

Mr Baethan Mullen
General Manager, Retail Electricity Pricing Inquiry
Australian Consumer and Competition Commission
23 Marcus Clarke Street
Canberra, ACT 2600

By email: retailelectricityinquiry@acc.gov.au

24 November 2017

Dear Mr Mullen,

Re: Submission to the ACCC's Preliminary Report on Retail Electricity Pricing

Spark Infrastructure welcomes the opportunity to respond to the ACCC's Preliminary Report on Retail Electricity Pricing.

Background to Spark Infrastructure

Spark Infrastructure is listed on the Australian Stock Exchange (ASX) and is a leading Australian investor in Australian electricity transmission and distribution network service providers (NSPs) who transport electricity to customers in South Australia, Victoria and NSW. Spark Infrastructure has been an ASX listed investment vehicle since 2005, with a current market capitalisation of around \$4.5 billion. Spark Infrastructure's investment portfolio includes 49% interests in SA Power Networks (South Australia), CitiPower and Powercor (together known as Victoria Power Networks, in Victoria), and a 15% interest in TransGrid (NSW). Spark Infrastructure is approximately 75% owned by Australian professional, superannuation and retail investors, with the remaining 25% representing foreign investors.

The NSPs in our investment portfolio rank amongst the top performing electricity transmission and distribution NSPs in Australia, maintain constructive labour relations (including investment in employees and apprentices), and achieve best in class safety and reliability. We are very focussed on ensuring that our networks provide the services our customers require at least cost.

Spark Infrastructure's views are important to this review as Spark Infrastructure and its investors are the providers of long-term equity capital into these NSPs which is necessary to build and maintain the networks required to deliver critical electricity to customers whilst maintaining the high standards of safety, reliability, security of supply and efficiency demanded by customers. Domestic and global capital is highly liquid and is attracted by secure and robust investment destinations. Uncertainty in industrial markets, regulatory frameworks or in sovereign risk will see efficiently priced (i.e. low cost) capital quickly relocate to alternate investment locations, whether that be alternate industries or countries. Historically, Australia has been seen as an attractive and safe investment destination, but this perception is being questioned.

Summary

We are concerned that the findings and recommendations in the ACCC report mischaracterise the network sector and could be unhelpful to the task of identifying ways to sustainably reduce electricity prices.

We are also concerned that the overall commentary by the ACCC plays down the important distinctions between different States and, accordingly, fails to reinforce the obvious and clear benefits that private ownership has brought to the efficient operation of network businesses over many years, both in terms of operating expenditure and capital expenditure efficiency.

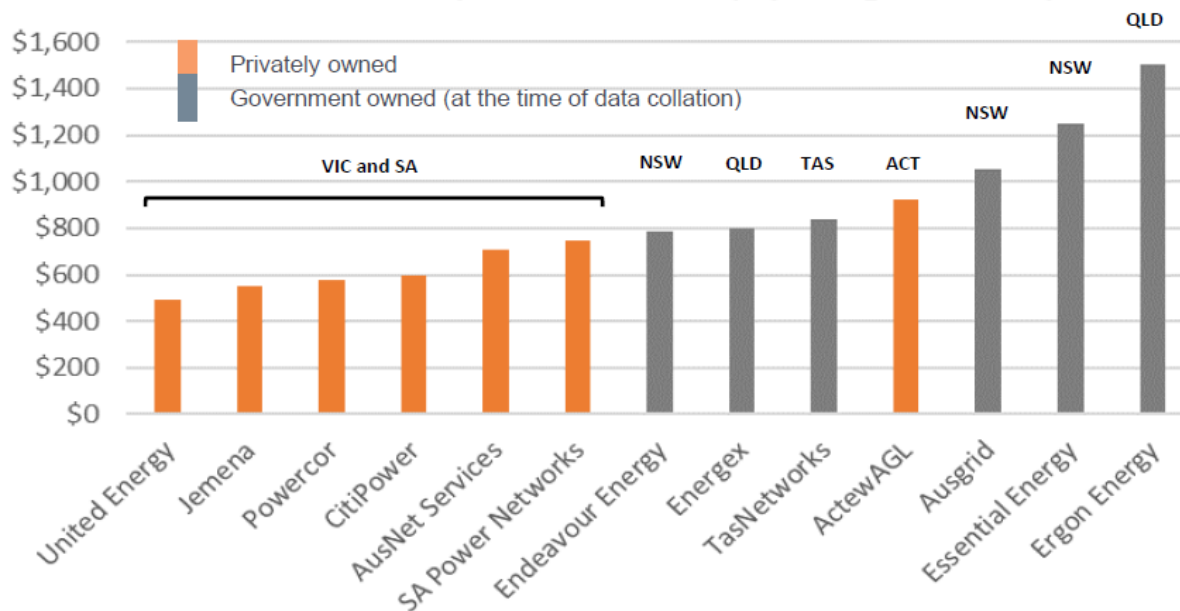
The National Electricity Rules and regulatory framework currently provide a robust and challenging environment for regulated networks, and provide adequate powers to the Regulator. Further misdirected and unwarranted

changes in regulation will only create uncertainty in the minds of investors, which can only lead to higher costs of capital or deterioration in reliability and service standards to customers.

Discussion

The current economic regulatory framework provides strong incentives for efficient investment, and is characterised by high levels of scrutiny and customer engagement. A critical underpinning of the framework is the ability for NSPs to recover the costs of efficient investment, including a reasonable return on that investment, and retain benefits of outperformance that are shared with customers over time. However, the incentive based framework is more effective where there is a profit motive which is stronger for privately owned NSPs.

Our distribution businesses in South Australia and Victoria rank in the top 5 of the Australian Energy Regulator's (AER) productivity benchmarking and have sustained relative better performance against their government NSP peer group over time. Further, based on total cost per customer, the privately owned NSPs outperform the government owned NSPs. This is illustrated in the following chart that compares total cost per customer based on a 5-year average to 2015¹.



Contribution to Residential Bills and Increases in Electricity Prices

The ACCC makes the statement that network costs comprise 48% of a typical 2015-16 residential bill. The ACCC has conducted its detailed analysis on data provided by electricity retailers and appears to have drawn this conclusion from its own estimation process.

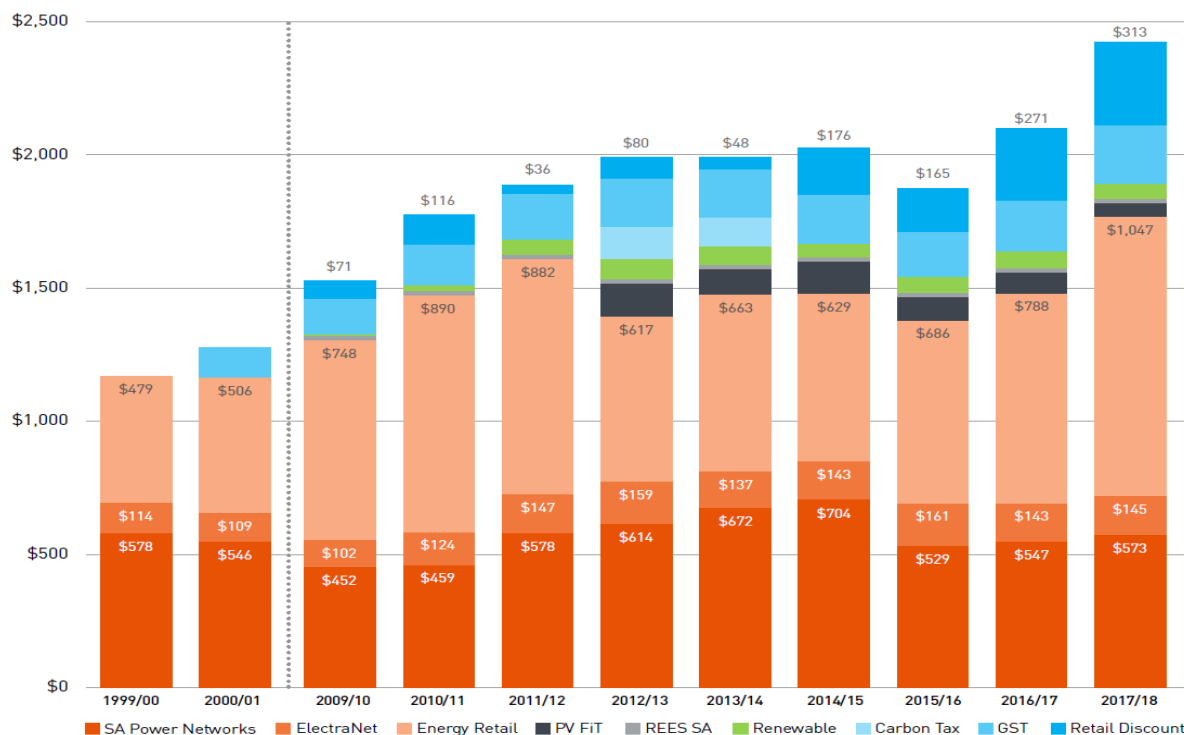
In the first instance an averaging across all States misrepresents the true picture; there are obvious differences in operating efficiency between privately owned and government owned NSPs as shown in the above chart.

Secondly, we have concerns over the accuracy of the data produced. The information relied on to form conclusions about network costs appears to have been sourced from retailers and has not been verified or subject to scrutiny. We note that the information available on network costs and charges is subject to consistent rules about categorisation and allocation, verified, scrutinised by the AER and publicly reported. We encourage the ACCC to consult with the NSPs to reconcile and verify information.

¹ AER distribution partial performance indicator trends.xls, 2015

Further, more recent data on network costs is available for the ACCC to consider in the next stage of this review. The AER will release its 2016 performance report on 30 November 2017 and information about prices and revenue in future years is available for most network businesses in the current final and draft revenue determinations.

Information sourced from SA Power Networks and Victorian Power Networks conflicts with the information presented in the ACCC's report. For example, in South Australia, distribution charges are approximately 24% of a typical household bill, and have risen by less than CPI since the business was privatised in 1999. A break down of the average residential network bill in South Australia is presented in the chart below²³.



The ACCC report states that the average Victorian residential network bill increased by 47% across the period 2007/08 to 2015/16. However, no adjustment has been made by the ACCC for government mandated schemes e.g. smart meters and premium/transitional feed-in-tariffs (FITs) which were not introduced until post 2007/08.

In a report submitted to the Victorian government's retail market review, Oakley Greenwood found that the contribution of network costs to bill increases over the same period was considerably lower⁴ and that average electricity network costs in Victoria were \$100 lower in real terms in 2017 than they were at the time of privatisation in 1995⁵.

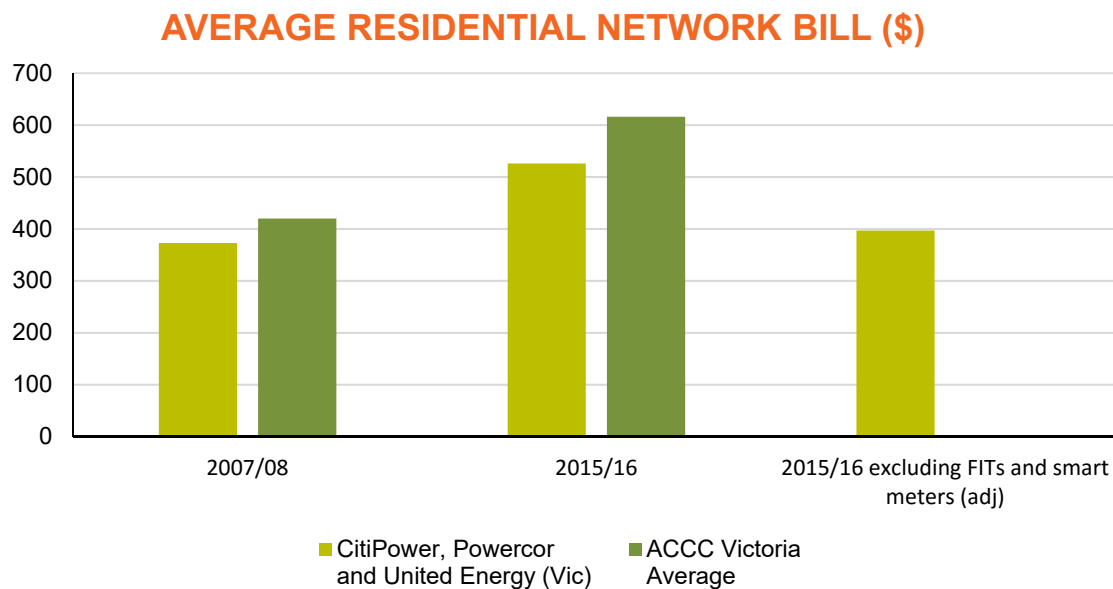
² All amounts in 1999/00 dollars.

³ From Spark Infrastructure's Asia Investor Presentation November 2017 available at http://sparkinfrastructure.com/wp-content/uploads/2017/11/044_Nov-2017-Asia-Investor-presentation-8-November-2017.pdf

⁴ Oakley Greenwood, *Causes of residential electricity bill changes in Victoria, 1995 to 2017*, February 2017, p. 11.

⁵ Oakley Greenwood, *Causes of residential electricity bill changes in Victoria, 1995 to 2017*, February 2017, p. 19.

The average residential network bill for CitiPower, Powercor and United Energy has increased for the period 2007/08 to 2015/16 by 8% (excluding government mandated schemes)⁶. However, during this time, hundreds of thousands of new customers were connected to the Victorian electricity network, customer demand grew, and service levels remained high⁷. Network charge decreases that occurred in 2017 reduced the increase in network charges over the prior 10 year period to 2%. A comparison with ACCC's analysis is shown in the following chart⁸.



As noted in the ACCC's report, the contribution of network costs to a customer's bill and increases in a customer's bill varies considerably across networks and jurisdictions. A key driver of the variations is government policy; governments have imposed obligations on NSPs that have increased costs and costs have increased more in jurisdictions where networks remain in government hands.

The ACCC should ensure that it treats government policy changes and initiatives included in network charges consistently between States and should record them in a similar manner to environmental costs, and not included in network costs.

Network Cost Trends

We note the ACCC's comment that the return of capital comprises over 50% of network revenue. The regulatory period for the period 2010-15 was significantly impacted by the Global Financial Crisis (GFC) which critically affected interest/bond rates and borrowing costs. Thankfully Australia navigated the GFC better than most countries. However, equity and lending costs were impacted during this period, which led to a significant increase in network costs. Since then, markets have improved and rates of return for equity and debt have reduced which has seen network costs fall significantly since 2015.

In summary, the economic market and regulatory pricing mechanisms have been working as expected. However, other elements such as environmental schemes/incentives, gas supply issues, coal generation plant closures,

⁶ Spark Infrastructure's Asia Investor Presentation November 2017 available at http://sparkinfrastructure.com/wp-content/uploads/2017/11/044_Nov-2017-Asia-Investor-presentation-8-November-2017.pdf, p. 30.

⁷ Victorian Electricity Network Businesses, *Submission to the ACCC Retail Electricity Pricing Inquiry preliminary report*, November 2017, p.3.

⁸ From Spark Infrastructure's Asia Investor Presentation November 2017 available at http://sparkinfrastructure.com/wp-content/uploads/2017/11/044_Nov-2017-Asia-Investor-presentation-8-November-2017.pdf

wholesale energy trading issues and increases in retailer margins have clouded the visibility of reductions in network costs.

Tariff Reform

Whilst network charges are a pass-through in concept, this does not necessarily flow down to individual bills which can and do distort messages and pricing signals to customers.

Spark Infrastructure supports the ACCC's findings that network tariff reform can reduce electricity prices over time. Efficient network tariffs that signal to customers the real cost of using the network can reduce the need to invest in building capacity and facilitate efficient adoption of emerging technology and behind the meter generation. Further, the benefits of investment in advanced interval meters will only be delivered if efficient tariff structures are passed through to customers.

Electricity networks are being used increasingly differently by customers as electricity flows move from traditional one-way flows from centralised coal-fired baseload plants to multi-directional and net flows from new distributed and intermittent renewable generation sources. This fundamental change in the way customers engage with networks requires a new tariff charging paradigm, away from the largely volumetric basis that is used today.

Whilst network tariff reform is critical, we would also recommend the ACCC investigate ways to improve the pass through of network price signals to customers. We support separately identifying network charges on bills to customers.

Incentive to Over-Invest

The ACCC makes the broad statement that *"as network operators receive a guaranteed return on their assets, there is an incentive to invest in more assets which can lead to over-investment if the rate of return set is too high"*.

This is a gross generalisation and fails to consider the commercial philosophies of private owners for whom capital is scarce, and who view their investment time horizons over many regulatory periods, not just one period. It also fails to take into account the high levels of scrutiny and discretion permitted and exercised by the AER in the regulatory determination approval process.

The extension of the ACCC's inference is that consideration should be given to writing down asset values, where appropriate. As stated earlier, we consider that the current economic regulatory framework provides sufficient incentives and scrutiny to support efficient investment and that the focus should be on increasing the strength of incentives to maximise the benefits to be shared with customers over time. We strongly oppose the suggestion to investigate retrospective re-valuation of investment. Writing down the value of assets privately held will reduce the incentives to invest and increase the cost of capital resulting in poorer services and higher prices to customers. This was recognised in the Finkel Review⁹ and has been strongly supported by work undertaken by the Energy Networks Association (ENA)¹⁰.

We consider that further investigation of past investment to future costs will be costly and prolong investment uncertainty. If further work is to be undertaken, it should include an independent assessment of the contribution of government ownership of NSPs to network charges, because, if inefficient over capacity exists, it is more likely in the NSW and QLD NSPs. Figure 2.34 of the ACCC report illustrates the significantly higher growth in NSP's Regulatory Asset Bases (RABs) in NSW and QLD for the period 2006 to 2016. Further, the relatively lower RAB growth that has occurred in Victoria is inclusive of the government mandated rollout of advanced metering infrastructure. In summary, the ACCC's report and the AER's annual benchmarking report reveal a clear divide between the benefits to customers in terms of productivity, efficiency and services between privately held NSPs and government owned NSPs.

⁹ Dr Alan Finkel, AO, Independent Review into the Future Security of the National Electricity Market, Blueprint for the Future, June 2017, p. 136.

¹⁰ Energy Networks Association, *Written Down Value? Assessing proposals for electricity network write-downs*, August 2014.

Concluding Remarks

We note that the ENA, TransGrid, SA Power Networks and the Victorian Electricity NSPs have all provided responses to the ACCC Retail Electricity Pricing Inquiry. We strongly support these submissions and their recommendations.

Specifically, Spark Infrastructure's key comments and recommendations are as follows:

1. The ACCC analysis does not appropriately disaggregate network costs into transmission, distribution and policy/environmental costs. In addition, the overall commentary and averaging across the entire NEM distorts the contribution of network costs to retail electricity bills and price increases, and downplays the important distinctions between States and hence between private and government ownership.
2. The ACCC should reconcile and verify their assertions on network costs and increases directly with the NSPs rather than relying on data provided by electricity retailers, and update the analysis for 2017.
3. Tariff reform should be accelerated.
4. Retailers should be required to separately identify network charges on customer bills to improve transparency.
5. Investigation in to writing down asset bases should not be pursued. Writing down regulated asset bases, and continuing discussion of writing down asset bases, increases investment uncertainty and the cost of capital. If any policy initiatives are adopted to reduce the contribution of past investment to future costs, these should be funded by government or be implemented prior to the transfer of ownership to the private sector (i.e. should occur outside the regulatory framework).

We welcome the opportunity to discuss this submission and are willing to assist with any further supporting information required by the ACCC. Please contact Sally McMahon, Economic Regulatory Advisor on 0421 057 821.

Yours sincerely,



Rick Francis
Managing Director & CEO
Spark Infrastructure

