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28 July 2016

Jai McDermott
General Manager Corporate Affairs
United Energy and Multinet Gas
6 Nexus Court, Mulgrave VIC 3170

Submitted via email: jai.mcdermott@ue.com.au

Dear Mr McDermott,

Re: Incentive mechanisms for the Victorian Gas Distribution Businesses

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to make a submission to the Farrrier Swier Issues Paper (the Issues Paper) on the Incentive Mechanisms for the Victorian Gas Distribution Businesses (Victorian DBs).

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria and New South Wales and electricity in South Australia and Queensland to over 1 million customers.

Red and Lumo do not support the introduction of a Capital Expenditure Sharing Scheme (CESS) on the Victorian DBs.

At a recent public forum in Melbourne the AER argued the capital expenditure arrangements that apply to the Victorian DBs deliver efficient outcomes. As such, the Victorian DBs operate very close to the efficient Production Possibility Frontier (PPF).

Any changes to the current arrangements risks threatening this outcome. Hence, we do not support them.

The Victorian DBs do not receive a carryover value on capital expenditure for efficiencies achieved in the current regulatory period. But efficiencies achieved by underspending their actual capital expenditure relative to forecast benchmarks are kept.

This approach has delivered efficient investment in capital expenditure in the Victorian gas distribution system with correspondingly high service levels. We have not seen any evidence that suggests that Victorian DBs are inhibited from providing efficient solutions under the current model.

Absent of an incentive scheme on capital expenditure, the Victorian DBs argue that they have no incentive to improve efficiency. More specifically, they argue the current incentive arrangements on capital expenditure fail to encourage dynamic efficiency. As a result they explore the option of implementing a high powered incentive regime.[1]

[1] Farrier Swier Issues paper – Incentive mechanisms for the Victorian gas Distribution Businesses" – 2018-to 2022 Gas Access Arrangement Review – 10 June 2016 p. 25 " The argument for higher-powered incentives may be more cogent where a business is operating at or close to the efficiency frontier where achieving further efficiencies gains are more challenging, and greater managerial effort and investment in innovation may be required.

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If the AER decides to introduce a CESS on gas distribution in Victoria, it needs to be convinced that it will deliver improvements in dynamic efficiency before implementing such a scheme. It must also be convinced that a CESS will not threaten the current high levels of reliability.

Should you have any further enquiries regarding this submission, please call Con Noutso, Regulatory Manager on 03 9976 5701.

Yours sincerely

Ramy Soussou
General Manager Regulatory Affairs & Stakeholder Relations
Red Energy Pty Ltd
Lumo Energy Australia Pty Ltd