UnitingCare Australia

SUBMISSION

To: AEMC

Regarding:
SCER request for advice on differences between actual and forecast demand in network regulation.

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UnitingCare Australia

UnitingCare Australia is the Uniting Church's national body supporting community services and advocacy for children, young people, families, people with disabilities and older people.

The UnitingCare network is one of the largest providers of community services in Australia, providing services and supports to more than 2 million Australians each year in urban, rural and remote communities. The network employs 35,000 staff and 24,000 volunteers.

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

Stewardship of our environment is a fundamental responsibility of societies both in the short-term and for the benefit of future generations. We strongly support the notion of the triple bottom line for government community and business organisations whereby economic stewardship, environmental stewardship and the nurture of citizens (social stewardship) are equally valued and reported on publicly.

UnitingCare Australia's principle interest in energy regulation arises because energy is an essential service with rising costs that are putting inordinate financial pressure on growing numbers of households in Australia.

In the following document, when the term 'consumers' is used, we are speaking of household and small business consumers, including family farms and family businesses.

Uniting Care Australia's energy vision is that by 2030 energy in Australia will be plentiful, renewable and affordable for all citizens.

SCER request for advice on differences between actual and forecast demand in network regulation.

UnitingCare Australia appreciates the opportunity to comment on this AEMC consideration of advice on differences between actual and forecast demand on network regulation.
Before moving into considerations on questions in the issues paper we wish to raise two sets of general overview comments.

<u>Lens for policy consideration</u>
In considering this issue UnitingCare Australia urges the AEMC and the SCER to consider the lens of a pensioner couple who are retired, living in their own unit and for whom the government pension as their primary source of income, we'll call them Jack and Evelyn Lloyd. They are experiencing a heatwave (or it could be an extended cold period) and refuse to turn on air conditioning (or heating) despite extreme temperatures ,in order to save on their energy bills. Considering all aspects of this issue through their eyes provides a salutary perspective on the end impacts of these, seemingly esoteric policy decisions. Simply considering impacts for NSPs of revenue or price cap models for example really does fail to adequately consider the impact on the "Lloyd's test" for energy policy and advice.

A similar test could be applied by looking at the impact of policies through the lens of a western suburb of Sydney couple with three children (or they could be based in the outer suburbs of Victoria, Elizabeth in South Australia or Logan City in Queensland, it doesn't really matter), we'll call them the Edwards family. The critical thing is how will policy and regulation decisions impact on this family who between them have three jobs, all casual, all part time and all insecure. They are living in rental housing, the price of which has doubled in real terms to the prices their parents paid, and their real income is static at best despite a portfolio of three different jobs.

The question of how energy policy impacts on the Lloyds or Edwards families should be the primary 'lens' when considering impacts of policy proposals.

<u>2nd Overview consideration.</u>
UnitingCare Australia recognises this request for advice from the SCER is in the context of three very significant developments, each carried forward from work which reached points of culmination late last year. These three very important contextual aspects of work are:

1 The review of the limited merits review.

We have submitted previously the view that the past practice of 'limited merits review' was largely inaccessible to consumers meaning that just about every regulatory decision that NSP's were unhappy with was taken to appeal as a matter of course, with the Lloyds and Edwards families, and millions of others, losing in every instance. Reform of the limited merits review is a priority and we would urge the AEMC to advise the SCER that the first priority in dealing with consumer price impacts from network regulation is to fix the problem that has been the limited merits review, by enacting the recommendations made by the recent review panel.

2. Network Price Regulation Rule Changes

The AEMC is of course familiar with these significant rule changes which were made late last year and which reaffirmed the role of the Regulator as having the power to take leadership in regulation. We note that the AER has instigated a "Better Regulation" programme to determine guidelines to best apply the detail of these rule changes. It continues to be important that SCER backs the regulator in taking leadership and in being proactive in regulating. We cannot have a regulator that through volume of submission or through weight of participation or through volume of submission from NSP's is unable to make independent determinations in the best long term interests of consumers.

3. Impending tariff setting rule changes.

UnitingCare Australia understands that both SCER (as an outcome of the Power of Choice Review) and IPART are making rule change proposals to the AEMC regarding tariff setting arrangements. We regard tariff setting processes as significant and is an issue for consideration as part of third aspect of the issues raised in the forum discussion paper which forms the basis of this response.

<u>Specific Responses to Questions in AEMC – Workshop Discussion Paper</u>

Before moving to the 7 questions that the AEMC ask in their issues paper, we note the comment made in pages 1 and 2 under "Scope of AEMC's Advice". In the paper the AEMC says:

> *"The incentive property of the framework is derived from the fact that once the NSPs' allowable revenues are determined for the regulatory control period, it will keep a share of any cost savings it makes on the ex ante expenditure allowances set by the regulator. In turn, consumers ultimately benefit as the savings are passed on to them in the longer term via efficient investment decisions from the NSP being reflected in lower network prices."*

We believe that the experience of the Lloyd and Edwards households over the last five years, in any jurisdiction in Australia, would make that statement to be one that is factually inaccurate. There have been no benefits passed onto consumers. We believe the NSP's have been able to extract profits of higher levels than they should have been able to, in part because the NSP's have been able to utilise differences between actual and forecasted demand to increase their net returns.

Indeed we suggest that the nature of energy markets whereby profit maximising businesses are assumed to produce efficient outcomes for consumers is a flawed assumption particularly in regulated markets but also in the oligopoly markets that are Australian energy markets.

We now turn to the first of the three groups of questions asked by the AEMC in their issues paper.

1. How do NSPs respond to changes in demand and factor them into their investment planning processes within the current framework?

a. What options do NSPs have to delay or bring forward capex in response to changes in demand during their regulatory control period?

b. Are there any differences between transmission and distribution NSPs?

2. How should the regulatory framework recognise the investment risks from changing demand?

a. What are the costs of these risks?

b. Does the current regulatory framework provide appropriate mechanisms to manage the risks and provide the right incentives for efficient investment?

Firstly we believe that NSP's have considerable capacity to influence the timing of and bringing forward their CAPEX in responses to changing demand. We also believe that NSP's have considerable capacity to engage with consumers more directly in order to better forecast and manage their CAPEX, system upgrades and the like. UnitingCare Australia considers that Transmission businesses generally engage with consumers less than distribution NSP's although there is very variable experience of db's engaging adequately with consumers. We strongly support the directions of recent policy announcements, including the AER's guideline development work in this stream of the "Better Regulation" program. We expect to see network business more actively engaging with consumers in the near future and believe that this is part of the solution to better responding to timing of CAPEX.

Similarly we regard that the regulatory framework has the capacity to recognise investment risk but fails to adequately consider the question of who bears risks. The evidence of the last five years across Australia has been that the risk of investment failure or poor forecasting is borne almost exclusively by consumers through higher costs. NSP's have in fact been very effective at minimising their own exposure to risk and passing this risk onto consumers. This is despite the fact that consumers in fact pay NSP's and retailers to manage risk, however consumers have borne the full brunt of changing risk profiles.

3. How does each form of control mechanism permitted in the current framework affect an NSP's risk of recovering its allowed revenues?

a. How does revenue cap and price cap approach balance the volume risks from changes in demand?

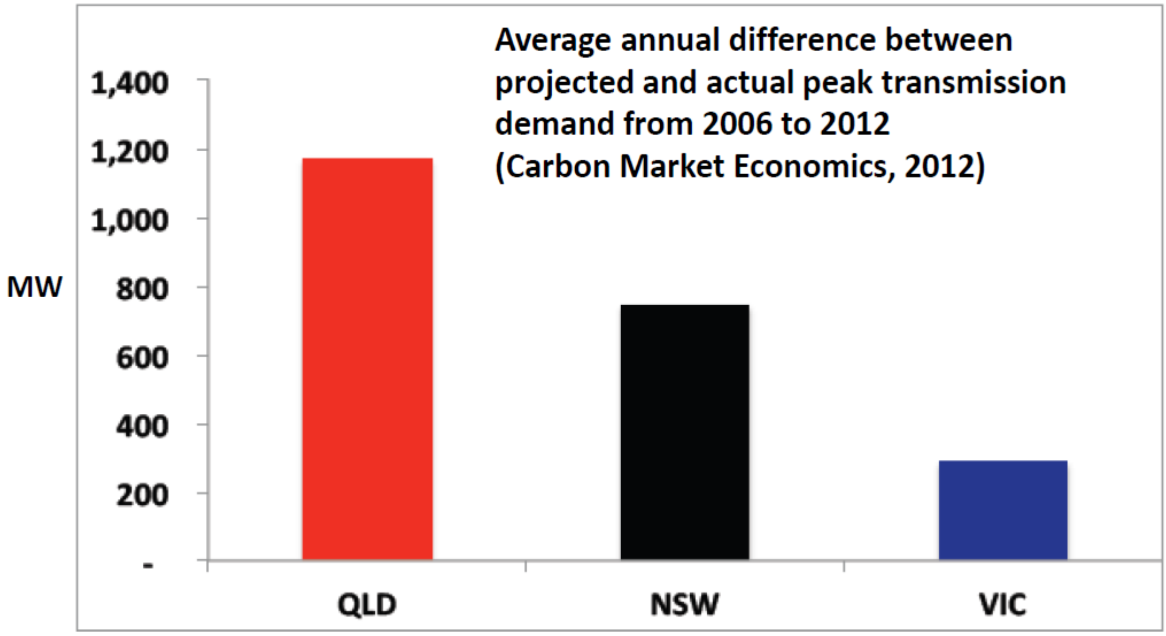
4. Is there appropriate consideration of consumer impacts in the choice of form of control mechanism under the current arrangements?

5. Is the current framework adequate to recognise the costs and benefits of volume risks?

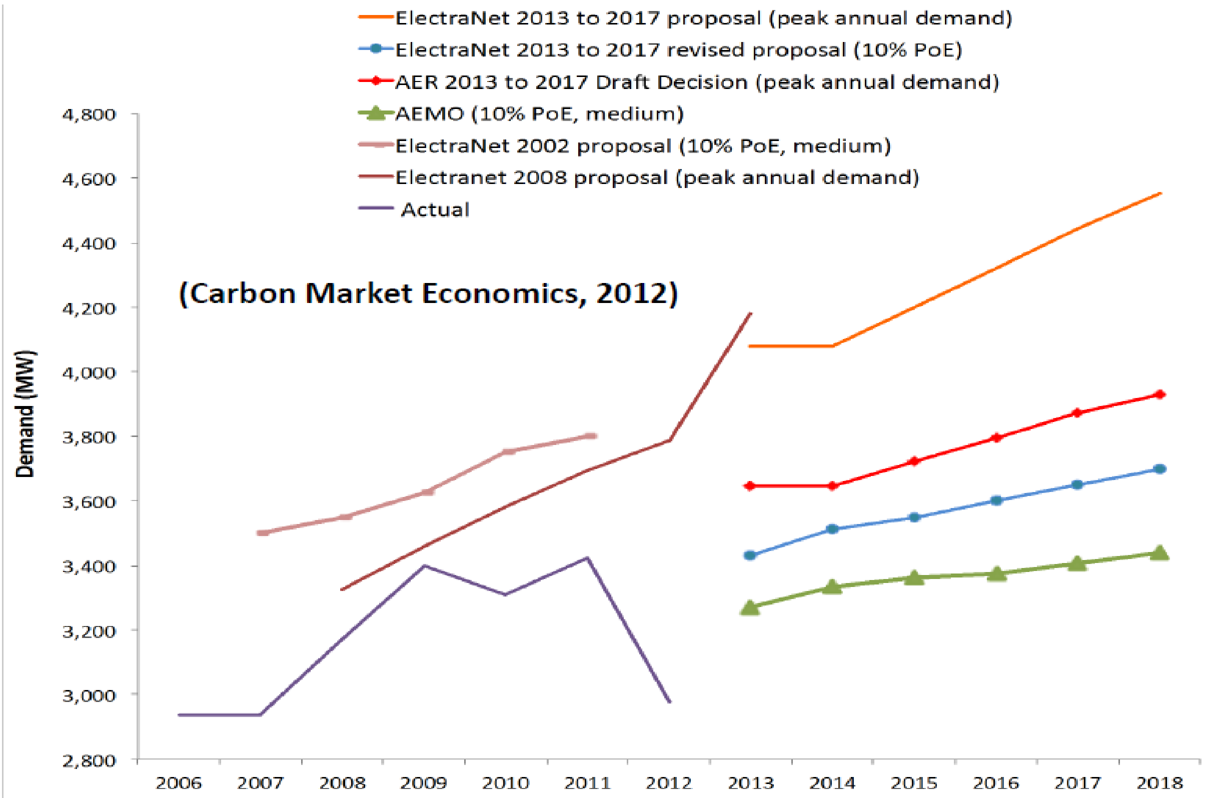
a. Are the control mechanism criteria in the NER for DNSPs appropriate?

b. How do other aspects of the regulatory framework manage the revenue recovery risks?

Graphs 1 and 2 below were presented at the Forum conducted by the AEMC on this issue and show quite clearly the degree of forecast error and the extent of consumer detriment from this error.



Graph 1; From Craig Memery (ATA) presentation to forum



Graph 2; Source Carbon Economics and Craig Memery (ATA) presentation to forum

UnitingCare Australia recognises that there are some difficulties associated with forecasting including unseasonable weather, uptake of Photovoltaic systems etc. However these factors are not new and can be estimated within reasonable bounds. The consistent disparity between forecast consumption and actual consumption indicates systemic forecasting error which is having real and adverse impact on consumers, particularly smaller household consumers.

Form of control mechanisms

We now turn to the question of form of control mechanisms. We highlight that irrespective of the method used, consumers bear most of the risk under current arrangements despite the fact that consumers are supposed to be paying for risks taken by NSP's. A fundamental problem with our current regulatory system is that in seeking to establish an allowed return to NSPs, whether that comes from revenue or price cap is of little consequence; the reality is that by using the building block type approach, disaggregation of cost structures to determine network costs has allowed an estimate of efficient cost for each disaggregated item plus a margin for each item to afford greater certainty to an NSP. Consequently in aggregation a series of modest margins, sum to form a significant net cost impact which is borne by consumers.

To reapply lyrics from a famous Paul Kelly song, the impact of network regulation is that for consumers "from little costs big costs grow"!

In all circumstances net consumer impact, the impact on the families Lloyd and Edwards, need to be considered at the end of any regulatory determination or in any consideration of legislative or regulatory changes. A 'Net Consumer Impact Reasonableness Test' must be applied in all circumstances and this includes using benchmarks from similar businesses overseas and from other domestic industries as well.

Considering briefly the revenue versus price cap question for establishing network business returns, we observe that under a revenue cap where actual demand exceeds forecast, then consumers tend to lose out and when forecast demand is greater than actual demand then consumers also lose, as identified in Appendix 1 of the discussion paper.

Under a price cap where actual demand is greater than forecast demand consumers again lose out by paying more than they actually should because actual demand exceeds prices allocated under forecast demand however for consumers where forecast demand is greater than actual this simply provides a disincentive for networks to invest in demand management and NSP's will promote energy use in faster growing areas often these are areas of relatively inelastic demand, which is a situation for lower or modest income households. So again, the net impact is that consumers lose.

We do not have a strong view as to which option is preferable given that under both revenue and price caps there is a tendency for consumers to lose out.

Notwithstanding this concern UnitingCare Australia leans slightly towards a ‘revenue cap’ as this is more likely to apply a greater restraint on network charges. However, we stress that irrespective of whether a price or revenue cap is used, for effective regulation to occur and for consumers to not be hit with unfair price burdens, regulation must happen in conjunction with other measures to increase the likelihood of consumer best interest being applied. These measures include genuine ongoing consumer engagement, more responsive and fairer tariff setting and a stronger regulatory environment, including urgent adoption of the recommendations of the review of the Limited Merits Review process.

6. What incentives and risks are created for efficient tariff structures from the choice of control mechanism?

7. **How much discretion should NSPs have in restructuring their network tariffs? Should DNSPs under a price cap be allowed to restructure their tariffs as means of managing volume risks?**

The question of tariff setting by networks has been of concern to UnitingCare Australia for some time and we are heartened by likely tariff setting rule changes to be considered by the AEMC in the near future. Rule changes which provide greater time for consumer consideration and greater opportunity for engagement are crucial.

In response to the question about whether NSP’s should be allowed to restructure their tariffs under a price cap as a means of managing volume risks, we believe that any tariff structure should only occur as a consequence of detailed and informed three way dialogue between NSP’s, consumers and the regulator. We also strongly highlight the importance of a ‘reasonableness test’ applying to any attempt to restructure tariffs; the reasonableness test deals with the question of “what changes consumers will actually pay?”

The other test is whether any restructure process enables capacity for prices paid by consumers to actually go down as circumstances become more ‘consumer friendly.’ This is as applied to the prevailing situation where prices only go up and where NSP’s are only interested in restructuring tariffs to enable prices to go up meaning consumers will be paying more. We also conclude by noting a number of consumer risks that are likely to apply in the near future with the introduction of time of use tariffs and critical peak pricing. This is counterbalanced by increasing investment in smart networks and smart meters which we believe should reduce the risk for NSP’s and lead to lower prices, in the best interests of consumers – we live in hope!

The bottom line is that any change in regulation or legislation should be done with full consideration of the national electricity objective which we suggest can be applied by thinking through the impacts on the Lloyd and Edwards families and asking if any changes are fair and reasonable for them?