

Committee Secretariat
Senate Standing Committee on Environment and
Communications References Committee
For submission by email to ec.sen@aph.gov.au



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**RE: Inquiry into the performance and management of
electricity network companies**

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Dear Senators,

Thank you for the opportunity to make a submission to this important inquiry. As the peak body for the community services sector in South Australia, SACOSS has a long-standing interest in the delivery of essential services. Our research shows that the cost of basic necessities like energy and water impacts greatly and disproportionately on vulnerable and disadvantaged people. Our advocacy is informed by our members; organisations and individuals who witness these impacts in our community.

Our experience with electricity network businesses (and, in fact, regulated gas and water businesses) is that they become very good at responding to the incentives they are exposed to. In this sense, there are clearly issues with the regulatory framework. Some of this has been addressed by the Better Regulation program although it is too early to say how effective this is going to be. It is also clear to us that there are natural limitations in the concept of regulating a monopoly with a strong profit motive.

In our view, the best outcome for consumers, investors and tax-payers is stable, modest returns on a low-risk investment.

The focus of this brief submission is on the role of risk in electricity, gas and water network regulation. We understand that if these businesses are to remain viable and attract the investment they need they must provide a risk-weighted return on investment. This is true for the privately owned energy network businesses in South Australia as well as our government owned water business (SA Water). However, our consistent experience is that:

- these businesses end up taking on a lot less risk in practice than they argue for when it comes to setting their regulated return;
- decisions that transfer risk to consumers can occur without a commensurate adjustment in a network business's regulated return.

A recent example from South Australia's electricity distribution business, SA Power Networks, is that of the change of regulatory approach away from weighted average price-caps to a revenue cap for their upcoming regulatory period (2015-20). Combined with the ability to expand the application of cost reflective pricing under the AEMC's new rules for

distribution network pricing¹, SAPN will be able to defer most demand forecasting risk onto consumers and deliver more stable cash flows for the business.

Despite this lowering of risks, SAPN in its regulatory proposal argued that the risks it face have substantially increased and given the progress of solar, storage and smart-grid technologies and the threat of mass-defection from the grid, “...*that there is no basis to continue the trend of reducing regulated returns on the assumption that energy network businesses are low risk.*” SAPN then argue for an increase rate of return on their capital deployed to compensate investors for the increased risk.

So, in an example of the mechanics of the ‘energy market death spiral’ in action, SAPN would like to respond to the risk of consumers leaving the grid by increasing their prices – something that will only motivate more consumers to do the same.

SACOSS recently convened an industry workshop “*The Death Spiral: Supporting ‘On Grid’ Consumers*” in order to facilitate some constructive dialogue on this critical issue for the energy market and for consumers. It became clear that there was likely to be significant losses incurred by either investors or consumers or both and, of course, the commercial incentive is to shift these losses on to consumers. In light of this, we encourage the committee to consider not just their past performance but how these businesses are likely to respond to the challenges ahead.

We thank you in advance for your consideration of our comments.

Yours sincerely,

Ross Womersley
Executive Director

¹ See Distribution Network Pricing Arrangements, Rule Determination 27 November 2014 at www.aemc.gov.au (AEMC reference ERC0161)