The South Australian Council of Social Service (SACOSS)
Submission to
Australian Energy Regulator
— Draft Decision on South Australia's Gas Access Arrangements 2011-16
and Envestra's Revised Proposal of March 2011

27th April 2011

The South Australian Council of Social Service (SACOSS) Submission to Australian Energy Regulator – Draft Decision on South Australia's Gas Access Arrangements 2011-16 and Envestra's Revised Proposal of March 2011

First published in April 2011 by the
South Australian Council of Social Service

47 King William Road
Unley, SA, 5061 Australia
Ph (08) 8305 4222
Fax (08) 8272 9500
Email: sacoss@sacoss.org.au
Website: www.sacoss.org.au

Written by Jo De Silva and Andrew Nance, South Australian Council of Social Service.

Scope of interest

The South Australian Council of Social Service (SACOSS) is the peak body for social services in South Australia, and is an independent non-government organisation with a sixty year history of advocating for disadvantaged and vulnerable South Australians. SACOSS is a not-for-profit independent organisation whose members represent a wide range of interests in social welfare, health and community services. SACOSS is part of a national network assisting low income and disadvantaged people, and shares with its members the vision of *justice, opportunity and shared wealth for all South Australians.*

In its role as a peak body for community services in South Australia, SACOSS covers a broad range of policy areas including the impacts of disadvantage on the most vulnerable South Australians. In recent years SACOSS has led or participated in debate and advocacy in the areas of consumer credit, electricity and gas, telecommunications, water management, financial counselling, payday lenders, food security, and gambling.

Contents

Introduction

SACOSS has been involved in numerous gas and electricity distribution price determinations over a number of years. In its participation, SACOSS will initially seek to minimise the revenue allowed by a regulated entity to the minimum amount required to complete necessary work and for the entity to deliver a return to its investors commensurate with the risks of such a highly regulated activity.

Once opportunities to minimise revenue are exhausted, it is appropriate for SACOSS to represent the interests of its core constituency, vulnerable consumers, in the way in which a regulated entity proposes to collect the allowed revenue. At this point, the views of SACOSS can diverge from other consumers.

This submission will make some brief observations regarding total revenue then focus on issues related to the allocation of revenue to the residential tariff.

SACOSS has reviewed the AER's Draft Decision (17 February 2011), Envestra's Access Arrangement (AA) Proposal and Revised Proposal (24 March 2011). SACOSS attended the March 2nd Public Forum in Adelaide. SACOSS and other community sector representatives also met with Envestra on residential tariff matters on April 19th, 2011.

Overall, SACOSS is deeply concerned that residential gas distribution charges are set to increase significantly during this regulatory period. Further, SACOSS is equally concerned that the vast majority of the likely increases appear in the supply charges and in the initial consumption bands – hence consumers wishing to minimise the impacts of the rises by reducing consumption are going to be able to achieve very little.

Observations

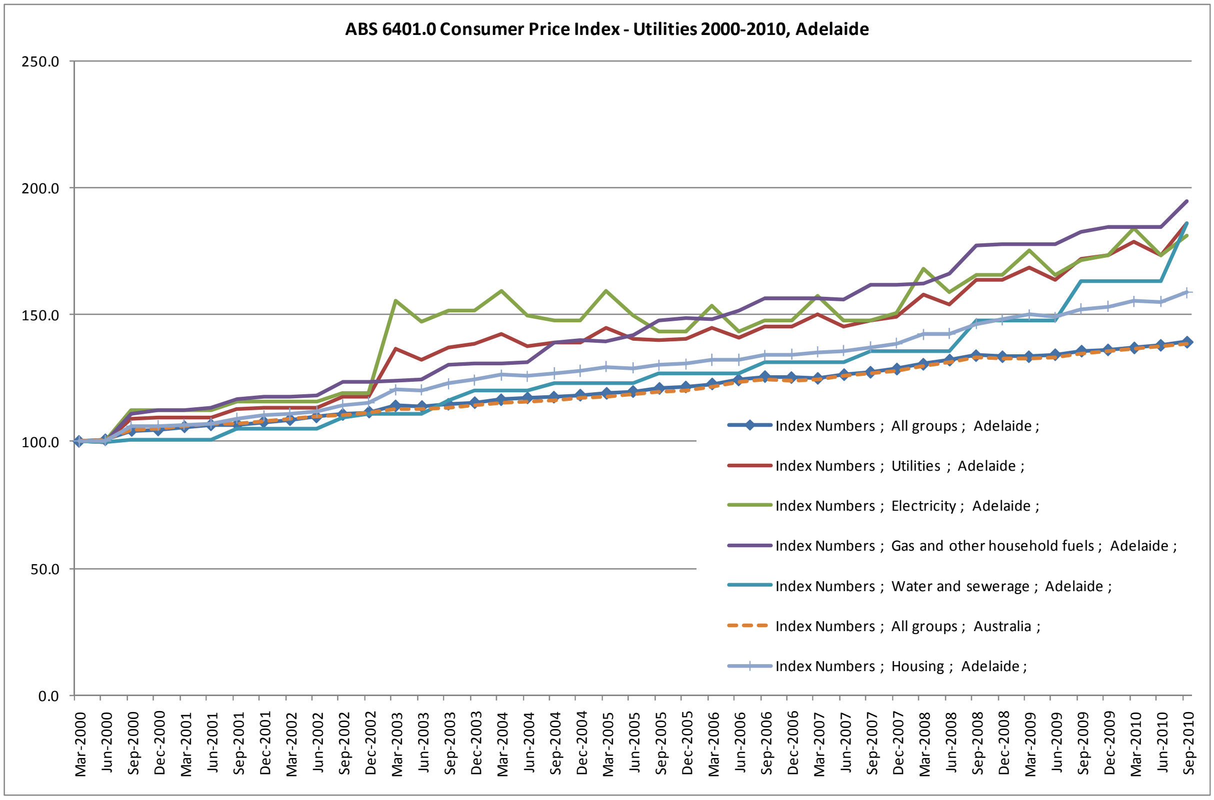
In terms of process, SACOSS would make the observation that regulatory processes involving the gas industry are notoriously difficult due the lack of disclosure of relevant information due to claims of commercial sensitivity.

It leaves consumers in a position of having to trust that the regulator will ensure their interests are well protected and the regulated entities will always bare their interests in mind. Unfortunately, this information asymmetry always leaves an air of scepticism over any decision and it makes it impossible for groups such as SACOSS to seriously review or test any of the claims and supporting information of commercial operators. This may be particularly problematic when seeking to specifically ensure that people most vulnerable to price increases have their interest sincerely protected.

On another front, discussions with stakeholders in relation to gas pricing in SA has revealed an emerging view that gas is becoming unaffordable – to a point where it is much less desirable as a housing attribute. Gone are the days where tenants and home purchasers would seek out properties with a gas connection.

SACOSS is increasingly concerned that rather than being a 'fuel of choice', it is a liability of no choice for many renters.

SACOSS produces regular Cost of Living Reports and monitors ABS reported trends in a range of expenditure categories. Figure 1, below, charts sub-indices of the Consumer Price Index (ABS 6401.0). As can be seen, the trend for 'Gas and other fuels' (dominated by reticulated gas) exhibits the greatest increase since 2000, even greater than for electricity over the decade from 2000-2010.



SACOSS is forming a view that the long-term viability of reticulated gas distribution is now seriously questionable. To the extent that gas can be cost-effectively replaced with electricity and or solar-thermal options, it is clear that if gas and electricity costs continue to diverge, the residential demand for gas will continue to decline although there may be a move for gas to be sent to an electricity generator for delivery to the home as electricity.

Revenue

SACOSS took some comfort in the AER's draft decision and was disappointed to see Envestra's revised proposal seek virtually the same revenue as its original.

Envestra's proposal will see tariffs some 60% higher, in real terms, than today's by the end of the regulatory period. The AER Draft decision would see tariffs around 30% higher than today's over the same period.

Key elements in the revenue ask are the mains replacement program (MRP) and in extensions of gas supply to new areas such as Tanunda, Buckland Park and McLaren Vale. On top of these capital expenditure items are, of course, the parameters determining the Weighted Average Cost of Capital.

If SACOSS is to accept the need for expenditure such as the extensive MRP and extensions of the network then the tariffs proposed by the AER are much more acceptable than that put forward by Envestra. SACOSS is of the view that tariff increases as proposed by Envestra will result in householders increasingly abandoning reticulated gas as a domestic energy option.

Chapter 5 of Envestra's revised proposal details the Outsourcing Arrangements for which significant costs were rejected by the AER in its Draft Decision.

It should come as no surprise to Envestra that consumers would be suspicious of a Network Management Fee (NMF) of 3% of total revenue payable to an entity that is a service provider to, and also a significant shareholder of, the regulated entity.

It is not for SACOSS to judge the quality or efficiency of the APA Group's work under the network Operating and Management Agreement (OMA). The end result of the arrangement may even be an 'efficient' service, however it is a consumers perspective that it is unlikely to advance the National Gas Objective.

The national gas objective, as stated in the National Gas Law, is to[1]:

> "... promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."

The NMF will clearly motivate an outsourced operator/manager to maximise revenue.This is not however the same as being motivated to minimise likely costs. In fact it would appear to be more likely to motivate the operator/manager to identify capital projects. Efficiently delivering non-essential works is not in the best interests of consumers in either the short or long term.

It is one interpretation of the touted 'efficiency of scale' of the APA Group's role that the value added by the Envestra management layer is questionable. It is an observation that the Envestra Corporate Structure (largely outsourced) has been identified as a risk by investment analysts (according to Australian Financial Review Smart Investor Magazine, April 2011) and, apparently, a takeover by the APA Group is considered a possibility.

SACOSS certainly supports the AER's draft decision to not allow the NMF.

In relation to new connections and network extensions, SACOSS notes that the approach to gas appears somewhat different to that for electricity. Customer (capital) contributions appear to be much more significant in electricity extensions and augmentations as opposed to what appears to be the case for gas. Significant expenditure related to accessing new consumers is spread across existing consumers, seemingly running counter to the approach to electricity that seeks a more 'efficient' user pays approach.

On this subject, it is not clear from the proposal that the Business Cases used to justify the extensions of the network to areas such as McLaren Vale, Buckland Park and Tanunda have been conducted by assessing the willingness to pay (WTP) of prospective consumers in light of the proposed new tariffs – do they still want the gas on if distribution charges will cost 60% more than currently?

SACOSS is also aware of concerns raised by analysts for the Energy Consumer's Coalition of SA (ECCSA) in relation to a number of the WACC parameters. It is an observation, in this case and in others, that regulated businesses are regularly able to access capital at lower cost than the benchmark 'prudent' business modelled by regulators. It begs the obvious question as to whether the maturing sophistication of these businesses means that the benchmark expectation of performance should now be set somewhat higher than might have historically been the case.

Residential Tariffs

SACOSS seeks assurances from the AER that they have considered Envestra's cost allocation models (not publicly available) and that the apparent allocation of 75% of revenue to residential customers is fair and cost reflective.

[1] www.aemc.gov.au/Gas/National-Gas-Market.html

Further, since such a large proportion of the increase is in relation to the MRP, is it fair that the same proportions apply in relation to this expenditure – or should it be more ‘consumption’ based, in which case residential consumers should be more efficiently asked to make a smaller contribution to the revenue. If ‘mains replacement’ refers more to the ‘bulk distribution’ parts of the network then surely the contributions to this should be more fairly allocated in proportion to gas used.

Summary

The proposed hike in residential tariffs prompts a re-think on the role and uptake of gas as a domestic fuel option.

The ‘choice’ of using gas is a myth for a significant number of householders – especially renters – who have significant capital hurdles to overcome to replace gas appliances with electrical equivalents. Gas consumers then become a soft target for collecting the revenue required for excessive expenditure.

In terms of process, information asymmetry is clearly apparent and SACOSS is therefore compelled to support the AER’s Draft Decision (17 February 2011). SACOSS has not observed anything in the revised proposal that would suggest Envestra fairly deserves more revenue and without greater access to information currently withheld is not in a position to suggest they deserve less than the AER suggests.

This project was funded by the Consumer Advocacy Panel (www.advocacypanel.com.au) as part of its grants process for consumer advocacy projects and research projects for the benefit of consumers of electricity and natural gas.