Senate Select Committee on Electricity Prices

NSW Government Submission

October 2012

The NSW Government is concerned about the pressure of rising electricity prices on households and businesses. We are committed to putting downward pressure on electricity prices by addressing poor policy settings that impose unnecessary burdens on households and businesses and by supporting the development of a market where customers can take greater control of their electricity bills.

Many factors have contributed to the July 2012 increases in electricity prices, both in NSW and across Australia, with the impact of the carbon tax and other green schemes being the largest component.

We remain convinced that the Commonwealth's carbon tax design is not an appropriate and efficient mechanism to achieve its stated objectives. The recent backflips on the floor price and "cash for closures" confirms this view. Furthermore, it is estimated that the carbon tax will add $168 to the average NSW household bill in 2012/13.

The Commonwealth renewable energy target has also contributed to electricity price increases, adding over $100 to the average NSW household bill. It is now clear that that the 20 per cent by 2020 target will be exceeded by a wide margin and at considerable cost to electricity consumers.

The Senate Select Committee should question the RET's efficiency and effectiveness as well as the justification for having two schemes (the RET and the Carbon Tax), resulting in households paying twice, for broadly the same policy outcome.

The NSW Government is taking actions both to cut costs and to increase pressure for improved efficiency through regulatory initiatives.

The actions taken to date include:

- Restructuring the distribution network business to make cost savings;
- Reforming inefficient work practices and curtailing excessive wage increases;
- Capping electricity dividends at or below existing forecast levels
- Reviewing the cost effectiveness of the current reliability standards;
- Increasing rebates and assistance for vulnerable customers;
- Closing the Solar Bonus Scheme;
- Closing the Greenhouse Gas Abatement Scheme (GGAS);
- Establishing a fair price for small scale solar generation; and
- Harmonising Victorian and NSW energy efficiency schemes.

The NSW Government believes that while the basic regulatory structure is sound, it must evolve and adapt as circumstances change. The States and the Commonwealth together through national energy reform initiatives are introducing enhancements to the regulatory process.

These will enable the AER to use greater scrutiny when considering network businesses' expenditure proposals and clarify processes for calculating the appropriate levels of returns.

The NSW Government will continue to investigate ways to improve efficiency and reduce pricing pressures both through participation in national processes (COAG, SCER) and through its own initiatives.

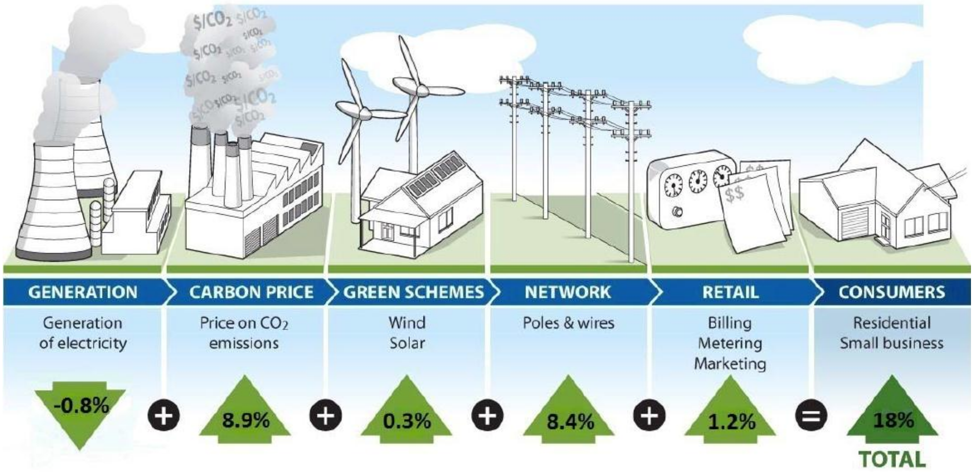
At a national level, the NSW Government intends to commence the National Energy Customer Framework in 2013 to harmonise the retail energy market and promote a more efficient and effective retail market with strong consumer protections.

The NSW Government will go further by introducing additional customer protections to empower customers with better information and greater choice when engaging in the energy market. This includes making metering data available to customers and putting appropriate restrictions on exit fees.

Already, NSW customers can choose between a regulated price set by the state's regulator IPART, or shopping around to get a competitive offer from another retailer. They can see what is available to them by comparing prices at www.myenergyoffers.gov.au.

1 What are the causes of the recent electricity price increases?

The increases in the average residential bill for regulated NSW customers from July 2012 occurred largely as a result of the imposition of the carbon tax and increases in network charges as shown below:



Source: IPART, *Changes in Regulated Electricity Retail Prices from 1 July 2012—Final Report,* June 2012

The two largest factors are: the combined impact of the carbon tax and green schemes, and the increase in network charges—the costs of providing, maintaining and operating the poles and wires.

In 2012/13, the carbon tax combined with green schemes such as the Large Scale Renewable Energy Target (LRET) and the Small-scale Renewable Energy Scheme (SRES) account for more than half of the increase (9.2 per cent of the total 18 per cent) approved by IPART and now account for around 15 per cent of the annual average regulated residential electricity bill—amounting to $314 per year.

Recent backflips on the carbon tax—the abandonment of the $15/tonne floor price and the failure of the "cash for closures" scheme—do not engender confidence that the tax is well considered policy. The recent debate over floor prices shows that the current tax of $23/tonne is unsustainably high.

In essence, the current level of the carbon tax is causing an unnecessary increase in electricity costs, without creating incentives for efficient reductions in emissions. Given the poor design of the carbon scheme, it is not surprising that that it has and will do little to change generation patterns at this time.

The LRET has further substantially increased costs to customers by shifting electricity generation from lower cost generation (coal and gas) to higher cost generation (wind and solar). The LRET will also overshoot the 20 per cent renewable energy by 2020 by a large margin. Some sources suggest that the actual amount of renewable energy will be around 25% of the total at an additional cost of around $25 billion.[1]

The SRES as an uncapped fixed price scheme has substantial flaws. It has led to current electricity consumers paying for "phantom" renewable energy through the solar multiplier and paying now for energy that will not be generated for up to 15 years in the future through the deeming of whole of life generation for solar panels.

While a 20 per cent target is supported, that are better ways of achieving it than the current schemes. At the very least, the combination of the LRET and SRES should be capped at 20 per cent of the forecast electricity generation in 2020 so that this target is achieved at least cost to consumers. This will avoid imposts such as that caused by the previous NSW Government's excessively generous Solar Bonus Scheme exceeding its target uptake by an order of magnitude.

Further to this, while the policy objective of the combined Renewable Energy Targets (LRET and SRES) may be valid, the NSW Government opposes customers being charged twice through both the RET and the Carbon tax for what is broadly the same policy outcome.

[1] *Renewable energy target $25bn too costly: TRUenergy*, Australian Financial Review, 7 September, 2012

1.1 Network Costs

Network costs—that is the cost of providing, maintaining and operating the poles and wires—have increased in recent years in NSW and in other States. The reasons for the increase are complex and revolve around the interplay of factors such as:

- **Electricity load becoming peakier**—that is, maximum demand has been increasing faster than average demand. This has largely been driven by the large increase in residential air-conditioning over the past decade and a reduction in off peak hot water installations. It results in higher costs as additional network infrastructure needs to be constructed to meet the demand—but may only be used for a few hours a year;
- **Past under-investment**—during the 1990's as electricity network businesses transitioned from government agencies to efficient and commercially focused entities as part of the Competition Policy Reforms, investment, operating costs, and staff numbers declined rapidly. In hindsight it is likely that there was insufficient investment in the networks during this period;
- **Replacement of aging infrastructure**. In common with most Australian States, there was large scale growth and expansion of the electricity network in the 1950s and 1960s in NSW. Much of that infrastructure has now reached the end of its economic life and needs to be replaced. We are seeing the "echo" effect of previous peaks in investment;
- **Increased reliability standards.** In 2005 the previous NSW Government increased reliability standards. The recent review of those standards by the AEMC, commissioned by the NSW Government, suggested that the increased standards were not economically justified and:

  "…that NSW is unusual in that (legally binding) *design planning criteria appear to be driving significant amounts of investment in NSW"*[2]

- **Higher financing costs**. As a result of the global financial crisis, the cost of raising debt and equity to fund capital expenditure has been increasing.

To a lesser or greater extent these factors have influenced price increases in network costs in most Australian States. In Queensland, for example, reliability standards were substantially increased as a result of the 2004 Sommerville Inquiry—and are now being relaxed.

Another factor contributing to overall network costs is the cost of declining labour productivity and real wage increases for network employees. Historically there has been little incentive for network businesses to consider the impact of operational costs on customers' electricity bills.

In NSW, increases in labour-related costs (wages, allowances, superannuation and accruing entitlements) continue to be around 6-7 % per year. Labour productivity has declined in the network businesses because of real wages growth, additional employees to deliver increased capital programs (the permanent workforce of the three NSW distributors has increased by 2050 employees over the last five years) and a lack of capability to initiate and deliver real enterprise reform.

It is important to note that inefficient work practices have been occurring across the energy industry and have been allowed to become part of the expected wage structure within network and generation businesses. Examples include:

- Excessive overtime payments because rostering arrangements do not take into account that electricity networks operate 24 hours a day, 7 days a week;
- Generous long service leave provisions providing additional leave for long term employees;
- Employer contributions to superannuation well above standard level for some employees ;
- Bonuses paid to permanent employees just to allow contractors to undertake capital projects;
- Planned night work is paid at double time with employees then stood down the next day effectively receiving triple time for the shift;
- Income supplements that can double or triple the base level income of regular employees.

It is frequently suggested that electricity prices would be lower if Government's instructed their businesses to operate at least cost and not pay returns as dividends to customers. This assumes that the dividend is a tax, which it is not. Dividends collected from the three state-owned electricity networks and

[2] *Review of Distribution Reliability Outcomes and Standards.* AEMC, 31 August 2012

each of the state-owned generators provide funding for a range of core government services including new roads, hospitals, teachers and police.

If dividends from the businesses were not collected by the Government, then the taxpayer contribution to the capital investment of these businesses would become a subsidy.

The NSW Government sees no reason why such a subsidy would be good policy. The revenue shortfall would require cuts to government services, or additional taxation. It would also impact the NSW Government's credit rating because revenue would fall but net financial liabilities would remain unchanged. All State and Commonwealth governments have accepted this principle in the Competition Principles Agreement.

In saying that, the NSW Government has committed to limiting the amount collected from each of the state-owned electricity generators and network businesses to a level at or below the levels estimated when Labor was in government.

Another important point to note is that, the NSW Government does not believe that its ownership of transmission and distribution should lead to NSW businesses being regulated differently to private sector counterparts. In that regard we note with concern the Committee's Terms of Reference 1(d) (v) which state:

> *"The arrangements to support and assist low income and vulnerable consumers with electricity pricing, in particular relating to the role and extent of dividend redistribution from electricity infrastructure"*

Competitive neutrality between publicly and privately owned enterprises was a central plank of National Competition Policy. The Competition Principles Agreement ensures that privately owned and government owned businesses are treated equally. The AER, as the independent regulator sets prices regardless of ownership, capital structure or dividend policy, so a policy of not paying dividends would have no impact on electricity prices but detrimental impacts on NSW taxpayers.

We note that that the Commonwealth Government also collects or proposes to collect dividends from businesses that it owns—notably the National Broadband Network. If no dividends are paid on the $30b plus investment the Commonwealth is making in the NBN this would represent a huge subsidy from taxpayers to broadband users.

2 What actions has the NSW Government taken?

The NSW Government is taking specific actions both to cut costs directly (in its role as the shareholder) and to improve standards and governance in the sector. These actions to improve governance will ensure that the NSW-owned distribution and transmission businesses better respond to the efficiency incentives created by the regulatory regime.

These actions are in addition to NSW's participation in national energy market reforms undertaken by all Sates and the Commonwealth through SCER and COAG.

Those actions that will impact directly on network businesses and their prices to customers are:

- **Deferring network spending**: With reduced projections on peak demand, network businesses have reviewed future capital expenditure projects with a view to defer any projects that are no longer necessary in light of the updated forecast information;
- **Stopping inefficient work practices:** The NSW Government has made it clear that customers should not be paying for inefficient work practices in NSW energy businesses. Inefficient work practices in the past have included excessive overtime pay-outs, unjustified bonuses and workplace agreements, such as paid shower time, that no longer fit in today's energy sector. Savings in the network business will ultimately flow through to end use customers.
- **Curtailing wage increases:** Through the NSW Government wages policy, state-owned energy companies must base any wage increases on clear guidelines that ensure projected savings are delivered.
- **Limiting the amount collected from state-owned energy businesses through dividends:** in 2012/13 the NSW Government will be only be collecting dividends from state-owned energy businesses at a level at or below the amount that was forecast by the previous Labour

government. The Boards of the three state-owned electricity network businesses and each of the state-owned generators will be required to declare that the dividends collected by the Government will not place additional pressures on price, service quality or future reliability.

- **Restructuring.** The NSW Government has taken action through the recent reform of its three distribution companies to save on duplicated management and administrative costs, procurement and service provision. The reforms will improve the efficiency of the businesses and will result in savings of more than $400 million over four years. These will be passed back to customers in a variety of ways including increased assistance and rebates for vulnerable customers.
- **Reliability and Service Standards**. The NSW Government commissioned the AEMC to report on the trade-off between network costs and is considering the AEMC recommendations that cost savings can be achieved if reliability standards were lowered.
- **Increased Rebates.** The NSW Government has increased rebates and assistance to vulnerable customers including increases to the Low Income Household Rebate, the introduction of the Family Energy Rebate and changes to the Energy Accounts Payment Assistance Scheme. This is in addition to the Medical Energy Rebate and the Life Support Rebate that already exist in NSW. Increased assistance through rebates will be funded from general revenue and the savings to be achieved from reform of the network businesses.

In addition the NSW Government is also taking action to reduce upward pressure on prices arising from other components of the electricity value chain, including:

- **Determining** a fair price for small scale generated solar energy. The IPART report *Solar feed-in tariffs: Retailer contribution and benchmark range for 1 July 2012 to 30 June 2013* (June 2012) determined a fair and reasonable feed-in tariff range for solar PV is between 7.7 and 12.9 cents per kilowatt hour. The full report is available at www.ipart.nsw.gov.au;
- **Increasing harmonisation** between the NSW and Victorian energy efficiency schemes; and
- **A draft Renewable Energy Action Plan** designed to ensure that renewable energy, built in NSW to meet the Commonwealth RET, can be delivered at the least cost with more focus on stand alone investment. This aims to benefit all NSW citizens, particularly those in regional areas and encourage less reliance on government subsidies.

The NSW Government also supports greater engagement from customers in the energy space. There a number of ways in which this engagement is already being encouraged in NSW through both the provision of information and the introduction of consumer protections that give customers the choice and the ability to play a greater role in how they consume electricity. This includes:

- The Terms of Reference issued to IPART for retail price regulation maintain the “safety net” option of regulated price until 2016 but move towards a competitive price market. Customers that use between 100 and 160MWh of electricity per year (such as pubs, clubs, motels and large strata plans) will enter the competitive market and boost retail competition across the State.
- Encouraging customers to shop around for a good deal. NSW customers can already choose between a regulated prices set by IPART or shop around to find a retailer that can offer them a better deal that suits their energy needs. Competitive offers can vary and customers need to be aware of different pricing structures (such as a flat rate, or a time of use price) and detailed terms and conditions (such as pay on time discounts and exit fees) but can make huge saving on their electricity bill if they choose the right product.
- Committing to the implementation of the National Energy Customer Framework. NSW supports the harmonisation of the the energy retail sector including the introduction of national retail licences, a harmonised scheme to make sure all customers have “retailer of last resort” or back-up retailer and providing across the board customer protections particularly to vulnerable customers.

The NSW Government will continue to seek out opportunities to reduce pressure on prices by improving the performance of the network businesses, reforming the regulatory framework so that it is more efficient and effective in considering the interests of consumers and pursue ways for customers to take control of their own electricity bills through participation in the energy space.