

What should be the key objectives of the network pricing framework?

Distribution Networks Pricing Arrangements rule change workshop

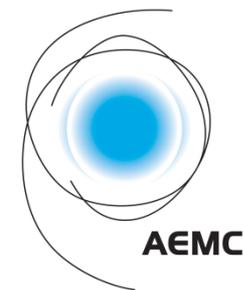


RICHARD OWENS
DIRECTOR
AUSTRALIAN ENERGY MARKET COMMISSION

OVERVIEW OF THIS SESSION

- **Purpose:**
 - To build agreement around what the pricing framework should aim to achieve.

- **Objectives we have identified for discussion:**
 - revenue recovery;
 - regulatory verification and oversight of tariffs;
 - adequate notification of network price changes;
 - stakeholder input into network tariff development; and
 - information and education of price signals being sent.



OBJECTIVES OF THE NETWORK PRICING FRAMEWORK



OBJECTIVE: REVENUE RECOVERY

- Why do we have an annual pricing process?
 - A way for DNSPs to adjust their tariffs to recover the allowed revenues.
 - Annual revenue requirements set every 5 years in the revenue reset process, and known in advance but prices change each year.
- Converting allowed revenues into annual prices requires many inputs.
 - Data availability and inherent uncertainty with some forecasts.
- Consequences if DNSPs are unable to recover their allowed revenues.
 - Impact on investment, service quality, reliability etc.
- Annual price changes permitted to allow changes in revenues to be reflected in tariffs.
 - Assumption: changes in revenues = changes in costs, hence changes in prices.

OBJECTIVE: REGULATORY VERIFICATION AND OVERSIGHT

- This is a regulatory framework that regulates the revenues/prices of a monopoly.
- Regulator needs to check and approve the tariffs in a way that maintains credibility of the regulatory framework and promotes confidence that prices are set in accordance with the framework.
- Lack of consumer confidence in the regulatory framework will undermine the regulatory outcomes.
- Regulator needs appropriate powers to approve/reject proposed prices:
 - criteria for approval and consequences for non-compliance are important.

OBJECTIVE: ADEQUATE NOTIFICATION

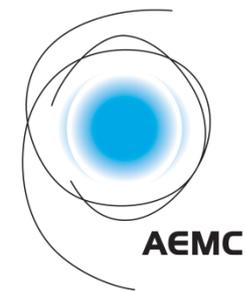
- A network pricing framework should allow adequate notification of changes to tariff structures and/or price changes.
- Retailers need this information to develop retail tariffs in a competitive environment.
 - Untimely notification of price changes can affect the competitiveness of the retail market.
 - Retailers also face regulatory obligations to notify customers of price changes, eg NECF.
- Adequate notification of annual price changes allow retailers and consumers – particularly large consumers – to plan and respond to network price signals.

OBJECTIVE: STAKEHODLER CONSULTATION ON NETWORK TARIFF DEVELOPMENT

- Consultation is not an objective in itself. It is a means of achieving a number of other objectives:
 - Allows for DNSPs to listen to what retailers and consumers might have to say about their proposed tariffs.
 - Gives DNSPs an opportunity to gain a better understanding of how their network prices will likely affect consumers and retailers.
- The type of consultation is also an important consideration.
 - Consultation could occur at the level of prices, or the structure of proposed network prices, or both. This is important because each of these issues could involve different levels of consultation.
 - Stakeholder expectations on consultation may also differ. Retailers may be more interested in understanding a DNSP's short to medium term tariff strategy while consumers may be more focussed on their individual changes in tariff prices from one year to the next.

OBJECTIVE: INFORMATION AND EDUCATION

- Finally, the network pricing framework should give consumers the information that they need to understand the pricing signals that the network tariff is trying to send.
- This will become even more important as we move to more cost reflective network tariffs.
 - The effectiveness of any new tariff structure will depend on the customer's ability to understand them.
 - If customers don't understand the tariffs, then they cannot meaningfully respond to the price signals.



DISCUSSION

