Submission
No 37

INQUIRY INTO LEASING OF ELECTRICITY INFRASTRUCTURE

Organisation: Energy Supply Association of Australia

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The Director
Select Committee on the Leasing of Electricity Infrastructure
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Leasing of Electricity Infrastructure Inquiry

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the NSW Select Committee on the Leasing of Electricity Infrastructure.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 37 electricity and downstream natural gas businesses. These businesses own and operate some $120 billion in assets, employ more than 59,000 people and contribute $24.1 billion directly to the nation's Gross Domestic Product.

Energy has already begun the transition from utility service to consumer good. Consumers are playing an increasingly active role in how they consume and generate electricity. The role for government is changing. It has evolved from provider of an increasingly essential service, to regulator of this service.

The Australian Energy Regulator (AER) will soon regulate all networks in Australia. Significantly, it has announced major cuts in the spending of NSW networks, which will also flow on to lower energy bills. The esaa represents businesses that both support and oppose the decisions taken by the AER. We observe that these cuts, lower energy costs and jobs losses will all occur regardless of who owns the NSW network assets.

Even if government was to retain control of the networks, it is not clear that they would continue to remain a service provider indefinitely. In electricity, change is the new normal. There are a growing number of private businesses offering a growing range of small-scale generation and operational systems. Owning the network assets is no guarantee of being able to control the evolution of the system. The rise of distributed solar, the potential for storage, falling demand from both industrial and residential sectors is re-inventing the industry. It's unclear how the industry will evolve over the next decade. There is a level of risk now in this industry that was not present a decade ago.

Private owners will not see this as a deterrent, but as a potential opportunity. To take advantage of these opportunities and to mitigate the risks, network businesses will need to become more agile and flexible. Private owners of business have a better track record at exhibiting these qualities than government owners. The reason for this may be as simple as having a stronger focus on the current and future performance of the business, including constantly evaluating the scope for investment while governments juggle competing responsibilities and typically tie investment decisions to the opportunities (or not) afforded by their overall fiscal status.

Since the Competition Policy Agenda in the mid-1990s, the role of government in electricity markets has been evolving. It has evolved less to owning and running businesses, and more to ensuring a strong and appropriate regulatory framework is in place for those parts of the industry that are not exposed to direct competition.

What is clear from the independent benchmarking of Australian networks is that private ownership removes the political interference in the operation of these business and allows them to deliver sustained efficiency and lower costs, which is clearly in the benefits of consumers. It also frees up these businesses to actively engage with the transformation they face in the 21st century.

We have set out our views in more detail in **Additional Information**.

If you have any questions relating to this submission, please contact Fergus Pope

Yours sincerely

Matthew Warren
Chief Executive Officer

Additional Information

Regulatory Framework

NSW network costs are regulated by the Australian Energy Regulator (AER): an independent statutory authority, which amongst other responsibilities, regulates all electricity networks in the National Electricity Market. The AER is responsible for setting revenue allowances, approving the prices distribution network services providers (DNSPs) charge and approving the pricing methodologies of transmission network service providers.

The framework is characterised by:

- separation of rule-making role from that of the regulatory decision making;
- an incentive-based regulation system, whereby businesses that successfully found efficiencies could earn a higher return on its investment but that in the subsequent period the regulator would share some of those gains with customers;
- a 5 year regulatory period, which balances the trade-off between the resource-intensive nature of a regulatory review against the increasing uncertainty that the revenue set for the last year of the period is at an appropriate level; and
- a propose-respond system, in which the network business submits a business case to the regulator who then challenges it using a wide range of tools available to them; including advice from independent engineering and other consultants, stakeholder evidence and their own benchmarking analysis.

The framework is designed to determine the efficient costs of a network under a notional financial structure. That is, the regulator assumes a standard level of debt gearing and then sets a benchmark cost of debt and equity based on market information. It allows for tax costs accordingly. This generic structure does not distinguish between state and private ownership. There is a strong rationale for this, given that the risk profile of the business is not different under a different owner when you have national regulation, and competitive neutrality rules require state owned businesses to pay a corporation tax equivalent payment to their shareholder.

Price increases

Network prices in Victoria since privatisation have gone down in real terms by 18 per cent[1] (1996/97 – 2012/13), whereas network prices for the publicly owned NSW networks have increased by 122 per cent[2] (1996/97 – 2012/13). Put another way, taking out the effects of inflation, a customer that was paying $100 in network charges in Victoria in 1996/97 saw that fall to $82 by 2012/13. But in NSW, a

[1] Ernst and Young - Electricity network services: Long-term trends in prices and costs, 2014.
[2] Ibid.

customer that was paying $100 in network charges in 1996/97 saw that rise to $222 by 2012/13. Public ownership has not led to lower network prices in NSW.

The AER recently released their final revenue determinations for NSW electricity network businesses proposing to cut the regulatory return (WACC), operating and capital expenditure allowances for the next regulatory period. Lower expenditure allowances are based on the AER's benchmarking analysis that concluded the NSW network businesses were significantly less efficient than their private sector counterparts in Victoria and South Australia. The determinations are estimated to result in an estimated decrease to the average residential electricity bill of between $131 and $338 in 2015-16. As such, one of the key reasons NSW customers will be enjoying network price relief on 1 July is because Victoria privatised their networks and the NSW ones are being forced to keep up with them.

Jobs

The significant cuts by the AER to the allowed operating costs of the NSW distribution networks will require these businesses to find significant efficiencies. Unfortunately this will entail job losses. This holds regardless of ownership. Job losses are always unwelcome to those that suffer them, but from a broader perspective, the state of NSW will benefit from the improved productivity that will result. As the Deloitte report for the government on its overall leasing and reinvestment into infrastructure proposal showed, better productivity leads ultimately to more jobs especially over the longer term.

As noted above, the evolution of energy supply means that opportunities for skilled electrical workers outside of the traditional industry are growing and will continue to do so. Electricity will remain an important energy source for the foreseeable future and may capture market share from other energy sources, such as transport. As electric vehicles take off, there will be jobs for skilled workers installing charging stations, for example.

Reliability

Over the period 1997-98 to 2012-13 the performance of the publicly owned NSW networks was similar to the privately owned networks in Victoria. NSW averaged fewer outages per customer, while Victoria's outages lasted for a shorter period of time on average and had a smaller impact on customers.

Performance of the distribution network – average 1997-98 to 2012-13[3]

	Outage duration	Outage frequency	Outage time
	SAIDI (mins/customer)	SAIFI (interruptions/customer)	CAIDI (mins/interruption)
NSW & ACT	251.8	2.3	116.5
Victoria	209.6	2.7	87.4

[3] esaa: Electricity Gas Australia – multiple.

Accountability

Like all businesses in Australia, networks in NSW will still need to abide by Australian laws. For network businesses in addition to general provisions around employment, OH&S etc. there is a vast array of electricity specific regulation that governs reliability standards, revenue and prices and equality of access to the network. These regulations will continue to apply under private ownership.