Major Energy Users Inc.

Australian Energy Markets Commission

National Electricity Rule Amendment

Distribution Network Pricing Arrangements

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Consultation Paper

Submission
by

Major Energy Users Inc

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Summary

The Major Energy Users Inc (MEU) is pleased that the Australian Energy Market Commission (AEMC) is progressing to the next stage of reform of the electricity distribution network industry in line with the National Electricity Objective (NEO) and the long-term interests of consumers.

The MEU has long advocated the importance of reforming pricing arrangements for both distribution and transmission network businesses operating in the National Electricity Market (NEM). In particular, the current approach under the NER leaves considerable discretion to the network businesses in how they categorise consumers and how they set network tariffs.

As a result network tariffs in most states in the NEM largely reflect various historical, regional, policy and technological limitations and are not relevant to the needs of the industry and consumers today.

MEU members are continually frustrated by the proliferation of different network tariff structures and prices across the NEM and the lack of consultation and transparency in how these tariffs are set and why they are changed from time to time. Inappropriate tariffs and structures act as barriers to efficiency in energy use and to the development of demand-side participation. The MEU will therefore strongly support rule changes that rationalise the network tariff setting processes and outcomes.

The MEU also sees the reform of the distribution network pricing arrangements as a logical extension of the reforms to the network revenue setting processes introduced under the Better Regulation program through 2012 and 2013. It is also an important step in the implementation of the AEMC's recommendations from its Power of Choice review and in managing the dual challenge of significant increases in network capacity and the parallel decline in demand and consumption currently being seen.

The amalgamation by the AEMC of the Independent Pricing and Regulatory Tribunal's (IPART) proposal to amend the National Electricity Rules (NER) and the Standing Council of Energy's (SCER) rule change proposal that arose in response to the Power of Choice review is also welcome and provides more cohesion to the rule change process.

The MEU responds to the AEMC's Consultation Paper[1] on the rule change proposals by IPART and SCER in three parts:

[1] AEMC 2013, *Distribution Network Pricing Arrangements, Consultation Paper,* 14 November 2013, Sydney. [Consultation Paper].

1. Rule change proposals by both IPART and SCER that require network businesses to conduct timely and meaningful consultation with stakeholders regarding the networks' plans for tariffs and how these plans are approved by the regulator.

2. Rule change proposals by SCER that are designed to improve the economic efficiency and cost reflectivity of tariffs while taking into account consumer interests.

3. Issues that are not fully identified or discussed in the Consultation Paper, which the MEU considers are relevant to the AEMC's consideration of the rule change proposals.[2]

These matters are discussed in Sections 2, 3 and 4 respectively of this submission. A brief summary of the MEU's position on each of these issues is provided below.

1. Consultation Process:

With respect to the consultation process, the MEU supports the rule change proposal that requires the distribution network service provider (DNSP) to prepare a Pricing Structures Statement (PSS) as part of their 5-year regulatory revenue proposal to be approved by the Australian Energy Regulator (AER).

The MEU also supports the rule change that requires the DNSPs to adopt enhanced consultation processes in the development of the PSS. This consultation process should be guided by the best practice principles set out the AER's guideline on consumer engagement.[3]

However, while the MEU agrees that the PSS should be binding on the DNSP with respect to the proposed tariff structures (subject to AER approval for changes), there should be some flexibility allowed with the development of annual tariff prices in order to reflect changed circumstances that will inevitably occur. An example of this is the unexpected fall in demand that has occurred in parallel to the recent and significant build-up in capacity. The MEU believes this poses a significant challenge to network pricing and must be worked through strategically in the DNSPs PSSs in consultation with consumers and other stakeholders.

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[2] The MEU recognises that the Consultation Paper is limited to consideration of the rule change proposals rather than the broader issues around network price setting. However, the MEU believes there are some gaps in the discussion of these rule change proposals.
[3] AER, *Consumer Engagement Guidelines for Network Service Providers*, November, 2013. [AER Consumer Engagement Guideline]

The purpose of the PSS is to provide a binding commitment on the DNSP to the pricing strategies and tariff structures set out in the PSS. In contrast, the annual pricing approval process should provide the DNSP with some flexibility to amend tariff prices on a year-by-year basis, providing these amendments are consistent with the PSS and the NER pricing principles and are also in the long-term interests of consumers.

It is the MEU's view that this approach will provide some certainty for consumers and other stakeholders such as retailers, while providing flexibility to adapt to changing circumstances during the 5-year regulatory period. Certainty is important because it provides consumers and retailers with confidence to invest resources in responding to the new network tariff structures.

As an adjunct to this, the MEU also recommends the PSS includes a 10-year, non-binding outlook on the DNSPs pricing strategy. This reflects the fact that the transition to fully cost reflective network pricing is a difficult process requiring extensive adjustments by networks and consumers and takes many years of commitment. A 10-year outlook provides guidance to all stakeholders on the longer-term directions of DNSP pricing.

2. Economic Efficiency:

The MEU supports the intent of the SCER rule change proposal to require DNSPs to move to more efficient network tariffs that reflect the costs of providing the service to each connection point. Given the plethora of approaches adopted by DNSPs in the past, the MEU also supports the SCER's proposals to bring more rigour, consistency and transparency in the development of network tariff structures and calculation of prices.

For this reason, the MEU supports the proposal to mandate the adoption of a consistent approach to setting tariffs by the DNSPs.[4] The MEU further supports the high-level definition of this approach being included in the rules, again in order to reduce the inconsistency and lack of transparency in the DNSPs' tariffs setting.

However, the MEU supports providing some flexibility in the approach by directing the AER to develop a guideline that sets out the detail of the pricing approach to setting tariffs. This will allow the AER to conduct a separate consultation process that includes DNSPs, consumers, retailers and other stakeholders to ensure that the detailed methodology is one that

[4] The SCER suggests this approach should be the LRMC. However, as noted elsewhere in this submission, the MEU believes the LRMC approach is inadequate as it does not allocate the sunk costs, the recovery of which forms a large part of the overall distribution revenue assessment by the AER. However, the MEU does support the principle that the over-arching approach (whether LRMC or some other form of cost allocation) should be mandated in the rules.

best achieves the NEO at this time, as well as the intent of the rule change. The MEU acknowledges the AER's experience in consultation processes through the 2013 Better Regulation program and believes it is best placed to achieve consensus on the detail of how best to implement the pricing approach that has been mandated in the rules.

Similarly, the AER should include in the guideline some direction on the treatment of residual revenue that is not captured in the pricing approach.

The MEU is also very supportive of a progressive move towards demand-based tariffs (eg kWh per day or kVA) as being the most economically efficient form of network tariffs as this is the driver of network augmentation, both past and present. However, the MEU also accepts that it is likely to take a significant time for smaller consumers on bundled retailer tariffs to transition to demand based tariffs. In the meantime, there are pricing strategies that involve less price shock but can better replicate the intent of a demand based tariff, such as a progressive network consumption tariff[5] or time-of-use tariff.

In the meantime, however, the MEU urges the adoption of demand based tariffs for consumers appropriately metered that are based on demand on the network coincident peak demand days, rather than the individual consumer's peak day. This will provide the strongest incentives for large consumers to manage their demand and to provide demand-side services to the network at the time the network needs it most.

The MEU considers that locational pricing based on 'signalling' constraints in the distribution system pose a number of issues for DNSPs, retailers and consumer alike. It should be introduced cautiously and over time, perhaps by first unbundling transmission and distribution tariffs for larger consumers within the distribution network. In this way, large consumers will be exposed to some locational signals without the complexities that will arise with a more wide-spread adoption of locational pricing signals.

However, the MEU would also strongly argue that locational pricing that reflects local constraints could be a very useful tool to encourage efficient demand-side participation. That is, by assessing costs of the network on a locational basis, the DNSP could offer higher rewards to consumers willing to modify their demand on network peak days in those specific and constrained areas within the network.

3. Outstanding Issues

[5] The progressive consumption tariff is a tariff where the price increases at discrete defined consumption levels (or 'steps'). This tariff can include a seasonal component as well. For example, in the summer period, prices on the higher steps can be higher than in other seasons of the year.

The MEU considers that there are a number of important matters that are not adequately identified in the AEMC's Consultation Paper and should be further explored by the AEMC when considering the rule changes proposed by IPART and SCER.

The MEU has raised these additional matters because of the fact that network tariffs have immediate importance to consumers, retailers and other stakeholders and the process of setting these tariffs is in urgent need of reform. The issues are detailed in Section 4. They include:

- The MEU is concerned with the assumption in the SCER proposal and the Consultation Paper that the LRMC approach is the most appropriate basis for setting cost reflective network costs given its complexity and the fact that it does not allocate sunk costs. Difficult decisions must then also be made as to how to allocate the residual amounts while preserving the intent of cost reflectivity. The MEU is not convinced with either of the options provided in the Consultation Paper (Ramsey pricing and postage stamp pricing).

  The issue of cost reflective pricing has been addressed in transmission pricing approaches and the issue of signalling tight capacity conditions can be signalled through the used of modified cost reflective network pricing (CRNP) methodologies. Although modified CRNP is seen as being both complex and somewhat subjective, it has a number of advantages over an LRMC approach in that it is a proven methodology and has some acceptance.

  The MEU therefore believes the LRMC approach should be critically examined by the AEMC and assessed against other cost allocation approaches such as the CRNP approach for transmission businesses that is set out in Chapter 6A of the NER. Following this evaluation, the AEMC could promote a 'better rule' to achieve the objectives of cost-reflective pricing.

- The lack of recognition in the Consultation Paper of the key role of the retailers who sit, for most consumers, between the DNSPs and consumers, and the imperative of ensuring there is early engagement between networks and retailers around network tariffs structures and retail products.

- The role of tariff structures in promoting, or inhibiting, the development of demand-side participation which is the focus of the AEMC "Power of Choice" report.

- The need to understand the importance to consumers of transparency, predictability and consistency in the DNSPs' approaches to setting

network tariff structures across the NEM. If consumers' needs are not prioritised, then consumer acceptance will be minimal.

- The importance of understanding the different impacts efficient tariffs will have on different consumer segments, and the need, therefore, to allow for effective transitional processes within the rules.

- The need for more empirical analysis of the outcomes of the LRMC approach and the outcomes of alternative approaches (such as the CRNP) that may provide more efficient signals of the availability and cost of capacity. It is important for consumers to be able to understand the impacts of these various approaches on different consumer sectors in order to allow consumers to more effectively participate in the rule and tariff setting processes.

- While there is considerable focus on greater transparency and communication by DNSPs about their prices, the rule change proposals appear to ignore the lack of transparency in the DNSPs decisions about how to allocate transmission use of system charges (TUOS) to consumers in the DNSP network. MEU members have experienced considerable difficulty in seeking clarification of the allocation process from the DNSPs.

- If the AER is to use a weighted average price cap approach to the total revenue, then the implications of this for cost-reflective network pricing need to be better understood. The MEU believes there are opportunities under the price cap control for DNSPs to increase revenues above the allowed revenues, and consumers are particularly vulnerable to this outcome during a process of change to tariff classifications, structures, and prices.

- The AEMC itself has an important responsibility to proactively engage with a broad range of stakeholders during the rule change process in order to ensure better understanding and acceptance of the rule changes that will have such significant impacts on many consumers.

The MEU contends that there are many other issues around the network pricing arrangements that need to be addressed if the reform objectives set out in the Power of Choice and elsewhere are to be achieved.

The MEU notes that that the AEMC appears to consider itself limited in this current Consultation Paper to considering only the rule change proposals presented by IPART and SCER. However, the AEMC has the ability to implement a 'better rule' than those proposed to achieve the objective of cost-reflective network pricing. The MEU believes that the AEMC should take this opportunity to explore whether there are better ways to achieve the goal that initiated the SCER rule change.

Moreover, the MEU believes that the reform of network pricing arrangements risks becoming fragmented across a number of different reform projects. For example, the objective of cost-reflective pricing should, in the MEU's view, encompass an integrated approach that includes transmission pricing. At a minimum, there should be:

- Better alignment of the pricing principles in the NER distribution pricing rules (Chapter 6 of the NER) and the transmission pricing rules (Chapter 6A of the NER); and

- Reforms of the way transmission prices are allocated by the DNSP to the NUOS charges that consumers or their retailers see on the DNSP bill. Transmission prices provide some locational signals yet these are completely "washed away" by the pricing approaches of the DNSPs. There is currently little transparency, equity or consistency in how transmission costs (and their locational signals) are integrated into the DNSP processes.

The MEU will, therefore, continue to seek a more integrated response from the policy makers to the reform of network pricing and service arrangements. The Consultation Paper and subsequent rule changes represent just one step in this process, the outcome of which must be an integrated, nationally consistent approach to delivering efficient levels of network services and encouraging consumer participation.

1. Introduction

1.1 Background

The Major Energy Users Inc (MEU) welcomes the opportunity to provide a response to the Australian Energy Market Commission's (AEMC) consultation paper on distribution network pricing arrangements (the Consultation Paper).[6]

The AEMC has been requested to amend the National Electricity Rules (NER) which relate to the way in which electricity distribution network businesses set and structure the distribution network prices. The Consultation Paper is the first stage in the AEMC's review of the rule change request.

The distribution pricing principles and rules are set out in Chapter 6.18 of the NER and include (inter alia) the timetable for providing pricing proposals to the AER, the requirement to define tariff classes in the proposal, pricing principles, side constraints on tariffs, publication of tariffs and the AER's approval of the pricing proposal.

The Consultation Paper brings together two separate, albeit partly over-lapping, rule change requests that propose amendments to the distribution network pricing arrangements in the NER.

The first rule change request is from the Independent Pricing and Regulatory Tribunal (IPART).[7] This request is focussed on amending the NER as it applies to the timing and consultation processes undertaken by distribution network service providers (DNSPs) when setting network prices. IPART was particularly concerned to see amendments to the NER that would result in enhanced engagement with stakeholders and amendments to the timing of publication on proposed network prices to facilitate this enhanced engagement.

IPART considered that enhancing consultation processes and allowing additional time in the price setting process would facilitate electricity retailers and consumers responding more effectively to DNSPs' network price changes.

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[6] AEMC 2013, *Distribution Network Pricing Arrangements, Consultation Paper,* 14 November 2013, Sydney. [Consultation Paper].
[7] IPART, *Network price changes, IPART's proposed changes to the National Electricity Rules,* September 2012. [IPART, Proposed Rule Changes].

The AEMC has already undertaken some public consultation on IPART's proposals and has incorporated the response of various stakeholders into the current Consultation Paper.

The second rule change request was from the Standing Council of Energy and Resources (SCER) and arose out of the recommendations contained in the AEMC's Power of Choice Review[8]. SCER indicates that its rule change request is designed to: [9]

- Clarify and strengthen the NER to ensure that DNSPs develop and set prices based on Long Run Marginal Cost (LRMC);

- Enable the Australian Energy Regulator (AER) to have sufficient time to evaluate DNSP pricing proposals to ensure they are consistent with the amended pricing principles; and

- Improve the existing consultation requirements for DNSPs so that retailers and consumer groups have greater opportunity to consider and influence network prices and pricing structures.

Although the two rule change proposals have been submitted in response to somewhat different issues, there is considerable overlap between the two proposals in their common emphasis on improved consultation by DNSP's with stakeholders and the strengthening the AER's role in the network pricing process.

However, SCER's proposal has an additional emphasis on the economic efficiency aspects of network pricing reflecting its links to the AEMC's Power of Choice Review and the recognition by governments of the need to encourage demand side participation and curb the need for investment in the networks to meet peak demand growth.

1.2 Proposed rule changes and issues arising from these changes.

Taken together, the key components of the AEMC's current consultation on the proposed rule changes can be summarised as follows:

- Require the DNSPs to produce a Pricing Structures Statement (PSS) as part of the DNSP's regulatory proposal for the 5-year determination period. The PSS would set out the DNSP's plans for any changes in tariff structures, tariff components and (potentially) changes in prices or pricing trends. The AER would need to assess these plans for

[8] AEMC 2012*, Power of choice review – giving consumers options in the way they use electricity, Final Report*, 30 November 2012, Sydney. [Power of Choice Review)
[9] SCER, *Rule change request - reform of distribution pricing arrangements*, September 2013. p 2. [SCER, Rule Change Request].

compliance with the stakeholder consultation requirements, the National Electricity Objective (NEO) and the distribution pricing principles in Chapter 6.18 of the NER.

The purpose of these rule changes is to provide more opportunities for consultation and more transparency and certainty for stakeholders on the direction of network tariffs. This will, in turn, enable retailers and consumers (and other third parties) to respond more effectively to the price signals in the tariffs.

- Require the DNSPs to set tariffs on the basis of the network's long run marginal costs (LRMC) and, in particular, the LRMC of augmenting the network to meet peak demand. The rule change makes it mandatory for DNSPs to use a LRMC approach as the basis for setting cost-reflective network tariffs.

  The purpose of this amendment to the Rules is to strengthen the current rule framework which only requires the DNSPs to 'take account of' the LRMC[10] of providing the services and does not specify how this would be done or what methodology should be adopted. This has led to DSNPs adopting very different approaches both over time and between different DNSPs (even within the one jurisdiction).

Implementing these new requirements raises a number of important issues that will need to be resolved (by reference to the NEO and the pricing principles) as part of the rule change process. The Consultation Paper raises a number of theses issues, for example:

- How to achieve a balance between a stronger regulatory framework that provides more certainty to stakeholders with the flexibility to adapt to changes in demand, regulatory environments and technological capabilities, as well as to real differences in the characteristics of the different DNSPs.

- What is the role of the AER in approving network pricing plans in the PSS given the AER's limited role in the approval of annual pricing proposals to date?[11] For example, what role should the AER play in ensuring that the DNSP has conducted adequate consultation with all stakeholders and appropriately takes into account the impact of tariff changes on consumers in their PSS?[12]

- What aspects of the new approach should be included in the rule changes and what aspects of reform are better met by the AER

[10] NER cl 6.18 (b)(1).
[11] NER cl 6.18 (a)(1)(2).
[12] This is one of the rule changes proposed by SCER.

developing guidelines for the DNSPs (which may or may not be mandatory for DNSPs to apply)? For example, should the AER develop guidelines in areas such as customer consultation practices, the content of the PSS and the selection of LRMC methodologies, or should these be details be included in the rules themselves?

- To what extent is it efficient, and practical for the DNSPs to develop prices that reflect directly the cost of peak demand costs for all classes of customers? And if not, what are the best most cost-effective alternatives for network prices?

- Should consumers of the same class pay the same tariff price regardless of location within the DNSP's area, and if so, does this apply to all consumer classes and what criteria should be used; locational constraints, age of the assets, etc?

- The extent to which individual consumers or classes of consumers will be negatively impacted negatively by tariff changes and how would these impacts be best managed in the process of moving consumers to cost-reflective tariffs?

1.3 Initial Response by the MEU

Some background observations and comments

The MEU members have had considerable direct experience with network service providers and network pricing for both transmission and distribution network services. The MEU brings this experience to bear in its consideration of the issues identified in the AEMC's Consultation Paper.

For example, the MEU notes the significant differences in the current NER between the approach to transmission pricing and the approach to distribution pricing.

The rules on transmission pricing in Chapter 6A of the NER are quite prescriptive compared to the distribution pricing rules in Chapter 6 where the focus is on stating pricing principles. However, in both instances, the end result has been a diversity of approaches to pricing that are not clearly linked to cost-reflective outcomes. Nor do the two approaches (in Chapter 6A and Chapter 6) deliver effective demand-side participation on either the transmission or distribution systems.

Both the significant diversity in pricing outcomes and the lack of support for demand-side management are sources of significant dissatisfaction for MEU members. The poor outcomes represent a lost opportunity for both business and the community to enhance the efficiency of the energy market.

The MEU also highlights the problematic way in which the current NER deals with the relationship between transmission and distribution pricing.

Even though the locational and capacity signals from transmission pricing are weak, DNSPs appear to reduce these even further by their approach to aggregation of transmission costs that are then 'smeared' across the various elements of distribution pricing in a totally non-transparent manner. The absence of clear principles and transparency in the DNSPs approach to transmission cost allocation is particularly concerning for those consumers where transmission costs are a significant proportion of their overall network use of system costs (NUOS).

However, the Consultation Paper does not take the opportunity to include reform of the rules to ensure greater transparency and economic efficiency in the allocation of transmission costs either by themselves or by the DNSPs in developing the NUOS charge. This is a missed opportunity, as is the opportunity to achieve better consistency between the pricing principles in Chapter 6 and the pricing approach 6A of the NER. It is only by aligning these principles that the overall efficiency of the electricity network system can be optimised.

The rule change proposals from IPART and SCER

The recent work by the AEMC in the Power of Choice review along, the Productivity Commission and others all reinforce the MEU's view that cost-reflective pricing is essential to achieving efficient investment in and use of the electricity transmission and distribution networks. It is only through reform of the network revenue and pricing arrangements, including greater engagement of consumers, that network prices can be constrained to be efficient and reach competitive levels in the future, let alone promote efficient demand side participation.

The MEU, therefore, strongly supports the overall objectives of the proposed rule changes to improve consultation processes, to develop more cost-reflective network prices and to introduce changes in the rules that will provide more transparency, consistency and predictability in network pricing. The MEU's principle concern is that the rule changes and the AEMC Consultation Paper do not go far enough.

The current rules, which given the DNSPs a very broad level of discretion to allocate costs and set tariffs, have resulted in a confusing array of approaches which lack transparency and induce a lack of confidence by users in investing resources to respond to the different network tariffs.

While it is important the DNSPs have some flexibility in setting tariffs that reflect individual circumstances, the MEU would argue that the primary

purpose of tariffs is to signal to consumers the cost of the network services that the consumer uses and allow consumers to respond to these in the most appropriate way.

With the DNSP's revenues effectively 'guaranteed' under the AER's application of maximum revenue control mechanism, the MEU strongly argues that the focus now should be on meeting the real needs of consumers (both large and small) for transparency, predictability and consistency while moving towards cost –reflective pricing.

The proposed rules changes go some way to achieving this outcome. However, the MEU believes that there are a number of areas that are not adequately developed in Consultation Paper. These include:

- The assumption that the LRMC approach is the most appropriate basis for setting network tariffs; this is a key question, particularly given SCER's proposal to mandate that DNSPs base their network tariffs on the LRMC (rather than taking LRMC 'into account', which is the requirement in the current rules[13]).

- The lack of recognition of the key role of the retailer, and therefore, the need for meaningful communication – and negotiation - between DNSPs and retailers in the introduction of new tariff structures.

- The role of tariff structures in promoting or inhibiting the development of demand-side participation.

- The need to understand the importance to consumers of transparency, predictability and consistency and the impact these factors can have on the willingness of consumers and retailers to 'invest' in responding to the network tariffs.

- A recognition that the mandatory application of LRMC principles and the consequential network tariff structure and price changes, will have different impacts on different consumer segments and the importance of quantifying these impacts before finalising rule changes.

- The need for more empirical analysis to enable consumers to assess impacts of the various approaches to pricing on different consumer segments and, therefore, to provide effective input to the AEMC based on informed consumer preferences.

- The lack of transparency in the way distribution networks allocate TUOS charges, which in turn, impacts on the ability of consumers to respond effectively to TUOS locational and demand price signals.

[13] See the pricing principles in the NER, cl 6.18.5(b).

- The need for a greater analysis of how the pricing reform process will interact with the form of regulatory control. In particular, the weighted average price cap control mechanism already opens up opportunities for DNSPs to exceed their allowed revenue and these opportunities will only increase if there is a period of significant change in network tariff classifications, structures and prices.

- The important role of the AEMC and AER in proactively engaging with a broad range of stakeholders in order to ensure better understanding and acceptance of changes.

The MEU requests further consideration of these issues by the AEMC during the development of the proposed rule changes.

1.4 Structure of the Submission

Section 2 will consider the issues raised in the Consultation Paper regarding improved consultation processes and the publication of network pricing plans.

Section 3 will examine some of the challenges arising from the SCER's proposals that are designed to achieve more cost-reflective network tariffs.

Section 4 provides a more detailed discussion of a number of the issues that the MEU believes are important and relevant to the rule changes but which have not been adequately addressed in the Consultation Paper.

Section 5 provides a detailed response to the specific questions raised by the AEMC in its Consultation Paper.

2. Consultation Requirements

2.1 Overview of the MEU's response

The MEU strongly supports the proposal to introduce a PSS, and to link the PSS with the regulatory network revenue determination process. This has several advantages:

- It enables a more efficient use of resources for the consultation process. This would be of benefit to DNSP, consumers, retailers and other stakeholders while facilitating the overall task facing the AER.

- It provides an explicit link between the overall revenue determination and the prices that DNSPs charge. For example the forecast demand and capital expenditure requirements set out in the revenue proposal should have a logical link to the structure and levels of network prices based on the costs for providing the services.

- It ensures that the PSS is a more strategic document with a minimum of a five-year horizon.

- Similarly, it reinforces to the DNSP that the PSS is a serious document that represents a real and enforceable commitment by the DNSP to consumers, retailers, regulators and policy makers.

- It provides a framework for assessing annual pricing proposals.

- It is a source of information to consumers and retailers that can guide their future investment decisions in energy efficiency, demand management, product innovation and the like.

Notwithstanding these potential benefits, the MEU recognises that the PSS will only be worthwhile if, in practice, it has been developed by the DNSP with serious intent to identify and address the underlying network issues and there has been a process of genuine consultation with a wide range of stakeholders.

The MEU, therefore, supports changes to the NER that will ensure the AER has the powers to enforce the rules or guidelines that define how this consultation should be carried out by the DNSP.

However, while preferring enforceable standards of consultation and a binding commitment to the tariff strategies and structures set out in the PSS, the MEU does not believe the PSS should be completely restrictive on the DNSP.

For instance, the MEU considers that the DNSP should have a right to seek the AER's approval for amendments to the PSS to reflect changed circumstances. In addition, the MEU would not support a requirement that the PSS include binding statements on specific *network prices* (although the approach to network tariff structures should be binding) over the 5-year period. There are too many other variables that impinge on revenue allowances and prices to make such a requirement useful or efficient. The current nexus between rapidly expanded capacity and the parallel decline in demand and consumption of electricity is one important example of the need for some flexibility in pricing arrangements.

The MEU also considers that it would be valuable for the PSS to include a 10-year strategy plan (non-binding) as well as the 5-year binding strategy and tariff structure plan. This is because the move to cost-reflective tariffs can be very complex, both politically and technologically, and may need to evolve beyond 5-year timeframes, particularly for small consumers.

2.2 Specific comments on the proposed rule changes

The MEU's more specific views on the proposed consultation process are summarised below.

- The PSS should bind the DNSP to the tariff strategy, tariff structure and tariff class allocations. In the event the DNSP believes it needs to amend these aspects of the PSS, it should require the approval of the AER following a period of genuine consultation with all stakeholders. Given the potentially significant impact of changes to network structures on consumers and retailers any amendments to the PSS should be advised at least 12 months in advance of the proposed change.

- The PSS should provide an indication of the expected direction of prices for each of the tariff components. For example, the PSS should indicate if the DNSP expects the price of the fixed supply charge to increase significantly over the 5-year period. However, these indications of price trends, while given in good faith, should not be binding on the DNSP, albeit the changes must be clearly identified and justified in the annual pricing proposals.

- The DNSP's annual pricing proposal must be consistent with the PSS as well as with the rules and any guidelines established by the AER.

While the AER's guidelines are not binding, the DNSP must be able to demonstrate it has complied with best practice consultation processes.

- The PSS needs to be approved by the AER and the AER should have a clear right to reject a PSS and an annual pricing proposal if it does not accord with the NEO, the NER, relevant guidelines and best practice consultation procedures. The AER should also have reserve powers to set the default tariff structure and prices, with the decisions on how this is done left to the discretion of the AER bearing in mind the NEO, NER and pricing principles.

- Engagement with all stakeholders must be conducted in good faith and in accordance with best practice principles – the AER's Consumer Engagement Guideline provides a sound starting point for a DNSP when planning its consultation program on network pricing strategies and structures.

- Although the MEU is very keen to see greater progress in the reform of network pricing, the MEU considers that it is important to establish from the start that the PSS is linked into the regulatory revenue determination process. For this reason, and because it would allow more analysis and consultation by the DNSP with its stakeholders, the MEU would prefer that the PSS is not introduced prior to the commencement of the revenue determination process in each jurisdiction.

- The MEU is not convinced that there is a need for significant change in the timetable for the publication of network tariffs in the annual tariff report – *assuming that the PSS is binding and implemented as suggested above*. Clearly, if the AER is able to shorten its approval processes for annual price updates (because of the PSS process), then the additional few weeks will assist retailers to adjust their retail pricing to consumers.

  However, if the change in timetable means that the DNSP has not got access to the necessary inputs (such as CPI), then the MEU believes the risks and complexity of subsequently adjusting for over/under revenues, outweigh the benefits to the retailers for the earlier advice.

- On the other hand, changes to the structures of network tariffs, or significant changes to the tariff parameters (not price related) require greater notification than that proposed by IPART in their rule change request.[14] That is, an additional month in the process is not adequate notification for retailers or consumers to respond effectively to changes

[14] IPART, *Timing and Consultation Arrangement*s, 2013, p 6.

in network tariff structures. Subject to further consultation, the MEU suggests that at least 12 months notification is more appropriate for these types of changes.

- Consideration be given to including a requirement for the PSS to include a non-binding long-term (10-year) strategy plan to ensure that long-term issues are taken into account.

3. Cost-reflective & efficient distribution network pricing.

3.1 Overview of the MEU's response

As noted previously, the MEU strongly supports proposals that introduce more certainty and consistency into DNSPs' tariff structures and pricing arrangements. The MEU also recognises that there should be some flexibility allowed for the DNSPs. However, this flexibility must be offset by concern for the difficulties and costs facing consumers in the absence of a coherent approach to network pricing across the NEM.

Therefore the MEU is generally supportive of the rules being amended to mandate the approach that the DNSP must take to allocating costs in order to ensure that the outcome is more cost-reflective and efficient prices.

However, the fact that the approach is mandated means that the AEMC should give greater consideration as to whether the most appropriate basis for cost-reflective pricing in the networks is the LRMC (whatever form that may take).

The MEU is concerned that while the proposed LRMC may capture the cost of new capacity investment, it may fall well short of delivering prices that recover the total revenue allowed by the AER, as the allowed revenue is determined on the basis of the costs of both new investment and sunk investment in the network. This will be particularly true as the community enters a period of declining demand, excess capacity and reduced capital investment in augmentation. The MEU considers that there may be better approaches to allocating costs that avoid this problem, such as the cost-reflective pricing approaches (modified and not modified) specified in Chapter 6A of the NER for transmission businesses to price their services.

In addition the MEU also cautions that a pure LRMC approach is likely to lead to price shocks for some consumer segments. Therefore, before mandating that the DNSPs must apply a LRMC approach as the basis for tariffs, it is essential that the impact of this approach on different consumer classes be better understood, and that there is agreement on transitional strategies.

Another important consideration in evaluating whether LRMC is the right approach or some other approach should be preferred, is an assessment of the quantum of the 'residual' revenue allowance that is not captured through the LRMC, and the extent to which this residual can be allocated to different classes of customers without distorting price signals or placing

significant burdens on some groups (see section 4.1 for further discussion on this).

At this stage, while the MEU has considerable concern about the LRMC proposal, there is little empirical analysis available to determine the extent of the concern. The MEU, therefore, again urges the AEMC to conduct further empirical investigations of the quantum of the residual revenue that must be allocated for different DNSP regions. This will enable stakeholders to better understand the import of the issue and, as noted, will enable stakeholders to make more meaningful assessments of the rule change proposal *before* the AEMC finalises the rule changes.

The MEU is also concerned with the conflict between the apparent support of jurisdictional ministers for moving towards cost-reflective and efficient network pricing, while at the same time seeking to include rules that promote the primacy of jurisdictional requirements over the national rules that may be contrary to efficient pricing.

The MEU understands that there may be some historical reasons why adjustments to cost-reflective efficient network pricing will take longer in some jurisdiction than in others. However, when jurisdictional requirements over-ride the national rules, then this undermines the broader policy intent (which has been agreed to by the respective energy ministers) of consistency and predictability in network pricing arrangements across the NEM.

MEU members continue to be frustrated by the delays in achieving a truly national market and the costs to MEU members and other stakeholders of this delay. Jurisdictions, therefore, have an obligation to be very transparent with their constituencies of the reasons for, and costs of, such variations.

3.2 Specific comments on the proposed rule changes

- The MEU supports the proposal to mandate an approach for the allocation of costs. This provides more transparency and predictability for consumers and retailers while also providing opportunities for DNSPs to tailor their tariffs to individual circumstances.

- The LRMC, or alternative mandated approach should be clearly defined in the rules and based on a single methodology developed by the AER through a consultation process with all stakeholders The AER's consultation should be supported by empirical analysis of the impact of the different approaches and methodologies. Again this ensures transparency and consistency, while not impinging on the ability of the networks to recover their allowed revenues.

The MEU notes there that under a revenue cap form of regulatory control, the DNSP is 'guaranteed' to receive its allowed revenue but no more, irrespective of the pricing methodology. However, if the form of control for a DNSP is a price cap, then the MEU considers that there needs to be a clear methodology on how the reform of prices is not used as a way of enhancing overall revenues above the total revenue allowance.

- To further ensure consistency, with some flexibility, the MEU recommends that the over-arching pricing approach be defined in the NER; however, other components of the calculation might be better captured in a guideline developed by the AER in consultation with stakeholders as the guideline can be more readily amended to changed circumstances.

- There should be a progressive move towards demand based network tariffs (kWh/day or kVA). However, consumer demand should be assessed in terms of the *coincident peak demand*, that is, usage on the days of network system peak. It is the coincident demand that defines the capacity requirement of the network. This is a significant change in the pricing approach adopted by most DNSPs. However, the approach better reflects the true costs of 'incremental' peak demand. It is also more consistent with network pricing arrangements that promote demand-side participation.

- While the MEU favours a move towards network pricing based on coincident peak demand, the MEU's support for locational pricing for *distribution* networks is more circumspect, particularly where the pricing is claimed to represent constraints on the network system.

  The MEU's proposal is therefore to introduce the concept of locational pricing by first requiring DNSPs to separately pass through TUOS locational charges as a separate charge for larger consumers. This would then be progressively introduced for other consumers.

  This step will ensure growing awareness of locational costs (although not necessarily of network constraints) and will generally improve the transparency of the DNSPs allocation of TUOS charges into the NUOS charges.

  For smaller consumers within a DNSP, the MEU considers that augmentation costs are currently 'socialised' across consumers in the DNSP's area, just as maintenance and replacement costs are currently socialised across all these consumers in the DNSP's area. This issue of socialisation of costs militates against cost-reflectivity and appropriate rewards for demand side participation but may be an

important policy principle for jurisdictional governments. Nevertheless, it must be addressed in a way that best approximates cost-reflective locational issues.

Therefore, the MEU believes it is essential to identify the costs of augmentation of network constraints, as this can be used not only for pricing but as the key input into assessing the value to the DNSP of demand-side participation at different locations within the network.[15]

- The MEU notes the AEMC's discussion on whether a Ramsey pricing approach or postage stamp approach is the most appropriate for allocating residual revenue to the pricing elements. It is of some concern that such decisions will have an impact on consumers, but this impact is not quantified. For instance, if Ramsey pricing was adopted for allocating residuals, what is the likely increase in fixed costs versus variable costs and how will this impact on consumers and how they respond to the network prices[16]?

- Jurisdictional requirements may be an impediment to achieving full cost reflectivity in network prices. It is disappointing to the MEU members that these differences might be perpetuated rather than resolved at the expense of progressing systematically towards a common basic approach to network pricing arrangements across the NEM.

- The MEU has reservations about the proposal to amend the NER pricing principles.[17] SCER has proposed that the pricing principles include a new requirement that the DNSP 'take into account the impact of tariffs on consumers'. This new clause would replace the existing clause that the DNSP must have regard to transaction costs and whether customers of the relevant tariff class are able or likely to respond to price signals.[18]

  The MEU considers that the new obligation is too vague and is open to exploitation by the DNSP's as a means to avoid moving to cost-reflective pricing. The MEU would prefer the general requirement to take account of the impact on consumers becomes one of the factors the AER takes into account when approving or rejecting a PSS or annual tariff proposal.

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[15] The recently released regulatory investment test guideline (RIT-D) will also contribute to this process.
[16] For example, if the approach is to increase fixed costs, then there will be no incentive to a consumer to reduce its demand when such a reduction would have value to the network
[17] The pricing principles are set out in NER, cl 6.18.5.
[18] NER, cl 6.18.5(b)(2)(i) and (ii)

- Similarly, the MEU has reservations about the proposal to amend the rules to mandate that DNSPs group customers into tariff classes (and tariff prices!) on an 'economically efficient basis'. The MEU agrees with the AEMC that the reference to 'economic efficiency' is such a broad criteria that it allows considerable scope for DNSPs to group consumers into tariff categories in many different ways. Mandating DNSPs to do this (rather than have 'regard to' economic efficiency[19]) will not change the risks to consumers from such broad terminology. Nor will it prevent DNSPs changing these categories at their discretion irrespective of the impact on consumers and other stakeholders.

  The MEU would therefore prefer to see progress towards a more consistent set of definitions across the different DNSPs. The MEU can see no useful purpose in the DNSPs being able to continue to have such varying tariff categories. However, this general right for the DNSPs comes at potentially significant risks and costs to consumers and retailers.

- The MEU understands the appeal of applying side-constraints to changes in average prices in a tariff category, both within and between regulatory periods, particularly given the history of significant changes in tariffs between regulatory periods. However, the MEU would also prefer to see further analysis by the AER of any impacts that imposing side-constraints on tariffs between regulatory periods[20] would have on the complexity and robustness of the AER's determination process.

  Separate from the debate over whether side-constraints achieve the objective of protecting consumers (given the constraints apply to the revenue from a tariff class rather than a specific tariff), there is currently an exemption for time-of-use and similar tariffs from the side-constraints.[21] The MEU sees no value in this exemption continuing.

[19] NER, cl 6.18.3(d)(1).
[20] That is, between the last year of one regulatory period and the first year of the next regulatory period. Currently, side-constraints do not apply to the tariffs in the first year; they can vary by any amount from the previous period tariffs.
[21] NER, cl 6.18.6(e).

4. Issues that need to be addressed by the AEMC

The MEU believes there are a number of important areas that are not adequately addressed in the Consultation Paper but which should form part of the rule change assessment process. They are discussed below.

4.1 Assessment of the LRMC as the mandated basis for setting network prices

The MEU has identified many aspects where the principle of cost reflectivity needs to be enhanced to ensure that all end users contribute fairly to receive the service they expect. The AEMC proposes that using the LRMC for the assets used to provide the service would assist in the achievement of cost reflectivity. The MEU is not convinced of this proposition.

LMRC is intended to assess the cost of providing an additional unit of service rather than reflect the cost of the assets actually used to provide the service. This means that LRMC will allocate higher charges for an additional unit of service where there is no spare capacity and lower charges where there is excess spare capacity. In the transmission rules, use of LRMC is akin to the modified "cost reflective network pricing" (CRNP) approach yet the reasons for most TNSPs not using the modified CRNP approach is because of the relatively high degree of subjectivity the approach imposes and the increased complexity resulting.

Using an LMRC approach requires an objective and equitable basis to allocate the "sunk" costs of the network, yet there is no agreement on what that approach should be. The approach used to recover sunk costs has a significant impact on the whether the pricing reflects the actual costs each end user causes the network.

The revenue rules provide a target allowed revenue for the network to recover - the pricing rules provide the basis on how this is to be achieved so that each end user pays for the service on an equitable basis. With this in mind, the MEU considers that the approach used in the transmission pricing rules (i.e. allocating costs based on the optimised replacement value of the assets used[22]) will provide an outcome that is cost-reflective

[22] Assessed either by a CRNP or modified CRNP basis. See Chapter 6A, S6A.3.2 and S6A.3.3. The CRNP is defined in the rules as 'an allocation process' and applies to the locational component of the allowed revenue for transmission services. At its most basic, it involves determining the ratio of the optimised replacement cost of a particular asset to

and will recover the necessary revenue but will not introduce the complexity of using LRMC.

4.2 Recognition of the importance of retailer engagement in the process

One of the concerning aspects of the Consultation Paper is the limited acknowledgement by the AEMC that success in progressing and implementing the rule changes will require the support of retailers as well as networks.

This point was recognised by IPART in their rule change proposal. IPART specifically highlighted the need for more extensive consultation by networks with retailers. However, this consideration seems to be somewhat lacking in the AEMC's discussion.

For example, in the presentation to stakeholders at the AEMC's public forum in Melbourne on 27 November 2013, IPART highlights the importance of retailers as the intermediary in delivering the DNSP pricing signals to consumers. IPART states that its proposed changes to the NER better meet the NEO by:

- Improving retailers and customer's ability to respond to network price signals;
- Allowing more time for retailers to develop retail pricing structures and reduce retail price risk;
- Allowing networks to better understand how customers and retailers will respond to price changes;
- Allowing retailers to respond to network price signals in developing retail prices; and
- Allowing customers to better understand the prices they are likely to face.[23]

While many of the MEU members can deal directly with networks regarding price changes, the MEU acknowledges that for most consumers, the retailer acts as an intermediary between the consumer and the network. Moreover, the great majority of these latter consumers will continue to purchase bundled energy products from a retailer and will have no direct knowledge of their DNSPs tariffs.

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the optimised replacement cost of all the transmission assets used to provided prescribed use of system services. As a result, the process allocates all the allowed revenue

[23] Adapted from IPART, *Improving the timing and consultation arrangements for annual network price setting,* 27 November 2013. p 2. [IPART, Timing and Consultation Arrangements].

Therefore, the MEU stresses that recognition of the role of the retailer in developing and promoting relevant products is essential and this can only be achieved if there is formal obligation on the DNSP to actively involve retailers in the development of the PSS (in particular).

This consultation process also requires the DNSP to work with the retailer to understand the overall cost implications of any changes to network pricing structures and parameters, including the costs for the retailer of developing appropriate retail products, marketing and communication material and modifying the retail billing systems.[24] [25]

At the end of the day it is the overall efficiency of the delivery of energy that counts to consumers and the NEO is not achieved by simply transferring costs from DNSPs to retailers through (for example) complex tariff structures[26].

In assessing the adequacy of the DNSP's engagement, the AER therefore needs to ensure that a comprehensive engagement with retailers as well as consumers has occurred in the development of the PSS.

4.3 The promotion of demand-side participation (DSP) in the market.

The MEU has long been concerned with the barriers that distribution tariffs create for the development of demand-side participation and embedded generation in the market.

The AEMC's Power of Choice review confirmed the potential for demand-side management to reduce the peak load and associated network (and generation) costs across the NEM. In fact, the SCER rule change proposal arose from the Power of Choice review, which as its name suggests, seeks to bring greater involvement of consumers in electricity market issues. A clear message from the AEMC's review was that network pricing acts as a barrier to demand-side participation; a barrier that arises from the structure of the network tariffs, their application and lack of cost reflectivity in both the DUOS and the TUOS pass-through.

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[24] The retailer must undertake all these activities even if the network costs are separately identified on the retail bill, as the total bill must include both the retail and network components.

[25] This is not to say that DNSPs do not have to adapt their billing systems to new tariffs. However, at the end of the day, their output is an XML file of usage data (or equivalent) sent to a retailer. In contrast, a retailer has to produce a bill for the consumer that is comprehensible and compliant with multiple rules regarding format and content. This may take many months to specify, program, test and implement.

[26] It must be remembered that retailers have the ability to "wash out" the network pricing signals just as DNSPs currently "wash out" TNSP pricing signals

The MEU is therefore most concerned that neither the proposed rule changes provided by SCER, or the AEMC in their discussion of the rule change proposals, make specific reference to the necessity of DNSP's tariffs being consistent with the promotion of cost-effective demand side participation (DSP) by consumers.

For example, in the MEU's response to the AEMC's Draft Power of Choice review paper, the MEU noted that while it was pleasing to see the AEMC promote the development of time related pricing, the AEMC's proposal did not address two key MEU concerns:[27]

> The one area that the MEU considers needs considerably more attention, relates to the barriers to embedded generation and the network pricing associated with it.

One of the network pricing barriers to demand-side participation that was identified by the MEU is the fact that in most DNSP regions, larger users are charged on the basis of their peak day usage irrespective of whether or not this peak day usage is coincident with the network peak demand or not. For example, a user may be willing to curb production on a network peak day (or use its own back up generation), but the user will still be charged for their individual maximum demand. As further stated in the MEU's submission:[28]

> The MEU considers that network supply tariffs should reflect usage at the time when there is the most stress on the network...there needs to be an incentive (by lower network charges) for those consumers who maintain or reduce their demand when the network demand is otherwise increasing.

These issues are long standing; yet they do not appear to be fully grasped either within the rule change proposals from SCER or in the Consultation Paper.

The MEU therefore believes that when amending the rules to improve economic signals, the AEMC should include a positive obligation on DNSPs to develop efficient network tariffs to promote cost-effective DSP. Alternatively, this might be included in a guideline.

Such an obligation would serve to encourage DNSPs to move towards network tariffs that directly 'penalise' users who cause the network constraints at peak times and 'reward' users who contribute to the reduction in actual peak demand on the network system. Current network tariffs that are variously based on charging users for their peak demand

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[27] MEU, *AEMC review of demand side participation (DSP3), Response to the Draft Report,* October 2012, p 4.
[28] Ibid, p 5.

irrespective of when this occurs are significantly less efficient in achieving the outcome sought by the reforms.

4.4 The importance of transparency, predictability and consistency to consumers.

In considering the role and content of the PSS, as defined in rules or guidelines, the AEMC should be more cognisant of the importance that consumers place on consistency and predictability in network tariffs.

For MEU members, network tariffs can make up a very significant component of their total energy bill. It is therefore a source of considerable frustration that, not withstanding there is a national market, the MEU members face network structures and prices and tariff allocations that lack transparency, and can vary significantly over time and across different DNSPs[29] – often for no apparent reason and without reasonable consultation or notification.

Such a situation reduces the confidence of consumers in the DNSPs commitment to their stated tariff strategy and is, therefore, incompatible with the goal of encouraging stakeholders to invest in services or equipment that might reduce their peak demand. For example, a large user may be considering investing in back-up generation so that it can better reduce its demand on a network peak day. However, the business may be reluctant to do so if there was no clarity about the future direction of network prices and/or the DNSP's commitment to their announced strategy.

In addition, if a DNSP's approach to tariff allocation and pricing structures are significantly different from one area to another, then consumers, who might otherwise be willing to provide DSP services to the network, may be reluctant to do so if this is limited to a single site and, therefore, the business can not achieve 'economies of scale' across all their sites.

In a similar vein, retailers will be most reluctant to invest in product development, billing changes, communication material etc., if they are not confident that there is some predictability in the way the DNSPs set their tariffs or the DNSPs commitment to stated tariff strategies.

The MEU suggests therefore that the rules require the PSS to include a 10-year guidance (non-binding) as well as the 5-year binding commitment to tariff strategy and structures.

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[29] For example, some MEU members have seen DNSP prices rise by more than 50% year on year with no apparent reason and a refusal by the DNSP to explain its tariff decisions. This lack of accountability and transparency is an example of DNSPs taking advantage of their monopoly position. The rule changes should ensure that this cannot be repeated in the future.

4.5 Different consumer segments will face different challenges

It is to be expected that the reform of network tariffs will provide benefits to some consumers but will lead to price increases for others.

For example, as indicated above, MEU members are generally comfortable with the implementation of peak demand pricing that applies to usage on the coincident peak demand day.

MEU members believe that there can be some benefit in locational based pricing for large consumers, providing this is introduced with some care given the sunk costs of existing establishments.

It is suggested that an effective starting point for introducing locational charges would be to base locational pricing signals on the transparent pass through of locational TUOS charges by the DNSP. While this will generally lead to relatively minor adjustments in overall network costs to individual sites[30], it provides a signal on locational costs.[31]

Importantly, this approach would increase the transparency of TUOS charges for users whose sites sit within the DNSP boundaries (i.e. are not directly connected to the transmission system). For most of these users, TUOS is bundled by the DNSP into a Network Use of System (NUOS) charge that may bear little relationship to the original TUOS charge.[32]

Notwithstanding the potential economic efficiency of locational and demand based network, the MEU is also cognisant that the consequent changes to network price structures and levels may cause significant price shocks to some consumers and/or add to the complexity of billing and related processes for DNSPs and (as applicable) retailers.

Both price shock and complexity are also most likely to be an issue for the smaller consumers with bundled retail tariffs. The more obvious example of this potential complexity would be the introduction of peak demand charges for small business and residential consumers such as KWh per peak day (per month or per year) or kVA prices..

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[30] TUOS charges generally make up a small proportion of network charges for consumers located within the distribution network. Moreover, less than half of TUOS charges are made up of locational TUOS charges (although this varies with jurisdiction and distance).
[31] Although these locational charges may not necessarily reflect the cost of constraints in the network, they do provide a starting point.
[32] For instance, the distributor PowerCor charges the same NUOS charges for smaller users in Mildura and Ballarat despite the different TUOS charges associated with each connection point.

In view of this, the MEU considers that any changes to more cost-reflective tariff structures and prices, may need to be introduced over a period of time. To ensure that it does occur, however, the DNSP must be required to set out a clear strategy in the PSS that sets out how and when the DNSP plans to reach the new network pricing structures.

In addition, the rules must explicitly allow for such transitional processes, perhaps directed and/or monitored by the AER through its role in approving the network's PSS and annual pricing proposals. The MEU notes, for example, the proposal by IPART to establish a 'target tariff' regime that sets out the transition steps and timing to cost reflective tariffs. This target tariff regime is similar to the process introduced by IPART to promote rebalancing of retail tariffs in the NSW distribution areas, but could equally apply to DUOS tariffs with the regime defined in the PSS and approved by the AER.[33]

4.6 The need for more empirical analysis on consumer impacts

The AEMC is seeking consumer input into the consultation process. However, the MEU suggests there are a number of areas in the AEMC's Consultation Paper where consumers could provide more effective input if there was more analysis provided on the impacts on consumers. For example, without further analysis, it is difficult to understand the overall cost-benefits and impacts on specific consumer segments in the following areas:

- What is the likely quantum of impacts of mandating the use of LRMC on prices to different segments; how much will this vary by DNSP area?

- What difference in impact will occur between the different approaches for calculating LRMC[34].

- How will different categories of consumers be affected by different approaches to the LRMC?

- How will different consumers be affected by different approaches to the allocation of residual amounts?

Just as the DNSPs will be expected to conduct meaningful consultation with consumers that outline the costs and benefits of their proposed network pricing strategies, it is important that the AEMC provide more

[33] IPART, Timing and Consultation Arrangements, November 2013, p 5.
[34] The MEU notes that in the rule change for generator market power, the AEMC consultant showed the difference between the LRMC perturbation approach and the LRMC additional generation approach varied by up to 50%

analysis of the cost and benefits of the proposals before the new rules are implemented.

4.7 Integration of TNSP charges into DNSP prices and tariffs

The MEU has noted above that currently the integration of TNSP charges into the DNSP prices and tariffs is non-transparent and that the locational signals that TNSP pricing provides are essentially "lost" in DNSP pricing.

Once the DNSP has 'bundled' the TUOS charges it receives for each of the connection points to its network into the NUOS charge, there is very limited scope for consumers to understand and act on reducing TUOS charges. Yet these TUOS charges are a significant component of the total network costs for large consumers located close to a DNSP zone sub-station.

The current approach to TNSP pricing and how the TNSP prices are passed through to consumers does not readily lend itself to ensuring that the goals driving the changes to DNSP pricing will be delivered in the most efficient manner.

The MEU considers that the AEMC should address TNSP pricing as part of its analysis to ensure that TNSP pricing does not have a negative impact on achieving the objectives the AEMC and SCER have set for the reform of changes to DNSP pricing. It is too limiting by the AEMC to look at DNSP pricing in isolation from the DNSPs treatment of TUOS pricing and how TNSP prices can be modified to enhance the review of DNSP pricing.

4.8 Cost-reflective pricing and price cap regulation

In section 3.2 above, the MEU notes that relationship between cost-reflective pricing and price cap regulation needs to be further considered by the AEMC. The principle of cost reflective prices combined with revenue cap regulation can be readily implemented and adjustments made to allowed revenue should the prices developed over/under recover the allowed revenue; revenue is therefore independent of changes in demand and/or consumption.

This is not so easy with price cap regulation where revenue increases or falls with changes in demand and consumption.

In practice, the MEU has seen priced capped DNSPs adjust their prices so that increases in usage will occur with high priced tariffs and reductions in demand occur with lower priced tariffs. Retirement of "obsolete" tariffs assists in this process. Because the tariffs are controlled under a weighted

average price cap approach (WAPC) the ability to change individual (profitable) tariffs allows the DNSP to recover more than the revenue set by the regulator even when forecasts of demand and consumption reflect actual usage. Implementing tariffs based on cost-reflectivity for price cap regulation will provide a new avenue for DNSPs to increase revenue even when no change in demand and consumption occurs, through tariff manipulation.

As price capped DNSP are expected to carry the risk of demand and consumption variances, there has to be some methodology that this risk remains with the DNSP and is not transferred to consumers under the guise of cost reflectivity

4.9 The need for the AEMC to proactively seek a broad consensus

The MEU considers that the implementation of these changes to network prices may prove to be both difficult and controversial. It is essential, therefore, that the consultation processes around the rule changes are comprehensive and build in some level of consensus across the community of stakeholders.

The MEU encourages the AEMC to ensure that it proactively seeks to build this consensus, and bring together an approach that recognises the concerns of policy makers, consumers, networks and retailers.

With a change that is so directly significant to consumers, the MEU believes it is not sufficient for the AEMC to follow its standard, industry focussed rule change processes. The oft-reported problems with the Victorian smart-meter rollout should serve as a warning that without broad consensus at an early stage in the process, reform will be difficult. The MEU strongly urges reform, but recognises the importance of bringing the community at large along with it.

5. Responses to AEMC questions

The MEU provides the following responses to the specific questions raised in the Consultation Paper. The MEU has endeavoured to keep its answers as concise as possible and refers to the commentary in the preceding sections to amplify its reasoning.

Chapter	#	AEMC question	MEU response
Chapter 5: Assessment Framework			
5	**Q1**	**What other considerations should be included in the assessment framework?**	The AEMC proposes the following assessment criteria for rule changes: efficient pricing, stakeholder engagement, predictability, allocation of risk and regulatory burden. (Consultation Paper, p 22). ***Problems with the proposed criteria;*** The MEU considers that the AEMC has unnecessarily restricted itself in its 'interpretation' of these criteria. For instance, the AEMC assumes that 'efficient pricing' will necessarily include a method for recovery of 'sunk costs' (p 23), but does not allow for the write-down of excess assets as an option for investigation. It is clear from a number of reports that the current assets have excess capacity and are over-valued due (in part at least) to the limitations of the previous regulatory regime. It is a reasonable question – perhaps a necessary one - to ask whether the rules should allow discounting the value of assets as preferable to the 'death spiral' of increasing average prices and declining usage. Similarly, the AEMC talks of 'stakeholder engagement' in terms of the engagement of consumers. However, it does not mention

			meaningful engagement by DNSPs with other stakeholders, most particularly retailers whose involvement is critical to the success of the pricing outcomes. This gap is in contrast to IPART's proposal, (and to a lesser extent SCER's proposal) which recognised the importance of engagement with retailers as well as consumers. The AEMC also fails to acknowledge in this section, the importance of predictability for consumers and retailers (as well as investors in DNSPs and consumers?). For retailers to invest in system changes required to bill consumers, they need confidence in the predictability of changes in the tariff structures and prices. Similarly, if consumers are to invest in demand-side participation, then they need confidence in the DNSPs plans. When considering the criteria of "regulatory burden', the AEMC's assessment takes a narrow view of regulatory burden. They should be considering the regulatory burden across the whole value chain, which includes retailers and consumers, given that consumers are expected to be proactive in assisting the networks. Similarly, there is a cost to consumers if the regulatory burden imposes an 'engagement process' that is particularly demanding on the resources (both dollars and expertise) available to consumers and their representatives. ***Other considerations that should be included:*** While the NEO does not explicitly require consideration of *consumer equity*, the MEU would argue that equity should be considered as part of objective of servicing the long-term interests of consumers. If

			the relevant changes are seen to produce inequitable results, then many consumers will resist them. This in turn may lead to a disruption to the broader reform process (as seen in the smart meter roll-out experience in Victoria). Unless there is actual and perceived equity in the process, it is unlikely that the overall thrust of the SCER rule changes (that enhances not only efficiency, but also the ability to achieve meaningful demand side responsiveness) can be achieved. At the very least, there should be an explicit analysis of the potential impacts of rule changes on different consumer groups, including large consumers, to assist the community to make informed input into the process.
Chapter 6: Balancing Consultation and Pricing Certainty Objectives in the Network Pricing Framework			
6.3	**Q2**	**Does Figure 6.1 reflect the key components of how network tariff structures and pricing levels are determined by DNSPs?**	In the interests of greater certainty, the diagram should explicitly include: (a) the allocation of consumers to different tariff classes (as this effects the other parameters such as structures, elements and cost allocation); (b) the form of price control (eg revenue or weighted average price cap); and (c) the inclusion and allocation of TUOS charges (there is currently no transparency on this process).
6.3	**Q3**	**How often are network tariff**	Historically, tariff structures varied little over time. However, there have been more frequent changes in tariff structures more recently.

		structures likely to change during a regulatory period and what are some of the reasons for that change?	The MEU considers this is a result of DNSPs seeking to manipulate tariffs to increase revenue (particularly where the revenue control is in the form of a weighted average price cap). As a general rule, tariff structures are at a sufficiently high level that they should not need to be changed during a regulatory period, and even between regulatory periods unless there are compelling reasons (of which moving to more cost-reflective tariffs might be one). However, some flexibility should be allowed, particularly because there is a timing mis-match between the regulatory periods and other industry reforms such as the introduction of smart meters, and new developments such as electric vehicles or cost effective storage. Changes during a regulatory period to the tariff structure plan that was set out in the PSS should, however, be subject to the same consumer/retailer consultation process and approval by the AER.
6.3	**Q4**	**What level of information on network tariff structures and network tariff pricing levels should be included in a network tariff document to assist retailers and consumers to understand and respond effectively to changing prices and structures over the regulatory period?**	The network tariff document must include clear definitions of tariff classes and tariff structures to apply for the regulatory period, and who will have access to them (e.g. – "this tariff is restricted to consumers with a smart meter"). The document should also include reasonable details on the charging elements and the cost allocation process. Equally important, if the DNSP plans to change these during the period, then this must be stated explicitly in the document (e.g. a statement that the DNSP intends to progressively increase supply charges to recover X% of the revenue in a tariff class by Year 5).

			The MEU is more cautious about how much detail should be provided on the network *pricing levels* because of the many factors that drive the overall revenue allowance and changes in this within a regulatory period. This is particularly true going forward because of the expansion of the various incentive schemes (which are a source of variations in revenue allowances relative to the original determination revenue path) and the AER's recent preference for applying a revenue cap as the preferred form of regulatory control rather than the average price cap for DNSPs. What would be useful for all stakeholders is for the network tariff document to include statements about the general direction of the tariff pricing levels, e.g. a statement like (simplistically) 'peak prices are expected to increase at twice the rate of off-peak prices'. These statements should be made on a 'best endeavours' basis but would not be binding on the DNSP. Overall, and given the importance of the network tariff document, the document should be approved by the AER as part of the regulatory revenue determination process and involve meaningful engagement by the DNSP with both large and small consumers and retailers in its development (i.e., not presented to stakeholders after the fact as a 'fait accompli', for their information only!). As discussed in later questions, the rules should provide high level principles about the content of the document and the AER develop guidelines that set out the expected content of the document.

6.3	**Q5.**	Should DNSPs be able to vary their network tariff structures during the regulatory period? Why or why not?	The MEU has a very strong view that the network tariff document should be a serious strategic document that is produced by the DNSP after effective engagement with all stakeholders. This is particularly true for the more fundamental aspects of pricing, namely the *network tariff structures*. Consumers and retailers should be able to place a high level of reliance on the document – if they can't rely on it, then the document will cease to have any relevance for retailers or consumers and will fail to achieve its main objectives. In addition, changes to fundamental features will undermine consumer and retailer confidence in the broader consumer engagement process – why go to the trouble of engagement with the DNSP if it can unilaterally change key aspects such as tariff structures and tariff classifications. As a result, network tariff structures (and tariff classifications) should not be able to be varied within the regulatory period unless there is a compelling reason and the change occurs only after the following: • The network conducts meaningful consultation with consumers and retailers on the change; • The network provides 12 months notice of the proposed change and publishes the revised document within 9 months of the year in question; • The network explicitly illustrates the consumer impact of the change; • The AER approves the change in the network tariff structures (and tariff classifications)
6.3	**Q6**	If a document on network tariff	See answer to Q5. The network tariff document should be a serious

		structures is put in place, should this be indicative document or should the DNSPs be required to apply it in their annual pricing proposals.	strategic document, and the rules should mandate that the fundamental aspects of tariff structures (and tariff classification) set out in the document should be applied to the annual pricing proposals. The MEU has seen DNSPs use changes in tariff structures, as a tool to increasing their revenue above the approved revenues – requiring the document to be binding on the development of the annual pricing proposals will reduce the opportunity for tariff manipulation. This is particularly the case, if the AER continues to apply the weighted average price cap in any jurisdiction.
6.3	**Q7**	If a document on network tariff structures is binding on the DNSP, should it be able to be varied and under what circumstances? If so, should it be varied outside or within the annual network pricing process?	See answer to Q5. Given that the energy market is in a state of change, there should be a reserve option to amend network tariff structures during a regulatory period but only under exceptional circumstances (e.g. an unexpected delay in a smart meter roll out) and subject to consultation, adequate notification and AER approval. The MEU considers that there must be adequate notification of the proposed change (with stakeholder consultation beginning at least 12 months prior to the year in question, and formal amendment completed within 9 months of the year in question. As such, it would not be appropriate to link the network tariff structure document formally to the annual network pricing process, although clearly the subsequent annual network pricing processes should reflect all the changes in the tariff structure document.
Chapter 7: Implementation of a Pricing Structures Statement (PSS)			
7.1	**Q8**	Should DNSPs be required to consult	The MEU considers that the DNSPs should be required to consult

		with stakeholders before submitting their proposed pricing structures statement (PSS) to the AER for approval through the regulatory determination process?	with consumers, retailers and other relevant stakeholders prior to submitting their proposed PSS to the AER. The MEU considers this initial consultation is fundamental to gaining consumer and retailer (and other stakeholders, such as governments and industry groups) support and commitment to the DNSP proposal. For example, without retailer engagement in the process new network pricing structures are unlikely to achieve their objectives for most classes of consumers. The consultation with consumers should include representatives from all tariff classes, including large and small businesses and residential consumers. The engagement of stakeholders should also include a clear analysis of the impacts of the tariffs structures on various tariff classes and consumers within classes. It is essential that when stakeholders evaluate the proposals, they have a clear view of the overall costs and benefits and of the impacts on different sectors. The MEU does *not agree* with the view that the initial consultation stage is not required because the distribution pricing principles may be amended to explicitly include consideration of consumer impacts, Simply announcing the potential impacts on consumers after the fact and without consultation with these consumers undermines the whole principle of effective engagement.
7.1	**Q9**	Is consultation necessary if DNSPs seek to amend their approved pricing structures during the regulatory period, as opposed to at the time of the regulatory determination?	See response to Q5 – Q7 above. The MEU believes consultation is necessary and should be transparent and allow sufficient time for consumers and retailers to respond to the changes. Changes must be approved by the AER.

		Are there circumstances where amendments to the network tariff structures in the annual pricing process should be exempt from consultation on amendments to the previously approved PSS?	No. The MEU considers that the PSS is a relatively high-level strategic document that represents a commitment by the networks and is subject to change only under limited circumstances and with appropriate consultation and approval by the AER. While network pricing may need to change on relatively short notice (that would curtail the opportunity for consultation), this is not the case with tariff structures.
7.1	**Q10**	Is it necessary for the AER (as opposed to the DNSP) to consult with stakeholders before approving any proposed amendments to the PSS sought by the DNSP.	The rules should allow the AER to exercise its discretion on this matter. If the DNSP can demonstrate it has conducted a meaningful and comprehensive consumer consultation process, the AER may choose not to conduct its own consultation process. However, if there are concerns about the adequacy of the consultation process and/or the changes in the network structures that will have significant impacts on all consumers or a sector of consumers, or are costly to implement, then further consultation should be undertaken directly by the AER.
7.1	**Q11**	Should the AER be required to provide guidance on the consultation process for DNSPs? Should the guidelines be binding on the DNSPs?	The MEU believes that it would be useful to extend the AER's existing guideline on consumer engagement by networks to include the PSS consultation (and consultation on any subsequent amendments to the PSS). The AER's consumer engagement guideline was developed after

			extensive consultation with the networks, consumers and other stakeholders and was influenced by best practice examples from overseas and locally. In addition, if the PSS is developed alongside the regulatory revenue proposal process, then having a consistent consumer engagement framework minimises the regulatory burden on the DNSPs and stakeholders. A further benefit to the DNSPs is that following the AER"s consumer engagement guideline will reduce the likelihood of the AER conducting its own consultations on the DNSP's PSS. However, the guidelines should not be mandatory on the DNSPs. The guidelines demonstrate best practice across the industry but individual DNSPs should be able to vary their approach according to their particular circumstances. What is not acceptable, however, is that the broad principles of consumer engagement that are set out in the guideline are put aside by the DNSP. If that is the case, and the consultation process fails the test of best practice, then the AER should be obliged to conduct its own consumer consultation process (see Q 10 above).
7.2	**Q12**	Does the PSS need to be approved?	Yes, the MEU considers that the PSS needs to be approved by the AER. The PSS must comply with the NEO, and with the Pricing Principles in the NER. It represents a firm commitment to stakeholders of the DNSP's intentions in compliance with these. Without a formal approval process, the objective of reforming network pricing to achieve greater efficiency under the NEO will be considerably more

			difficult, as is illustrated by the fact that there has been limited progress to date and very inconsistent outcomes across DNSPs in the NEM. While it may be more time consuming to include formal AER approval, this is minimised when the PSS is included as part of the overall regulatory determination process.
7.2	**Q13**	Should the AER be able to amend a DNSP's PSS? If the AER does not approve a DNSP's proposed PSS, what arrangements would be suitable for default network tariff structures?	The MEU considers that the AER should have 'reserve' powers to amend the DNSP's PSS. However, it should be rarely used. This is because the PSS is a high level document focussed on tariff classes and tariff structures and the AER would only reject the PSS if it did not comply with the pricing principles in the rules, including adequate consultation process and analysis of consumer impacts. Indeed, the MEU would go further. If a DNSP's proposal does not comply with the rules (and noting that they have had the chance to resubmit their PSS following a draft determination) then the AER has a positive obligation to reject it. The MEU further notes that this approach still provides considerable flexibility for the DNSP to develop tariff structures and prices that meet their business objectives, so long as these comply with the NEO, rules and consultation principles. The AER should be left to exercise its own discretion on how it might determine default tariff structures, subject to compliance with the NEO and the and also bearing in mind the need for the DNSP to recover its allowed revenues (although this risk to the DNSP is

			mitigated if subject to a maximum revenue cap rather than a maximum average price cap). The MEU notes here that under the current rules, the AER may reject a DNSP's pricing proposal, and if not corrected by the DNSP, 'the AER may itself make the amendments necessary to correct the deficiencies' [to comply with Part 6 of the NER, any particular determination, and that the 'forecasts associated with the proposal are reasonable' (see NER cl. 6.18.8(a)). The MEU's recommendations above with respect to the PSS are consistent with the current approach by the AER to non-conforming DNSP proposals in their annual pricing proposals and are not therefore particularly more onerous or limiting on the DNSPs. Re the AEMC's question on the 'default' option: While the option to use the 'most recent year's annual pricing proposal' has some appeal in terms of minimising consumer impact, it is also open to gaming by a DNSP. The MEU notes that the current rules on the annual pricing proposal do not specify how the AER will establish a default tariff, only that it must 'correct the deficiencies'. (NER cl 6.18.8 (b)(2)). The MEU recommends that the AER has similar discretion about how it amends the PSS, after taking into account the NEO, the pricing principles in the NER, and the findings of the consumer consultation process (conducted by either the DNSP or the AER, or both).
7.3	**Q14**	What are the risks to the annual pricing process if DNSP's do not comply with	The MEU considers that not only the pricing process, but the broader process of reform (of which network pricing changes are an

		their approved PSS or are late submitting a full pricing proposal?	important component) is compromised by failure to comply with an approved PSS. Confidence in the PSS and the annual pricing process by consumers, retailers and other stakeholders will be rapidly undermined if there are failures of compliance. Once confidence is lost, consumers and retailers will be reluctant to 'invest' in actions/products etc. It must also be remembered that the main driver for amending the network pricing arrangements is to achieve greater demand side participation. This cannot occur if the DNSP does not comply with the rules and guidelines designed to achieve this outcome. For this reason, it is reasonable to impose strong penalties for non-compliance (noting that the process allows the DNSP to resubmit their proposal following a draft determination). The penalty should also take into account the potential cost impacts on consumers and retailers of a DNSPs non-compliance with a PSS.
7.4	**Q15**	How should DNSPs be incentivised to comply with their approved PSS in their annual pricing proposals? How should compliance incentives be balanced against the financial risks for DNSPs and certainty for stakeholders?	The MEU sincerely hopes that DNSPs will respect the rules and comply with them in accordance with good business practice and in their own and consumers' long-term interests. There should be no reward for complying with the requirements of the rules, but there must be a penalty for non-compliance. Therefore, the incentive for complying is the risk of sanctions when not complying. As noted above, the rules currently require the DNSP to comply with the pricing principles and this should be supplemented with a rule requiring the DNSP to both develop and then comply with the PSS (or a PSS varied by approval by the AER). The NER then leaves the

			AER the discretion to amend the annual pricing proposal to comply with these requirements. If the DNSP is a repeat offender during a regulatory period, then the AER should set compliant prices for the remainder of the regulatory period rather than allow the DNSP to further 'play games' with the process. This should be the primary incentive for the DNSP to comply (i.e. if it does not, then the AER will 'correct' the prices in order to comply with the PSS). The imposition of financial penalties for annual pricing proposals that do not comply with a PSS (as proposed by the AEMC and previously adopted by the ESCV) raises a number of issues and may be excessively appealed by the DNSP. The MEU suggests, therefore, that the incentive be at the discretion of the AER and staggered. For instance, the AER could have the right to not accept an annual pricing proposal and to amend it to comply with the NEO, the pricing principles and an approved PSS. However, if the AER determines that there had been a consistent and/or deliberate noncompliance with the PSS, the AER would have the right to also impose financial penalties (up to a cap) that reflect the seriousness of the issue. This is in addition to the AER issuing an amended annual pricing statement.
7.4	**Q16**	Should DNSP's include forecasts of their expected changes in network	See response to Q 4. It is appropriate that DNSP's be required to include an indicative forecast of pricing trends at the tariff component

		tariff pricing levels in the pricing structures statement?	level (not necessarily specific prices), and an outline of factors that might alter these prices. However, the MEU believes the pricing trend forecast should be non-binding (unlike the tariff structures) because of the multiple exogenous factors that may impact on the DNSP over the regulatory period. What is important, however, is transparency in the process. If the DNSP's annual pricing process is inconsistent with the pricing trend forecast in the PSS, then there must be clear explanations as to what has changed and what are the likely impacts of the new prices compared to the trends outlined in the PSS.
7.4	**Q17**	Should any changes to the network tariff pricing levels included in the PSS be subject to consultation? If so, what level of materiality should apply to the change.	It would be onerous on the DNSP and the stakeholders if there was consultation on relatively minor variations in pricing trends set out in the PSS. However, it is essential that such variations are clearly explained to and information is provided to stakeholders on the expected impact of the changes (compared to the 'base case') on different tariff classes and consumer segments. (see also answer to Q16) In addition, if the changes in prices (against the trends set out in the PSS) are significant in terms of their impact on the overall market or on particular segments, then some consultation is required (albeit not to the extent required for the original PSS). The MEU considers it is neither possible or desirable to define the materiality threshold at this stage, particularly as a change may be very material to one

			segment or tariff class while not materially significant overall. Therefore, at this stage, the MEU believes the AER should have discretion to determine if a more extensive consultation process is required for changes in the pricing levels (from the PSS indicative plan), in line with the NEO, the pricing principles etc.
7.5	**Q18**	Should a PSS be introduced as soon as possible? If so, what risks are there from having it in place before the next regulatory period?	On balance, the MEU would prefer the PSS to be introduced as part of the normal regulatory determination cycle. It is recognised that this may result in some delays in implementing reform but by delaying the process, the DNSPs have more time to develop strategic plans and consult more thoroughly on their proposed strategy (given that the tariff structures (if not prices) are likely to be binding on them). In addition, there may be complexities for pricing strategies arising from a change from a weighted average price control to maximum revenue form of control (for NSW and Victoria at least), that need further time to consider. Moreover, the delays will not be all that significant, given the timetable for new regulatory determinations. Putting aside the transitional period of 2014/2015 for NSW/ACT (and in the view of the MEU, it would be precipitous to impose the PSS in this transitional period), NSW, Queensland and South Australia will be on a similar timetable with the new regulatory period process commencing in early 2014 (with the AER's Framework and Approach). Thus, delaying the PSS until the network proposal stage means that the PSS will be developed in the context of greater certainty for the DNSPs (and their stakeholders) of the overall regulatory control

			mechanism, demand forecasts, revenue allowances, tariff classes and incentive mechanisms. While the Victorian regulatory period commences in January 2016, there is already an established mechanism for providing (non-binding) forecasts of likely tariff structures and pricing trends. In the view of the MEU, it is better to leave this process in place for 2015 calendar year pricing update while developing the PSS for the new determination period (commencing 2016) with comprehensive and integrated analytical and consultation processes. It is worth noting, that by 2016, the smart-meter roll out in Victoria will be completed providing the opportunity (in consultation with stakeholders and government) to develop a PSS that includes more cost effective network tariff structures.
7.5	**Q19**	Does the AER consultation guideline need to be in place before a PSS can be implemented.	The MEU believes it would be preferable to have the AER consultation guideline in place prior to a PSS being implemented. Moreover, given that a network consumer engagement guideline has already been published by the AER for the revenue determination process, it should be a relatively simple process to review this guideline and amend or supplement it with any additional requirements for consultation on the PSS.
Chapter 8: Changes to the Timing of the Annual Pricing Process			
8.1	**Q20**	If the PSS framework were implemented, would this reduce the timing pressures for the DNSPs, the AER and retailers that have arisen from	To answer this question, it is necessary to identify the nature of the change in network tariffs. For instance, (and assuming that the retailer plans to pass through the network tariffs in the retail tariff to consumers):

		the first year and subsequent year annual pricing process?	1. If the specific tariff change is just a change in prices, then the time period for notification required by the retailer can be *relatively* short as this does not generally require complex system updates or customer notification (beyond the retail code requirements); 2. If the tariff change is also a change in pricing parameters, then this requires more complex changes in billing systems and customer notifications. 3. If the tariff change also includes a change in tariff structures then this will add further complications to the IT requirements for the retailer. Depending on the change, this may take 6 months or more, and come at significant cost in order for the new structures to be specified, programmed, tested, implemented and included on the customer's bill in accordance with the retail code requirements. In addition, the tasks of product development and managing communication with customers (before and after the change) will be significantly more complicated for the retailer. In the first instance (a 'simple' price change), it is unlikely that the PSS will directly assist the process (in that it is unlikely that specific prices will be firmly set in the PSS). However, if the PSS, in practice, does simplify the annual tariff price approval task for the DNSP and the AER and, therefore, enables additional notification of new network prices to the retailer without compromising the accuracy of the data used by the network (such as actual CPI), then this would be of potential benefit to all parties.

			Certainly, it would be preferable to gain more time for the retailers by achieving greater efficiencies in the AER's pricing approval process (as above) compared to the alternative of providing more time to retailers requiring the DNSPs to publish network tariffs earlier using estimates for key network inputs such as CPI. However, it is unrealistic to suggest that the proposed improvements to the timing of network price publications by (say) one month will facilitate the immediate implementation by retailers of changes in network *tariff structures* (and probably, network tariff charging elements) in their retail prices. These require a longer-term approach. The PSS is the key to providing this longer-term view on proposed network tariff structures and its publication in conjunction with the determination process should allow retailers to respond to new tariff structures over the course of a year. However, it will only succeed if retailers are closely involved from the inception of tariff structure changes and are confident that the networks will comply with their PSS both in content and timing of changes in tariff structures.
Chapter 9: Reforms to Distribution Pricing Principles.			
9.2	**Q21**	What would be the likely impacts on customers of making a LRMC approach mandatory?	The MEU answers this question in two parts. (a) Should the LRMC be the preferred method for setting network prices in the NEM as indicated by SCER's rule change request? The MEU cautions on mandating the use of LRMC as the basis for setting network tariffs (as opposed to having 'regard to' LRMC)

			without understanding the full implications of its use and how the costs associated with sunk assets are recovered. The purpose of the proposed changes to network tariffs is to ensure that prices are cost-reflective and provide some locational and available capacity indications. Equally, prices have to recover the total revenue allowance allowed in the AER's determination. The MEU is not convinced that a LRMC approach will recover a sufficient proportion of these revenues to drive capacity constraint signals. The remainder of the revenue will have to be recovered in ways that are not necessarily related to building new capacity in the system. It is essential that much more is known about this issue before confirming the LRMC cost approach (see also answer to Q 31 on allocation of 'residual' amounts). (b) If the AEMC considers that the LRMC is (nevertheless) the required approach, then should its use be mandated? One of the important impacts of making a LRMC approach mandatory will be to generate more consistency and predictability across DNSPs in their methodology for assessing network tariff structures, charging elements and prices. The MEU, whose members operate in multiple locations, acknowledges that there will be geographically based differences in pricing levels across different regions in the NEM. However, it is important that these differences are based on a more rational economic assessment of regional costs than is currently the case. A NEM-wide approach (including mandating any cost allocation process as a basis for tariffs) will facilitate transparency and

			consistency. However, making an LRMC approach mandatory (or some other tool) is likely to mean that some groups of consumers will face significant prices shocks. The MEU believes that much more analytical work needs to be undertaken to examine whether the proposed approach will deliver cost reflective prices and what level of price shocks likely to be faced by consumers in different areas and on different tariff categories, if tariffs were based on LRMC. It is also important to understand what the 'residual' amounts (between the allowed revenue, and the revenue associated with the LRMC) would be and the basis on which they are to be recovered.
9.2	**Q22**	What would be the impacts on DNSPs of making an LRMC approach mandatory? Does it result in increased compliance risk	The MEU is not concerned if the mandating of LRMC (or any other approach) means that some DNSPs feel they are 'restricted' in innovation. DNSPs are monopolies and their focus should be on developing efficient tariff structures and prices, not experimentation with 'new pricing products'. The introduction of a mandated approach will not, for instance, restrict a DNSP in developing an efficient time of use tariff or new demand based tariffs – these outcomes are quite compatible with the proposed reform. If the regulatory requirements of the pricing approach are clear, then making it mandatory for the DNSP to use that pricing approach, should not add to the regulatory burden. In particular, DNSPs already have to provide estimates of the 'stand alone cost' and the 'avoidable cost of servicing a tariff class (NER, cl 6.18.5(a)(1) and

			(2)) and 'must take into account the long run marginal cost for the service…' (NER, cl 6.18.5(b)(1)).
9.2	**Q23**	How limited will DNSPs be in basing pricing at LRMC if they must first comply with jurisdictional instruments.	Clearly this will depend on the nature of the jurisdictional requirements on both the network and the retailer. For example, at this point in time, developing network tariffs based on LRMC in Ergon's area is largely a waste of time (from a consumers' perspective) as retail tariff structures in Ergon's area are based on the (progressive) pass through of network costs in Energex's areas (a jurisdictional requirement for consumers less than 100 MWh per year). The MEU considers that the issue should be put back to SCER. That is, the MEU believes that if a state government wants to impose jurisdictional specific requirements it should do so only in a manner that does not significantly impact on the DNSP's ability to charge in a cost reflect manner (or at least move to that over time). Moreover, jurisdictions should be required to make a public explanation of the reasons for imposing such restrictions, and the impact this will have on consumers and the trajectory to cost-reflective tariffs.
9.2	**Q24**	Should LRMC be defined? If so, what level of detail would be appropriate?	There is little point in making LRMC (or any other approach) mandatory – to provide certainty and consistency – to consumers and retailers, *if* the approach is not clearly defined[35]. Lack of a clear definition will also make the DNSP's compliance requirements and

[35] This point reflects that there a number of approaches used to develop long run marginal costs and many assumptions made in the implementation.

			interactions with consumers, retailers and the AER more difficult. As the DNSPs are monopolies and their overall revenue is 'guaranteed', the DNSP's should have no real objection to a rule that defines LRMC (or other approach) in a manner that will enhance consistency across the NEM. The MEU would like to see more analysis of the impacts of different definitions of LRMC (or other approach) before commenting on what level of detail that would be appropriate. From the MEU's point of view the question is an empirical one, to be tested against the pricing principles and, more immediately, against the issues that have arisen to date in terms of different approaches to LRMC. The general guiding principle is that the rules should contain the level of detail required to achieve the optimal balance of objectives. For example, it should specify a level of detail that will adequately satisfy the objectives of predictability, transparency, consensus., ability to provide effective pricing signals for encourage greater demand side participation, etc while providing some flexibility by the use of AER guidelines.
9.2	**Q25**	Should one methodology apply to calculating LRMC or should multiple methodologies be allowed? Which is/are the most appropriate methodology(ies)?	See above Q 24 As a matter of principle, the MEU would prefer one methodology for assessing LRMC (or equivalent pricing approach), with this to be determined by the AER on the basis of a consultation process conducted by the AER (similar to the development process for the rate of return guideline). It is possible that other methodologies

			could supplement the main model, but only if they provide additional useful 'information' to the process. These alternatives should be prescribed too (although not obligated to use them). The MEU considers that further investigation is required about each of the alternative methodologies before decisions can be made about which methodology(ies) is the most appropriate for this particular purpose. This investigation should test the methodologies against a number of standard statistical tests (for validity, reliability and absence of statistical biases). Most important will be to investigate how well approach LRMC outcomes align with the network revenue allowances in order to avoid the problem of allocating a large residual to different tariffs and tariff components. The residual arises because the sum of LRMC based prices (regardless of which LRMC approach is used) is unlikely to add up to the total allowed revenue. The MEU notes that the overall intention of the pricing approach is to deliver cost reflective prices that (given forecast tariff class volumes) will deliver the total allowed revenue and encouragement for DSP. As noted, there is no certainty that LRMC will achieve this, whatever methodology is chosen for the LRMC calculation. The larger the amount of residual as a proportion of the total revenue required, the less value the LRMC approach is in setting cost-effective prices. The MEU therefore believes that the AEMC should look critically at the proposal to use LRMC (whether mandated or not), before

			examining what cost allocation methodology is most appropriate for this purpose. It may be that simpler approaches to cost reflective pricing, such as the one set out in the rules for transmission networks based on replacement costs (CRNP or modified CRNP – see NER cl 6A.23.3(1) and S6A.3.2 (1)) will remove the problems of residuals and maximise the cost-reflectivity of the DNSP prices.
9.2	**Q 26**	Should the AER be required through a guideline to specify the methodology or methodologies of calculating and applying LRMC?	The MEU acknowledges the precedence that the AER has set in its approach to developing the guidelines under the Better Regulation program. The AER therefore has established a process to undertake consumer and industry consultation. However, the MEU notes that the development of best practice methodologies must have broad acceptance by all stakeholders, and should not be distorted by differences in 'lobbying' capacity, but focused on achieving the long-term interests of consumers. The MEU is inclined to support an approach that provides certainty to stakeholders on the pricing principles and approach (including mandating the cost allocation methodology). However, there should be some flexibility allowed in how the approach is applied. For example, the MEU highlights that attempts in the past to mandate specific elements of pricing have still resulted in inefficient outcomes (for instance in transmission pricing). Nevertheless, while some flexibility is important, this must be accompanied by transparency and a willingness by the DNSP to effectively engage with its stakeholders and demonstrate that its proposal in the long-term interests of consumers.

			For this reason, the MEU generally supports the approach where the rules include key definitions and principles but the AER is instructed to develop guidelines on how these principles can be enacted and how the AER will assess the proposals. For example, *if* the LRMC approach was adopted, the rules would set out the requirement to use a LRMC, would define this term and the obligations of the AER to develop a guideline. The guideline would set out the implementation requirements such as the methodology or methodologies to be used, the treatment of residuals, the analysis of consumer impacts and, if relevant, the impact of jurisdictional requirements. Using a guideline will also provide the AER with greater flexibility to amend the approach as new information and techniques become available. The MEU believes that further consideration needs to be given to the question of whether the guideline is mandatory or not on the DNSP. For example, under the revenue determination model, the "propose-response" model – many of the AER's guidelines are not mandatory although a DNSP would have to demonstrate why variation from the guideline is in the long-term interests of consumers (as per the NEO). Further investigations of the options, and the impacts of these options on consumer segments are required before decisions can be made on whether the guideline is made mandatory or not, and the level of detail the guideline should include to ensure reasonable consistency of approach by DNSPs.

9.3	**Q27**	What is the impact of coincident peak demand on network costs and how are these additional costs currently recovered in network tariffs/	The coincident peak demand is one of the largest single contributing factors to the DNSP's new capital investment program (as noted by the AEMC in the Consultation Paper at page 61). As such, truly cost-reflective tariffs would in principle seek to price demand on the basis of the contribution of a consumer, or consumer segment to this peak demand. The MEU notes that across the NEM there are very few instances where network charges are based on the **coincident peak day** demand. The only examples are in the Victorian locational TUOS prices that are based on demand for the 10 peak days at a connection point. However, even here, only very large direct connection customers will see this type of pricing in their bills. For most customers (even large users in embedded in the distribution system) will see a 'bundled' distribution and transmission network charge (i.e. NUOS charge) with little transparency about how transmission costs are captured in the charge. Generally, therefore, coincident peak costs are captured through tariffs that are, to various degrees, merely proxies for capturing the full cost of coincident peak demand in a region and/or constraints on the network system. A common approach in many NEM regions is for large consumers (either directly connected to the transmission system or within the distribution network) to be charged a capacity charge that is based on their own peak demand (either contracted or actual), which may be – but is likely not to be – coincident with the regional peak

			demand. Time-of-use tariffs (with or without seasonal components) are even weaker proxies for coincident peak demand costs, while consumption only tariffs provide no signal at all of peak demand costs. However, to date, the great majority of small consumers have been supplied under consumption only tariffs (perhaps with off-peak water heating charges). The MEU's view is that for large customers at least, there is no reason to not (progressively) introduce network charges based on the user's co-incident peak demand (rather than the user's individual site maximum demand). This will also provide a strong signal not only for the cost of peak demand, but also for the benefits of demand-side participation such as the provision of interruption services to the DNSP. It is also important that research continue into critical peak pricing for smaller customers – probably on a voluntary basis. Critical peak pricing provides an opportunity for residential or business consumers to modify their demand on days when the system is under stress. However, its overall impact on the general population of small consumers is not sufficiently well understood for widespread application at this stage, particularly as these tariffs are most effective when combined with smart metering and communication devices to the premises (such as a home area network or HAN). Unfortunately, therefore, because of delays to implementing network tariff reform, rigid retail price controls in some jurisdictions, and

			resistance to new metering and communication technology, the benefits of peak demand pricing for the coincident peak day will not be fully realised for many years.
9.3	**Q28**	How should LRMC pricing reflect additional costs associated with coincident peak demand and what are the practical impediments to DNSPs adopting tariffs that reflect coincident peak demand	The MEU considers that network pricing is best expressed through capacity charges based on demand during the coincident peak demand in the DNSP region (or sub-region). However, the MEU also recognises that there are impediments to fully rolling out capacity charges of this type particularly for some classes of consumers. There should be no significant impediment for either transmission or distribution networks to roll out coincident peak locational demand charges to large consumers, in preference to charges based on individual peak demands. Providing there are means to communicate in advance to those consumers with demand meters, pricing demand on a coincident peak day basis will also provide better encouragement for demand side offers (see also Q28 above), i.e., it will promote more efficient pricing of demand side offers, such as: (a) the avoidance/reduction of demand at peak times; and (b) compensation for 'stand-by' facilities; and (c) ability to reflect locational constraints. For large consumers, metering facilities are already in place, and SMS technology can be used to 'pre-warn" customers of the probability of a peak demand day (or other network constraints).

			However, it is the large numbers of small consumers without demand metering but with occasional large demands that remains to be addressed. As noted above (Q27), there are many practical difficulties rolling out coincident peak demand charges to these consumers (other than voluntary critical peak tariffs). For example, interval meters are a prerequisite for implementing peak charges. To fully benefit, in terms of reduction in peak demand, two-way communication systems to the home or business are also required (either through smart meter/HAN technology or through third party providers). In addition, extensive cooperation with retailers to develop and implement retail products that reflect these charges would be essential. One such approach could be that consumption only tariffs are to be made progressive (ie higher charges with increasing demand. Whilst this is a poor proxy for a demand charge, it does provide better signalling of a consumer's actual demand.
9.3	**Q29**	How important are locational pricing signals for distribution networks? Are locational pricing signals for some types of customers more important than others?	DNPS have traditionally not applied locational charges that signal different levels of network constraints within the network. Rather, different charges in different networks reflect historical events and, in particular, the initial DORC evaluation of the assets and the subsequent capital investment made in each network region. For larger customers there may also be locational differences because of the threat of by-pass (as allowed under the rules). The MEU does, however, pose an additional question regarding how

			the locational signals provided through the locational TUOS charges are passed through to all consumers. Generally, it appears that these different locational TUOS signals are washed out by the DNSP in their NUOS charges (although very large users over 40GWh can ask for separate identification of TUOS charges on their bill). For example, Mildura and Ballarat are both in the distribution zone of Powercor in Victoria. Although they are subject to different locational TUOS charges, the NUOS charge is the same for the same class of customers. A similar situation faces Ergon customers in (say) Cairns and Gladstone. Overall, the process of allocating locational TUOS charges to the NUOS charges lacks transparency. The MEU recommends that there should be a progressive roll out of separate charging for DUOS and TUOS so that locational signals are increasingly seen by all consumers (although this may be limited in the first instance to customers where NUOS charges are separately identified on the bill and can be more readily split into DUOS and TUOS without substantial investment in systems etc). However, the MEU takes a more cautious view of locational pricing related to constraints *within a DNSP area*. Large customers already pay a significant proportion of their connection costs and these vary with the extent to which the network has to be upgraded to meet their peak demand. It would be inequitable to further charge these customers for growth in their region, which they have no control over.

			On the other hand, there are significant practical – and political - difficulties with introducing locational pricing for smaller consumers within a DNSP area. In general, the MEU takes a practical view that the network used to support small consumers' demand *within a DSNP area* should be seen as a shared cost (across the small customer segment) with a common network tariff. The issues of capacity cost reflectivity could be dealt with indirectly, through (for instance) higher fixed charges for 3-phase metering, progressive consumption tariffs and time-of-use prices (although these must be carefully designed to optimise against demand profiles. One aspect of locational pricing that could be further considered is in situations were there are different reliability requirements imposed on the DNSP. For instance, the NSW government set very high reliability standards for the Sydney CBD (N-2 in some cases) that have come at a very high cost that is at least in part shared across all Ausgrid customers. It may be appropriate (if this reliability standard continues) that there is a premium charged to CBD customers in their NUOS prices for this very specific and bounded requirement. This would also provide greater transparency of the true costs of higher reliability standards. While locational NUOS charges may be difficult to apply *within a DNSP*, there is no reason why demand side network pricing should not have a locational price signals associated with it. Under the new RIT-D, there will be a much stronger emphasis on cost-benefit analysis between supply and demand side solutions for a localised constraint in the distribution area (e.g. at a sub-station level). This cost-benefit analysis will also indicate, therefore, the value to the

			DNSP of a demand side solution and potentially allow differential pricing offers from the DNSP for demand side projects in different areas within the DNSP.
9.3	**Q30**	What are the practical impediments to DNSPs adopting tariffs that reflect locational pricing signals?	See answer to Q 29. There should be few barriers to passing through locational TUOS charges to larger customers in the DNSP area, although this would have to be done over time and in a manner that recognises sunk investments by these large customers in their businesses and in the direct contributions they made to system upgrade at the time the business was established or expanded. Localised pricing signals should also be available to large consumers offering demand side management services to the network. However, there are considerably more difficulties in providing locational signals to consumers within a network area. For instance, while it is conceivable that there could be different NUOS charges for all segments of consumers in Powercor's areas based on differences in TUOS (e.g. Ballarat and Mildura could have different NUOS charges), it would be difficult to apply locational prices based on constraints within an area (e.g. in different parts of Ballarat) to smaller customers. The MEU agrees with the AEMC (page 62) that government policy and metering technology would be an issue and that DNSPs would need to considerably expand their network analysis and provide transparency to consumers on the reasons why network prices are different in adjacent neighbourhoods.

			In addition, however, the MEU doubts whether such fine granularity could be captured in normal retail pricing arrangements. For instance, having to provide standard offer prices (or equivalent) for small areas would prove to be extremely costly for a retailer particularly where it is not the host retailer and has limited market share in that region. Retailers are unlikely to pass these detailed locational signals on. Rather, they are likely to seek higher retail margins to manage the additional risks. Certainly, at this stage in the evolution of the energy market, the MEU prefers that specific locational constraint costs within a distribution area should be socialised across all consumers in that area (with large consumers excluded from this if they have been separately charged). Given that most areas in a DNSP's region will need to be upgraded or reinforced over time, there is at least some intergenerational equity in socialising the cost. Note: As per previous answers, *this does not mean* that there is no benefit in further developing prices that better approximate peak demand costs.
9.3	**Q31**	Is an additional principle required to further encourage network prices which are based on the drivers of network cost to the maximum extent possible"?	As noted by the AEMC (page 63), the requirements that a DNSP must adopt a LRMC approach may be sufficient to capture the need to incorporate the drivers of network costs in the DNSP's pricing decisions (although, as noted earlier, the MEU has concerns with using the LRMC approach). However, the additional request by SCER ('that network costs

			should be based on drivers of network costs to the maximum extent possible' (page 60)) may be a useful addition to guide decisions about allocation of 'residual costs' (i.e. the amount of additional revenue allowed that is not captured through prices assessed under the LRMC approach). There is not sufficient information available to determine what the residual costs would be as a proportion of the total costs for the MEU to make a definitive comment on whether an additional (non-mandatory) obligation is appropriate for residual costs although as noted earlier, the MEU considers that demand has been the driver for past augmentations as well as new augmentations.
9.3	**Q32**	What are the pros and cons of using a Ramsey pricing approach or a postage stamp pricing approach?	The AEMC appears to be reconsidering its preference for postage stamp pricing of residual amounts in favour of the Ramsey pricing approach, in that (the AEMC claims) the latter achieves an outcome closer to the three factors proposed by SCER for residual amounts, namely, minimise distorting of flexible pricing, impacts on particular classes of consumers and balance between these impacts and efficient pricing. The MEU finds it difficult to comment on the preferred approach in the absence of more detailed information on the current status of the DNSPs' prices, and whether residual costs would be substantial or a marginal amount. As a general comment, however, the MEU suspects that different classes of customers would differ in what proportion of the total revenue allowance the LRMC approach will recover. As noted above, it is most important to understand the quantum of this gap, as this in turn will indicate the degree of

			potential distortion of the cost reflectivity tariffs caused by the allocation of the residual. The MEU notes that Ramsey pricing essentially aims to pass costs on to those with the least responsiveness to price thereby causing the '*least distortion to demand'* (page 63). The AEMC posits that Ramsey pricing will result in recovery of the residual amounts through fixed charges as 'most consumers require connection to the grid and are therefore very price insensitive to change in fixed charges' (page 63). If the 'gap' referred to above is large for a tariff class (i.e., the residual amount is large for), this may result in very significant increases in fixed charges with consequential impacts on users with relatively low consumption – that is, the pricing is punishing those who are most likely to be making the least contribution to peak demand. The MEU disagrees with the AEMC on the question of whether Ramsey pricing is compatible with flexible pricing. To the extent that Ramsey pricing means that more costs are captured in the fixed charge component, then it follows that variable charges are reduced and there is less opportunity to provide strong signals on peak demand related costs. More generally, the MEU emphasises that the purpose behind the network tariff reform proposals comes from the Power of Choice review that strongly advocated greater demand side involvement. If prices do not reflect the usage pattern of the consumer (i.e. a significant component is recovered on a fixed cost basis) there will be little incentive for consumers to change their usage patterns,

			when such a change provides the greatest value to the network.
9.3	**Q33**	Are there any other pricing approaches that should be considered to recover residual network costs?	The MEU notes that transmission pricing is based on allocation of the revenue in proportion to the replacement costs of the assets used to provide the service. This approach is relatively simple and addresses the issue of the recovery of costs for sunk assets. If such costs are then allocated in proportion to each customer's demand at times of coincident peak demand in the network, then a high degree of equity is achieved. However, the MEU would note again that more work is required on the extent of residual revenues that arise under a LRMC approach and the impact of different approaches (including the LRMC and the CRNP) on different consumer groups.
9.3	**Q34**	Should an approach or approaches be specified in the NER or an AER guideline?	It is important that DNSPs do not have the opportunity to change their approach from one year to the next, as this creates a great deal of uncertainty for consumers and retailers in their energy costs – it would, for instance, lead to a great deal of reluctance from retailers to invest and promote products linked to DNSP pricing if DNSP's were free to change their approach from year to year. The MEU again prefers the AER to develop a guideline with engagement of all stakeholders, so that the impacts on consumers and networks of different approaches are well understood. The AER might conclude that one or a number of approaches are acceptable, albeit to be tested against the NEO and the pricing principles in the NER before being included in the guideline.

			It would be expected that the DNSP would also include their preferred approach to pricing (taken from the guideline) in their PSS and further explained in the annual network pricing statements.
9.4	**Q35**	What jurisdictional instruments or requirements could limit the ability of a DNSP to comply with any requirement to base tariffs on LRMC (including where the LRMC may vary with customer location or with different local peak demands)?)	The AEMC identifies some of the jurisdictional impediments that have the potential to create a conflict between the requirements to price on the basis of LRMC (and pricing of residuals such as Ramsey pricing or postage stamp pricing) and jurisdictional requirements. This includes whether there has been a roll out of smart meters that enables more efficient pricing options. Also, whether a jurisdiction has a specific preference for more even pricing across and within DNSP areas. In addition, there are safety, reliability and other considerations such as underground wiring. For example, a jurisdiction may require that bush fire protection or undergrounding costs are shared by all consumers in a DNSP's region rather than the costs borne by individual segments in bushfire prone areas. In the past, jurisdictions have also imposed pricing protections for smaller consumers, with businesses often wearing the higher costs. Unwinding those cross-subsidies may be unacceptable to jurisdictional governments, or they may impose restrictions on the rate on which these cross-subsidies are unwound.
9.4	**Q36**	What are the potentials impacts of a NER requirement for DNSPs to comply with jurisdictional instruments?	As per answer to Q35. Given that some jurisdictional governments have created significant barriers to efficient network pricing, it is inequitable that the DNSP should be caught between conflicting requirements.

			In the first instance, therefore, the MEU considers that the jurisdictional ministers that form SCER should provide guidance to the AEMC on how the objective of cost-reflective pricing can be implemented within jurisdictional requirements. In addition, until each jurisdiction revokes its specific requirements, the rules mandating that the DNSP price on the basis of the LRMC (or other approach) should be qualified by a recognition of the obligation on the DNSP to comply with jurisdictional requirements. In particular, the MEU notes SCER's proposal *that "where jurisdictional instruments and other practical constraints affect a DNSP's ability to price in accordance with the pricing principles, the DNSP should bring this to the AER's notice when the AER is approving prices'*. (page 66). The MEU would go further than this. The MEU considers that there should be a significant level of transparency about the impact of jurisdictional decisions on the level of efficient pricing for each consumer segment that can be achieved by the DNSP. This should form part of the annual pricing submission to the AER. The AER in turn can assess whether the DNSP's claim of jurisdictional impacts is reasonable, or not. In this way, both the actions of the jurisdictional government and of the DNSP are subject to a transparent scrutiny. It is also then up to the consumers at large to consider whether this is an appropriate trade-off and if affected consumers are

			compensated (for instance, by increases in concessions). At the current time, however, there is minimal transparency about the effect of jurisdictional decisions on efficient pricing.
9.4	**Q37**	Should a requirement for DNSP's to take into account the impact of tariffs on consumers be included in the pricing principles?	In the first instance, the MEU strongly supports improved transparency about the impact of tariffs on consumer segments. Where new tariffs are proposed, there should be an obligation to conduct full consultation with consumers of various types and to report on that in the PSS and/or the annual pricing report. However, the question also seeks a response on whether the NER should require the DNSPs to '*take into account the potential impact of tariffs on consumers*' when developing the tariffs (i.e. in addition to demonstrating the impact of the tariffs on consumers, the design of the tariffs should be influenced by the impact on consumers). SCER is suggesting that such a general obligation should form part of the pricing principles set out in the rules. The MEU's view is that a general requirement such as the one suggested by SCER, is too broad and may provide scope for DNSPs to defend the lack of cost reflectivity in their tariffs by reference to this general requirement. The MEU's preference is to retain the current more specific requirement that is focussed on whether a '*consumer is able or likely to respond to the price signals*'. This is a far more practical objective that is within the remit of the DNSP to assess and act on. For instance, it may restrict the DNSP from introducing too 'fine' a gradation of steps in the tariff as consumers are unlikely to be able

			to differentially respond to details such as a 4 part variable charge (as opposed to a simple 2 step tariff). Similarly, it restricts the DSNP introducing tariffs that require advanced meter types that are not available (or are available at a significant cost). Moreover, social equity issues such as this are better left to governments and/or the regulator to assess. For example, the DNSP's proposed PSS would indicate the direction they plan for tariff structures and prices components to move, and the AER could approve or disapprove this plan in accordance with (inter alia) whether the proposal is in the long-term interests of consumers – this obligation on the AER would include assessments of different impacts and whether the long-term interests of consumers are better served by transitional arrangements to cost-reflectivity.
9.4	**Q38**	If a requirement is included, does the proposed principle provide enough guidance on how it is to be complied with, or would an AER guideline be useful?	If such a requirement is included (and the MEU does not support this), then the AER would need to develop a guideline that set out what matters it would take into account when considering consumer impacts, what information it would require to assess this, and how it would go about considering the balance between economic and social impacts.
9.4	**Q39**	If a requirement is included, does the proposed principle conflict with other principles within the NER?	The proposed principle has the potential to conflict with a number of other principles under the NER, including the other principles proposed by SCER (e.g. mandating LRMC, and having regard to cost drivers when setting prices). This is one reason why the MEU considers that, if it is introduced as an important principle, a guideline is required that sets out the AER's

			expectations for how it would be assessed.
9.5	**Q40**	Should network tariffs reflect transmission pricing signals? If so, what would be the most appropriate way to achieve this for different types of network customers?	See answer to Q29-30. The MEU believes there is some benefit in introducing network pricing signals (particularly, but not only, locational signals) for larger consumers and, more generally, greater transparency for these larger consumers on the components of their NUOS charges. The MEU"s understanding is that currently consumers with usage over 10 MW or 40 GWh are able to access their TUOS component of their NUOS charge (NER cl 6.23). There seems to be no barrier to progressively extending this down to consumers of (say) 1 GWh, (albeit the process of providing the information could be simplified). However, for smaller consumers, particularly those on bundled retail tariffs, there would be little point in this. What is important here is more transparency about how the DNSP allocates the TUOS costs to these segments and whether this would change if there was a direct pass through of TUOS costs for more of the larger consumers (I.e. are there any cross-subsidies in the allocation of TUOS)
Changes to How Tariff Classes are Determined			
10.2	**Q41**	Is the change to a mandatory requirement to group customers into tariff classes likely to achieve the desired outcomes?	The MEU considers that changing the requirement to a *mandatory* requirement to group customers on an economically efficient basis (versus 'having regard to…economic efficiency') will bring only a limited improvement in the consistency with which consumers are allocated to tariff classes.

			As the AEMC highlights (page 70) '*grouping customers on an economically efficient basis can potentially provide a very broad scope for how tariff classes are defined'*. The MEU agrees with this, and can see little benefit in allowing such wide discretion for the DNSPs to allocate customers on different bases (e.g. voltage level, customer type, tariff structure, or capacity). Many of the MEU's membership have establishments in multiple states, and to have such a range of approaches reduces opportunities for cohesive national energy strategies. More generally, allowing such a mix of approaches makes it more difficult for retailers and others to develop products and services that deliver the right signals to consumers (retail markets are based on categories of consumer type, and size). National consistency provides substantial efficiencies for both consumers and retailers. However, it is likely that harmonisation of tariff categories within and across jurisdictions is likely to result in some significant adjustments for some consumers. Transitional arrangements and sound consumer communication will be important in this process.
10.2	**Q42**	Is the change to a mandatory requirement to group customers into tariff classes likely to result in inconsistencies within the NER or with any jurisdictional instruments or requirements?	The MEU does not consider that mandatory tariff grouping will be inconsistent with other parts of the rules. In practice, all customers are grouped as is evidenced by the different tariff proposals provided by DNSPs. The MEU is aware that a few very large customers embedded in DNSPs do have specific tariffs but essentially this means that these customers are in a group of one. So the MEU considers that mandating specific features of customers in order to group them will merely harmonise the groupings across the NEM.

			To the extent there are inconsistencies between the establishment of efficient (and more consistent) tariff classes and any jurisdictional requirements, there should be an emphasis on reviewing these jurisdictional requirements and highlighting whether they are beneficial to the long-term interests of consumers. Reclassification of consumers to other tariff classes will also raise issues around the application of side-constraints in protecting consumers as the side-constraints apply to a tariff class. It is also important to recognise the limits that regulatory constraints on retail prices will place on the ability of retailers to pass through any such changes in tariff categories (and associated prices).
Changes to the Operation of Side Constraints			
11.2	**Q43**	Is the proposal to apply side constraints across regulatory periods likely to materially benefit consumers by protecting them from price shocks?	The MEU agrees with the AEMC (page 73) that there are a number of issues that arise in using side constraints across regulatory periods. The MEU agrees, for instance, with the AEMC that imposing such a restriction raises issues with rebalancing tariffs at the start of a regulatory period, and with the need for the AER to specify 'X' factors for the first year of the regulatory period (given the constraint is expressed in the rules in terms of CPI-X + 2% (for an increase in price) and CPI-X (for a decrease in price). This is likely to pose a number of problems for the AER, and it is essential that the AER has the opportunity to set out the issues it will face. This will assist stakeholders to better consider the proposal for side-constraints to apply between regulatory periods.

			The MEU also considers that this may complicate the introduction of different tariff classes (see answers to Q41 – 43) – assuming that this is most likely to occur at the start of a regulatory period and has been specified in the approved PSS. On the other hand, it has been a source of considerable frustration to consumers that tariff class revenues and the specific network tariffs in a tariff class can change significantly between regulatory periods, as DNSPs can take the opportunity of no side-constraints for significant rebalancing of network prices in the first year. This increases risks to consumer businesses in their budgeting processes as they may only know 1 month before the new prices come into affect, what network prices they will be facing for the coming year (the average price for the first year will be known at the time of the final determination, but this does not provide much of an indication of the prices that individual tariff segments will face) Similarly, retailers face additional challenges in developing the retail prices that will apply in that first year of the network regulatory period. The AEMC suggests that the proposed PSS (which must be approved by the AER), together with the requirements to take into account consumer impacts, will place a constraint on the level of a DNSPs 'rebalancing' between tariff classes in that first year. Similarly, standardising customer tariff classes and providing a

			guideline that sets out the principles of allocation of revenue to these tariff classes should limit the scope for DNSPs to manipulate prices between regulatory periods. However, the MEU remains concerned that in practice these are rather broad constraints and may still fail to constrain the DNSPs introducing significant shifts in tariff class revenues and individual tariff prices between regulatory periods, to the detriment of consumers. The MEU would like to see this issue explored further to better understand the trade-offs between adding complexity to the regulatory process if the side-constraint is applied between regulatory periods and managing the risks to consumers of large tariff changes between regulatory periods.
11.2	**Q44**	Is the proposal to apply side-constraints across regulatory periods likely to lead to inconsistencies with other requirements in the NER	It may to lead to inconsistencies with the economic reform objectives, to the extent that it adds further delays to the process of moving to new cost-reflective tariffs.
11.2	**Q45**	Are there likely to be implementation issues in applying side constraints across regulatory periods?	See answer to Q43. The MEU would like the AER to identify the issues it believes arise from the application of side-constraints to apply *across* regulatory periods. Whether applied or not, the discussion further highlights to the MEU the importance of the PSS and the need to ensure that DNSPs commit to the process and the AER has the regulatory power to enforce DNSPs to comply with their PSS.

11.2	**Q46**	Should network tariffs of customers with interval meters or other types of time-based meters be subject to side constraints?	The side-constraint applies to a 'tariff class' level rather than individual network tariffs *within a class.* This means that individual tariffs within a tariff class can vary by more than the side-constraint as long as it is compensated by changes in other tariffs within the class. It would seem to the MEU that this provides enough scope for DNSPs to introduce and manage flexible tariffs within a tariff class (for instance, the residential tariff class may include both flat tariffs and TOU tariffs, so changes in one can be offset by changes in another). In addition, the side-constraints do not apply to the individual tariff parameters such as the supply charge. For this reason the MEU considers that there should be not be any significant issues with removing the current NER clause that provides an 'exemption' from the side-constraint for time of use and similar tariffs. Consumers within a tariff class on time-of-use tariffs should not be discriminated against or exposed to additional pricing risks. Despite support for removing the "exemption" the MEU notes that DNSPs under price cap regulation have used the flexibility they have been provided with, to manipulate the tariffs in order to increase their revenue. However, the comments above assume that the costs of smart meters (if provided by the DNSP) are separately accounted for outside the side-constraint.