
Press Release

ESC Final Decision on Electricity Prices is Bad for Business

The Essential Services Commission (ESC) released a final determination last week on electricity distribution charges for the five years beginning on 1 January 2006. These monopoly charges are 'non-negotiable' and make up around 30-50 per cent of the costs of buying electricity for Victorian business users.

The EUAA estimate that the ESC has delivered a decision that will cost business users AT LEAST \$1.1 billion over the next five years without any real service improvements.

For businesses competing nationally and internationally, this decision will have an unnecessary and detrimental impact on their cost competitiveness.

The Final Decision reveals a number of unnecessary business cost imposts (see attached information sheet for more details), including:

- No justification or evidence that the network system is in dis-repair and therefore DBs need this level of extra funding
- No material change in service standards from the Draft to Final Decision to justify extra expenditure
- Halving of the energy consumption growth from the Draft to Final Decision but mysteriously an increase in expenditure and no explanation of the logic in this
- \$250 compensation to small business for DBs failing to meet interruption / connection service standards, even though the cost of interruptions are likely to be far more costly to business operations

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- No requirement that the 2006 price reductions be shared between business and household consumers
- Final 2006 tariffs will not be known until early December, just 3 weeks before the new tariffs take effect and business users do not have an input into new tariffs
- A roll-out of an expensive interval meter program with costs smeared across business users who do no benefit and no requirement for DBs to introduce time-of-use tariffs until 2012
- Limited scope on Demand Management initiatives (only 0.07% expenditure has been allocated to DM initiatives) to manage critical peak demand growth
- A Rate of Return that is higher than other recent State Regulator decisions on electricity distribution networks and the recent ESC Water Distribution Decision

Don't be fooled by the commentary talking about price reductions and a "trifecta" for Victorian energy users. The ESC decision is manifestly unfair on Victorian businesses and will impact negatively on their competitive position. It is akin to backing a losing trifecta!

As a matter of priority, Victorian businesses are urged to raise these excessive costs with the Victorian Government and the ESC. Business groups are urged to inform their members about these unjustified costs.

Don't be fooled by the smoke screen of price cuts. These disguise the fact that the cuts are only half (or less) what they were at the time of the ESC draft decision, they are driven by forecast growth in consumption (ie they aren't based on more efficient DBs) and they include a hefty component of monopoly fat.

INFORMATION SHEET: IMPACT OF ESC 2006-2010 ELECTRICITY DISTRIBUTION PRICE REVIEW ON VICTORIAN BUSINESS

The EUAA has undertaken an analysis of the ESC's Final Electricity Distribution Price Review on Victorian business users of electricity. This review sets electricity distribution prices, which make up around 40% of electricity bills (on average) for the period 2006 to 2010. The results show a range of unjustified cost imposts on business users that should concern Victorian business. The EUAA is a national association of business energy users and its members include many of the largest energy users in Victoria. The EUAA was extensively involved in the ESC review.

The following emerged from our analysis:

1. No evidence that the DB's below-forecast spending reflects underspending on maintenance of the networks. However, they still gained a 5.7% increase in the allowance for business-as-usual capital expenditures (excludes forecast capital for new customer connections growth) relative to the amount spent last period, and a 15% increase in the allowance for operating and maintenance expenditures (excludes increase for forecast energy consumption growth).

Impact on business: Given the DBs have consistently under-spent their allowances over the past 10 years, and there is no clear evidence the network system is in dis-repair, this is a high level gamble the ESC is asking the Victorian business community to fund.

2. The ESC has given the DBs an extra \$562 million in expenditure compared to the Draft Determination, but has made no material change to the service standards benchmarks that the DBs are required to achieve.

Impact on business: Business users will be funding an extra \$562 million in DB expenses as a consequence of the shift by the ESC from the Draft to Final Determination and will not get anything (ie improved services) in return for this funding.

3. The ESC has halved the energy consumption growth forecasts for the next 5 years from the Draft Determination but there is no evidence that it has allowed for the impact of this on reduced DB expenditure, instead providing the DBs with more money than the Draft Determination.

Impact on business: Businesses will be required to pay higher than necessary charges for electricity network services with no offsetting increase in service.

4. Small businesses will receive up to \$250 compensation if the DB fails to meet a benchmark level number of unplanned interruptions and/or fails to meet an appointment time within a specific window.

Impact on business: This is small compensation given that a business could face significant loss, such as sales, laying-off staff, failing to meet suppliers' deadlines, etc.

5. DBs have absolute discretion on how each of their tariffs will be adjusted to meet the new network price cap (ie Po adjustment). Hence, end users are not guaranteed a drop in their 2006 network charges. The DBs have until 17 November 2005 to lodge their final tariffs for 2006 and the ESC has a further 3 weeks to confirm them.

Impact on business: Business users will have less than one month to absorb the complex new tariffs and determine how they will impact on their cost structures. Further, users are not involved in the process for determining tariffs and therefore do not have a say in the setting of the individual tariffs. There is some evidence emerging from business users that they will be saddled with less than average network price reductions in 2006.

6. The ESC has put most (if not all) their eggs in the roll-out of interval meters to send price signals to domestic customers to switch off during peak periods. The interval meter roll out is not scheduled to be finalised until 2012 (nearly halfway through the next regulatory period) and even then as many as 40% of small consumers may not have interval meters. Hence, end users (including business users who already have 'smart meters') are to provide the DBs with \$518.4 million of capital to roll out interval meters over the next 5 years without any guarantee (or obligation) the DBs will use the information from the interval meters to provide benefits back to end users until after 2012. Four of the five of the DBs have, to date, failed to propose the introduction of time-of-use tariffs for these users.

Impact on business: The cost of the interval meter roll-out program is smeared across all end users, whereas business users are not the major contributors to the rate of growth in peak demand. Hence, business users are required to compensate for the costs of interval meters for air-conditioning users. This is being mandated by the ESC without any offsetting benefits to energy users in terms of price signals or incentives to reduce demand.

7. In addition, the ESC has no power to ensure retailers pass on any cost benefits to affected consumers. If retailers develop and introduce 'cost reflective' tariffs, and pass on cost benefits to consumers, consumers who create high costs will have only one avenue to avoid those costs - manually turn off their own appliances and deny themselves services they have come to expect. It is stretching credibility to think they will do this. If retailers do not develop 'cost reflective' tariffs, consumers will be saddled with up to \$518.4 million in additional costs for no benefit.

Impact on business: Without 'cost reflective' tariffs for domestic consumers, business users will be required to pay a major chunk of the \$518.4 million, and there will be minimal, if any, impact on growing peak demand (which business users are not the cause of).

8. The ESC has provided a paltry \$600,000 (or 0.07% of total expenditure approved) for each distributor over the next 5 years to seek out Demand Management responses (or other non network solutions) to curb peak demand growth.

Impact on business: An EUAA Trial of Demand Side Aggregation conducted in 2002 (and submitted to the ESC) shows that Demand Management is far less costly in reducing stress on a network in peak periods than spending money on augmenting the system to cope with peak demand, which only occurs between 1% to 5% of the time but requires many times this percentage of their investment. NSW and South Australian Regulators have responded by introducing stronger incentives for their DBs' to seriously consider Demand Management options to curb peak demand.

9. The ESC is providing the Victorian DBs a benchmark rate of return of 5.9%. This is well over recent decisions by other States on their distribution network and well above the ESC's decision on water distribution (rate of return set at 5.2%) handed down just 3 months ago. The DBs are a low risk business and do not justify such a handsome return.

Impact on business: As the ESC decision is higher than other State Regulators, Victorian businesses will be paying higher than necessary charges for electricity network services. Hence, this component of the decision on its own has a direct impact on reducing the competitiveness of the Victorian business community relative to their counterparts in New South Wales, Queensland and South Australia. The ESC used an Equity Beta¹ value of 0.75 in its recent Final Decision for the water sector as opposed to 1.0 in electricity. This aspect of the Final Decision imposes a cost of approximately \$42 million/year on consumers (or about \$200 million over the next regulatory period), which is nothing more than a 'free kick' to the DBs that business customers will be required to fund.

¹ Equity beta is one of the major components the ESC uses to calculate the benchmark rate of return. The equity beta reflects the level of non-diversifiable risk associated with a particular asset (ie electricity distribution network), relative to the non-diversifiable risk associated with a well diversified portfolio of assets