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ADVOCACY CENTRE

Submission in response to the NSW DNSPs 2019-24 regulatory proposals and AER issues paper

8 August 2018

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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;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association NSW;
- Tenants Union;
- The Sydney Alliance; and
- Mission Australia.

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1. Introduction

PIAC welcomes the opportunity to respond to the regulatory proposals submitted by the three NSW electricity distribution network service providers (DNSPs) and the associated Australian Energy Regulator (AER) issues paper.[1]

This submission was prepared with the help of Bev Hughson of Dararch Energy Consulting Services. We thank Bev for her insights. We also thank the AER, Ausgrid, Endeavour Energy and Essential Energy for productive pre-lodgement engagement over the last 18 months.

1.1 The context for the 2019-2024 NSW distribution regulatory determinations

Any response to the DNSPs' proposals for the 2019-24 regulatory control period (RCP) must be prefaced by considering both the current state of the National Electricity Market (NEM) and the recent history of distribution regulatory processes in NSW.

Across the NEM, electricity consumers, businesses and regulators are grappling with an affordability crisis. Recently, the Australian Competition and Consumer Commission (ACCC) noted that "High prices and bills have placed enormous strain on household budgets and business viability. The current situation is unacceptable and unsustainable".[2] PIAC agrees with this statement: through our work in the community, and as observers at DNSP customer engagement events, we have heard that affordability is the key priority for energy consumers.

The history of NSW distribution determinations is similarly important. In short, NSW consumers pay extremely high prices for their distribution networks. After a period of relatively stable electricity prices, the 2009-14 RCP saw an unprecedented increase in network investment. The ACCC have recently confirmed this to have been over-investment.[3]

In the current 2014-19 period, all three DNSPs will recover less revenue than in 2009-14. Essential Energy's final decision on the remitted 2014-19 determination and Endeavour Energy's draft decision indicate that the DNSPs will be allowed to recover revenue at the level of the final 2015 determination, and retain some additional over-recovery.[4] PIAC welcomes the resolution of the extended appeals process and notes that this outcome is considerably better for consumers than either the 2009-14 RCP or what the DNSPs originally proposed for 2014-19.

NSW distribution charges remain extremely high. Due to the period of over-investment and ongoing expenditure levels, NSW consumers are still paying for the largest regulatory asset bases (RAB) in the NEM.[5]

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1 Ausgrid, *Ausgrid's Regulatory Proposal: 1 July 2019 to 30 June 2024*, April 2018; Endeavour Energy, *Regulatory Proposal: 1 July 2019 to 30 June 2024*, April 2018; Essential Energy, *Empowering communities to share and use energy for a better tomorrow: 2019-24 Regulatory Proposal*, April 2018; AER, NSW electricity distribution determinations, Issues Paper, June 2018.

2 ACCC, *Restoring electricity affordability and Australia's competitive advantage*, June 2018, iv.

3 Ibid, ix.

4 AER, Essential Energy 2014-19 electricity distribution determination, Final Decision, May 2018; AER, Endeavour Energy 2014-19 electricity distribution determination, Draft Decision, July 2018.

5 ACCC, *Restoring electricity affordability and Australia's competitive advantage*, 159.

This context forms the backdrop to this determination process. It is no longer acceptable for DNSPs to propose, and the AER approve, large investment programs based purely on bottom-up engineering assessments. Instead, consumers need affordability to be considered as a top-down constraint on decisions by DNSPs and the AER.

1.2 The scope of PIAC's submission

All three DNSPs have made a considerable improvement in pre-lodgement consumer engagement since their last regulatory determinations.[6] Through this engagement, PIAC and the DNSPs have reached agreement on a number of matters, reducing the scope for debate through the formal AER process. For example, all three DNSPs have agreed to adopt the AER's standard approach to the rate of return.[7] In the past, this has been an area of significant disagreement between PIAC and the DNSPs. Further, we have reached agreement with individual DNSPs on specific issues such as connections policy (Ausgrid), demand tariff design (Endeavour Energy) and vegetation management strategy (Essential Energy).

This has allowed us to narrow the scope of our submission compared to the equivalent document in 2014.[8] Instead of challenging the DNSPs in a line-by-line assessment of each proposal, we have primarily concentrated on the consumer focus and affordability of the proposals.

We begin with overall assessments of the consumer engagement and affordability constraint that should underpin the proposals, before assessing the proposals in three key areas:

- Capital expenditure (capex) issues;
- Operating expenditure (opex) issues; and
- Tariff structure statements (TSS) and tariff reform.

Each of these areas is addressed in a section. Each section primarily addresses cross-cutting themes that apply to all DNSP proposals. Analysis of individual capex proposals are included in attachments B, C and D, while we make some comments about individual TSS proposals in the TSS section.

The remainder of the submission is structured as follows:

- **Section 2** discusses consumer engagement;
- **Section 3** discusses affordability;
- **Section 4** discusses capex;
- **Section 5** discusses opex; and
- **Section 6** discusses TSS.

6 This is explored in more detail in section 2 of this submission and the attached engagement evaluation report.
7 AER, NSW electricity distribution determinations, Issues Paper, 15.
8 PIAC, *Moving to a new paradigm: submission to the Australian Energy Regulator's NSW electricity distribution network price determination*, August 2014.

2. Consumer Engagement

2.1 The context for DNSP consumer engagement

Consumer engagement is a core responsibility of DNSPs in the NEM. This is reflected in the expectations outlined by the AER in its Consumer engagement guideline for network service providers (NSPs).[9] The Guideline outlines the AER's expectations for how NSPs should engage with consumers, and underpins PIAC's view that consumer engagement should be the bedrock of business planning by the NSW DNSPs.

In previous regulatory determinations, consumer representatives did not consider the NSW DNSPs to have done consumer engagement well. In PIAC's response to the 2014-19 AER issues paper, we wrote that "On the whole, PIAC does not consider that the consumer engagement undertaken by the three NSW networks has been sufficiently extensive or effective".[10]

This time, the NSW DNSPs state that their proposals have been guided by consumer engagement and have sought to identify consumer support for their proposals where possible. PIAC has been involved in this process both as a participant in stakeholder engagement and as an observer when the DNSPs engaged with their customers directly. The remainder of this section outlines our view about the issues raised in, and the effectiveness of, the consumer engagement that supported the proposals.

2.2 Consumer priorities

Through their consumer engagement programs, the NSW DNSPs have heard relatively consistent messages from their customers and consumer representatives. According to the DNSPs, consumers identified three over-riding themes for DNSPs to consider:

- Affordability;
- Reliability; and
- Safety.[11]

Ausgrid also reported sustainability as a key theme.[12]

PIAC agrees with the DNSPs' assessment of the themes raised in consumer engagement. In particular, consumers are concerned with the high price of electricity. In PIAC's view, affordability is the number one priority for consumers in this regulatory determination.

This is directly reflected in both Endeavour Energy's and Essential Energy's proposal documentation. Endeavour Energy's proposal highlights affordability as "the number one concern for many of our consumers",[13] while Essential Energy's consumer engagement summary reported some support for accepting slightly lower reliability for better affordability.[14]

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9 AER, Consumer Engagement Guideline for Network Service Providers, November 2013.
10 PIAC, *Moving to a new paradigm*, August 2014, 28.
11 Ausgrid, *Ausgrid's Regulatory Proposal*, 27; Endeavour Energy, *Regulatory proposal*, 56; Essential Energy, *Regulatory Proposal*, 32.
12 Ausgrid, *Ausgrid's Regulatory Proposal*, 27.
13 Endeavour Energy, *Regulatory Proposal*, 52.
14 Essential Energy, *4.2 How engagement informed our proposal*, 16.

While Ausgrid has not ranked its consumer priorities, PIAC contends that affordability should be central to its thinking too.

Recommendation 1

That the AER consider affordability to be key consumer priority in the 2019-24 determinations.

2.3 PIAC's consumer engagement evaluation project

In response to the context outlined in section 2.1, PIAC evaluated the NSW DNSPs' consumer engagement as they prepared their 2019-24 regulatory proposals. Our report is appended to this submission as Attachment A.

The purpose of this project was twofold. Firstly, to provide a framework within which PIAC can assess consumer engagement practices and provide ongoing feedback to the DNSPs as they engage with consumers. Secondly, to provide an independent, evidence-based assessment of DNSP engagement to the AER. While DNSPs are required to report on their consumer engagement process as part of their regulatory proposal, corresponding assessments from consumers are not often submitted to the AER.

PIAC used the AER's Guideline and other information to design an evaluation framework, allowing us to rate each DNSP out of five stars for consumer engagement. Table 1 describes the meaning attributed to each star rating.

Table 1 – Engagement project star rating descriptions

Star Score	Description
	***Best practice.*** Sector-leading, innovative engagement that is an exemplar for the wider industry. Stakeholders can be confident that consumer preferences and interests are at the core of DNSP's actions and activities, and customer outcomes have been put first.
	***Good practice.*** Stakeholders can be confident that consumer preferences and interests have informed DNSP's actions and activities, and some genuine compromises have been made by the DNSP to get to that point.
	***Standard practice.*** Stakeholders can be confident that consumer preferences and interests have been a feature of DNSP's actions and activities. Engagement outcomes have had some impact on business decisions, but improvement will be needed to keep pace with change in the sector and to justify moving to new regulatory models.
	***Box-ticking.*** DNSP did the bare minimum to engage with consumers, and/or little evidence that consumer preferences and interests are reflected in the DNSP's actions and activities. This level of engagement may become unacceptable over time with change in the sector.
	***Unacceptable practice.*** The DNSP has not been committed to good consumer engagement. Stakeholders cannot have confidence that consumer preferences and interests are reflected in the DNSP's actions and activities.

Overall, there was a significant improvement in consumer engagement by the NSW DNSPs compared with that done to support their 2014-19 proposals. If we had performed this analysis on those consumer engagement programs, none of the businesses would have received a rating above 1 star. This progress is in line with the more collaborative regulatory process promoted by the AER over last year, and demonstrates that DNSPs and consumers can work together much more closely than had previously been the case.

However, there is still improvement required by the DNSPs. In particular, more could have been done to ensure that consumer engagement programs made a measurable difference to the proposals. While the DNSPs have accurately reported that affordability is the primary concern for consumers, with reliability, safety and sustainability also factors, they are yet to translate this into changes in the way they do business.

The remainder of this section summarises the results for the NSW DNSPs.

2.3.1 Ausgrid – 2.8 stars

Despite improvement from last period, Ausgrid has still not shown a high level of commitment to consumer engagement. PIAC considers the Ausgrid's consumer engagement program was somewhere between a box-ticking exercise and standard practice.

Ausgrid's network customer engagement program was characterised by superficial consultation, an over-reliance on online surveys and glossy corporate communications. PIAC observed that Ausgrid appeared to approach this process as a means of supporting existing positions rather than seeking input from its customers.

While generally of a better standard than its customer engagement, Ausgrid's consumer representative engagement did not take full advantage of good stakeholder working groups to negotiate compromises and improve its standing with consumers.

There is some evidence that Ausgrid's engagement has translated into a better proposal. However, this is limited to a general price decrease. On most specific issues, Ausgrid did not adopt consumer positions and continued to treat these views as secondary to board positions.

However, PIAC is encouraged by signs that Ausgrid has sought to develop a better culture of, and approach to, engagement over the period. In particular, PIAC considers the consumer representative engagement in 2018 to have been of a much higher quality than that in 2017. If Ausgrid continues to use deliberative engagement and commit to a culture of compromise, we are hopeful that Ausgrid will rate much higher in the future.

2.3.2 Endeavour Energy – 3.5 stars

Endeavour Energy's consumer engagement was inconsistent over the evaluation period. While some aspects of its engagement program were good, this was punctuated by periods of inactivity and unwillingness to compromise.

When it did engage, Endeavour Energy exhibited good practice network customer engagement. Endeavour Energy provided customer forum participants with clear, accurate and accessible information and worked hard to elicit informed feedback. However, this engagement did not start early enough, nor continue for long enough, which limited its effectiveness.

Endeavour Energy's consumer representative engagement was even more inconsistent. In mid-2017 and in the 2018 extended consultation period, it worked closely with consumer representatives and provided them with a wealth of information. PIAC was particularly impressed with how Endeavour Energy ran its 2018 'deep dive' forums. By structuring each session around

a particular aspect of its regulatory proposal, Endeavour Energy ensured that consumer representatives were given the time and information required to provide meaningful feedback to Endeavour Energy.

However, this approach was undermined by Endeavour Energy's unwillingness to compromise on key issues.

Therefore, there is mixed evidence of Endeavour Energy incorporating consumer input into its regulatory proposal. While its TSS was developed in collaboration with consumer representatives, Endeavour Energy has made decisions about capital expenditure and connections policy that, if approved, would increase its RAB and network charges against the express wishes of consumers.

In PIAC's view, Endeavour Energy is well-placed to build on the considerable improvements made in its approach to engagement. If it seeks to embed a willingness to compromise into its engagement culture, Endeavour Energy's next round of consumer engagement has the potential to be rated considerably higher.

2.3.3 Essential Energy – 4.0 stars

Essential Energy's consumer engagement was the best of the three NSW DNSPs in the evaluation period. Through 2017, Essential Energy demonstrated a commitment to consulting in good faith, using deliberative engagement approaches and acting transparently.

In particular, Essential Energy had a strong network customer engagement program. Essential Energy invested significant resources in conducting three rounds of customer forums across seven locations. By conducting repeat forums over nine months, Essential Energy developed a strong relationship with the participants and facilitated educated input from its customers.

Essential Energy initially placed less emphasis on consumer representative engagement. However, it responded to stakeholder feedback and developed this as part of its engagement program in 2017. While they were not as detailed as Ausgrid and Endeavour Energy's deep dive forums, Essential Energy did use similar approach and sought to reach negotiated outcomes with consumer representatives where possible.

Overall, Essential Energy was transparent about its business plans and sought to reflect consumer preferences in its regulatory proposal. In particular, Essential Energy responded to consumer concern about energy affordability by proposing to significantly reduce its capital and operating expenditure in the 2019-24 RCP.

In PIAC's view, Essential Energy could improve its consumer engagement further by starting earlier, reducing the size of its customer forums and investing more in consumer representative engagement.

3. Affordability

3.1 The affordability crisis

Energy consumers are currently struggling to afford high energy bills. A combination of high wholesale electricity prices, high gas prices and long-term growth in network RABs has meant that consumers have faced unusually high bills in recent years. Recently, 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".[15] PIAC agrees.

The affordability crisis is also reflected in what consumers are telling the NSW DNSPs. As noted above, energy affordability was identified as the top consumer priority in DNSP consumer engagement.

The recognition that inflation and cost of capital are at historically low levels exacerbates PIAC's concerns. 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/when the cost of capital increases, a second round of affordability crises will arise – absent genuine reforms to the underlying business operations.

3.2 Affordability as a constraint

Given this context the current and potential ongoing affordability concerns for consumers, PIAC contends that affordability should be the central driver of decisions by the DNSPs and the AER.

Traditionally, DNSP revenue allowances in the NEM have been determined using a 'bottom-up' process, where DNSPs propose a range of expenditure programs to be covered by the building blocks in an AER determination. Proposals are then approved or rejected by the AER based on an assessment of their efficiency. In this framework, expenditure is constrained by a set of cost-benefit analyses by the DNSP and the AER. It is not, however, explicitly constrained by a top-down assessment of what consumers are willing and able to pay for distribution services. Given the affordability crisis outlined above, this must change.

Recently, Energy Consumers Australia (ECA) stated that "Affordability must be a constraint on all the decisions we make about the energy market".[16] PIAC agrees with this view. This implies 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.

This means that the DNSPs 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 do what is 'nice to do'. They must establish a capex program that recognises future changes, and not build in long-life assets that will be 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 improving affordability for consumers.

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15 ACCC, *Restoring electricity affordability and Australia's competitive advantage*, June 2018, iv.

16 Energy Consumers Australia, *ACCC draws a line in the sand on electricity prices*, media release, July 2018. 1.

Therefore, PIAC does not support proposals that will increase distribution charges over the 2019-24 RCP. Such proposals increase the affordability crisis and increase cost of living pressures on consumers who are already struggling. Instead, DNSPs should be proposing, and AER approving, real price *decreases*.

Further, PIAC does not support DNSP expenditure programs that will result in continued RAB growth. This is, perhaps, even more important than short-term price paths. Expenditure allocated to the RAB results in higher prices paid by consumers of the life of the relevant asset, through higher return on capital and regulatory depreciation allowances. This is a major driver of the distribution charges paid by consumers and is relatively unresponsive to later reforms or efficiencies in regulatory and business practices. Recently, the Grattan Institute and ACCC have argued that network over-investment in NSW has led unaffordably high RABs.[17] PIAC considers it is not in the long-term interests of consumers to exacerbate the problem through further RAB growth in the 2019-24 RCP.

Recommendation 2

That the AER and NSW DNSPs apply a top-down affordability constraint on expenditure in the draft decision and revised proposals.

3.3 Affordability in the proposals

Overall, PIAC does not consider the DNSP proposals to have gone far enough to address affordability concerns. As noted by the AER, "These proposals would – if approved – deliver relatively stable distribution network revenues…in line with those that followed significant reduction in revenue from the 2009-14 regulatory control period to the current, 2014-19 period".[18]

Figure 1 in the issues paper charts the changes in regulated revenue of the NSW DNSPs from 2009-10 to 2023-24 under the proposals. While all three DNSPs propose to recover considerably less revenue from consumers than in the peak 2009-14 RCP, that does not imply that prices at the 2014-19 level are sustainable and that further reduction are not necessary. As noted above, consumers need much more than revenue stability from the DNSPs to address the affordability crisis.

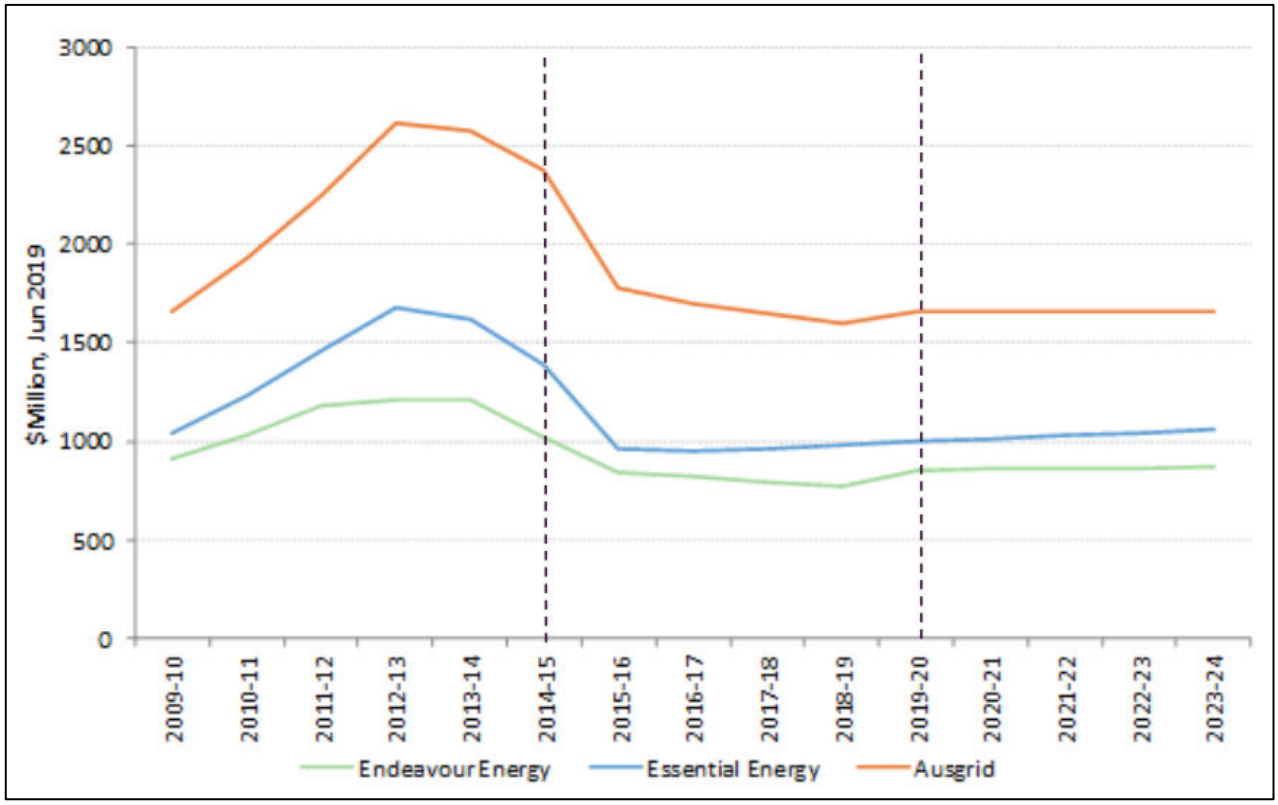
Indeed, a reduction in the cost of capital explains a significant component of the pricing outcomes set out in the proposals, and changes to the cost of capital in the future pose a continuing risk to consumers.

The price and RAB impacts of these revenue forecasts are discussed below.

17 Grattan Institute, *Down to the Wire: A sustainable electricity network for Australia*, March 2018; ACCC, *Restoring electricity affordability and Australia's competitive advantage*, 171.

18 AER, NSW electricity distribution determinations, Issues Paper, 12.

Figure 1 – Changes in regulated revenue, by NSW DNSP, 2009/10 to 2023/24 (real $2018/19)



Source: AER, *NSW electricity distribution determinations, Issues Paper*, Figure 1, 13.

3.3.1 Ausgrid

Ausgrid is the only NSW DNSP forecasting real reductions in distribution charges over the 2019-24 RCP. As proposed, Ausgrid's x factors would reduce prices by 5.7% in 2019-20 and remain stable in real terms over the rest of the RCP.[19] PIAC notes that this partly due to overall reductions in both capex and opex compared with 2014-19,[20] and welcomes this price decrease as a positive affordability measure.

However, Ausgrid has much more to do. As noted above, the current low cost of capital appears to be providing much of the price moderation in all three proposals, indicating that Ausgrid can do more to ensure that its investment decisions are also having affordability benefits.

Additionally, Ausgrid's RAB will continue to grow through the 2019-24 RCP. While the projected growth of 2.7% is lower than that during the 2009-14 peak, it is an acceleration compared to the 0.2% growth in 2014-19.[21] As noted above, PIAC does not consider further RAB growth to be in the long-term interests of consumers and will not support proposals that have that effect.

3.3.2 Endeavour Energy

Endeavour Energy has made efforts to reduce expenditure over the 2014-19 RCP, reducing both capex and opex compared to the 2009-14 high. PIAC welcomes these efforts.

19 Ausgrid, *Ausgrid's Regulatory Proposal*, 59.
20 AER, NSW electricity distribution determinations, Issues Paper, 22; 27.
21 Ibid, 20.

However, Endeavour Energy is still proposing a price increase in 2019-24. PIAC does not agree with Endeavour Energy's assertion that its 2019-24 proposal offers a real price decrease of 1% per annum as this figure includes the proposed remittal outcome described in the AER's draft decision for that process.[22] [23] While PIAC welcomes the potential remittal outcome, we consider any decrease in distribution charges that result from it to be Endeavour Energy handing back consumers' money rather than from a reduction in the business' proposed expenditure. It should not be considered a price decrease in the context of the 2019-24 determination.

According to information provided by Endeavour Energy to CCP10, the true 2019-24 price path (i.e.: excluding the contribution from the proposed remittal decision) involves 0.8% per annum real price increases for the duration of the RCP.[24] As noted above, PIAC will not support a proposal that includes a real price increase.

Furthermore, Endeavour Energy's RAB will continue to grow quickly in the period, with a 12% increase between June 2019 and June 2024.[25] This reflects a significant growth in capex, which is discussed further in section 4. Given the position outlined above, PIAC will not support Endeavour Energy's proposal on this basis.

PIAC understands that Endeavour Energy is currently working with the AER and other stakeholders to investigate how to address some of these concerns ahead of its revised proposal, particularly regarding capex levels. We welcome this and will engage productively with this process.

3.3.3 Essential Energy

Essential Energy has made strong efforts to reflect the need for affordability in its proposal. This is reflected in proposed reductions in both capex (8.5%) and opex (6%) compared to 2014-19. PIAC welcomes these efforts.

Despite these reductions, this work has failed to result in a price decrease and Essential Energy will continue to experience significant RAB increases over the 2019-24 RCP. If the current proposal is approved, Essential Energy's customers would receive real price increases of 1.63% per annum for the duration of the 2019-24 RCP (excluding remittal).

This is driven by continuing RAB growth, which is forecast at 5.7% for the 2019-24 RCP.[26] In stakeholder forums, Essential Energy has identified a number of reasons for this outcome, including inaccurate initial RAB valuations, the size of its existing RAB and the nature of Essential's rural network. While we have some sympathy for the difficulty of Essential Energy's circumstances, PIAC cannot support a proposal that increases both price and RAB.

PIAC also understands that Essential Energy is currently undertaking a program of work to try and address some of these issues ahead of its revised proposal. We urge Essential Energy to

22 Endeavour Energy, *Regulatory Proposal*, 6.
23 AER, Endeavour Energy 2014-19 electricity distribution determination, Draft Decision, July 2018.
24 Consumer Challenge Panel (subpanel 10) (CCP10), *NSW Regulatory Proposals 2019-24 – CCP10 Initial Response*, presentation slides, July 2018, slide 9.
25 AER, NSW electricity distribution determinations, Issues Paper, 32.
26 Essential Energy, *Regulatory Proposal*, 32; AER, NSW electricity distribution determinations, Issues Paper, 44.

continue to work with the AER and other stakeholders to ensure that this can translate into a more affordable proposal.

Recommendation 3

That the AER not approve the NSW DNSPs' current proposals.

That the AER work with the DNSPs to ensure that affordability is explicitly considered as a constraint on expenditure to deliver real reductions in prices for consumers.

4. Forecasts of capital expenditure (capex)

This section assesses capex issues that apply to all three proposals. Analysis of the individual capex proposals is contained in:

- *Attachment B – Ausgrid's Capex Proposal*;
- *Attachment C – Endeavour Energy's Capex Proposal*; and
- *Attachment D – Essential Energy's Capex Proposal*.

4.1 Capex and affordability

PIAC's over-riding concern is that the NSW DNSPs have not rigorously reviewed their capex proposals with affordability as a constraint, even though they acknowledge that affordability is the number one concern for their consumers.

One of the primary causes of the current affordability problem has been the significant capital and operating expenditures made by the NSW DNSPs in the past decade. While DNSP opex has come down somewhat since its peak, the problems caused by the surge in capex remain due to the ongoing returns provided on the RAB.

To address the problem of past excess capex investment, and to ensure improved affordability in the future, each DNSP will need to make a very strong commitment to delivering significant capex reductions now. Only then, will prices revert to efficient levels over time.

Therefore, PIAC is looking for clear evidence that significant efforts have been made to reduce capex and reign in the RAB growth through the proposals. This is not yet evident in most areas of the capex proposals, despite the significant reduction in augmentation capex (augex) levels. Other expenditure areas, particularly replacement expenditure (repex), have now become the major component of capex proposals. It is not clear to PIAC that these levels of replacement expenditure are warranted, particularly in the context of the relatively high levels of reliability of the networks as a whole.[27]

In the context of the priority of affordability, PIAC recommends that the AER does not accept the DNSPs' current capex proposals. Our reasons are summarised below and explained in more detail in the response to each DNSP's individual proposal.

4.2 Capex productivity continues to decline

PIAC is concerned that the productivity of the NSW DNSP networks across a number of measures has been historically been, and continues to be, quite poor.

Capex efficiency underpins the long-term efficiency of the RAB and, therefore, the long-term trends in network prices. Therefore, the NSW DNSPs must ensure their current proposals lead to sustained improvements in capex productivity while continuing to work on opex productivity.

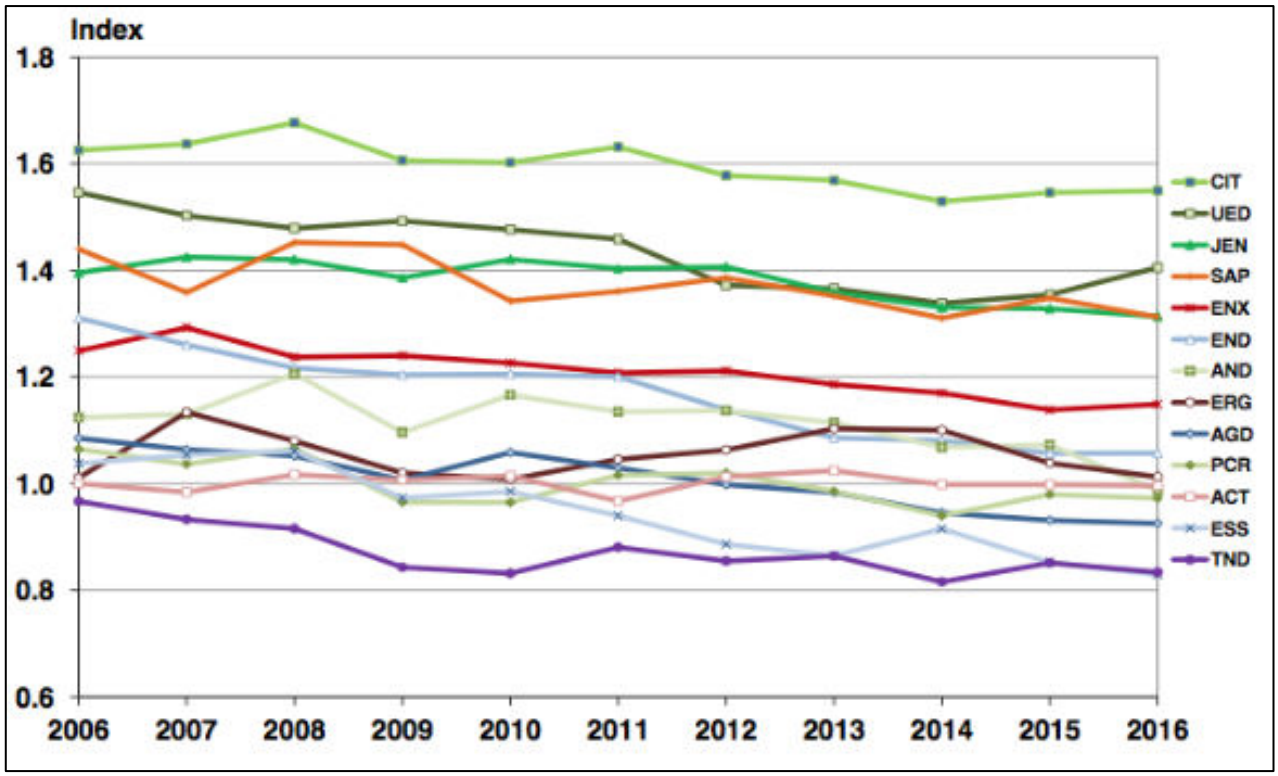
The AER's most recent economic benchmarking report confirms that overall, the NSW DNSPs remained amongst the lowest of the DNSPs in the NEM in terms of multilateral total factor

[27] PIAC acknowledges that there are certain feeders or areas which experience particularly poor levels of reliability and quality of supply. However, these are in the minority.

productivity (MTFP), despite numerous reforms to the three businesses. Out of 13 DNSPs in the NEM, Endeavour Energy, Essential Energy and Ausgrid were rated 8, 11 and 13 respectively.[28]

The MTFP measure can be disaggregated into a measure of opex multilateral partial factor productivity (opex MPFP) and capex multilateral partial factor productivity (capex MPFP). While the NSW DNSPs have showed some improvement in opex MPFP, this was largely offset by the continuing decline in capex MPFP through to 2016. In addition, the NSW DNSPs remain amongst the lowest performers in capex productivity in the NEM. In simple terms, this continued decline in productivity is a result of inputs continuing to grow at a faster rate than outputs of the networks over the 11 years of the benchmark study. Figure 2 and Table 2 illustrate these trends.

Figure 2 – Capex multilateral partial factor productivity, by DNSP, 2006 to 2016 (Index)



Source: AER, *Annual Benchmarking Report – Electricity distribution network service providers*, November 2017, Figure 16, 36.

[28] See for instance, AER, *Annual Benchmarking Report – Electricity distribution network service providers*, November 2017, Figure 14, 31; AER, *Annual Benchmarking Report – Electricity distribution network service providers*, Table 2, 34.

Table 2 – NSW DNSPs – Output & Input measures, total factor productivity & partial productivity indexes, 2006 to 2016 (annual growth rate % for the period)

	Output Index	Input Index	Total Factor productivity	Opex Partial Factor	Capital Partial Factor
Growth rate 2006-16	0.88%	2.73%	**-1.86%**	**-1.18%**	**-2.11%**
Growth rate 2006-12	0.98%	4.47%	**-3.49%**	**-4.77%**	**-2.57%**
Growth rate 2012-16	0.72%	0.13%	0.59%	4.20%	**-1.43%**

Source: Economic Insights, *Economic Benchmark Results*, October 2017, Table 4.3, 29.

While the figures above refer to the economic benchmarking approach, the AER also reported on a range of partial performance indicators (PPIs) in its 2017 benchmarking report. The NSW distribution networks again perform relatively poorly on a range of these indicator measures.

The extent of the productivity challenge facing the NSW DNSPs can be seen in the table below. Table 3 sets out the annual costs for opex and depreciation as well as the total RAB averaged across the 2012-16 period. The last column in the table includes the asset cost which is the sum of annual depreciation and the average return on investment in the RAB. The AER states that:

> This measure has the advantage of reflecting the **total costs of assets for which customers are billed on an annual basis,** using the average return on capital over the period. *[emphasis added]*.[29]

While PIAC cannot assess this directly, the high levels of repex across the three DNSPs' proposals, along with non-network investments and capital overheads, suggest that capex productivity will continue to decline over 2019-24 to the detriment of consumers now and in the future. PIAC's consideration of more specific aspects of the capex programs suggest a number of areas where networks can reduce capex while providing regulated services to the required standards.

Recommendation 4

That the AER assess the DNSPs' capex proposals in the context of ensuring improvements in productivity outcomes.

[29] Ibid, 63.

Table 3 – Average annual costs for network inputs for 2012-16 ($m, real 2015/16)

	Opex	RAB	Depreciation	Asset cost
ActewAGL (ACT)	66.91	879	50.29	88.13
Ausgrid (AGD)	595.16	13,164	475.15	1,041.78
AusNet Services (AND)	198.23	3,132	143.90	278.72
CitiPower (CIT)	57.78	1,377	68.90	128.18
Endeavour Energy (END)	274.54	4,745	208.82	413.06
Energex (ENX)	386.53	7,606	297.12	624.51
Ergon Energy (ERG)	363.43	7,367	315.60	632.70
Essential Energy (ESS)	407.76	6,647	290.27	576.39
Jemena (JEN)	75.46	959	60.78	102.07
Powercor (PCR)	193.01	2,556	130.36	240.38
SA Power Networks (SAP)	236.15	3,491	212.17	362.45
TasNetworks (TND)	76.81	1,474	77.72	141.18
United Energy (UED)	130.04	1,880	111.63	192.55

Source: AER, *Annual Benchmarking Report – Electricity distribution network service providers*, November 2017, Table 6, 64.

4.3 Trade-offs between replacement expenditure and DNSP's performance against regulatory targets.

PIAC does not accept that there is necessarily a trade-off between reliability and investment, at least in the way the DNSP's present this issue. In particular:

- The reliability of the NSW distribution networks in general exceeds the standards set by both IPART and the AER, and has largely done so since 2011-12.[30] In the current environment, the prudent capex target is not to maintain the current level of reliability, but to operate within the reliability standards set by the regulators on behalf of consumers in NSW; and

- There is significant redundancy in key areas of the networks reflecting the previous investment to achieve the N-2 and N-1 standards first imposed on the networks in 2005. It was expected that the required investment program would be largely completed by 2014 and

[30] See for instance, AEMC Reliability Panel, *Annual Market Performance Review, final report*, March 2012, 64, cited in AEMC, *Review of Distribution Reliability Outcomes and Standards, Final Report-NSW workstream*, August 2012, 10.

the AER revenue and capex allowances in its 2009 decision were designed to allow the networks to achieve this.[31]

This determinative approach to reliability has imposed significant and unnecessary costs on NSW consumers, costs that will continue to impact the RAB and consumer prices for another 30 to 40 years (or more). The problem is further exacerbated by the decline in both volumes and peak demand relative to a forecast of continued high growth. The result is a steep decline in network utilisation rates as evidenced in the network Regulatory Information Notices (RIN) data.[32]

Given the extensive headroom available to the DNSPs, PIAC contends that they should have used their proposals to investigate trade-offs between price and reliability; proposing less reliability-based capex to ensure that prices could decrease.

In practice, PIAC's concerns with this issue flow through to the assessment of the repex proposals, which are by far the largest single item in each of the networks' capex proposals (ranging from 29% to 54% of total capex). The DNSP's proposals provide descriptions of their risk-based approach to assessing repex and their top-down assessment of this, including use of the AER's repex model. However, closer examination suggests that within this modelling there may be a shift in the assumed operational asset age.

PIAC is not in a position to investigate the issue of asset age-based replacement rates in any detail, although we will make some comment on a DNSP specific basis below. We, therefore, urge the AER to thoroughly investigate this issue to ensure that it is not resulting in excessive replacement capex and that it also takes account of the reduced stress on the networks as a result of the decline in asset utilisation rates.

Recommendation 5

That the AER thoroughly review the capex proposals to assess the extent to which there is an opportunity to reduce capex while maintaining reliability within the regulatory standards.

4.4 Responding to the challenges of network transformation

The proposals also discuss the need to adapt to a new network environment. This includes the challenge of converting the current 'one-way' network to a 'two-way' network as a result of the growth in distributed energy resources (DER). PIAC acknowledges the challenges facing the networks in this area.

The proposals, however, largely lack detail regarding the extent of the issue of two-way flows during the current regulatory period and the potential benefits to the network in terms of deferred capital investment. Nor do the networks appear to incorporate the work by the ENA/CSIRO,

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31 The AEMC reports that the AER approved levels of expenditure for 2009-10 to 2013-14 for each of the NSW DNSPs based on the following levels of targeted compliance with the standards (as required at the time). Ausgrid proposed works to achieve a 95% probability of compliance; Endeavour Energy proposed to target 100% probability of compliance and Essential Energy proposed targeting 80% probability of compliance in any year. See: AEMC, *Review of Distribution Reliability Outcomes and Standards, Final Report-NSW workstream*, 9.

32 The Economic Benchmarking RIN data indicate that all networks saw reductions in utilisation. The most recent RIN data (2016-17) indicates all three NSW have an asset utilisation rate remaining below 50% with Essential in particular at 30%.

AEMO, AEMC and others into how the networks and the market generally can adapt to the changing world.[33]

In particular, where a proposal includes high levels of replacement and/or augmentation capex and IT, it is essential to consider whether the proposed investments in new assets incorporate optionality to facilitate future growth in the DER market and curb network demand growth. In the alternative, excess capex and RAB growth 'crowds out' opportunities for prudent non-network investment.

However, the network proposals do not appear to consistently include plans for promoting DER as a first option in areas of constraint on the existing network or in green acre developments. Both Ausgrid and Endeavour Energy forecast substantial growth in demand and customer numbers above trend, but do not appear to seize this unique opportunity for cost-effective DER in collaboration with third parties (such as developers).

Recommendation 6

That the AER ensure NSW DNSPs adequately consider non-network and DER options rather than rely on expensive capex solutions.

Nor is it apparent that the networks have considered the longer-term forecasts for DER and the impact of this on peak demand. Every proposal for replacement or expansion capex must consider these trends as it is consumers who (again) will bear the risk of overinvestment in capex. The options to adopt shorter term opex based solutions (higher maintenance regimes, demand management programs etc) must be given full consideration in the current climate.

In the 2017 Distribution Market Model final report, the AEMC concluded that "There is expected to be a large future demand for distributed energy resource technologies, such as solar PV, energy storage and electric vehicles", which is likely to reduce network peak demand.[34] Figure 3 shows Bloomberg New Energy Finance's (BNEF) forecast of the capacity of 'behind the meter' activities by consumers such as demand response, small-scale solar PV and batteries relative to business as usual trends out to 2040. Most of the proposed new replacement and augmentation capex could be expected to have an asset life of 40-50 years, well beyond the BNEF forecast horizon.

PIAC, therefore, is concerned that the replacement and augmentation plans of the networks do not reflect the inherent risk of investment in new capacity. It is essential that the networks are required to explicitly include in their proposals how they have considered this issue and built it into their capex, opex and DER plans. Alternatively, the Rules should be modified so that the risk of over forecasting demand and overbuilding does not rest solely with consumers but is shared with network owners.

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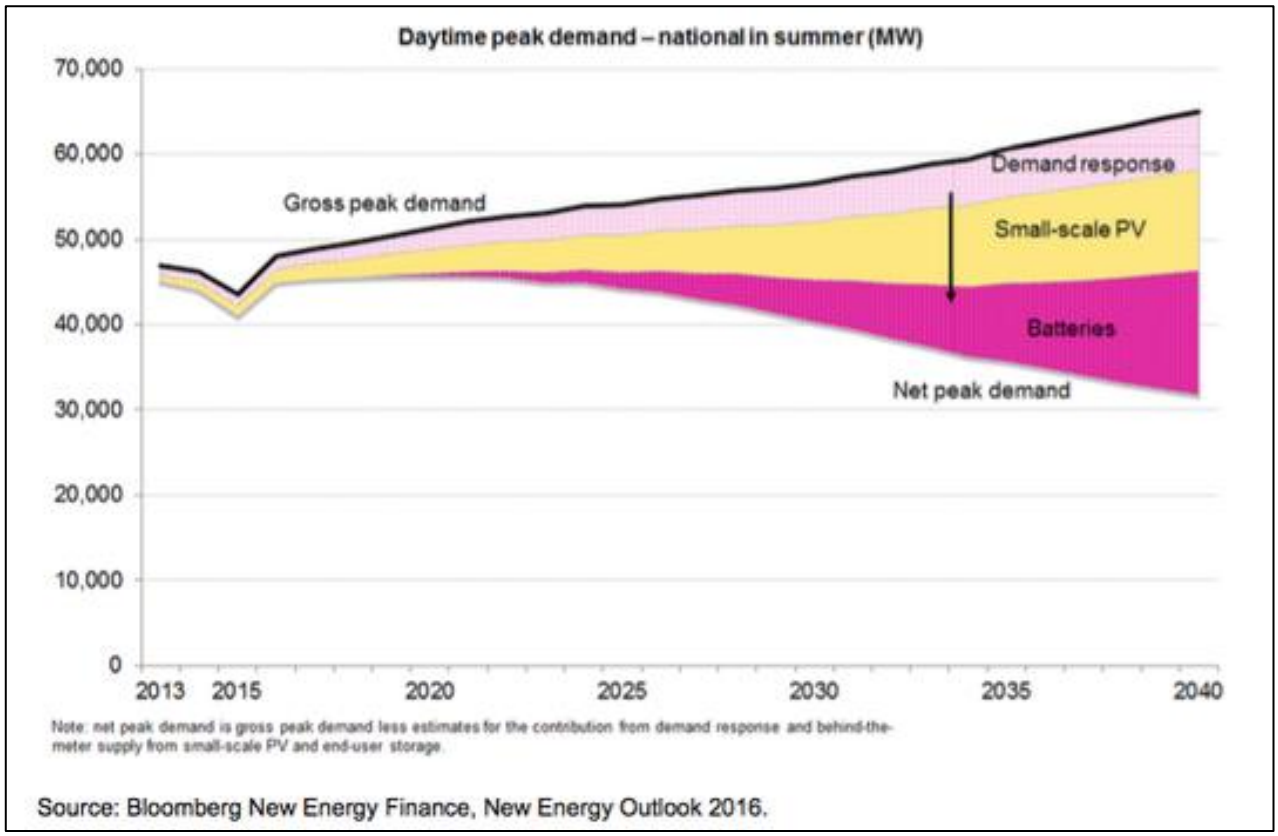
33 See, for example: AEMO and Energy Networks Australia, Open Energy Networks – Consultation Paper, June 2018; AEMC, Economic regulatory framework review 2018 – Final report, 26 July 2018; AEMC, Distribution Market Model – Final report, August 2017.

34 AEMC, Distribution Market Model – Final report, 26.

Figure 3 – 'Behind the meter' capacity relative to national aggregate peak demand, 2013 to 2040 (MW)



Source: AEMC, *Electricity network economic regulatory framework review 2018 – Final Report*, July 2018, Figure 2.1, 11.

Recommendation 7

That the AER assess the DNSPs' proposals in the context of the future DER market.

4.5 Demand growth forecasts

The section above provided PIAC's views on whether the DNSPs have adequately allowed for DER in their forecasts of capex requirements for 2019-24. The discussion below focuses on other aspects of the DNSPs forecasting approach.

Both Ausgrid and Endeavour Energy are forecasting significant long-term growth in peak demand in the order of 1.5% per annum or more over the regulatory period to 2024. As can be seen from Figure 3 above, this growth forecast by the two DNSPs' is contrary to the forecast from BNEF which shows flat or declining net peak demand.

Endeavour Energy's forecast peak demand growth appears to be largely based on expectations for above-trend growth in new development areas and growth in urban centres such as the Parramatta region. Ausgrid states that its above-trend growth in peak demand represents a mixture of growth in consumer numbers due to urban in-fill and large development projects in the city area.

In both instances, this growth is above the growth in the current regulatory period and higher than AEMO's most recent forecast of growth in the Sydney LGA of around 0.9% pa. Equally as important are the characteristics of this growth. For example, the forecasts by '.id' include 11% in housing from 2016 to 2021 in the City of Sydney.[35] However, this does not mean that electricity demand will grow at the same rate: The .id also states that:

- …the majority of new dwellings that are expected to be built over the 2011-2031 period are apartments many of which are relatively small (one or two bedroom);
- The apartment market has been dominated by young singles, couples and students;
- it is common to have a wider variety of vacancy rates across the City of Sydney. Areas with a large supply of dwellings are more likely to have a high vacancy rate…; and
- There is significant potential volatility in the housing market of the City of Sydney over the next fifteen years….[36]

Moreover, these apartment developments are usually replacing existing housing stock or light industrial and commercial sites with greater energy intensity than a typical apartment.

Other bodies have observed a gradual decline in average consumption per residential meter in the City of Sydney. PIAC also notes the comments by the Consumer Challenge Panel regarding the forecasts developed by Ausgrid for TransGrid as input into the Powering Sydney Future Program.[37]

PIAC highlights the AEMO forecasts and the BIS Shrapnel forecasts that were prepared specifically for TransGrid. The forecasts noted that the long-term demand forecast growth was 0.9% pa compared to the long-term demand growth forecast by Ausgrid for the City region of 1.5% pa. These higher forecasts were one of the factors that resulted in an initial proposal by TransGrid to spend over $350m in additional capex in 2016-21 periods to augment the City network.

Even more significant however, is the apparent assumption by the NSW DNSPs that DER will have little impact on forecasts of consumption and demand growth. They appear to assume, for instance, that new large developments will not have any back-up generation or DER, and therefore are fully exposed to any temporary loss of supply – the only solution to which is to extensively replace/rebuild the network. In addition, the forecasts do not appear to consider local government areas plans for energy efficiency and greenhouse gas emission reductions. The City of Sydney, for example, states that it has a target of 70% reduction over 2006 GHG emissions by 2030.[38]

PIAC considers that the AER should carefully examine the demand forecasts by both Ausgrid and Endeavour and the way in which these forecasts are used to determine its capex proposal.

35 .id, *City of Sydney, Drivers of population change*, October 2017.
36 .id, *City of Sydney, Population, households and dwellings*, October 2017.
37 See: Consumer Challenge Panel Subpanel 9, *Submission on TransGrid's revised revenue proposal*, February 2018, 21.
38 See: City of Sydney: *State of the Environment*, June 2016, p 10.

Recommendation 8

That the AER assess the reasonableness of the DNSPs' energy and demand forecasts with respect to the assumptions of growth rates and the impact of DER.

4.6 Information and Communication Technology (ICT)

The NSW DNSPs' capex proposals demonstrate a wide range of proposed investment in non-network projects, ranging from around 8% of total capex for Endeavour to 24% of total capex for Essential. This raises questions about the underlying drivers of this non-network capex investment and whether this expenditure is efficient and prudent in the current environment where affordability is the top priority of consumers.

A particular concern for PIAC is the approach to investment in Information and Communication Technology (ICT). Relative to other investments, ICT poses a particular challenge to affordability because of its relatively short asset life. ICT is generally depreciated over 5 years or less. For instance, a $200m investment in ICT, will result (simplistically) in a $50m depreciation cost each year. The value of an ICT project must therefore be particularly carefully scrutinised in the context of a priority on affordability.

PIAC understands the importance of improving the security of the networks ICT systems against cyber attack and we support in principle the networks' proposals for greater capex investment in this area – subject to assessment of the efficiency and prudency of the proposals. However, this is not a blank cheque.

Over a number of regulatory periods, there has been very large expenditures on ICT by some networks, much of which has been justified on the basis of reducing costs and/or improving services to customers. However, what is currently missing is the link between the investment made and the consumer outcomes being delivered.

In an efficient business operating in a competitive environment where capital is scarce and must be prioritised, there would be a business plan that states clearly that investment 'x' will result in savings 'y' over the lifetime of the investment. Or will deliver improvement in customer service of 'z'. There would also be an ex-post review of this expenditure.

With the possible exception of Essential Energy, PIAC does not see these clear and measurable ex-ante benefits, nor do we see ex-post reviews – what did customers save (in opex or capex) as a result of the capex they have funded (and continue to fund over the life of the asset).

Given the current focus on affordability and prudent management of the RAB, the AER should require that this information is made available to consumers in the proposal.

Recommendation 9

That the AER require the DNSPs clearly define measurable benefits to consumers arising from their proposed ICT investment.

4.7 Capital Overheads

PIAC is also concerned about the level of capital overheads in the DNSPs' proposals. These overheads range from 19% to 28% of the total capital expenditure. The overhead costs fall into two broad categories:

- Direct costs that directly relate to the delivery of the capital program, including network planning
- Indirect costs such as divisional management, business support functions, logistics, procurement and IT (not non-network ICT costs).

Direct overhead costs should decline in conjunction with the lower capital programs, particularly augex. Indirect overhead costs are particularly subject to issues such as cost allocation and the efficiency of management and support functions.

The networks report that capital support costs are allocated to the various capital projects and programs based on direct labour, and depreciated according to the regulatory depreciation rates for the various RAB asset categories.

Given the total capex allocated to overheads and the inclusion of these costs in the RAB and in depreciation costs, PIAC is of the view that this category warrants further review and benchmarking of the NSW DNSPs by the AER. For example, to the extent that capital overheads are allocated to ICT, the overhead costs will be depreciated considerably faster than overhead costs allocated to repex and augex.

This is an issue not only about the quantum of the amounts, but also an issue about allocation between the regulated standard control services, alternative control services and the increasing involvement of the businesses in unregulated activities. For example, PIAC would expect overheads for regulated standard control network services to decline given that metering is now classified as an alternative control service, and connection services may be provided by third parties.

Moreover, for capex overheads allocated to ICT, PIAC would expect to see significant reductions in overhead costs as the networks move to deliver ICT via cloud services and the level of direct labour costs in ICT projects declines.

Similarly, as the businesses increase the level of contracting to third parties for all their operational activities, the direct staffing levels and internal direct overhead costs should also reduce.

At this stage, we do not see a transparent connection between the proposed capital overhead costs and the business strategies in the DNSPs' proposals.

Recommendation 10

That the AER review the overhead component of the DNSPs' proposals to assess the efficiency of the proposed capex, the allocation principles and the link to other aspects of the business strategy.

5. Forecasts of operating expenditure (opex)

5.1 Opex and affordability

As with capex, PIAC's over-riding concern in assessing the NSW DNSPs opex forecasts is its impact on affordability. While opex does not have the long-lasting effect on RAB that capex does, it remains a large component of the revenue funded by consumers in the current period, during an affordability crisis.

Therefore, PIAC is looking for clear evidence that significant efforts have been made to reduce opex in the proposals. PIAC welcomes the reductions in opex by NSW DNSPs in the 2014-19 RCP, and that they propose to maintain these cost savings by adopting their forecast 2017/18 opex as the basis for their 2019-24 forecast. We support this proposal. However, PIAC notes that these reductions were necessary in order for the DNSPs to reach the AER-determined efficient levels of opex. In the spirit of continuous improvement and the focus on affordability, we expect DNSPs to make further reductions in 2019-24.

Pleasingly, all three DNSPs have proposed reductions in opex compared with their projected 2014-19 spend.[39] PIAC welcomes these proposals. However, we contend that more could be done to address affordability through opex. The AER should seek further opex reductions in the draft determinations.

5.2 Forecasting productivity and output growth

PIAC notes that CCP10 questioned the AER's approach for forecasting output growth and productivity trends in their submission to Evoenergy's regulatory proposal. Specifically:

- Why the AER's analysis of the relationship between costs and customer numbers is significantly different to the New Zealand Commerce Commission;[40] and
- That it is not in the long-term interests of consumers to continue to assume zero productivity growth.[41]

PIAC agrees with CCP10 that these are issues the AER should investigate and contends that they also apply to the NSW DNSPs.

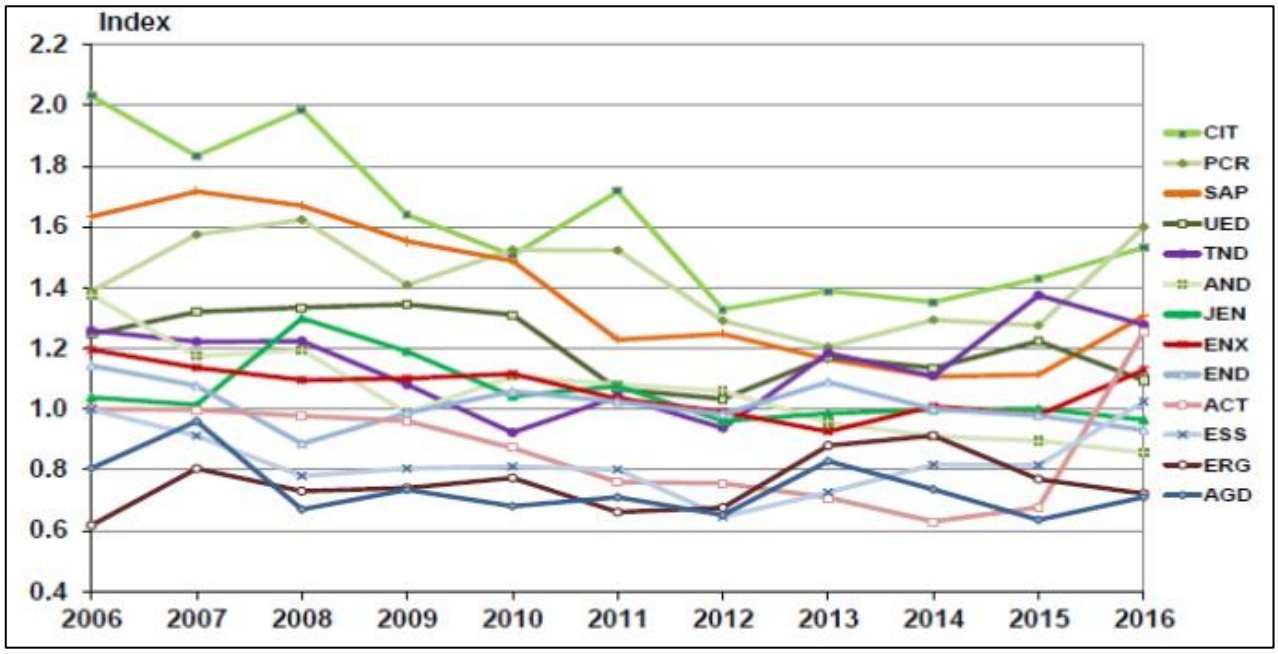
PIAC is particularly concerned about the zero productivity assumption included in both recent AER determinations and the NSW proposals. One of the central purposes of the network regulation framework is to replicate the pressures of a competitive market on NSPs. In a competitive market, businesses plan for continuous productivity improvement. By contrast, we have been asked accept the assumption that the NSW DNSPs will achieve zero opex productivity improvements over the 2019-24 RCP.

Further, two of the three DNSPs have actually achieved opex productivity improvements in recent years. Figure 4, taken from the AER's 2017 benchmarking report, plots the opex productivity for all DNSPs in the NEM. This shows that Ausgrid and Essential Energy achieved improvements in

39 AER, NSW electricity distribution determinations, Issues Paper, 27; 39; 49.
40 CCP10, *CCP10 Response to Evoenergy regulatory Proposal 2019-24 and AER Issues Paper*, May 2018, 10.
41 Ibid, 15.

opex productivity of 12% and 26% respectively in 2015/16. While PIAC acknowledges that this improvement was in response to the AER's final 2015 determination, we do not accept that the DNSPs productivity growth should stop now they have reached more efficient opex levels.

Figure 4 – Opex multilateral partial factor productivity, 2006-2016, by DNSP (Index)



Source: AER, *Annual Benchmarking Report – Electricity distribution network service providers*, November 2017, Figure 17, 36.

Recommendation 11

That the AER investigate why its output growth analysis differs from the NZ Commerce Commission's.

Recommendation 12

That the AER require the NSW DNSPs to include annual productivity improvements as part of their revised proposals.

5.3 Opex overheads

PIAC remains concerned about the level of opex overheads in the DNSPs' proposals. According to CCP10 analysis, these overheads range from 35% to 56% of total opex for standard control services depending on the year and the DNSP. [42] Over the 2019-24 RCP, Essential Energy is proposing to marginally reduce its overheads proportion from 38% to 35%. Ausgrid and Endeavour Energy are proposing to keep their opex overhead ratio constant, at 44% and 56% respectively.

PIAC is concerned that:

- This is a very large proportion of total opex; and
- There is either no or very little ongoing efficiency improvements built into the proposals.

[42] CCP10, *NSW Regulatory Proposals 2019-24 – CCP10 Initial Response*, slide 17.

Given the consumer requirement for increased affordability in these proposals, PIAC contends that this requires further investigation by the AER.

Recommendation 13

That the AER review the overhead component of the DNSPs opex proposals to assess the efficiency of the proposed opex, the allocation principles and the link to other aspects of the business strategy.

5.4 Expected opex benefits of capex

As noted in section 4, PIAC expects the DNSPs to achieve opex savings as a result of some proposed capex. In particular, we expect this from non-system capex, like ICT investment, where the new assets should allow the business to be operated more efficiently.

Generally, these expected opex savings have not been well articulated through the proposals, making it difficult for consumers to assess whether both capex and opex programs are efficient. PIAC contends that this information should be included in revised proposals.

Recommendation 14

That the AER require the NSW DNSPs to provide explicit information on capex/opex trade-offs associated with new investment in the revised proposals.

5.5 Ausgrid's step changes

PIAC does not support Ausgrid's proposed tariff research step change. Ausgrid contends that the AEMC's 2014 distribution network pricing rule change requires them to spend $3m of opex to fund a tariff research program.

PIAC does not agree that the research program is required by the Rules. Instead, we consider the Rules to require a rapid transition to cost reflective network tariffs. As noted in section 6.1.2, the time has passed for trials and DNSPs should transition to demand tariffs in the 2019-24 RCP.

If Ausgrid feels it needs to conduct trials, it should be able to do so. But it should not require a $3m step change to fund it. It should be funded out of existing opex.

Recommendation 15

That he AER not approve Ausgrid's proposed tariff research step change.

PIAC is, however, minded to support Ausgrid's demand management step change. We note the analysis that this will produce long-term capex savings and consider this to be a positive affordability measure.[43] In general, PIAC supports DNSPs using opex to defer or avoid capex. In doing so, DNSPs may increase opex costs but, by limiting RAB growth, create a saving for consumers in the long term.

Provided that this trade-off is deemed efficient by the AER, we support it.

[43] Ibid, 136.

Recommendation 16

The AER should approve Ausgrid's demand management step change, provided that it is deemed to be an efficient trade-off between capex and opex.

6. TSS

In this section, PIAC addresses the NSW DNSPs' TSS proposals at a principles level, before addressing issues that apply across the business and, finally, turning to DNSP-specific responses.

Because PIAC represents the interests of residential consumers of electricity, gas and water in NSW, our assessment of tariff reform and DNSP TSSs is limited to residential, low voltage tariff classes.

6.1 Tariff reform principles

PIAC was involved in drafting, and supports, the CCP-prepared paper: *Pricing Directions: A Stakeholder Perspective*.[44] That document is attached to this submission and explores the key issues for tariff reform in more depth.

The recommendations in *Pricing Directions* are consistent with the recommendations in ACCC report.[45] In particular, ACCC's recommendation 14 supports a more rapid transition to cost reflective network tariffs (CRNT), albeit through greater emphasis on mandatory tariff assignment supported through strengthened consumer protections. The ACCC also:

- Does not favour increasing fixed charges (see page 177);
- Provides a similar rationale for supporting CRNT (see page 179): i.e. CRNT could both help reduce overall peak usage and costs, but also more fairly distribute costs between customers;
- Agrees that retailers are best placed to manage the price risk of more dynamic network charges (see page 181);
- Argues that mandatory of cost reflective tariffs to retailers would force retailers to manage the network price risk (see page 182);
- Supports targeted transition assistance (see page 185); and
- Supports the us of DM strategies to manage locational constraints (see page 183).

Below is a summary of some key principles that underpin PIAC's views of the TSS proposals.

PIAC supports a rapid transition to CRNT as a means of promoting the long-term interests of consumers. In PIAC's view, CRNTs allow retailers to respond to price signals about efficient network costs by helping consumers efficiently manage their electricity use, generation and storage. In doing so, they are likely to reduce the need for future network augmentation expenditure and, therefore, consumer bills.

Even in the absence of a response to price signals, CRNTs still have the benefit of equitably allocating costs between consumers on a more 'causer pays' basis.

To allow retailers to adjust to CRNTs, PIAC contends that the transition should involve incremental increases in the cost reflective component of a tariff. For example, a DNSP with a demand tariff that charges based on peak kilowatt (kW) usage within a specified time period

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44 CCP10, with PIAC, ECA, TEC and NCOSS, *Pricing Directions: A Stakeholder Perspective*; see Attachment E.

45 ACCC, *Restoring electricity affordability and Australia's competitive advantage*, xix.

could initially set the demand component to account for only a small proportion of the total network charge to a connection. Over a TSS period, this proportion should be incrementally increased so that more of the network cost is recovered through the demand charge, and commensurately less through volumetric and fixed charges.

6.1.1 Retailers and CRNTs

PIAC considers that retailers should be the primary targets for CRNTs, rather than consumers themselves. Except for some very large customers, the tariffs consumers see are those charged by the retailer, which cover wholesale, network and retail costs. Therefore, it is retailers who will respond to CRNTs in the first instance.

PIAC recently addressed this issue in a submission:

> Based on discussions with retailers over a number of years in relation to network tariff price setting across the country, PIAC considers it likely that many retailers will not offer (or impose) cost reflective tariffs to (or on) their wider consumer base when peak kilowatt demand tariffs are first introduced. Further, they are unlikely to do so until the underlying kilowatt demand (or other peak) charge exceeds a material portion of their overall network charges across the whole consumer base, such that the cost risk in smearing it across the customer base is higher than the perceived cost of customer attrition from customers seeking a better deal in the event of facing cost reflective pricing structures.
>
> Even then, a retailer may choose to continue offering consumers a flat tariff and address their peak demand by providing a peak time rebate or energy efficiency improvements. In doing so, the retailer would be responding to the network price signal as intended without passing the cost reflective network tariff through to consumers, and the retailer would have an incentive to help the customer use less energy during peak time – to the benefit of all consumers.[46]

Given that they are already required to do so in the wholesale market, retailers are well placed to manage the risk associated with time varying prices. This will allow them to manage network price risk through innovative methods that may include peak time rebates, load control or cost reflective retail tariffs.

The ACCC recognised the link between mandatory tariff assignment and a focus on the role of retailers in pursuing tariff innovation in a way that reflects customers' concerns and impacts in Recommendation 14 of its report. Mandatory assignment ensures retailers see the CRNT and have an incentive to work with customers and offer innovative retail price options that better reflect consumers' concerns and preferences. ACCC also recommended targeted protection of those who may not be able to shift their load as easily. CCP21, ECA, and stakeholders, such as PIAC, can provide support for a better integration of network tariffs and retail tariffs and the development of hardship programs.

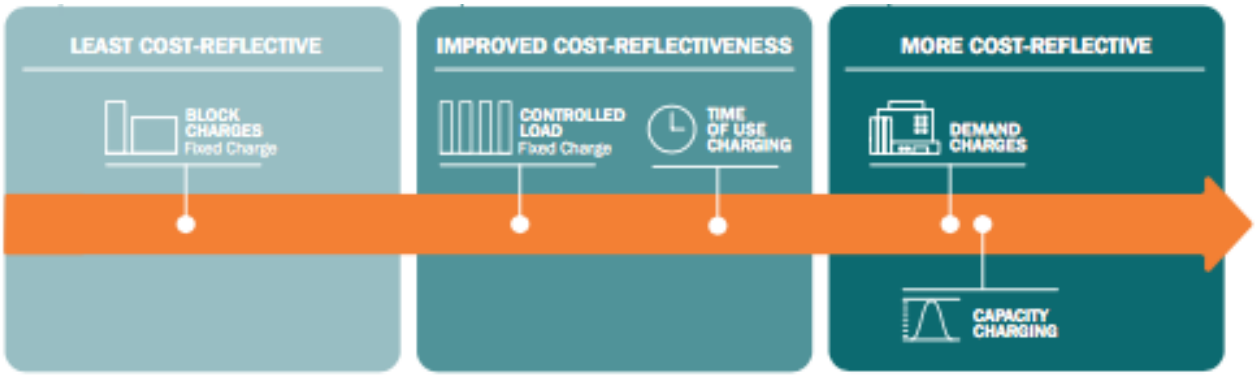
[46] PIAC, *Affordable and efficient, or overpriced and underwhelming 2.0?: Options for the future energy market*, November 2017, 18.

6.1.2 The spectrum of cost reflectivity

In 2014, the AEMC made a new rule requiring DNSPs to set prices that reflect the efficient cost of providing network services to individual consumers.[47] Following that process, the Rules are clear: DNSPs are required to transition to tariff structures that reflect long run marginal cost (LRMC).

However, the Rules are not prescriptive about what tariff structures DNSPs should adopt. In PIAC's view, tariff structures can be considered on a cost reflectivity spectrum, ranging from declining block tariffs (least cost reflective) to critical peak prices (most cost reflective). Figure 4, from Essential Energy's TSS proposal, accurately characterises the relative cost reflectivity of different tariff structures.

Figure 4 – Tariff structures, by cost-reflectivity



Source: Essential Energy, *Tariff Structure Statement*, April 2018, 7.

To date, the NSW DNSPs have moved, with varying speeds, to the 'improved cost reflectiveness' section of the Essential Energy diagram, using a range of time of use (ToU) energy tariffs. However, this is not sufficient to satisfy the cost reflectivity requirement in the pricing principles.

While ToU tariffs are more reflective of costs than a flat energy tariffs, they do not effectively target either a consumer's or the system's peak demand. Instead, they target daily maximum demand. By merely charging a higher c/kWh rate for energy during DNSP-identified peak windows, they do not effectively target that which drives future network investment: kW demand during network peaks.

The most desirable CRNTs very accurately target this demand. These include critical peak prices, where demand is priced very sharply during very specific peak events (normally two or three per year), or peak time rebates, which use the opposite mechanism and provide rebates for demand response during those events.[48]

However, DNSPs across the NEM are reluctant to move directly to these tariff structures, instead preferring a gradual transition using demand tariffs.[49] These tariff structures are a halfway house between ToU and critical peak pricing, calculating a demand charge based on a consumers' kW

47 AEMC, National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014, November 2014.

48 PIAC, *On the road to cost reflective pricing*, October 2016, 7-8.

49 Demand tariffs retrospectively charge based on peak kW demand, while capacity tariffs involve the prospective nomination of a fixed level of peak kW demand.

demand during peak windows. PIAC is willing to accept these tariffs as means of transition to more targeted CRNTs in future TSSs.

Therefore, PIAC contends that the goal of this round of tariff reform should be to ensure that DNSPs across the NEM move into the 'more cost reflective' segment and implement demand tariffs.

6.1.3 Speed of tariff reform

The NSW DNSPs have been slow to react to 2014 rule change, with only marginal progress made towards cost reflectivity in the first round of reform. In their approved 2017-19 TSSs, the DNSPs all adopted ToU energy tariffs as a 'cost reflective' tariff option.[50] As noted above, PIAC does not consider this tariff structure to be adequately cost reflective.

In general, DNSPs often argue that they are unable to progress more quickly with tariff reform because they do not have the required information about how consumers will respond. At various points, all have stated that they would like to conduct more tariff trials before they implement CRNTs across their networks. In pre-lodgement TSS engagement, all NSW DNSPs have made this point with varying degrees of conviction. Ausgrid, in particular, maintains this position and remains unwilling to assign any consumers to CRNTs beyond its existing ToU energy tariffs until they have completed further tariff research.[51]

PIAC does not accept the need for more small trials of CRNTs before they can be implemented. Given that retailers are the primary entity exposed to CRNTs, PIAC contends that it is appropriate, and indeed perhaps preferable, to allow retailers to work with consumers on how to respond to these price signals. Retailers are large, sophisticated businesses, and PIAC considers it unlikely that they will be unable to manage CRNTs if implemented on a non-trial basis.

Recommendation 17

That the AER should ensure that DNSPs are rapidly transitioning to CRNTs in line with the Rules, and not using extended trials as a means of delaying reform.

6.2 Cross-cutting tariff issues

6.2.1 Fixed charge increases

During pre-lodgement TSS engagement, all three NSW DNSPs proposed increasing the proportion of their costs recovered through the fixed component of their DUOS charges.[52] PIAC does not support such proposals.

An increase in fixed charges will undermine the ability of consumers to reduce their bills by lowering energy use. It is well established that consumers value the ability to influence how much they are charged through reducing consumption. This preference was repeatedly raised in the DNSPs' customer forums.

50 AER, NSW distributors – Tariff Structure Statements – Final Decision, February 2017, 54-55.
51 Ausgrid, *10.01 Tariff structure statement*, April 2018.
52 Fixed charges are charges that do not vary with past or current demand or consumption.

In addition, the inability of consumers to control their bill through usage patterns has a disproportionate impact on low income and vulnerable consumers. Recently, the NSW Council of Social Service found that these consumers rely on their ability to control their energy costs through usage decisions to ensure they can afford to pay energy bills.[53] While an inability to control bills through usage patterns has the potential to impact all consumers, it is disproportionately harmful to consumers for whom that control can be the difference between paying their bills or disconnection.

The DNSPs have used three arguments to justify higher fixed charges:

- That the non-distortionary pricing principle means they have to recover fixed costs through fixed charges;
- That increasing fixed charges is the first step towards capacity tariffs, where fixed level of demand is nominated and charged for – similar to a mobile phone or internet plan; and
- That higher fixed charges are more equitable because they allow for greater recovery of costs from DER customers who avoid variable energy charges through consumption of their own distributed generation.

PIAC does not accept these justifications. The first has been used, at various times, by all three DNSPs. However, it is based on a selective reading of the Rules. While the pricing principles do require DNSPs minimise distortions,[54] the consumer impact principle also needs to be considered. In particular, the requirement for DNSPs to have regard to:

> the extent to which *retail customers* are able to mitigate the impact of changes in tariffs through their usage decisions.[55]

As noted above, high fixed charges reduce the ability of consumers to mitigate the impact of changes in tariffs through usage decisions. Given that increased fixed charges reduce the ability of consumers to mitigate the impact of changing tariffs through usage decisions, they clearly fail the consumer impact principle. This interpretation is consistent with the AEMC's final determination on the 2014 rule change, which stated that analysis from both the Brattle Group and NERA "demonstrate that this principle does not require that residual costs are recovered through increases to fixed charges".[56]

The second argument has been prosecuted extensively by Ausgrid and underpins its 'Price Rebalancing' strategy.[57] As PIAC supports Ausgrid moving to cost reflective network tariffs, we are pleased that Ausgrid is considering capacity tariffs. That would be a considerable improvement over Ausgrid's current ToU energy charges. However, it does not follow that Ausgrid should increase fixed charges as a means of transition.

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53 NCOSS, *Turning off the Lights: The Cost of Living in NSW*, June 2017, 19.
54 NER, 6.18.5(g)(3)
55 NER, 6.18.5(h)(3)
56 AEMC, National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014 – Final Determination, November 2014, 160.
57 Ausgrid, *Ausgrid's Regulatory Proposal*, 189; Ausgrid, *10.01 Tariff structure statement*, 10.

Essentially, Ausgrid's argument is that high fixed charges will prepare consumers for bills that are relatively unresponsive to changes in *kWh energy use*.[58] Given that capacity charges are very responsive to changes in *kW energy demand*, PIAC does not consider this to be a good justification. A less responsive tariff will do nothing to prepare consumers to respond to a kW-based capacity tariff.

The final argument has been made by both Ausgrid and Essential Energy. PIAC agrees that current DNSP tariff structures result in a small cross subsidy in favour of DER consumers, where they avoid paying network costs by avoiding variable energy charges. However, we disagree that increasing fixed charges is the appropriate response. Instead, DNSPs should rapidly transition to CRNTs. A well-designed demand tariff would ensure that DER and non-DER consumers pay equally for their contribution to peak demand, and therefore future network costs.

Recommendation 18

That the AER not approve TSS proposals that unnecessarily increase fixed charges.

6.2.2 CRNT assignment

PIAC contends that DNSPs should implement default assignment of CRNTs for new customers and those upgrading their connections. Opt-in cost reflective prices are a barrier to widespread take-up of these tariffs. The ACCC recently explored this issue in the final report for its Retail Electricity Pricing Inquiry:

> …the move to cost reflective tariffs is likely to remain too slow. Stakeholders have questioned whether retailers have sufficient incentives to pass through or otherwise react to cost reactive network pricing in retail offers, particularly when offered on an opt-in basis. Retailers have an incentive to maintain simpler network tariffs, allowing them to maintain simple retail offerings without facing network price risk. Retailers also face other disincentives to move to cost reflective network tariffs, including the costs associated with supporting customers on these tariffs with better energy management tools and billing systems. Equally, cost reflective tariffs may incentivise customers to use less than under current structures, reducing the overall energy volume being sold by retailers. Because of this, opt-in arrangements for cost reflective network tariffs are unlikely to encourage sufficient uptake to enable successful tariff reform.[59]

To address this issue, the ACCC recommended that DNSPs introduce mandatory assignment to cost reflective network tariffs.[60] PIAC supports this recommendation.

However, Endeavour Energy and Essential Energy expressed a strong preference against mandatory assignment to cost reflective tariffs in pre-lodgement engagement. Instead, they proposed default, opt-out assignment for new customers with appropriate metering. While PIAC's preference is for mandatory assignment, we stated that we would accept this option as a compromise. By making cost reflective tariffs the default pricing structure, a barrier presented by consumer (or retailer) inertia would be removed.

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58 Ausgrid, *Tariff structure statement*, 42.
59 ACCC, *Restoring electricity affordability and Australia's competitive advantage*, 181.
60 Ibid, 187.

Since PIAC indicated its acceptance that the CRNT can be offered an opt-out basis, the ACCC has supported mandatory tariff assignment. While we are still willing to accept opt-out assignment in this TSS, we continue to support mandatory assignment where networks wish to move more quickly to CRNTs and:

- Retailers are the primary target for the mandatory tariffs;
- There is a strong expectation that retailers will work closely with consumers to provide innovative tariff solutions; and
- There are adequate protections in place for vulnerable customers.

Recommendation 19

That the AER approve default assignment to CRNTs by the NSW DNSPs, or mandatory where proposed.

6.2.3 TSS consistency

In the issues paper, the AER asked whether stakeholders support the view that tariff structures and assignment policies should be consistent across all NSW DNSPs.[61]

PIAC contends that jurisdictional TSS consistency is generally desirable. This would be simpler for both consumers and retailers. However, consistency should not come at the expense of tariff quality. That is: it is only desirable for tariffs to be consistent as long as they are consistent with best-practice tariff design. Lowest common denominator tariff design should not be an option.

Currently, the NSW DNSPs have not proposed consistent tariffs. Endeavour Energy has proposed the best-designed tariffs. Therefore, PIAC supports Ausgrid and Essential Energy proposing tariffs consistent with Endeavour Energy in their revised proposals, rather than Endeavour Energy reducing the quality of their TSS to be consistent with the other DNSPs.

Recommendation 20

That the AER ensure that any requirement for tariff consistency does not result in 'lowest common denominator' tariff structures.

6.2.4 Tariff flexibility and mid-TSS reviews

In the issues paper, the AER identified the trade-off between flexibility and certainty in tariffs over the five year TSS period.[62] PIAC advocates the use of mid-period TSS reviews as a means increasing flexibility in the tariff reform process.

This issue was explored in the *Pricing Directions* paper:

> Circumstances can change significantly, quickly, and in directions not anticipated. For example, in the lead-up to the review of the pricing principles by the AEMC, peak demand had been rising quickly putting pressure on existing networks and investment requirements. By the end of the AEMC review the problem was one of stagnant or declining demand and the implications of this for the fixed component of network bills. This is a practical example of

61 AER, NSW electricity distribution determinations, Issues Paper, 63-64.
62 Ibid, 64-65.

changes occurring in a short term that can lead to significant differences in pricing strategies. It is expected that the pace of change in the technology for supply and use of energy to provide the services consumers need will accelerate. Our knowledge of how we can best provide the right signals to consumers is also expanding and changing. It is increasingly understood that it is not all about the price, but understanding what signal (price and non-price or informational) and how consumers respond to different signals. This is leading to innovations in customer-facing signals in various fields that are moving beyond traditional pricing models. While NSPs may innovate in pricing the responses of customers and retailers and other intermediaries may be uncertain. Hence, there may be a need to adapt strategies to their responses.

The key implications are that:

- the 'end-point' for pricing should not be seen as fixed. It is important to have a vision of where prices are headed, but this end-point cannot be fixed. It will need to adapt to changing circumstances, new information, and responses of others;
- mid-point reviews of the TSS are desirable to build in adaptability in pricing strategies;
- changing end-points may well mean that prices are in 'constant transition'."[63]

Ausgrid and Essential Energy have agreed to build mid-period TSS reviews into their proposals, albeit through different mechanisms.

Ausgrid contends that the Rules are "not well-suited to amending a TSS mid-period" and have instead proposed a demand tariff that would initially have no customers assigned to it.[64] This will allow them to adjust its pricing strategy mid-period and begin assigning customers to that tariff once Ausgrid has a clearer "vision of where prices are headed".

Given our preference for demand tariffs, PIAC does not support Ausgrid's decision to not assign customers to these tariffs from 1 July 2019. Further, we disagree that the Rules prevent a mid-period pricing review. The Rules state that a DNSP may request to amend an approved TSS if there is an event that "could not reasonably have been foreseen by the DNSP at the time its TSS was approved",[65] a low bar given the uncertainty outlined in *Pricing Directions*.

However, we are willing to accept the use of Ausgrid's proposed mechanism in theory. If Ausgrid were to assign customers to a demand tariff from the start of the period, we would accept the proposal of a variety of other unassigned tariffs as a means of managing uncertainty.

Essential Energy accepted PIAC's suggestion of a mid-period review and has proposed this be undertaken two years after the commencement of the 2019-24 period.[66] PIAC supports this proposal.

Recommendation 21

That the AER approve the mid-period reviews built into the NSW DNSPs' TSS proposals.

63 CCP10 et al, *Pricing Directions*, 1-2.
64 Ausgrid, *Tariff structure statement*, 45.
65 NER, 6.18.1(b)
66 Essential Energy, *Tariff Structure Statement*, April 2018, 16.

6.3 DNSP-specific tariff issues

6.3.1 Ausgrid's TSS proposal

PIAC does not support Ausgrid's TSS proposal. While we support the inclusion of a mid-period review mechanism and Ausgrid's safeguard tariff, we oppose the lack of demand tariff assignment and the proposed fixed charge increase.

PIAC notes Ausgrid's commitment to its Pricing Working Group and will continue to work with this group to resolve these issues.

Ausgrid have proposed the following tariffs:

- A mandatory inclining block tariff (IBT) for consumers with historical consumption <2MWh per annum and consumers with basic metering;
- A mandatory ToU energy tariff for consumers with historical consumption 2MWh-15 MWh and CRNT-enabled metering; and
- A demand tariff with no consumers assigned to it.[67]

6.3.1.1 Demand tariff – or lack thereof

PIAC does not support Ausgrid's proposal to assign no customers to its residential demand tariff. In justifying this proposal, Ausgrid's states:

> …we propose to include in our TSS a residential demand price structure that will initially have no customers assigned to it. We propose that the assignment of residential customers to a demand price structure be contingent on our research program identifying that it is appropriate to commence assigning residential customers to our demand price structure. We expect that theoretical, empirical and customer research, pricing trials and further customer engagement will be required to adequately investigate the appropriateness of demand pricing, as compared with other price structures.[68]

While PIAC supports mandatory assignment CRNTs, we do not accept Ausgrid's argument that:

- IBTs or ToU energy tariffs are sufficiently cost reflective to satisfy the Rules requirement for tariff reform; or
- Ausgrid requires further research and trials to implement demand tariffs.

Our reasoning is outlined in sections 6.1.1 and 6.1.3 above.

6.3.1.2 Fixed charge increase

Ausgrid has proposed a significant increase in fixed charges, far above what the Endeavour Energy and Essential Energy have proposed. Under its 'Price Rebalancing' strategy, Ausgrid has proposed to increase average fixed charges by 6.4% per annum on the default ToU tariff, and 11% per annum for the inclining block tariff.[69] We do not support these proposals.

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67 Ausgrid, *Tariff structure statement*, 57.
68 Ausgrid, *Ausgrid's Regulatory Proposal*, 187.
69 Ausgrid, *Tariff structure statement*, 14-16.

Ausgrid states that this will be offset by a 0.6% per annum decrease in its ToU shoulder charge, leaving a typical residential customer's network bill unchanged. However, this does not address PIAC's concerns about the ability of consumers to respond to a bill that includes high fixed charges.

Ausgrid contends that an increased fixed charge is a means of remedying cross subsidies, required by the Rules and desirable as preparation for future implementation of a capacity tariff. As noted in section 6.2.1, PIAC neither accepts these arguments nor considers fixed charge increases in the long-term interests of consumers.

Therefore, PIAC does not support Ausgrid's proposed fixed charge increase.

Recommendation 22

That the AER not approve Ausgrid's TSS proposal and encourage Ausgrid to:

- *commit to a rapid transition to demand tariffs; and*
- *not increase fixed charges.*

6.3.2 Endeavour Energy's TSS proposal

PIAC considers Endeavour Energy's TSS proposal to be the best of the three NSW DNSPs.

Through its consumer engagement program, Endeavour Energy heard from its customers and consumer representatives that demand tariffs were the appropriate structure for their CRNT. In response, Endeavour Energy has proposed the following tariffs for consumers with CRTN-enabled meters:

- A default transitional seasonal demand tariff for all new connections and existing connections upgrading to a 3-phase or bi-directional flow;
- An opt-in, fully cost reflective demand tariff, with the same structure as the default tariff, but with a higher proportion of costs recovered through the demand charge; and
- An opt-in flat energy tariff.[70]

6.3.2.1 Introduction of demand tariffs

PIAC supports the introduction of a default demand tariff as a positive move towards cost reflectivity by Endeavour Energy. This tariff is a monthly maximum demand structure, with maximum demand averaged over a five day period. In PIAC's view, this is an appropriate means of striking the balance between cost reflectivity and consumer impact. While not as cost reflective as a critical peak price or single point demand tariff, it would allow consumers to manage their demand over a five day period and therefore reduce the initial impact of a particularly high demand day.

Further, we support the introduction of the fully cost reflective optional demand tariff. This allows early adopters to receive the full financial benefit of behaviour change to reduce future network costs. These consumers are likely to be better off under this tariff, and encouraging them to adopt it early will accelerate the network benefit of tariff transition.

[70] Endeavour Energy, *Tariff structure statement*, 13.

PIAC considers both these tariffs to be significantly more cost reflective than Endeavour Energy's 2017-19 ToU energy tariffs and supports their introduction.

Recommendation 23

That the AER approve Endeavour Energy's demand tariffs.

6.3.2.2 Retention of flat energy tariff

Endeavour Energy proposes to retain an optional flat energy tariff. As noted above, PIAC accepts that CRNTs will not be mandatory for all DNSPs in this TSS. Therefore, we accept that DNSPs must include less cost reflective tariffs for those consumers opting out.

However, we would prefer to see consumers opting out of demand tariffs be assigned to ToU tariffs, as a more cost reflective option than flat energy tariffs. PIAC understands that Endeavour Energy has chosen a flat energy tariff instead for simplicity, arguing that having two complex tariff structures is more confusing for consumers than one.

While we commend Endeavour Energy's desire for simplicity, we are not convinced that it over-rides the requirement for effective tariff reform. Given that retailers are the primary target for CRNTs, not consumers, PIAC contends that Endeavour Energy could replace its flat energy tariff option with a ToU tariff without consumer detriment.

Recommendation 24

That the AER encourage Endeavour Energy to replace its flat energy tariff option with a ToU tariff.

6.3.3 Essential Energy's TSS proposal

PIAC considers Essential Energy's TSS to have gone some way towards effective tariff reform, but not far enough. Essential Energy has proposed the following tariffs for consumers with CRNT-enabled meters:

- A default ToU demand tariff for new customers with 'new technology';[71]
- A default ToU tariff for all other new customers;
- An optional flat tariff.[72]

6.3.3.1 Introduction of a demand tariff

PIAC supports Essential Energy's proposal for a ToU demand tariff for customers with new technology. As noted in section 6.1.1, we consider this to be an improvement in cost reflectivity when compared to ToU tariffs.

However, we would like to see this demand tariff extended to more customers. As proposed, Essential Energy's TSS would see a majority of its consumers remaining on less cost reflective tariff structures like its ToU tariff. Instead, Essential Energy should follow Endeavour Energy's lead and assign all new customers to a demand tariff as a means of accelerating tariff reform.

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71 Distributed generation, storage, electric vehicles etc

72 Essential Energy, *Tariff Structure Statement*, 29.

Recommendation 25

That the AER encourage Essential Energy to apply its ToU demand tariff to all new customers.

6.3.3.2 Fixed charge increase

PIAC supports Essential Energy's proposal to limit fixed charge increase in the 2019-24 TSS. While Essential Energy proposes an increase of $5 per annum over the period, this is lower than both Ausgrid and Endeavour Energy.

Further, it represents a compromise by Essential Energy following feedback from its customers and consumer representatives that a higher fixed charge increase is undesirable. Originally, Essential Energy consulted on fixed charge increases up to $20 per annum. However, Essential Energy received strong feedback that this was unacceptable and have proposed lowest increase it consulted on.

While PIAC would prefer to see no change in fixed charges, we commend Essential Energy for responding to consumer feedback.