10 years.

The bottom line for consumers is a reduction in the RBA’s inflation rate on 8 May 2020 will mean a higher revenue for Ergon Network. In Ergon Network’s revised regulatory proposal the reduction of 0.05% (2.42% to 2.37%) increased the *annual* allowed revenue by \$10 million per year (see Figure 6).

Figure 6: Ergon Energy annual revenue drivers, 2020-25



Source: Ergon Network Revised Regulatory Proposal, 10 December 2019



In the QEUN submission on Ergon Network's 2020-25 revised regulatory proposal our conclusion stated:

"The Ergon network has falling customer numbers, falling consumption, rising peak demand, a growing regulatory asset base, is at risk of damage from multiple natural disasters and according to the revised regulatory proposal, requires an additional \$500 million to return it to a safe operating state."

According to the management and owners of Ergon Network the network requires urgent investment to return it to a safe operating state.

Yet Ergon Network claim that by using the current AER methodology for inflation, and the inflation rates in their revised regulatory proposal, the equity holders/owners must pay in 1.4% of the capital base each year.

From Ergon Network's revised regulatory proposal:

1. The AER first determines the total allowed return on equity. That figure depends on the prevailing yield of 10-year government bonds and is currently 4.56%.
2. The AER's spreadsheet models then make a deduction for the return that equity holders will receive in the form of inflation indexation of the RAB. The models work by providing that the interest on debt finance must be paid in cash each year, such that the entire benefit of inflation indexation of the RAB flows to equity holders and becomes part of the return to equity. This benefit is then deducted from the allowed return on equity, such that the remainder is available as a cash payment to equity holders. Since, equity represents 40% of the benchmark efficient capital base and the AER's current inflation forecast is 2.37%, the deduction to be made from the total allowed return on equity is $2.37 \div 40\% = 5.9\%$.
3. The outcome of the AER's current approach is that the cash available to pay dividends to equity holders is $4.56\% - 5.9\% = -1.4\%$. That is, the AER's spreadsheet models currently provide that equity holders must *pay in* 1.4% of the equity capital base each year – because they are due to receive a total return of only 4.56% p.a. and are expected (according to the AER's inflation forecast) to benefit to the tune of 5.9% p.a. from RAB indexation.
4. In summary, under the AER's current approach, not only is there no cash available to pay any dividends at all to equity holders; rather equity holders are required to effectively *pay* to the extent that the AER's estimate of the benefits of RAB indexation exceed the AER's estimate of the required return on equity. This results in us being allowed a negative net profit after tax under the AER's current approach.

It is in the best interest of the network to have viable customers and conversely it is in the best interest of the customers to have a viable distribution network.

What is missing in the discussion about viability is the equity holders do not pay income tax and can borrow at interest rates not achievable by other non-government owned network businesses.

The equity holders (Queensland Government) have also laden Ergon Network with a debt level greater than the 60/40 ratio deemed by the AER to be efficient. This has provided Ergon Network with a higher Weight Average Cost of Capital and hence greater profits. The Queensland Government owned distribution and transmission networks have collectively provided over a billion dollars in revenue to the Queensland Government (see Table 2). This has come at the expense of business and residential electricity consumers.

Table 2: Revenue to the Queensland Government from publicly owned network assets

	Budget (\$ millions)	Estimated Actual (\$millions)	Actual (\$millions)
2016-17			
Dividends	1,000	1,068	1,083
Tax Equivalent Payments	463	541	556
Competitive Neutrality Fee	94	48	48
TOTAL NETWORK REVENUE TO QUEENSLAND GOVERNMENT	1,557	1,657	1,687
2017-18			
Dividends	716	948	976
Tax Equivalent Payments	324	417	442
Competitive Neutrality Fee	59	69	67
TOTAL NETWORK REVENUE TO QUEENSLAND GOVERNMENT	1,099	1,434	1,485
2018-19			
Dividends	618	695	
Tax Equivalent Payments	290	331	
Competitive Neutrality Fee	67	89	
TOTAL NETWORK REVENUE TO QUEENSLAND GOVERNMENT	975	1,115	
2019-20			
Dividends	596		
Tax Equivalent Payments	371		
Competitive Neutrality Fee	106		
TOTAL NETWORK REVENUE TO QUEENSLAND GOVERNMENT	1,073		

Source: Compiled by QEUN from Queensland Budget Papers

Recommendation 3

The Australian Energy Regulator includes business and residential consumer advocates in its 2020 Inflation Review which expects to reach a final position by December 2020.

Reason for recommendation 3

We have spent two years working with Energy Queensland and the AER on Ergon Network’s 2020-25 Determination. During this two year period the inflation rate was not raised by Energy Queensland or the AER as a topic consumers should be concerned about or should seek more information on. However, in Ergon Network/Energy Queensland’s revised regulatory proposal Ergon Network requested the AER to undertake a full review of its approach to inflation and implement an improved approach for the 2020-25 Determination. As the revised regulatory proposal was submitted to the AER on 10 December 2019, it is clear the inflation rate was an issue prior to COVID19.

Consumers need more knowledge of the impact of inflation on their network tariffs therefore need to be actively included in the AER’s 2020 Inflation Review.

Recommendation 4

The Australian Energy Regulator informs consumers of any changes/impacts on Ergon Network’s 2020-25 Determination as a result of the AER’s 2020 Inflation Review.

Reason for recommendation 4

We understand that if changes are made to the inflation rate due to the AER’s 2020 Inflation Review these changes will be implemented in 2021. This will impact the first year of Ergon Network’s 2020-25 Determination.



Queensland Electricity Users Network

Thank you for allowing us to provide a consumer perspective to the proposed delay of Ergon Network's 2020-25 Determination due to the impact of COVID19 on the inflation rate.

Yours faithfully

Jennifer Brownie
Coordinator
Queensland Electricity Users Network