

## **INQUIRY INTO ELECTRICITY SUPPLY, DEMAND AND PRICES IN NEW SOUTH WALES**

**Organisation:** Ausgrid  
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Mr Stewart Smith  
The Director  
Select Committee on Electricity Supply, Demand and Prices  
New South Wales Parliament House  
Macquarie Street, Sydney, 2000

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Dear Mr Smith,

**RE: Inquiry into electricity supply, demand and prices in NSW**

Ausgrid appreciates the opportunity to respond to the Select Committee's inquiry into electricity supply, demand and prices in NSW. We understand the Committee is seeking feedback on the drivers of recent increases in electricity prices. Our attached submission responds to each of the Committee's questions.

We strongly support the direction of the Committee's inquiry, as our research shows that electricity affordability is a major concern of our customers.

As a distribution network service provider (DNSP), Ausgrid's prices are set by the Australian Energy Regulator (AER) every 5 years. We recover our revenue by charging retailers a network tariff that is approved by the AER on an annual basis.

In the past, our network costs were a key driver of electricity price increases in NSW. During 2009 to 2012 we invested significantly in renewing the network to meet stringent license conditions. However, recent business transformations and changes to licence conditions have helped reduce our costs. This has resulted in an 8% reduction in the network component of electricity bills since 2013. Over this period, the retail component of electricity bills increased by 30%.

Our submission identifies a number of potential drivers in the electricity supply chain which may be contributing to recent price increases. We support an evidence based approach to identifying the underlying causes of recent bill increases, and encourage the Committee to explore these issues further.

By examining these factors, the Committee will be in a position to develop well targeted and proportionate recommendations that help improve affordability for customers.

If you have any queries please contact Son Truong Vu, Regulation Strategy Manager

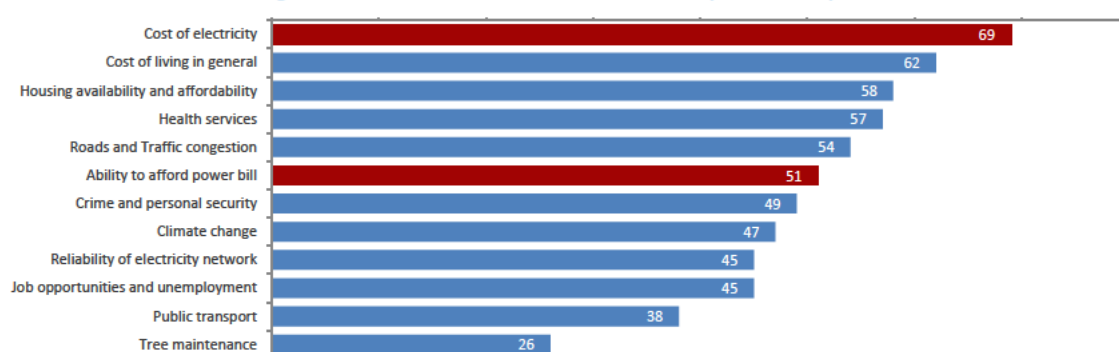
Yours sincerely,

Rob Amphlett Lewis  
**Executive General Manager – Strategy and Regulation**

## Response to Select Committee Questions

We strongly support the Committee's inquiry. Our recent customer research indicates that 69% of customers are very concerned about the cost of electricity. As seen in Figure 1, our customers consider that electricity affordability is more of a concern than housing availability, traffic congestion, and health services.

Figure 1: Research on issues our customers are very or extremely concerned



Source: NEWGATE Customer Research: Ausgrid Customers at the Centre, p 8.

Our response to the Select Committee's questions draws on our experience as an electricity distributor in NSW. Our network infrastructure distributes electricity to 1.7 million electricity customers, servicing the Sydney and the Hunter region in NSW. We incur capital and operating costs in building, maintaining and operating the network, which we recover through network tariffs. For a typical residential customer, Ausgrid's network tariff comprises approximately 40% of the bill.

Our network tariffs are regulated by the Australian Energy Regulator (AER) due to the monopoly characteristics of distribution businesses. Every 5 years, the AER assesses our regulatory proposal, and sets the maximum revenue that can be recovered for efficient costs. The AER also approves our tariff structure statement which sets out how we intend to collect revenue from customer segments.

Our network tariffs are charged to retailers, rather than directly to the customer. Retailers operate in a competitive market, and set tariffs that provide a commercial return that covers their cost of purchasing electricity from generators, and network charges.

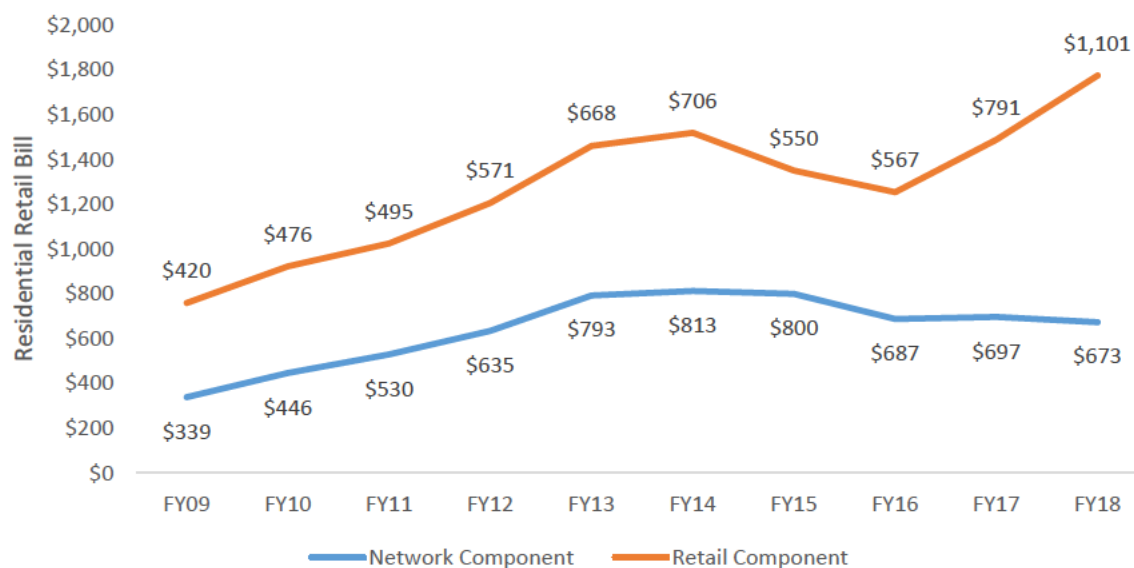
### (a) Comments on the reasons for recent large increases in the price of electricity

Electricity prices have increased significantly over the last decade. Ausgrid was a major driver for electricity price increases in NSW between 2009 and 2014. During this period we made significant investments to replace aging network assets to meet stringent reliability requirements.

Over the last four years, Ausgrid has transformed its business by significantly reducing our operating expenditure and implementing more innovative and cost-effective capital delivery approaches. We have also been able to delay capital investment as a result of less stringent reliability standards taking effect in NSW in 2014. Between 2013 and 2016, we reduced our annual expenditure by 53 per cent.

Figure 2 provides a comparison of retail and network components of an average 5MWh customer retail bill to show how the profile for these components have changed over time. Importantly, the figure reflects how Ausgrid's transformation initiatives have reduced the network component of customers' bills.

**Figure 2 - Comparison of network and retail component for an average (5MWh) customer retail bill**



Our analysis of average 5MWh customer billing data since 2013, as seen in Figure 3, shows that the network component of the electricity bill reduced by 8% over the last 5 years, while the non-network component increased by 30%. Consequently, this indicates that recent prices increases are associated with the retail component of electricity bills, which also consists of generation charges.

**Figure 3: Changes in the network and retail component of average electricity bills since 2013**



As we do not operate in retail or wholesale markets, we do not have a complete view as to why retail prices have risen substantially in recent years. Our view as an industry participant is that there may be one or more reasons for the price rise including:

- **Changes in the generation sector in the National Electricity Market (NEM)** – Retailers buy electricity from generators in the National Electricity Market. If the price of generation rises, retailers would need to pass on the additional cost to customers to maintain current profit margins. We note that there may be short and long term factors driving the price of wholesale electricity. For example, the tightening of supply and demand for energy through the closure of existing plants (supply reduction), or one-off weather events such as extreme heat (demand increase) is likely to lead to higher wholesale prices in the short term. In the long term, higher wholesale prices may also signal uncertainty in long term investment in generation.

- **Market failure** – A market failure in the retail or generation sector could be a driver of higher prices for customers. However, there would need to be sufficient evidence of inadequate competition either as a result of natural barriers for a new entrant to enter the market, or uncompetitive behaviour. As a DNSP, we are not in a position to observe evidence that suggests a market failure, however the Committee may wish to examine:
  - the market power of ‘gentailers’ to assess whether this is causing a substantive lessening of competition in the market; and
  - the Australian Energy Market Operator (AEMO) investigation of bidding practices by generators, as this may provide further insight on whether the existence of potential generator market dominance.
- **Complexity in pricing** – The complexity in tariff options offered by retailers may provide disincentives for customers to explore options that reduce their electricity bill. In turn, this could lead to less vigorous competition in the retail market. A key metric that could be examined by the Committee is the turnover of customers. Our customer research suggests that energy literacy is a key issue faced by customers. We are working with our stakeholders on programs that could help with energy literacy.
- **Lack of transparency and muted price signals** – Ausgrid notes that there is a lack of transparency for customers on the components that make up their electricity bill. This makes it difficult for customers to determine the underlying driver for increases in their electricity bills (i.e. increasing generation costs, network charges, or retail margins). Similarly, there is no obligation for retailers to pass through network price signals, which mutes their effectiveness and makes it difficult for customers to understand how changing their usage patterns may enable them to reduce the network component of their electricity bill.

We encourage the Committee to examine the evidence for each of these potential drivers, and develop proportionate solutions. In particular, we note that introducing regulation to address an issue that is unrelated to market failure, may not provide optimal outcomes.

#### **(b) Comments on the impact of the deregulation of electricity prices in 2014**

As a monopoly distributor, we are subject to price regulation by the AER. Every 5 years the AER makes a determination on the amount of revenue that can be recovered from customers for the provision of electricity supply services. This amount is recovered via network tariffs charged to retailers, who in turn recover these charges from customers as part of the network component of a customer’s electricity bill. The AER also provides further pricing oversight, by annually approving the level of network tariffs that can be charged to retailers.

In contrast, the retail and generation markets are not subject to a price cap. We consider the underlying principle of deregulation for these markets is sound from an economic perspective. In theory, there is sufficient competition in these markets to drive the lowest price for customers, without regulatory intervention.

As we do not operate in retail or wholesale markets we are not aware of any evidence to suggest that prices would have been lower under regulation. As noted above, the Committee would need to consider evidence of whether there is a substantive market failure that is driving higher prices, or other reasons such as price signals on generation availability in the future.

#### **(c) Comments on alleged collusion and price gouging by energy retailers**

As a DNSP, Ausgrid does not have any information or insights on the veracity of these allegations.



#### (d) Comments on the effectiveness or impact of any current regulatory standards and guidelines

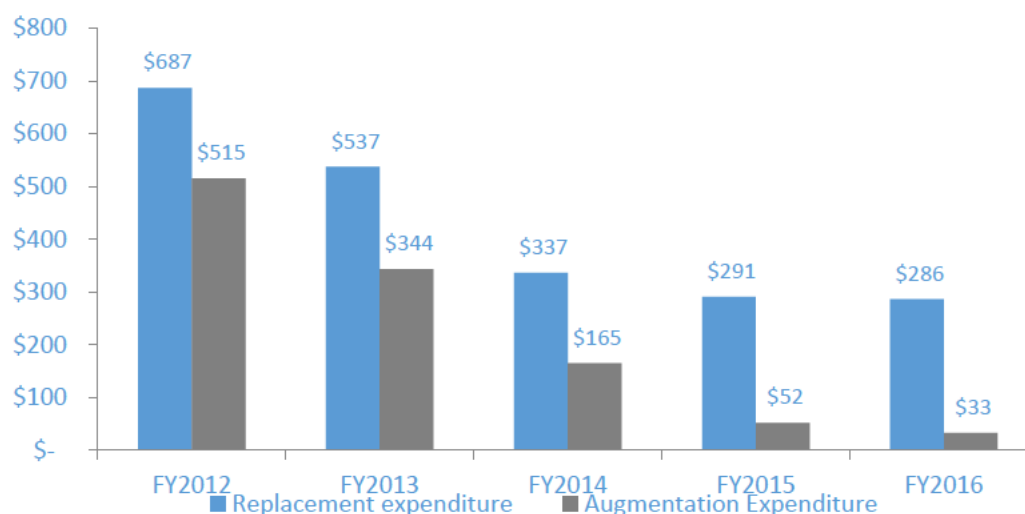
We are subject to a range of industry specific obligations regulations that set out the manner in which we supply electricity in the Australian National Electricity Market. These regulations include the Electricity Supply Act 1995 (NSW), the National Electricity Law (NEL) and Rules (NER) and the National Energy Retail Law and Rules.

We consider that the current regulatory standards in NSW for distributors are effective. In particular, we consider that recent changes to our licence conditions in 2014 have helped us to minimise our investments over the last 3 years. The changes removed the security criteria that had previously determined our investments in network infrastructure under set thresholds. We are now required to invest to meet an average level of reliability across different segments of our network, and to reinforce poor performing parts of the network.

The removal of the security criteria in the licence conditions means that we can now apply 'probabilistic planning'. Under this approach, we undertake a 'case by case' assessment of the need for large projects based on the value to customers from improvements to reliability. This means that we have been able to delay the timing or avoid the need for major projects where customers will not be adversely impacted by a reliability outage.

Figure 4 below, shows how the change in licence conditions, together with our internal transformation program has helped us to reduce replacement and augmentation capex since the peak of our investment program in FY 2012.

**Figure 4 - Ausgrid's Replacement and Augmentation Capital Expenditure between FY12-FY16**



Source: Ausgrid response to AER Regulatory Information Notice FY12-FY16

#### (e) Comments on options for future government oversight and responsibility in the re-regulation of electricity prices

As discussed in our response to (a) and (b), we consider that the Committee should examine the underlying reasons for higher prices. Any decision for government intervention should be based on evidence based analysis of market failures.

**(f) Comments on the adequacy of planning to meet future electricity demand, including utilising high efficiency, low emissions coal technology as well as the use of nuclear, gas, solar and wind energies, and energy storage through batteries, pumped hydro and hydrogen, and improved transmission between regions**

We do not have sufficient knowledge of all planning instruments in the regulatory framework to comment on the overall adequacy of planning to meet future electricity demand. We note that the Finkel Review undertook comprehensive analysis on these issues, and recommend that the Committee consider the key findings from this review as part of its investigation.

From a network perspective, we consider the existing suite of planning requirements provide a good framework that promotes efficient network decisions.

There are already a number of mechanisms under the regulatory framework that require us to publish information on the future network. These include but are not limited to:

- The Distribution Annual Planning Report - which requires network firms to publish network information on demand and capacity, replacement planning, future limitations on our network and possible solutions.
- The Regulatory Investment Test for Distribution - which requires network firms to publish information and seek feedback from stakeholders on material planned projects. This includes setting out credible options including demand management, and net present value analysis.

In addition, the AER's price determination provides a further level of oversight. The AER examines the veracity of maximum demand forecasts, and evaluates the prudence and efficiency of expenditure programs.

Together with other partners in the Energy Network Association (ENA), Ausgrid has been considering its response to the transition to a future network characterised by high penetration of household and embedded generation. Based on the ENA Transformation Roadmap, our upcoming 2019-24 regulatory proposal contains initiatives designed to facilitate the integration of distributed energy resources (DER) into the future network. DER is likely to be an important tool for both networks and retailers in areas/times of peak congestion and high demand. Ausgrid is committed to working customers and other industry partners to utilise DER as far as possible in our network.

**(g) Comments on the adequacy of programs to assist low income earners, pensioners and senior card holders to afford electricity as well as the impact of additional fees, such as late payment fees, included in energy bills**

People on low incomes including pensioners and senior card holders are likely to be disproportionately impacted by rising energy prices. This is because electricity bills represent a relatively high proportion of disposable income for these customers.

We encourage the Committee to examine the effectiveness of existing customer hardship schemes to determine whether they are appropriately targeted at delivering assistance to those who need it most. While there are a number of different hardship schemes available, these may not be performing effectively due to a lack of sufficient harmonisation, awareness or ease of access.

Our customer research has identified that energy literacy is a key challenge for customers. Specifically, our research has found that most customers do not understand the energy market structure, nor how their choice of electricity tariff and usage patterns may impact the size of their electricity bill. While Ausgrid has been partnering with our stakeholders to improve energy literacy, we suggest that this could be further strengthened by requiring retailers to provide a transparent breakdown of the different components (generation, network and retail) that make up a customers' final bill. This would provide customers with a better understanding of what might be driving any changes in their bill, as well as the levers available to positively impact on their bill.

In addition, Ausgrid is also considering introducing a safeguard tariff, as part of our upcoming regulatory proposal. This tariff would be aimed at supporting low income earners that could otherwise be disproportionately impacted by our tariffs.