Queensland Council of Social Service (QCOSS) Submission on the AER Draft Decision

Queensland Distribution Determination Process 2010-2015

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Introduction

Queensland Council of Social Service (QCOSS) is the peak body for over 600 welfare and community sector organisations in Queensland. For over 50 years QCOSS has worked to promote social justice and exists to provide a voice for Queenslanders affected by poverty an inequality. We act as a State-wide Council that leads on issues of significance to the social, community and health sectors. We work for a Fair Queensland and develop and advocate socially, economically and environmentally responsible public policy and action by community, government and business.

QCOSS has been funded by the Department of Mines and Energy and Department of Justice and Attorney-General for an energy consumer advocate project in Queensland. The purpose of this project is to advocate on behalf of Queensland consumers, and particularly vulnerable and low income households, in relation to energy.

The AER distribution determination for the Queensland electricity distribution network service providers for the regulatory period from 1 July 2010 to 30 June 2015 is an important process that will set future distribution charges, impact service levels and provide a regulatory context for Energex and Ergon, the two Queensland Distribution Network Service Providers (DNSPs) This is the first time that Queensland distribution networks will be subject to economic regulation by the AER, the distribution networks regulation having been recently transferred to the AER from the Queensland Competition Authority, the Queensland jurisdictional regulator.

As distribution prices account for some 40% of retail electricity prices and all energy users in Queensland will be subject to the charges that result from this determination, the outcome of the AER's determination has significant implications for residential consumers, and low-income and vulnerable consumers in particular.

QCOSS thanks the AER for the opportunity to make submissions to this process and trusts that it can keep an open dialogue on these important issues.

As discussed in its previous submission, QCOSS has restricted its commentary to those matters on which it can credibly contribute to the regulatory process. As QCOSS is unable to make credible comment on the levels of required capital or operating expenditure, or the required cost of capital, it has refrained from commenting in these areas.

Summary of key issues raised

The key matters covered in this submission include:

- The scope for contributions from consumer organisations
- Air-conditioning as a driver of increased costs and the cross subsidies that arise as a result
- The need for incentives and alternatives to network augmentation
- Cost allocation and options for tariffs to protect vulnerable consumers
- The need for greater coordination of regulators and government on price regulation and the impacts on consumers.

In this submission QCOSS makes a number of comments that are directed to the adequacy of the regulatory framework for the Queensland distribution price determination process. In this regard QCOSS acknowledges that some of the points are directed to relevant policy makers as well as the AER.

Scope for contributions from consumer organisations

It is clear to even the most casual observer of the National Electricity Rules that the regulatory framework includes an abundance of consultation procedures. The distribution network determination process alone includes numerous steps that provide for consultation. However QCOSS has found that the scope for consultation is, in practical terms, restricted to the detailed technical inputs to the process – in this case the components of the Building Block Approach, notably the engineering and economic prudence of capital and operating expenditure and the Weighted Average Cost of Capital. This technical focus is codified in the Constituent Decisions the AER must make under section 6.12.1 (notably a Building Block Determination under S.12.1(2)).

QCOSS has made a concerted effort to frame its commentary in line with the provisions of the National Electricity Rules. However, QCOSS finds that there are very few "levers" in the process for participation by consumer or environmental organisations especially in relation to the impact on various classes of consumers.

QCOSS submits that, save for expending vast sums on technical consultants, it is extremely difficult for a consumer organisation to make informed commentary on a DNSP's Regulatory Proposal.[1]

In particular, QCOSS finds the Rules to be rigidly focused on the inputs to the price determination process, with virtually no scope for the AER (or any other body) to have regard to the overall reasonableness of the outcomes, particularly as they relate to achieving social or environmental policy objectives.

Importantly, there is no scope for consultation on the overall *outcomes* of the regulatory process and the impacts on consumers, or scope to feed these consumer impacts into the decision-making process.

As discussed further below, QCOSS submits that it is critical that some body, potentially Government, be engaged and charged with the responsibility of undertaking socio-economic research and customer impact analysis and maintaining an overall "sensibility" oversight brief on behalf of vulnerable consumers.

Having said that, there remain some aspects of the regulatory process on which QCOSS can contribute, and we trust the AER will find our contribution helpful.

Engagement with network businesses

As discussed in our previous submission in this review, QCOSS undertook to engage with the businesses in order to inform its commentary to the regulatory process.

QCOSS would like to express its thanks to the management and staff at both Energex and Ergon Energy for their warm reception and willingness to discuss matters of interest.

Air conditioning as a driver of increased network costs

QCOSS acknowledges the impact the rapid population growth and air conditioning penetration throughout Queensland, and especially in South East Queensland, is having on the networks, in terms of the capability to defer network augmentation investment through demand management activity. QCOSS understands how the sharp increase in peak

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[1] It is also noted that many of the components of the Regulatory Proposal which would lend themselves to detailed technical analysis are filed confidentially with the regulator. While QCOSS is mindful of the Regulators' comments on information asymmetry concerns, it is noted that there is even less information available to interested parties

demand, driven by the air conditioning load, is having a profound effect on network costs, and therefore network prices.

However, the costs of this rapid population and air conditioner growth are being borne by all customers –not just those customers who are causing the costs to be incurred. In particular, the costs associated with network augmentation caused by the rapid growth in air conditioner usage is being borne disproportionately by vulnerable consumers that in many cases do not have air conditioning,[2] and are therefore driving neither the peak demand nor the network investment to meet it.

Introduction of regressive cross subsidies

It is critical for the AER to understand the negative cross subsidy effect that an average network tariff has on Queensland's vulnerable customers. It is a clearly regressive result to impose costs associated with air conditioning peaks on those vulnerable customers who cannot afford air conditioning in the first instance.

To the extent that one of the objectives of the regulatory process introduced by the Hilmer reforms of the mid 1990s was to remove cross subsidies, it appears to be a retrograde step to re-introduce cross subsidies, and a regressive step to impose payment of that cross subsidy on those consumers least capable of affording it.

QCOSS requests the Queensland network businesses to consider this matter carefully in preparing their pricing proposals, and the AER to consider this matter in assessing those pricing proposals.

Alternatives to network augmentation

As a longer term response, alternatives to manage peak demand are required. Network augmentation as the only current response will simply lead to rising network costs and increasing pressures on consumers, especially vulnerable consumers. The Demand Management Incentive Scheme is only a very small step in this direction and the current framework continues to incentivize the distributors to focus on augmentation alone. QCOSS encourages changes to the regulatory framework to allow for much greater innovation and expenditure on alternatives to augmentation. In the long run, consumers are likely to be better off if alternatives such as direct load control and micro generation can be investigated and introduced. QCOSS also requests the AER to consider different options for funding this expenditure than increasing the costs to all consumers. Low income and vulnerable consumers are already paying the highest proportion of income on energy.

Cost allocation

In its discussions with the network businesses, QCOSS discussed in some detail the process of allocating network costs to customer classes. As a result of these discussions, QCOSS accepts the DNSPs' approach to allocating costs to customer classes, noting that this is based on discussion and explanation rather than detailed process auditing.

It is also important to note, however, that these costs are allocated to residential consumers on the assumption that this is a homogenous customer class.

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[2] Studies in the UK and Victoria clearly indicate that vulnerable users have lower levels of consumption than non-vulnerable users, consistent with absence of an air conditioning load. See Centre for Sustainable Energy (2008) *Assessing the social impacts of a supplier obligation: report to DEFRA* and Department of Human Services, *Responses to the Review of Effectiveness of Retail Competition and the Consumer Safety net for Electricity and Gas*: Issues Paper, 2003, p4.

QCOSS submits that the vulnerable customers within the Residential class have sufficiently different cost drivers, notably a lower penetration of air conditioning, that they could reasonably be considered a separate tariff class under S6.18.3. QCOSS requests the AER to consider the different characteristics of low income consumers in its considerations under S6.18.4 (a):

6.18.4 Principles governing assignment or re-assignment of customers to tariff classes and assessment and review of basis of charging

(a) In formulating provisions of a distribution determination governing the assignment of customers to tariff classes or the re-assignment of customers from one tariff class to another, the AER must have regard to the following principles:

(1) customers should be assigned to tariff classes on the basis of one or more of the following factors:

(i) the nature and extent of their usage;

(ii) the nature of their connection to the network;

(iii) whether remotely-read interval metering or other similar metering technology has been installed at the customer's premises as a result of a regulatory obligation or requirement;

(2) customers with a similar connection and usage profile should be treated on an equal basis;

(3) however, customers with micro-generation facilities should be treated no less favourably than customers without such facilities but with a similar load profile;

(4) a Distribution Network Service Provider's decision to assign a customer to a particular tariff class, or to re-assign a customer from one tariff class to another should be subject to an effective system of assessment and review.

However, it is clear from QCOSS' discussions with the network business that the network customer information and cost allocation process is not sufficiently granular to specify a vulnerable customer class. That is, the networks do not have sufficiently detailed information to know which customers are vulnerable (this aspect being in the retailer domain), or which customers do or do not have air conditioning installations.

QCOSS therefore proposes that, for the purposes of this regulatory control period, acknowledgement of the different characteristics of vulnerable customers be addressed through tariff mechanisms rather than the cost allocation process.

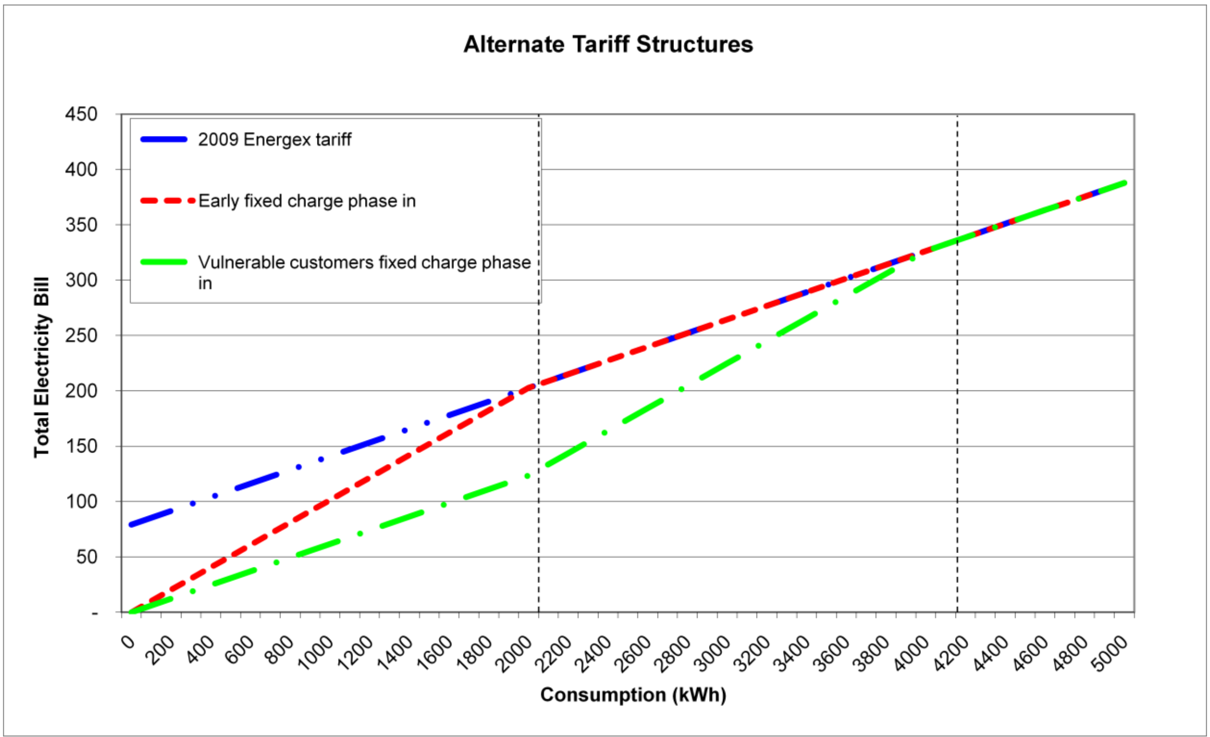
Looking forward, QCOSS suggests, as a preliminary action, that the network businesses coordinate with the Queensland Department of Housing (now Housing and Homelessness Services) to identify those NMIs (National Meter Identifiers) in the service territory attached to Department of Housing dwellings. QCOSS submits that this would then form the foundation of a "Social" customer class, which would be targeted for tailored tariff structures that align more closely with the customer class' cost drivers.

QCOSS would be pleased to work with the network businesses in this endeavour.

Tariff design

One area in which QCOSS has been disappointed is the disinterest on the part of the network businesses to consider the possibility of alternative tariff designs for vulnerable customers.

For example, QCOSS proposed a modified declining block tariff for which vulnerable customers would qualify by being part of a retailer's hardship or assistance programs. This tariff featured no fixed charge, but a higher unit charge for low levels of consumption. After a "break-even" point, this tariff reverted to the published energy charge. This is shown by the red line in the graph at right. The intended result of this tariff is to reduce the costs for low levels of consumption (basic non-discretionary load) and provided for a greater impact for reducing energy consumption at these low levels.



An alternative might be to defer the imposition of the fixed charge until a level of non-discretionary consumption had been exceeded, and phase it in over the next band of consumption. This is shown by the green line in the graph above. This provides for lower costs for those most vulnerable users who consume little electricity, consistent with the findings of studies in the UK[3] and Victoria,[4] which have indicated that vulnerable consumers tend to use less energy, with the most vulnerable consumers using the least energy.

QCOSS acknowledges that a tariff like those proposed above would appeal to low use customers in general. However, the purpose of this style of tariff is to ease the burden on low income consumers – it is not to reduce energy costs for owners of holiday homes. To this end, QCOSS proposes that this type of tariff would be subject to a qualification criterion - for example where the customer is a participant in some form of hardship or payment assistance plan or a concession card holder - and such tariffs would be available only on request from a retailer

QCOSS understands that the network businesses may hold the view that the question of tariff design was settled by the QCA in its recent report *Review of Electricity Pricing and Tariff Structures*.[5] However, this review was conducted in the context of making recommendations to Government on the Notified Tariff rather than the conduct of a network pricing review.

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[3] Centre for Sustainable Energy (2008) Assessing the social impacts of a supplier obligation: report to DEFRA

[4] Department of Human Services, Responses to the Review of Effectiveness of Retail Competition and the Consumer Safety net for Electricity and Gas: Issues Paper, 2003, p4.

[5] QCA, *Final Report – Review of Electricity Pricing and Tariff Structures – Stage 2,* November 2009, p6, at www.qca.org.au/electricity-retail/RevEPandTS/stage2rev.php

QCOSS submits that one aspect of the regulatory mosaic that requires further development is for some agency to take responsibility for undertaking an analysis of the impacts of different tariff structures on different consumer groups in order to develop a tariff design that protects vulnerable customers. While QCOSS has broached some preliminary suggestions with the network businesses in the context of this price review, QCOSS does not have the resources required to undertake a sufficiently robust analysis. QCOSS would be pleased to participate in such an analysis.

The question of tariff designs to protect vulnerable customers is related to a broader range of concerns regarding the need for coordinated policy development and approaches between government and regulators, as discussed below.

QCOSS notes the comments of the AER Chairman at the public forum that the AER's role in the pricing approval process is limited by the National Electricity Rules. However, QCOSS's analysis indicates that the restriction on the AER's discretion is at the total revenue level in approving the "X" Factor:

- *S6.5.9(b)(3) – a requirement to ensure the present value of forecast revenues recovers the present value of the building block annual revenue requirements, and*
- *S6.5.9(b)(2) – a requirement to ensure that there is minimal divergence between the final year revenue and Building Block revenue requirement:*

6.5.9 The X factor

(a) A building block determination is to include the X factor for each control mechanism for each regulatory year of the regulatory control period.

(b) The X factor:

(1) must be set by the AER with regard to the Distribution Network Service Provider's total revenue requirement for the regulatory control period; and

(2) must be such as to minimise, as far as reasonably possible, variance between expected revenue for the last regulatory year of the regulatory control period and the annual revenue requirement for that last regulatory year; and

(3) must conform with whichever of the following requirements is applicable:

(i) if the control mechanism relates generally to standard control services – the X factor must be designed to equalise (in terms of net present value) the revenue to be earned by the Distribution Network Service Provider from the provision of standard control services over the regulatory control period with the provider's total revenue requirement for the regulatory control period;

(ii) if there are separate control mechanisms for different standard control services – the X factor for each control mechanism must be designed to equalise (in terms of net present value) the revenue to be earned by the Distribution Network Service Provider from the provision of standard control services to which the control mechanism relates over the regulatory control period with the portion of the provider's total revenue requirement for the regulatory control period attributable to those services.

While it has become accepted practice for Australian regulators to leave the particular tariff design issues to the DNSP, QCOSS does not find in the Pricing Principles in S6.18.5 of the Rules any prohibition from the AER requesting the DNSP to offer particular tariff structures to particular classes of customers.

Government and regulatory coordination

As a general comment, QCOSS is disappointed at the apparent lack of coordination between economic regulators and Government in these types of price setting processes. This was most striking in the Queensland Competition Authority's November 2009 report *Review of Electricity Pricing and Tariff Structures*.[6] In this report, the QCA recommended retail tariffs be better aligned to network tariffs in order to achieve greater cost reflectivity. Such tariffs would be heavily weighted towards a fixed charge on the grounds that this reflected the fixed nature of providing services. QCOSS would argue that individual network tariffs are not necessarily cost reflective, and that in the absence of either a sufficiently robust framework for regulating network tariffs or coordination by the different economic regulators regarding tariff structure, an alignment of retail and network tariffs is premature.

Further, the QCA recognised that aligning retail tariffs with network tariffs would adversely affect vulnerable customers:

> The Authority recognises that meeting this objective may impact adversely on low consumption low income customers and vulnerable customers who may face higher fixed charges (and hence total electricity costs) and that this may affect their capacity to pay their electricity bills. (p15)

They also put the view that:

> Direct support from Government to those low income consumers adversely affected by any changes would be a preferable means of addressing the concerns raised by QCOSS (p 6)

QCOSS is most concerned that economic regulators like the QCA and the AER are approving or recommending revenue caps and tariff structures that will be disadvantageous to vulnerable customers and simply "washing their hands" of the matter on the grounds that the impact of their decision is a matter for Government social policy. To this end, QCOSS requests the AER to engage formally with the QCA and the Queensland Government to undertake socio-economic research on the impacts to consumers of revenue caps and both network and retail tariff structures. This will allow for the development of strategies to mitigate the impact on vulnerable customers.

QCOSS also requests the AER to include, in its price review processes, a formal consultation process with the jurisdictional Government in cases where there remains Government influence on retail tariffs. QCOSS will also raise this matter with relevant Government agencies.

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[6] QCA, *Final Report – Review of Electricity Pricing and Tariff Structures – Stage 2,* November 2009, p6, at www.qca.org.au/electricity-retail/RevEPandTS/stage2rev.php