Submission to

The Australian Energy Regulator (AER)

Response to Electricity Distribution Business Revised Regulatory Proposals for 2015-20, from SA Power Networks, Electricity Distribution Business, and AER Preliminary Determination

From UnitingCare Australia

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UnitingCare Australia is the national body for social services in the Uniting Church in Australia, supporting service delivery and advocacy for children, young people, families, people with disabilities, and older people

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UnitingCare Australia

UnitingCare Australia is the national body for the UnitingCare Network, one of the largest providers of community services in Australia. With over 1,600 sites, the network employs 39,000 staff and is supported by the work of over 28,000 volunteers. We provide services to children, young people and families, Indigenous Australians, people with disabilities, the poor and disadvantaged, people from culturally diverse backgrounds and older Australians in urban, rural and remote communities.

UnitingCare Australia works with and on behalf of the UnitingCare Network to advocate for policies and programs that will improve people's quality of life. UnitingCare Australia is committed to speaking with and on behalf of those who are the most vulnerable and disadvantaged, for the common good.

Response to SAPN Revised Proposal

In this submission we respond to some of the key aspects of the SAPN revised proposal, noting that much of this submission reiterates positions given in our previous submission. We do not consider that SAPN has responded to our substantive issues.

Our Observations

In energy policy discussions, Uniting Care Australia's main objective is to ensure that energy prices experienced by consumers are fair and reasonable and that any regulatory proposals ease cost pressures on lower income and disadvantaged people. UnitingCare Australia sees this as central to the National Energy Objective.

National Energy Objective

The starting point for both network businesses lodging their regulatory proposals and for the Australian Energy regulator (AER) must be the National Electricity Objective as set out in the National Electricity Law. The Objective is to:

"promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to -

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system."

The application of this objective is crucial because of the financial pressure on households from current high energy costs and because it is unlikely that widespread reduction of

household bills for lower income household bills will come from any other source, including concessions.

Over the last six years, electricity prices have been rising, doubling in real terms for many households whose incomes have declined. Figure 1 shows the electricity price rises for Australian jurisdictions. Total annual energy costs for lower income households, as a proportion of household income, is the second highest for all Australian jurisdictions in South Australia (SA); this is shown in Figure 2. The ABS household expenditure survey reports that average household expenditure on electricity Australia-wide is 2.3% of income. So SA lower income households are paying two and half times the national average electricity cost. We also know from our financial counselling, emergency relief and other services, that there are also households paying dramatically more than these average expenditure levels.

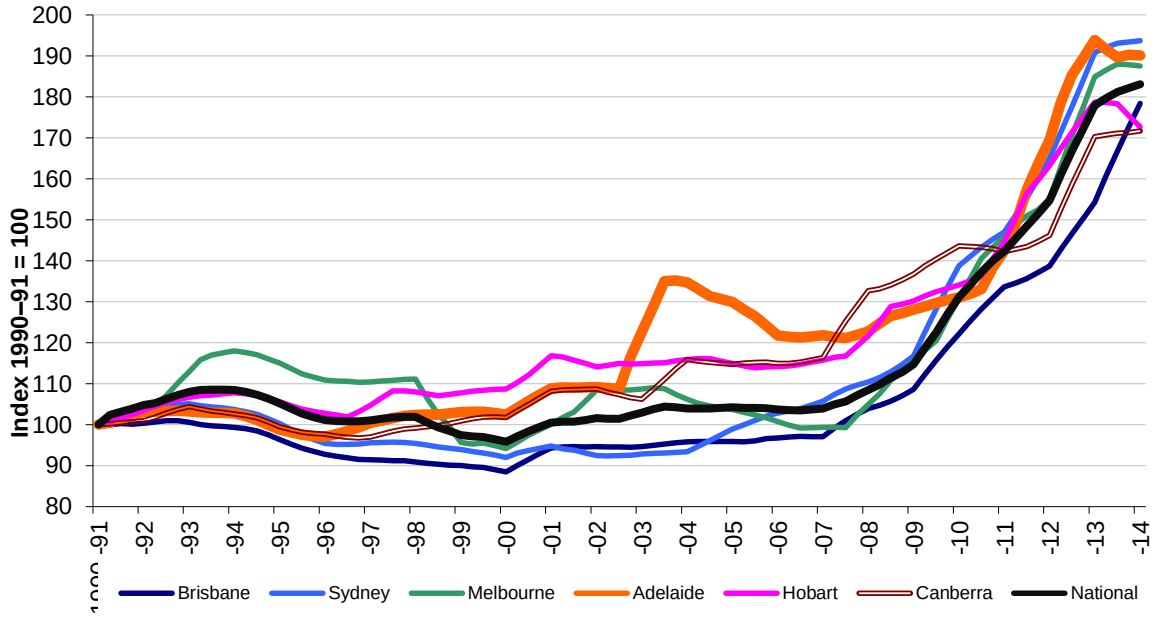


Figure 1: Electricity price indexes for Australian jurisdictions, 1990-91 = 100
Source: Australian Energy Regulator, State of the Energy Market report, 2014

The realities of this ongoing trend of substantial cost increases for electricity supply have not been recognised by SAPN, so their revised proposal is not reasonable.

We recognise that the AER in their Preliminary determination have proposed a reduction in aggregate revenue for SAPN, which would lead to reduced costs for residential customers, with reductions of about $198 per year for average use, residential customers. This reduction is largely accounted for by the much lower costs of capital than was allowed for the 2010-15 period. We do not believe that the AER has reduced other allowances for SAPN revenue to the best interests of South Australian consumers, in particular with regard to Opex, Capex, aspects of rate of return and taxation allowances.

We are satisfied with the AER's Preliminary Determination and their statement that "our preliminary decision contributes to the achievement of the NEO to the highest degree." The AER has balanced the "price, quality, safety, reliability and security of supply of electricity" of electricity supply for SA effectively. We comment later in this submission on the safety issue that SAPN have emphasised in initial and revised proposals.

Consumer Engagement and Consumer Behaviour

On page 12 of their revised regulatory proposal, SAPN states:

"In its Preliminary Determination, the AER stated that it gave less weight to SA Power Networks CEP[1] results because of some negative comments within a (very limited) number of submissions it received from stakeholders. ... we believe the AER has erred in not giving more weight to our CEP and not approving the funding for the initiatives that arose from it."

We assume that UnitingCare Australia is a part of the *"(very limited) number of submissions"* that SAPN is referring to and so we reiterate our concerns about their consumer engagement program (CEP).

UnitingCare Australia has a strong interest in approaches to and application of consumer engagement. We were amongst the first to provide input into the AER's 2013 process to develop guidelines for Consumer Engagement. We repeat comments we made in our earlier submission about consumer engagement processes:

> *In seeking to better understand "consumer engagement" we consider a selection of concepts, from different disciplines, that we suggest all inform the current use of the term "consumer engagement".*
>
> *Community Engagement (From Community Work)*
>
> *Most Uniting Care agencies apply "community engagement" principles to their work, and for this paper, we consider the term "community development" to mean the same thing as "community engagement"(recognising that this is somewhat controversial for some practitioners). We understand communities to be groups of consumers, so the concept is not so different from "consumer engagement".*
>
> *The Canadian Tamarack Centre for Community Engagement[2] is recognised as a leader in developing and documenting "Community Engagement" practice; they define the term:*
>
> *Community engagement is "people working collaboratively, through inspired action and learning, to create and realize bold visions for their common future." (Tamarack, 2003)*

[1] Çonsumer Engagement Program
[2] http://tamarackcommunity.ca/

While the Queensland government has been using the following definition for a decade

"Community engagement refers to arrangements for citizens and communities to participate in the processes used to make good policy and to deliver on programs and services."

We wish to highlight to the AER and SAPN that consumer engagement is a dynamic and interactive process, with interested parties working together to seek solutions.

Of critical importance is the understanding that consumer engagement is not a heterogeneous process, not all consumers think alike, nor do they all agree with each other. We have no problems with the Willingness To Pay (WTP) approach that that SAPN has undertaken with its' CEP, nor the rigour that has been applied to this approach, however, it is only one aspect of consumer engagement. In our previous submission we attempted to identify the range of consumer input that SAPN has access to from sources other than its' own processes. It is the diversity of consumer input that SAPN has failed to take into account

SAPN has used a fairly narrow range of consumer engagement processes, some of which represent market research rather than consumer engagement.

SA Power Networks state that they are engaging with consumers, who they say are happy with the reliability of their electricity supply. They conclude that their costs are efficient, and propose an increase in capex of about 50% and an opex increase of about 33% over the 2015-20 period.

Our experience and evidence about what consumers are doing in response to higher electricity prices is quite different, and we presented this in our previous submission:

- More people are being disconnected from supply
- Growing numbers of consumers are installing solar PV to avoid network costs
- Households report increasing energy stress, with more people affected by rising prices, and a 'deepening' of energy stress for some groups of consumers.
- Growing numbers of customers are on hardship programs
- There are more complaints from energy consumers; and
- People are using less energy.

More people being disconnected from supply

Figure 2 shows reported disconnections due to inability to pay. While disconnections data is likely to be variable over time, due to different collections processes employed by businesses, and other varying factors, the trend for electricity disconnections is rising in all mainland states. In these jurisdictions, more people were disconnected for inability to pay in each year of the most recent distribution regulatory periods.

Figure 2 shows that South Australia (SA) has the highest rate of disconnections in the NEM and has had either the highest or second highest rate of disconnections for the last 7 years. Figure 2a provides the SA only disconnections data and shows that high numbers of households have been disconnected: over 10,000 per year for the last two years.

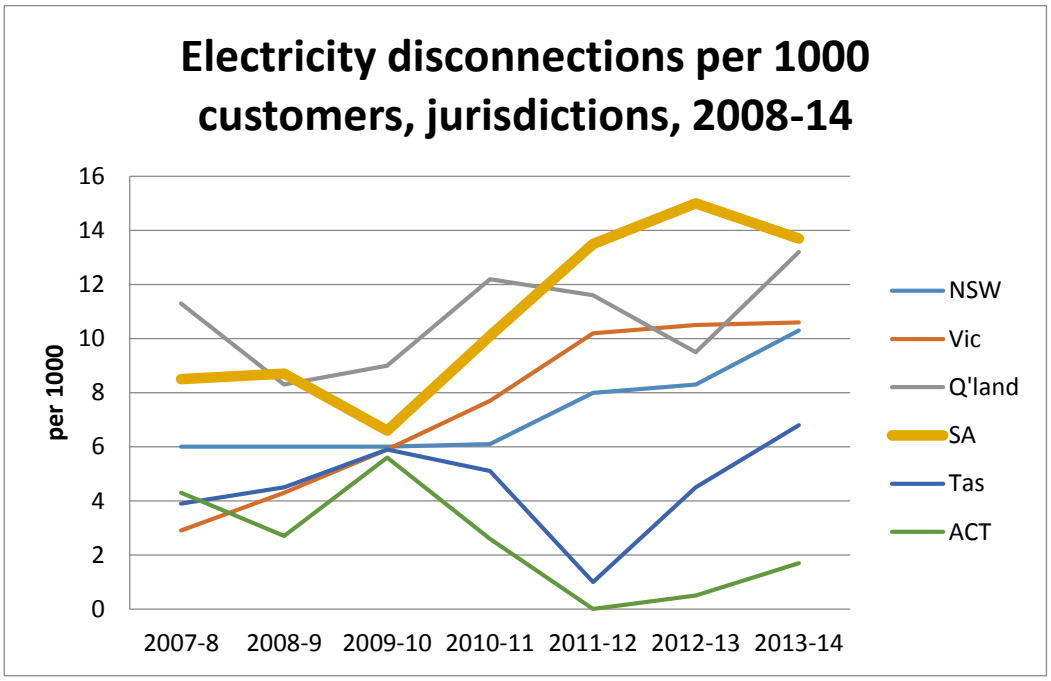


Figure 2: Disconnections due to inability to pay, jurisdictions, time series
Source: Australian Energy Regulator, State of the Energy Market report, 2014

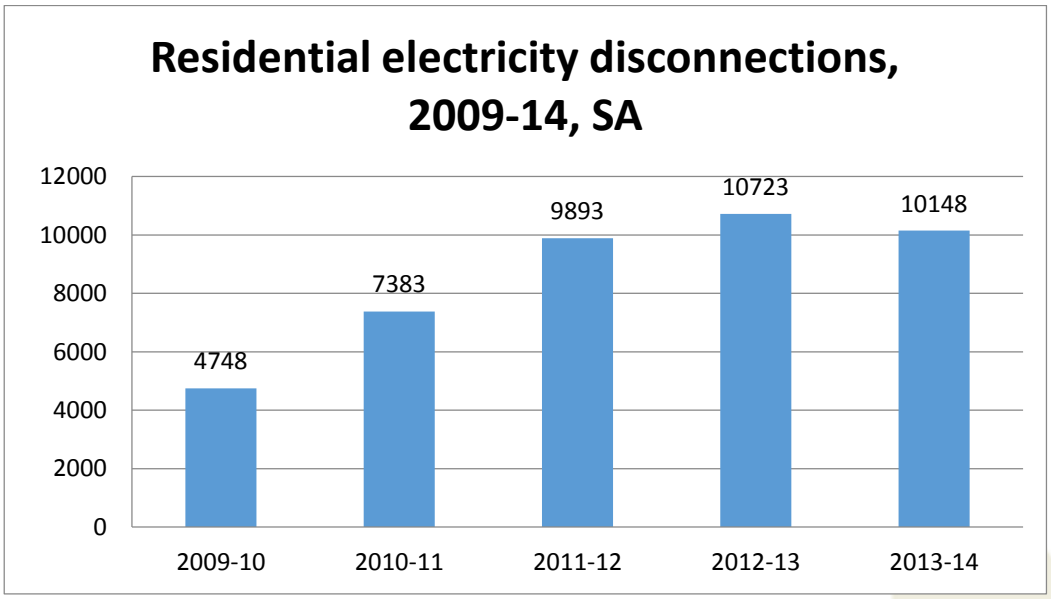


Figure 2a: Disconnections due to inability to pay, SA
Source: Australian Energy Regulator, State of the Energy Market report, 2014

More people installing solar PV to avoid network costs

About 23% of South Australian households now have solar photovoltaics (PV) on their rooves. From 2012/13 to 2013/14 there was an increase of 1.8% in the proportion of SA households with PV.

We recognise that there are many reasons for the rapid uptake of PV systems in Australia. Generous initial government incentive grants and guaranteed feed-in tariffs have certainly contributed to the initial uptake being beyond initial expectations. These have now largely concluded with market based feed-in tariffs all that remain. There was also an initial enthusiasm among people concerned about the environment and regarded personal PV as a means of reducing carbon footprints. These views remain; however, the current political context is quite dismissive of climate change and responses to it. The number of people installing solar PV is much greater than the number of Greens voters and certainly larger than membership of environmental groups, so we suggest that there is another major reason for the rapid and continuing uptake of solar PV.

UnitingCare Australia believes that a major reason for continuing PV uptake is that rapidly rising energy prices are pushing people to seek alternative means to manage their rising costs, particularly the network costs: households are wanting to 'future proof' their energy costs. This is evidenced by both the continuing installation of new PV systems, but also by the growing size of new installations, rising from a typical 1.5kW system about five years ago to an average of 4kW for each installation today. There is good evidence that the households most actively installing PV are lower-middle and middle income households, roughly deciles 3 to 7 from income distribution data sets, with households approaching retirement being significant installers.

UnitingCare Australia believes this trend reflects the desire of households to reduce their dependence on electricity networks and to give a degree of certainly about future electricity costs. This is evidence of the impact of cost pressures on households. While there are many advantages of domestic PV, we are also concerned because many low income households lack the capital, or lack control over their residential building, to respond to rising energy prices in this way.

Increasing energy stress

The number of people who are unable to pay their utility bills on time is substantial, as shown in Figure 3, using Financial Stress data taken from the ABS General Social Survey. Just over one in eight Australian households are unable to pay utility bills, mainly electricity, on time, but for the poorest 40% of Australians, close to one in five households can't pay their bills on time.

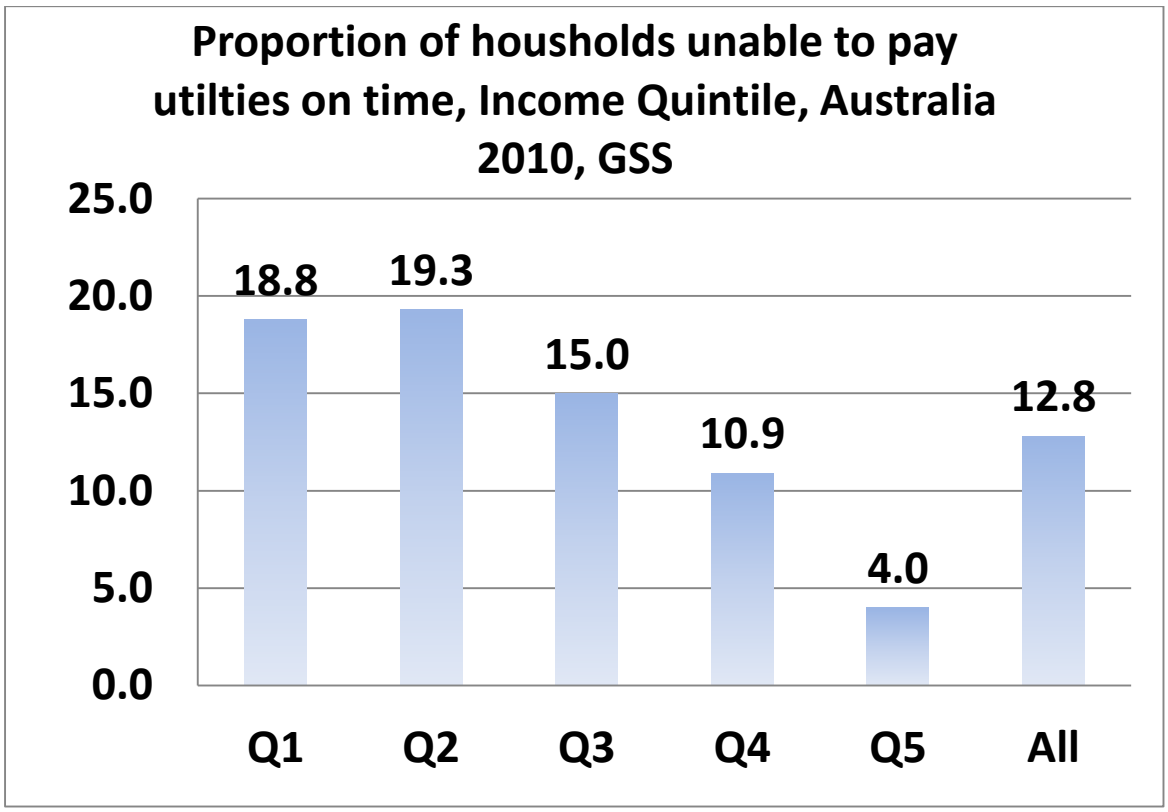


Figure 3: Inability to pay utility bills on time
Source: ABS, General Social Survey, 2012

This situation needs to be understood in the context of priority given to paying on time by consumers. Uniting Care Australia has sought to clarify this situation and has commissioned research surveying consumers about how they manage their energy bills. We have asked about the priority given to households in paying their energy bills on time, through 3 separate surveys each sampling about 1500 people. The results for each survey are almost identical, with the results for our most recent completed survey shown in Figure 4. We have classified respondents into 3 income bands; low - less than $40,000 annual income, medium income – $40,000 to $80,000pa and high – more than $80,000 per annum.

The survey results show that all households place a high priority on paying utility bills on time, but the lowest income households put greatest priority on this: 41% of lower income rate it as a high priority, while only 3% give electricity bill paying a low priority. This evidence certainly contradicts the occasional argument that households who don't pay their bills on time are 'won't payers' rather than 'can't payers'. Indeed, paying energy bills on time ranks second highest priority for many households, with only rent / mortgage payment rating higher.

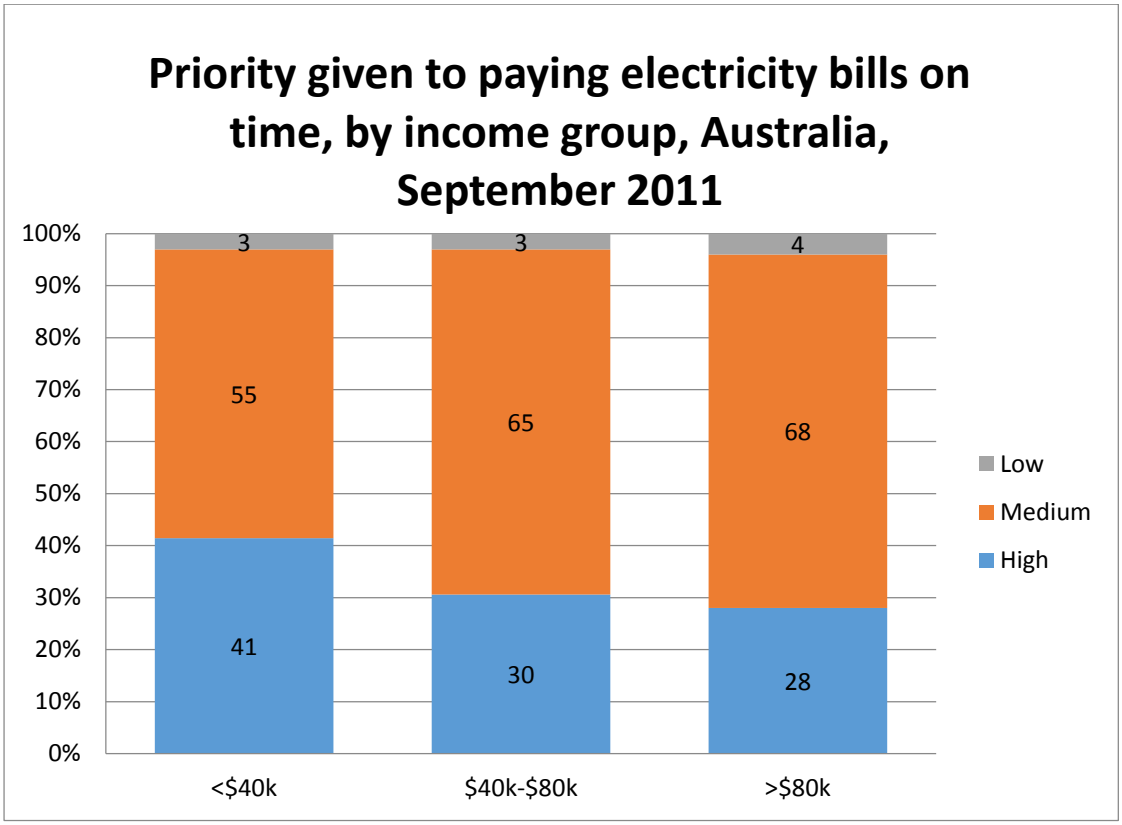


Figure 4: Priority given to paying electricity bills on time
Source: Survey for UnitingCare Australia, undertaken by The Australia Institute

In the same survey mentioned above, we have asked about the impact of electricity prices doubling over the next five years, given that this has been the reality for a number of people over the last six years.

Figure 5 shows the impact of electricity prices doubling, for the low income band, over three surveys during 2010 and 2011. The predicted impacts increased over the period of the surveys. Of particular concern is that, by September 2011, about a third of households were reporting that continuation of electricity bill increases would reduce visits to doctors and ability to buy medications. Over half of respondents reported that they were cutting back on buying fresh food, and we hear, through our welfare services, stories about 'two minute noodles' being all that families are able to afford to eat. Increasing electricity bills are having health impacts, not just because people get too hot or too cold, but because they can't afford to buy healthy food and because they cut back on doctor visits and medications.

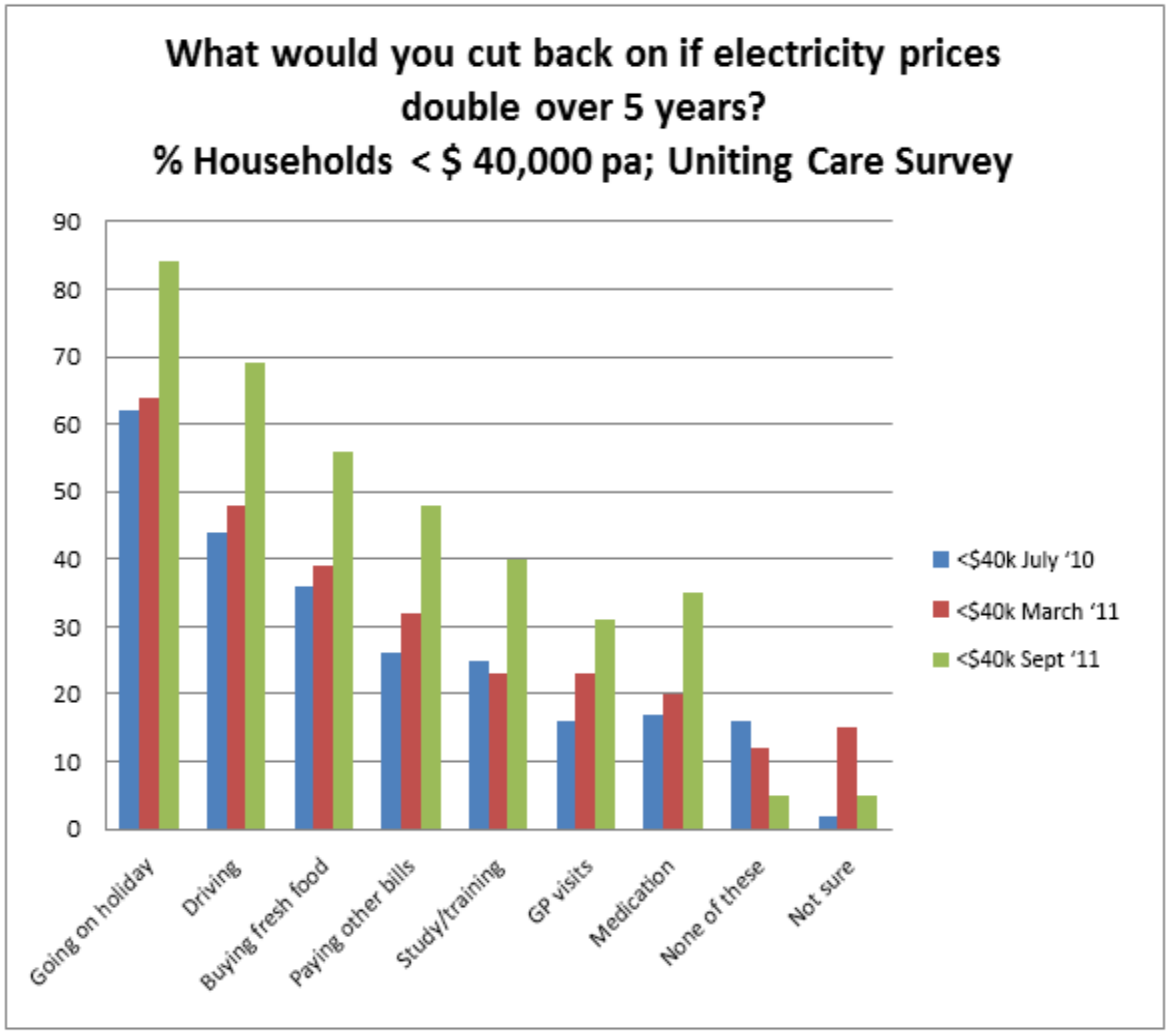


Figure 5: Impact of electricity prices doubling
Source: Survey for UnitingCare Australia, undertaken by The Australia Institute

Also of concern to us is that the data shows about 40% of low income households would cut back on self education and training as a result of rapidly electricity price rises.

In Figure 6 we show the impacts of electricity prices doubling for each of the income bands. The impacts for all income bands tracked each other relatively closely. Even moderately high income earners expect to cut back on a number of spending areas with rapid electricity price rises. Note too that the doctor visit reduction and medications decline are higher for the middle income band than the lowest income group. The impacts of large electricity price rises will be felt across the community, not just by poorer people, though poorer families will certainly be hit harder by the effects.

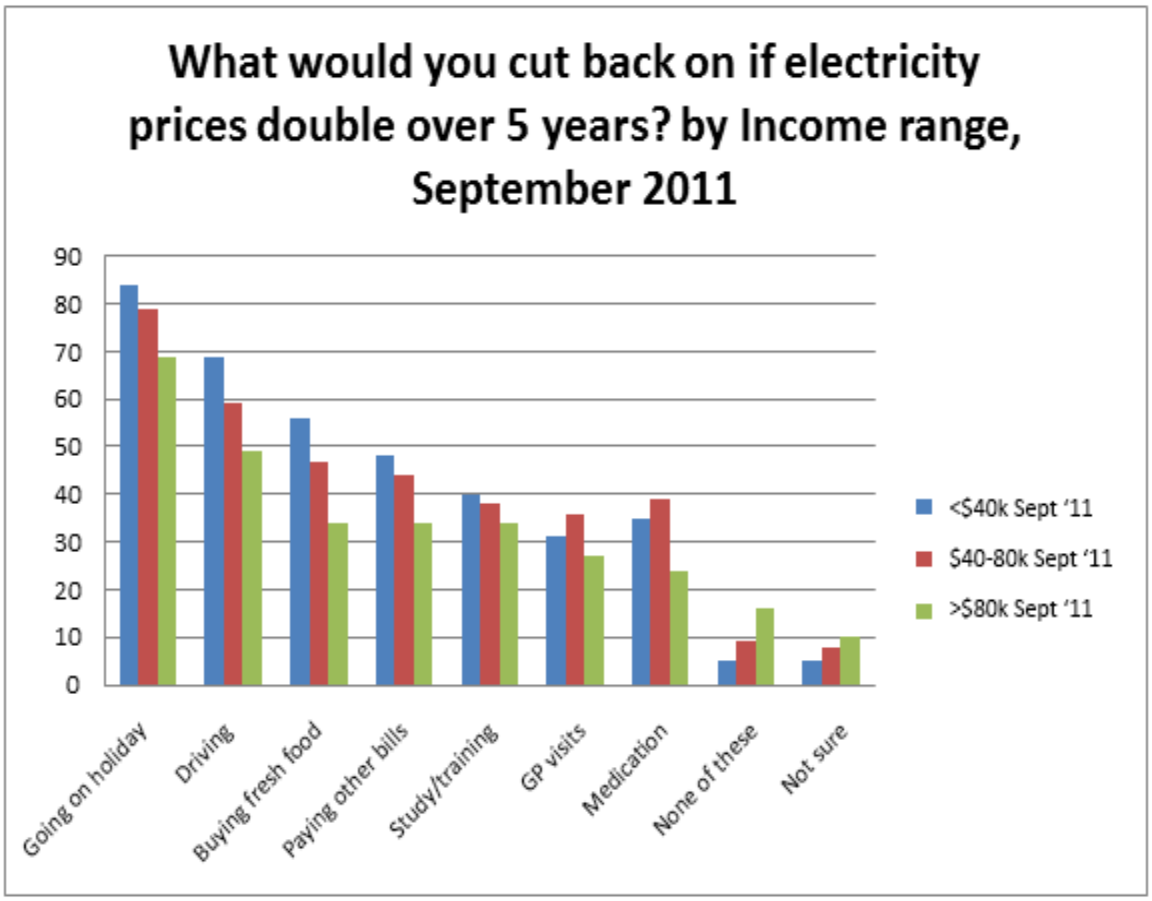


Figure 6: Impact of electricity prices doubling, by income band
Source: Surveys for Uniting Care Australia, undertaken by The Australia Institute

Our view is that electricity costs are too high for a significant number of people to be able to pay. UnitingCare Australia contends that this places the National Electricity Objective in jeopardy. We contend that a supply is not efficient if low income people can't afford to pay for this essential service.

Growing numbers of hardship customers

An important aspect of the National Energy Customer Framework (NECF) has been the requirement that all retailers offer an AER-approved hardship program. The number of people gaining access to hardship programs has been increasing substantially, albeit from a low base for some retailers. While UnitingCare Australia welcomes the operation of hardship programs, the demand for them is an indicator of the broader problem of growing numbers of people simply unable to pay for their basic electricity needs.

Of concern is the data in Figure 7 which shows that South Australia has the highest proportion in the NEM of residential customers on a retailer hardship program.

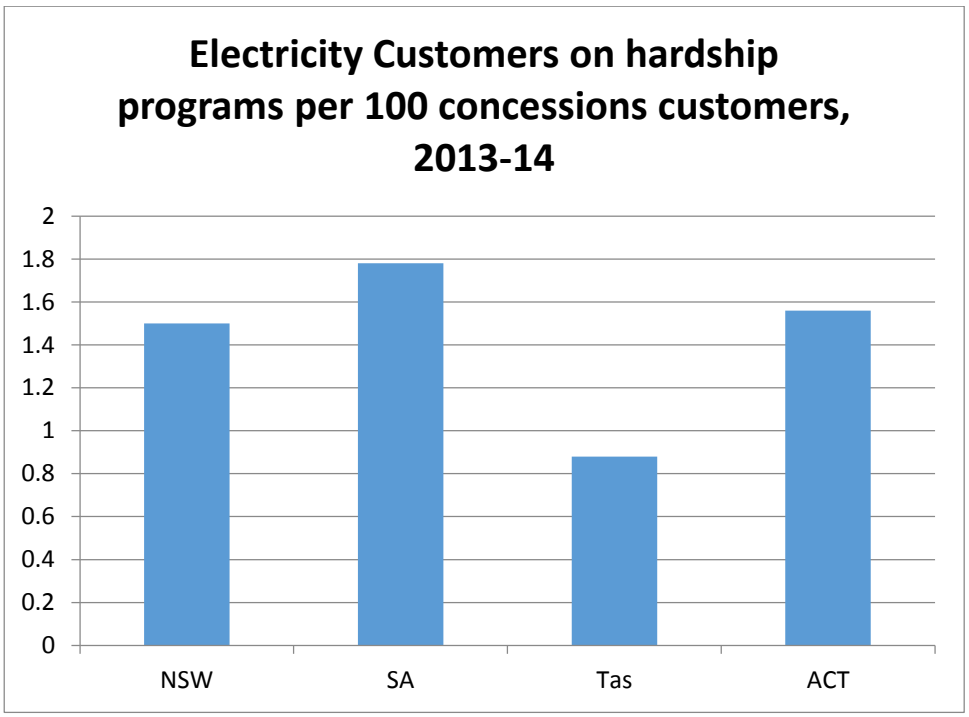
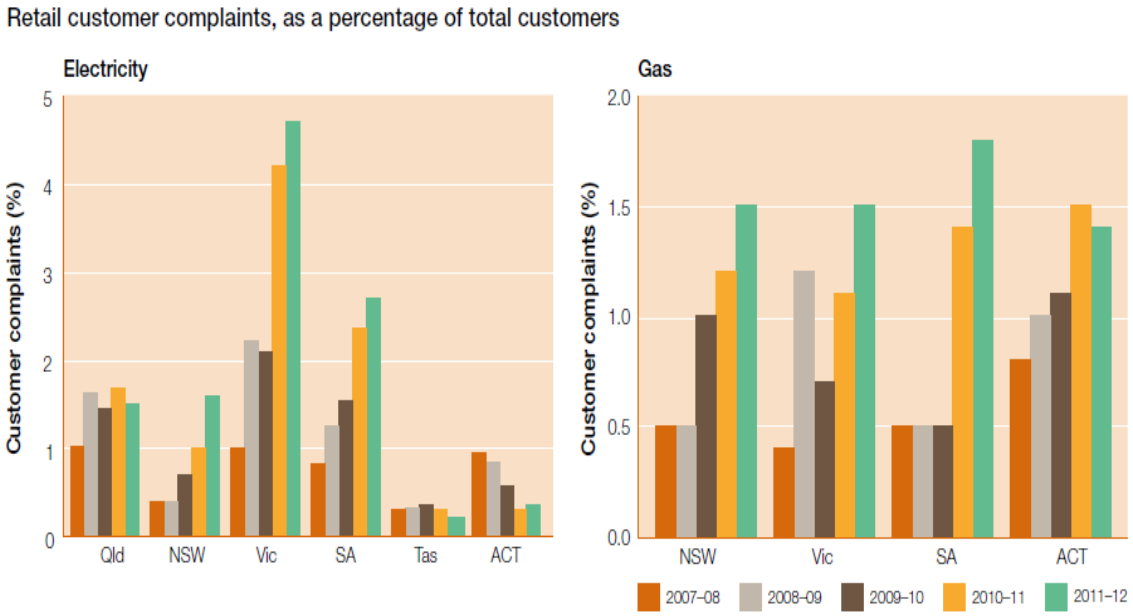


Figure 7: Numbers of people in Hardship programs, by jurisdictions
Source: Australian Energy Regulator, Annual Report on the performance of the retail energy market, 2013-14

Complaints

The number of complaints about electricity bills, contracts and related issues to Ombudsman schemes and to energy companies has increased during the most recent network regulatory period, as shown in Figure 8. The level of complaints has increased for all jurisdictions except ACT and Tasmania, and South Australia has the second highest rate of complaints in the nation (though we understand that there was a small decline in total complaints during 2013/14). Complaints about electricity supply have increased dramatically over the last 5 years.

Growing levels of complaints are an indicator that the current arrangements are not working for consumers. UnitingCare Australia contends that complaints arise from inefficient, disorganised markets, not from efficient, transparent and well-administered ones.



Sources for figures 5.5 and 5.6: Reporting against Utility Regulators Forum templates; retail performance reports by the AER, IPART (New South Wales), the ESC (Victoria), ESCOSA (South Australia), OTTER (Tasmania), the QCA and the Department of Employment, Economic Development and Innovation (Queensland), and the ICRC (ACT).

Figure 8: Retail customer complaints
Source: Australian Energy Regulator, State of the Energy Markets report, 2013

The number of complaints about electricity bills, contracts and related issues, to the SA Energy and Water Industry Ombudsman scheme is shown in Table 1.

Issues (Received)	2012-2013	% of Total	2013-2014	% of Total
Billing	8,762	41%	7,190	39%
Sales and Marketing	2,560	12%	1,901	10%
Credit Management	1,200	6%	1,815	10%
Customer Service	1,067	5%	920	5%
General Enquiry (inc. Other)	6,854	32%	5,776	31%
Land	65	0%	100	1%
Provision	620	3%	562	3%
Supply Quality	191	1%	105	1%
TOTAL	**21,319**	**100%**	**18,369**	**100%**

Table 1 Retail Consumer complaints, electricity, SA
Source: Energy and Water Ombudsman, SA, Annual Report 2014

People are using less energy

The trends described in Figure 9 are well known to energy companies and regulators. After an extended period of steady increase in annual demand for energy and more recently a more rapid growth in peak demand, demand is falling, in aggregate and at peak levels.

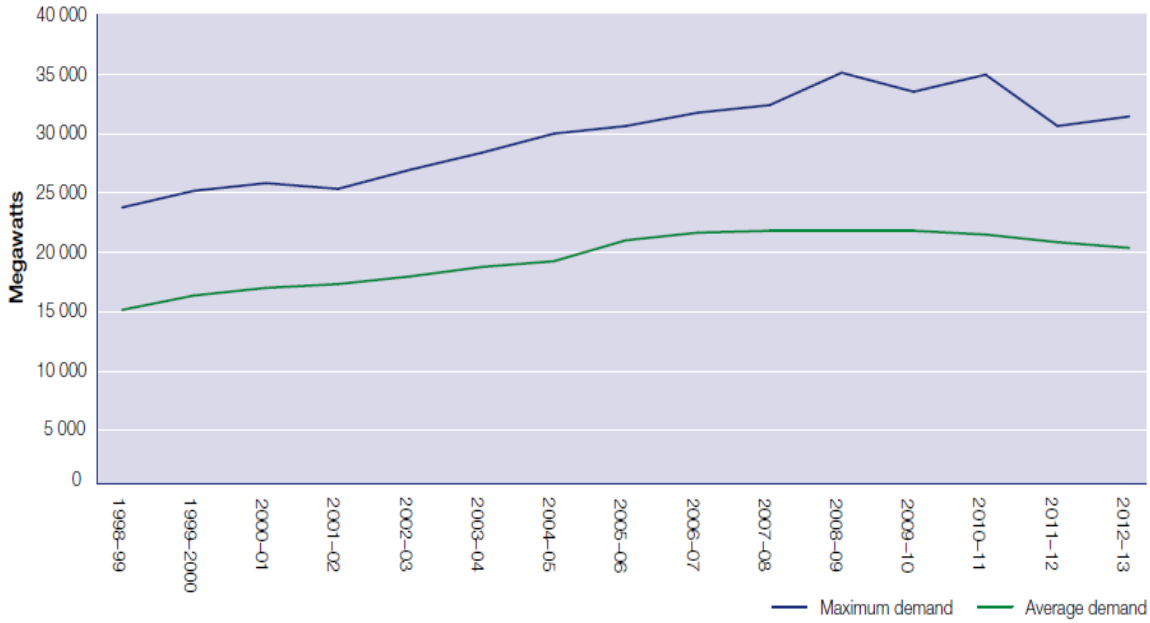


Figure 9: Declining energy use
Source: Australian Energy Regulator, State of the Energy Markets report, 2013

Factors influencing declining demand include shifts in industry consumption, more consumer awareness and so increased demand management, more energy efficient appliances, the impacts of solar PV installation, higher prices leading to lower consumption, and poorer people being too worried about bills to use the electricity that they need to keep them healthy.

Each of the factors listed above indicate that consumers are leaving or reducing their use of electricity networks, by conscious decision making or by being forced to by disconnection or the threat of disconnection, real or perceived.

Consumer behaviour and the National Electricity Objective

The behaviour of Australian electricity consumers, now and during the most recent regulatory period, has demonstrated that the market is not meeting their needs. Table 2 summarises current electricity market performance against the specific measures to which the NEO must have regard.

NEO: regard to	Being met currently?	Evidence
Price	No	High prices push the rapid uptake of solar PV as network alternative.
Quality	Don't know	Evidence in this paper does not generally pertain to quality (as distinct from reliability).
Safety	No	Health risk to some vulnerable groups due to inability to pay for electricity for heating / cooling in extreme weather conditions. High energy prices leading to poorer health outcomes due to priority in household budget to electricity over healthy food and medical care.
Reliability	No	Disconnections due to inability to pay. Increasing complaints. Self restriction of use for fear of future bills.
Security of supply	No	Disconnections due to inability to pay. Increasing complaints. Self restriction of use for fear of future bills.

Table 2 Factors to be considered in meeting the NEO
Source: Compiled by UnitingCare Australia

UnitingCare Australia draws attention to the issues of safety and reliability in our considerations of opex. The emphasis under safety discussions is usually on technical safety and on the likelihood of outages, particularly unplanned outages. However, from a low-to-middle income consumer point of view, the detrimental health effects of high electricity costs or disconnection, and the possibility of unreliability due to disconnection or denial of service,

are just as important. UnitingCare Australia asks the AER to ensure that these dimensions of safety and reliability are given as much weight as the more technical ones.

With the high costs of electricity and failure to meet other criteria specified in the National Energy Objective, we conclude that there has not been efficient investment in, or efficient operation of, electricity services in South Australia over recent years, so the long term interests of consumers have not been met.

A market cannot be considered to be efficient if consumers are being forced from it and growing numbers are actively seeking to reduce their dependence upon it.

Other Consumer Engagement Issues

UnitingCare Australia is concerned that there was little engagement with consumers on any of the major elements of return to businesses, including rate of return methodology, RAB values, WACC, and parameters β and γ. Yet these are the areas where consumers are most impacted by the bills that they end up paying. These aspects of the regulatory proposal have substantial impacts on network charges, yet to the best of our knowledge were not discussed in forums with consumers.

A third concern that we have is that SAPN can make use of consumer information and voices other than those specifically undertaken for the company itself. There is substantial other consumer input that SAPN could recognise and consider. These could include the approximately 10,000 consumers who were disconnected from supply, the over 18,000 who made formal complaints, mainly about costs of their bills, the large numbers of consumers who are having payment difficulties and the increasing number of customers going onto retailer hardship programs. These customer voices were not recognised by SAPN, yet we expect that very few of these customers would support increased levels of SAPN spending.

A fourth concern is the lack of any evidence to indicate that lower cost alternatives have been explored with consumers, particularly in respect of the substantial proposed capex and opex increases.

Our main concern with the SAPN consumer engagement is that we cannot see how they have concluded that consumers will support a capex increase of over 50% and an opex increase of over 33% over the 2015-20 regulatory period, with minimal evidence to link consumer preferences to the quantum of the cost of their bid.

We recognise that the practice of consumer engagement in energy markets in Australia is relatively new and are committed to working with energy companies to develop sound, agreed processes. Our main concern with SAPN's consumer engagement for this regulatory and revised regulatory process is that they have not shown that they have taken into account

the considerable information about consumer preference and experience that was available to them, from sources outside of the processes that they managed themselves.

CAPEX

The SAPN proposal from the initial proposal was to increase its capex by more than 50% over the next regulatory period, from base year 2013-14. The bid for renewal and replacement capex is dramatically higher than for 2010-15, yet the size of the network is not growing significantly as shown in Figure 10 below. From 2006 to now there has been very modest growth in the network length, however capacity utilisation has fallen significantly, see Figure 11. Figure 9 shows that demand has fallen over recent years with average demand declining since 2008-9 with 2012-13 demand being about the same as for 2005-6. This data is indicative of likely over-capitalisation, and so no need for significant new capital expenditure.

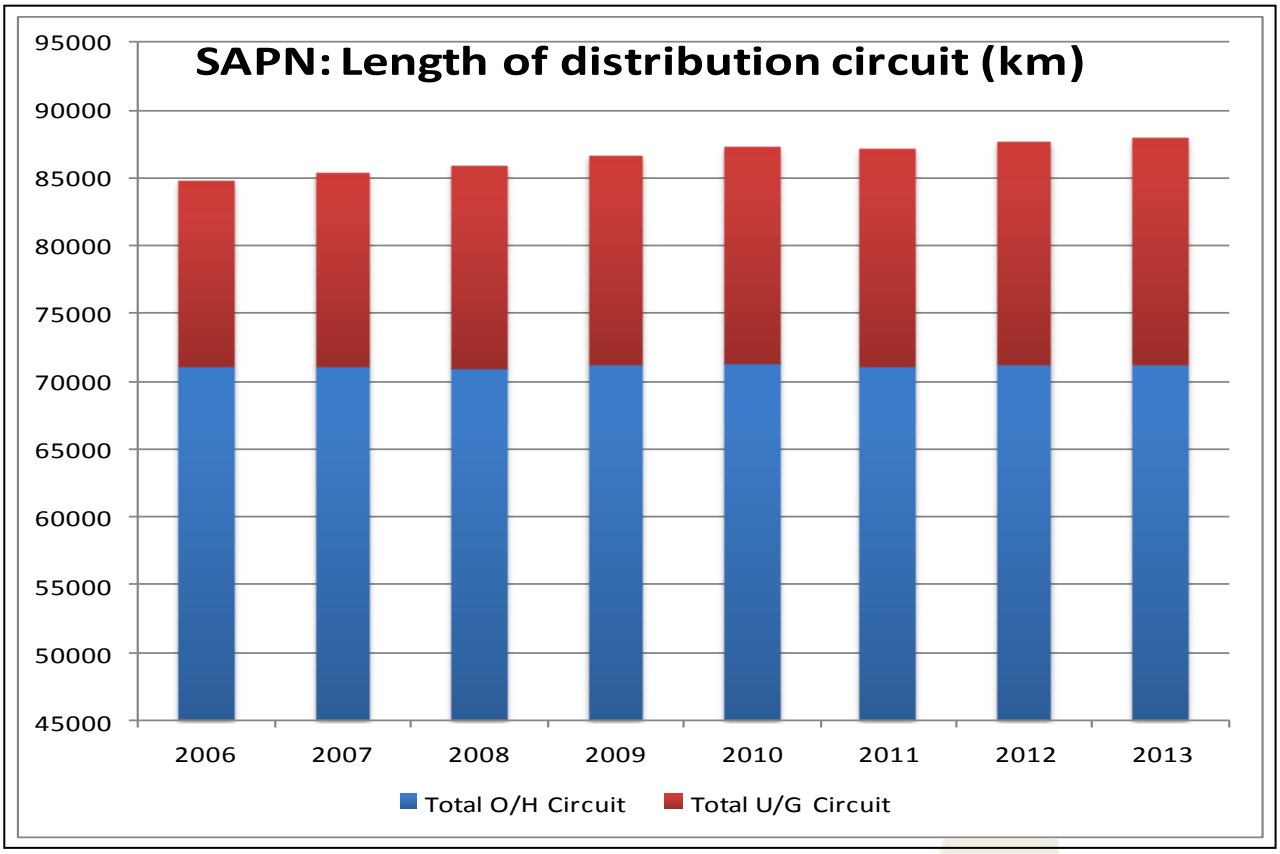


Figure 10 SAPN length and nature of network
Source: AER Issue paper, SAPN regulatory proposal, 2014

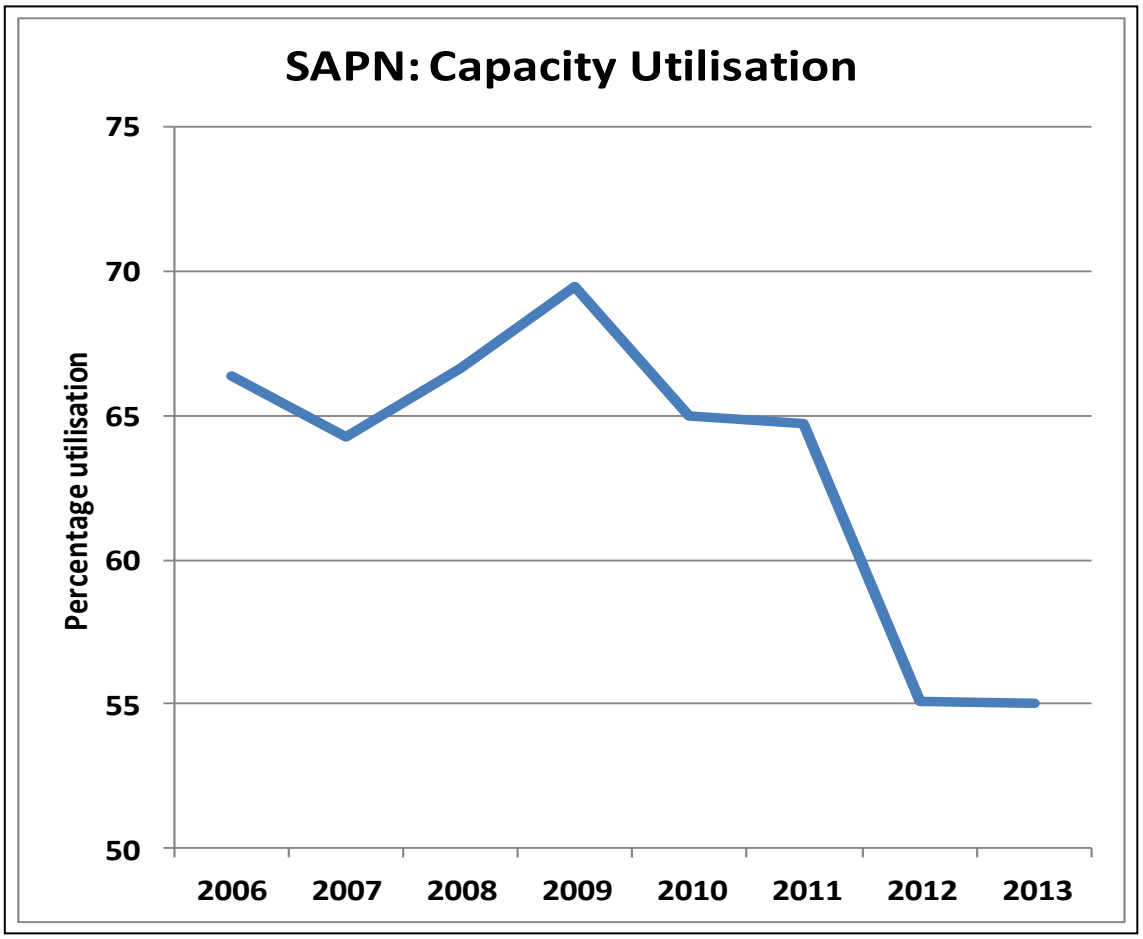


Figure 11 SAPN network capacity utilisation.
Source: AER Issue paper, SAPN regulatory proposal, 2014

The AER's preliminary decision has reduced the Capex allowance from that sought by SAPN, but it is still appreciably higher that for the 2010 -15 period, despite little, if any growth in demand. We assess the AER's preliminary decision for capex to be higher than is needed for an efficient firm with static demand growth and falling capacity utilisation. The SAPN revised proposal for CAPEX, being higher than AER's preliminary decision is consequently unacceptable. Further consideration of capex issues is provided in our previous submission regarding the SAPN initial proposal.

Regulated Asset Base (RAB)

The Regulated Asset Base (RAB) is a significant component in determining the allowed revenue for a network business and the amount that consumers end up paying for electricity. SAPN's initial proposal was for a 47 per cent increase over the 5 years to 2020 and a near doubling over the decade from 2010. The AER preliminary decision allowed for an increased RAB of 34%, to $5,132.5m, nominal by 2020 while the SAPN revised proposal has a nominal RAB growth of 32% over the 2015-20 regulatory period.

However, applying a CPI only increase on an opening RAB in 2015 of $3829.4 yields a closing RAB in 2020 of $4154.82m, nominal, an increase of 8.5%, using the proposed average inflation rate over the period of 2.06% as proposed by SAPN in their revised proposal. Any application of 'CPI – X' regulatory process would have a 2020 RAB for SAPN below $4154.82m.

We can find no justification for an increase in the RAB of the magnitude being proposed by SAPN, or the AER in their preliminary decision, during a period of declining demand and at a time when network utilisation is low

Of further concern is that increases in the RAB are maintained into future regulatory periods, so consumers keep paying for the current period's RAB increases well into the future. This is quite contrary to the long term interests for consumers.

UnitingCare Australia remains deeply concerned by the magnitude of RAB increases being considered over the 2015 – 2020 period, particularly given the RAB increases over the 2010-15 period. A near doubling of RAB over 10 years of minimal net change to average demand and even modest changes to peak demand are unacceptable.

Opex

SAPN has proposed an increase of about 33% over the next 5 years in their initial proposal, while the AER's preliminary decision allows Opex spending through to 2020 at 2013-14 levels at above. The SAPN revised proposal is for an increase of $196.1m above the AER preliminary decision.

Figure 9 shows average and peak demand for 2012-13 as being similar to 2007-8. Current demand is similar to 2012-13 levels. It is consequently reasonable to use a base year from the 2005-10 regulatory period as a fair base for Opex considerations, not 2013-14 which was historically a very high spending year for SAPN. We propose that the efficient operating costs for SAPN, and other Australian network businesses should be based on 2009-10, adjusted for CPI in subsequent years. 2009-10 was not heavily spending was not heavily affected by the GFC and had levels of demand reasonably similar to current demand.

The opex allowance should be lower than the AER's preliminary decision, and derived from a base year of 2009-10.

Safety

A broad theme that runs throughout the SAPN proposal, and revised proposal is that of safety. The SAPN initial proposal by way of example, states: *"Safety of the community is of paramount importance to SA Power Networks. We are committed to achieving the highest standards of safety for all our customers, employees and contractors, and the community."*

UnitingCare Australia agrees that safety is vital, however this 'commitment to safety' is used to justify considerable expenditure in OPEX (and CAPEX) components of the proposal that we consider to be too high for many consumers.

We do not see any evidence in the revised proposal of our concerns about the SAPN considerations of safety as a reason for justifying higher costs for customers. In particular SAPN has not considered our two key safety expenditure related issues:

1. Safety is a matter for consumers as well as network businesses
2. The SAPN revised proposal has not canvassed alternative, and lower cost approaches to many of the safety issues that they raise.

The following re-presents the safety issues section of our previous submission.

"There is no argument about the importance of safety and no one is going to argue the merits of 'less safety'. However, the claims and budgets related to 'safety' made by SAPN need close scrutiny. We suggest that there are a number of aspects of safety performance that are not explained, or considered by the SAPN proposal:

1. Safety of customers who cannot afford higher prices
2. Whether more spending actually improves safety?
3. Who else has relevant safety responsibilities?
4. Alternative, lower cost safety strategies.

Safety of customers who cannot afford higher prices

We observe that SAPN in considering safety fails to consider the safety impacts on consumers of rising energy costs. Uniting Care agencies, along with community service organisations more broadly, have been confronted with the reality over recent summers that on very hot days we need to make public comments to urge low income and disadvantaged people to use air conditioning, where this is available, to maintain a degree of personal safety. Many households, particularly aged pensioners are extremely reticent to use air conditioning because of the electricity costs and fear of unpayable bills as a consequence.

The following graphic represents a perspective from low income customers who respond to rising energy costs by using candles and relatively unsafe options for lighting; options that provide greater risk of house fires. This graphic was produced as part of a project that asked low and average income energy consumers to respond to the question of impacts on them and their households of rising electricity costs (see Appendix 1 for details). This photo is one from that exhibition and reinforces the safety risk to consumers of rising energy costs.

Photo 1; Source: Uniting Communities, Uni SA and SACOSS PhotoVoice exhibition

We do not consider that SAPN has considered the safety of its customers, and particularly lower income customers, who are forced to use less safe lighting and heating options in the face of escalating electricity prices. It is crucial that considerations of safety balance safety standards, responsibilities of network companies and safety of end consumers in coming up with budgets for expenditure on safety related matters. Striking this balance is the responsibility of the regulator, and we urge the AER to consider safety impacts for lower energy consumers along with the safety considerations that SAPN has proposed in its regulatory proposal.

We also note that SAPN has successfully operated for many years under established State and National safety provisions. We do not believe there is any substantial risk that they will change, to operate at below accepted safety standards and practice, if the cost increases that are claimed to be 'safety related' are not approved.

Does more spending actually improve safety?

While the SAPN proposal has argued for increased expenditure across the business on 'safety', the unproved assumption is that more spending will improve safety.

Scant attention is given to better management practices that could also improve safety, SAPN says that the safety of their staff (and contractors) is a priority, and we do not doubt this. What is less evident is proof that SAPN management regularly engage with staff (and contractors) seeking advice about approaches that can improve safety. We refer a little later to the application of the International Association of Public Participation (IAP2) spectrum for consumer engagement, which starts with "Inform" approaches at the least engaged level of the spectrum, while approaches that "empower" are at the most engaged end of the spectrum. The exact same spectrum of engagement could be applied to engaging with staff and contractors, regarding safety. We read little evidence of such 'safety first' strategies being applied or proposed by SAPN.

There are other approaches to improving safety performance without simply increasing expenditure; the increased expenditure proposed may do little to actually improve safety.

Who else has relevant safety responsibilities?

The SAPN regulatory proposal raises a number of areas where they argue, they should increase safety related spending. These include reducing bushfire risk and moving stobie poles on roads with higher levels of vehicle accidents.

In these situations, there are also other agencies with responsibilities in these areas, yet we are not made aware of their roles and how SAPN works with them. For example, regarding bushfire management, South Australians pay an emergency service levy, which has risen quite substantially this year. The emergency services, particularly the Country Fire Services, local government and residents in bushfire prone areas all have responsibilities to reduce bush fire risk; the dedicated emergency services levy supports some of these costs.

With regard to stobie poles located near roads with higher rates of vehicle accidents, there is a national 'black spots' funding program from government to make these locations safer.

We do not consider that the SAPN proposal adequately recognises other agencies and their budgets, with safety responsibilities in areas where they are proposing increased safety related expenditure. The SAPN regulatory proposal has failed to discuss their role in public safety in concert with other agencies with safety responsibilities.

Alternative, lower cost safety strategies

SAPN has not adequately considered alternative lower cost options to stobie pole relocation. These could include increased signage or 'traffic calming' options including speed humps, 'rumble strips' or slow points. Each of these options could also have road safety benefits beyond those achieved only by power line realignment, and might be delivered at lower cost. We do not see much evidence that SAPN have consulted with traffic engineers, transport authorities or communities with a view to considering the range of options (and shared payment responsibilities) that could be applied to improve road safety.

The SAPN proposals for increased 'safety' related expenditure have not adequately considered the safety impacts for consumers seeking less safe energy options due to rising electricity costs. SAPN has not adequately considered lower cost options, nor have they actively engaged with other agencies with shared or related public safety responsibilities. We urge the AER to very closely review all expenditure claims linked to increased safety, against these concerns. Consumers will also need to be convinced that any increases spending on safety, will significantly improve safety outcomes.

Other OPEX considerations

As with capex proposals, SAPN has proposed a considerable increase in opex expenditure compared with previous regulatory periods: 33% increase for the coming regulatory period. The opex proposal and past opex experience is shown in figure 15.

It is difficult to comprehend why SAPN has bid for such substantial increases in both capex and opex while demand is falling. A dramatic increase in capex would be expected to be at least partially offset by a decline in opex since the marginal productivity of capital is normally regarded to be a substitute for the marginal productivity of labour, a key element of opex. Stable or declining demand should generally result in stable or declining opex.

We consider some of the elements given by SAPN for opex growth:

- Labour cost escalation. The SA labour market is characterised by unemployment rates that are higher than the national average, extremely high levels of underemployment (employed part time, wanting more hours), a persistently lower than national rate for participation in the labour market, due in part to significant numbers of discouraged job seekers and the minimum wage, as determined by Fair Work Australia barely keeps up with the CPI, currently below 3%. These settings for the labour market would suggest that wages growth is going to be modest in nominal terms and flat or declining in real terms, yet SAPN proposes an increase to labour costs of $57.1million (in 2014-15 dollars). SAPN is effectively saying that many SA consumers who are experiencing

declining or steady real incomes should be paying more for their electricity bills so that SAPN can pay significant increases to their staff. We consider this proposition to be unreasonable.

This increase in labour costs is completely inconsistent with prevailing labour market conditions in SA and the level of proposed increase is unacceptable.

- Output Growth. The increase claimed, in 2014-15 dollars for the 2015-20 period is $46.7 million, when demand is falling or at best steady while network capacity utilisation is falling. There is no justification for the increased opex claimed for 'output growth'.

- IT and telecommunications. We accept the importance of effective IT systems, which should be about increasing network efficiency and business productivity. In short, there should be a much greater return to consumers from any substantial increase in IT and telecommunications spending.

- Asset Inspections. We do not accept the magnitude of this increase.

- Demand Side Participation. It is frustrating that the main mention of "Demand Management" in this proposal is with regard to metering and new charging arrangements, without much apparently coming back to consumers. Demand side participation should be about more efficient alternatives to high cost capex and opex options. To label new charging arrangements for customers as demand management misses the point completely. If new charging arrangements are to be introduced, they should only be introduced if they lower costs for consumers, they should not be a reason to be increasing charges to households and small business.

- Vegetation Management. The claim for an additional $31.9 million for vegetation management on top of the significant increase for the 2010-15 period is excessive.

We regard the opex increases proposed by SAPN to be an unsubstantiated ambit claim that fails to address the best interests of consumers.

Rate of Return

These proposals from the SAPN regulatory proposal for 2015-20 need to be put in context, and that context is that this regulatory proposal is lodged in a very different economic climate to that which existed in 2008-10 when the previous regulatory proposal was being developed. At that time, the Global Financial Crisis was at the forefront of thinking with expectations of

high interest rates on global capital markets for the foreseeable future. Energy network businesses are capital intensive and borrow on global capital markets.

Interest rates fell much more quickly following the GFC than was expected. As a result, for the past regulatory period, SAPN has had capital raising allowances from the regulator much greater than the actual costs that new capital raisings would have been experiencing. Meanwhile, the electricity bills paid by consumers have risen sharply. SAPN will have been able to benefit from the interest rate arbitrage that they have enjoyed.

The second reality of global interest rates is that they are now very low, and expected to remain low. The risk free rate for example has plummeted since the period immediately after the GFC. This new financial reality must be reflected in the AER's determination for 2015-20.

The regulatory period 2010-15 must be regarded as 'exceptional circumstances', with the more useful reference point for 2015-20 regulation being the period up to 2010, with modest projection of costs for the business from this period as the basis for 2015-20.

Table 3 tabulates rate of return parameters for the most recent UK distribution determinations, the AER SAPN preliminary decision and SAPN initial and revised proposals. All SAPN proposed parameter are dramatically higher than for the UK, and except for WACC are higher than the preliminary decision

	WACC Vanilla Nominal	Nominal return on Equity	Nominal Debt return	beta
Ofgem	4.8%	7.1%	3.7%	
SAPN proposal	7.62	10.45	5.74	0.91
AER Prelim decision	5.45	7.1	4.35	0.7
SAPN revised	5.45	9.83	5.29	0.91
UnitingCare opinion	5.45	7.1	4.35	0.4

Table 3 WACC and related parameter comparisons period and proposed
Source: AER Preliminary decision and SAPN revised proposal

We can see no reasons for the SAPN rate of return parameters to be higher than the AER's preliminary decision, which is still quite generous given global financial conditions.

Equity Beta (β)

We wish to comment briefly on equity beta because we believe that this is one parameter where SAPN's proposals are substantially outside of reasonable values. The 2013 rate of return guidelines recommended a range for β of 0.4 – 0.7. We are disappointed that SAPN is still proposing a β of over 0.8, outside the guideline.

Subsequent to the rate of return guidelines being published, a report commissioned by the AER has been released, undertaken by Olan Henry from the University of Liverpool.[3] Henry's work served both to respond to some of the debate around the issue of assessing β,[4] to test the robustness and optimal approach to determining β, and to provide some indication of where an appropriate value might lie. Henry argued that the approaches to analysis that produced the most reliable results used the longest available data series, tested at weekly intervals, and considered the market data using either equal weighting or value weighting of the portfolio (tables 2, 14 and 16) (p. 63). A majority of Henry's estimates were in the range 0.3 - 0.5, and the medians in the tables that he identified as providing the most robust results lay between 0.4 and 0.5.

We believe that the range in values for β lie on a continuum between low figures that serve the best interests of consumers, and higher figures that will serve the best interests of investors and owners, but that will come at the expense of affordability. Again, we recommend that the AER act in the best interests of consumers and select at the lower end of the range, 0.4. Such a choice would be consistent with relatively low risk businesses in a relatively benign capital market, which is the current situation.

Tax and Gamma

UnitingCare Australia asks which is the entity for which tax allowances are being made? We understand that SAPN, the regulated network, is a partnership and that partnerships do not pay tax. Consequently there should be no allowance for tax payments.

The efficient approach to tax allowances would be to treat tax as a pass through with actual tax payments made to the Australian Tax office being allowed as a pass through by the AER, thereby eliminating the need for any allowance in the regulatory determination.

[3] Olan Henry; Estimating β: An update, April 2014.
[4] In particular, Competition Economists Group, AER equity beta issues paper: international comparators, October 2013.

The value of gamma too becomes something of a ‘moot point’ under this consideration. Notwithstanding this perspective, we support the AER’s value for gamma, if a value for gamma is necessary.