



EnergyAustralia

EnergyAustralia Pty Ltd
ABN 99 086 014 968

Level 33
385 Bourke Street
Melbourne Victoria 3000

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

16 October 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
Email: aemc@aemc.gov.au

Dear Mr Pierce

EnergyAustralia submission – Distribution Network Pricing Arrangements: Draft Rule Determination (ERC0161)

EnergyAustralia is pleased to provide this submission to the Australian Energy Market Commission's consultation process for its draft rule determination and draft rules for pricing arrangements for distribution networks.

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to over 2.6 million household and business customers in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. EnergyAustralia owns and operates a multi-billion dollar portfolio of energy generation and storage facilities across Australia, including coal, gas and wind assets with control of over 5,600 MW of generation in the National Electricity Market.

EnergyAustralia fully supports more cost reflective network pricing as it will lead to more efficient network utilisation and efficient investment over the longer term, particularly as the profile of demand evolves. This will complement other regulatory initiatives that are being developed as an outcome of the AEMC's Power of Choice Review, including significant rule changes made in November 2012 to better equip the Australian Economic Regulator (AER) to set efficient revenues for network businesses.

However, an important aspect of network tariff reform is the ability of retailers to structure retail products that reflect underlying network costs, that can be understood by customers and can then encourage changes in consumption patterns.

This will only be achieved if retailers have sufficient opportunity to understand what Distribution Network Service Providers (DNSPs) are proposing and can influence the development of network tariffs. In the past, some DNSPs have seemed reluctant to engage

with retailers or have been very guarded about the information they provide so we welcome the formalisation of consultation requirements. Retailers interact directly with customers – of which there are numerous types – and are therefore, best placed to understand their preferences and their ability to understand and respond to different types of tariffs.

Furthermore, retailers are well placed to assist DNSPs understand the likely impact of different tariff structures and therefore, how they might comply with the proposed 'consumer impact' pricing principle. For example, some customers are more able will to adjust their consumption profiles in response to some potential tariffs that DNSPs might consider more cost reflective, such as capacity tariffs or critical peak pricing. Furthermore, retailers are often able to provide useful information on customer needs and are willing to participate in trials of new technology and tariffs, with the *Smart Grid, Smart City* initiative – in which EnergyAustralia partnered with Ausgrid to trial new metering and tariff design – as a recent example.

Therefore, EnergyAustralia strongly supports initiatives such as some elements of the AEMC's Draft Determination that seek to provide greater certainty and clarity around tariff determination. EnergyAustralia previously argued in its submission to the AEMC's Consultation Paper that:

'Over the years since the timing rules for network price approvals were originally set up, an increasing number of critical retail pricing tasks have arisen and new regulatory obligations created. The network timeframes are simply inadequate for retail pricing requirements. The actual situation is often made worse by the network prices being finalised later than the best case timeframes. In recent years, we've only had two or three weeks to complete all our repricing activities at times. To accommodate these tasks and obligations requires us to cut corners, make assumptions, and change our plans at short notice. However, we cannot do this without incurring additional costs and creating a less than optimal experience for customers.'

Therefore, EnergyAustralia is pleased that the AEMC is seeking to implement a more structured approval process and to encourage more effective engagement between networks and retailers, primarily through the Tariff Structure Statement (TSS). As the AEMC notes, this 'increases the likelihood that the benefits of cost reflective network prices will be passed on to consumers through retail price structures'.

Even so, DNSPs will retain considerable discretion and there remains uncertainty in terms of how each DNSP will determine and implement more cost reflective tariffs. Therefore, EnergyAustralia takes this opportunity to comment specifically on the proposed processes for the approval of annual tariffs and the Tariff Structure Statement (TSS). This includes restatement of our previous recommendation that the annual tariff approval process should provide retailers with a firm two month notification between the finalisation and effective dates for network tariffs.

Annual pricing process

As noted in our submission to the AEMC's Consultation, EnergyAustralia's annual repricing process requires input from a large group of people and affects a significant portion of our retail business. It is summarised in the following table.

Table 1: Retail tariff setting & implementation tasks per phase

Phase	Retail tariff setting and implementation tasks
1. Preparation	<ul style="list-style-type: none"> • Assess network tariffs – price levels, structure changes, rebalancing, new/obsolete tariffs • Competitor benchmarking and price positioning assessment • Price modeling and analysis • Pricing strategy creation • Prepare indicative prices, revenue/margin estimates
2. Tariff setting	<ul style="list-style-type: none"> • Check final network tariff changes, update pricing models • Set all regulated and market-based tariffs - considering tariff rebalancing and competitive position <ul style="list-style-type: none"> ○ Management & executive sign-off - MD approval for market tariffs ○ Answer questions from IPART and re-do tariff setting if required • Finalise IT specifications & test plans • Put final network prices & miscellaneous service charges into IT templates
3. Finalise regulated tariffs (where applicable)	<ul style="list-style-type: none"> • Prepare price sheets for upload to government comparator websites • Prepare newspaper notices for regulated tariffs
4. Implementation	<ul style="list-style-type: none"> • Put final retail prices into IT templates • IT update all prices, correct and deal with any issues • Prepare mail merge and mail house processes where individual letters are required • Prepare analysis of customer price impacts for call centre • Create price fact sheets • Update price lists & documentation on own website

In the past, the short and unknown period between the approval of network tariffs and their implementation further added to costs, created additional risks for retailers that were reflected in retail prices and / or resulted in retail prices that reflected estimated rather than actual network costs. At the same time, it has reduced the ability of retailers to consider and adjust the effects of network tariff changes on different customer groups. There have been instances where our ability to provide clear pricing messages around the reason for a reprice and its impact have been reduced due to insufficient notification of final tariffs.

Some aspects of this process are avoided and their impact reduced under the proposed arrangements; the proposed arrangements seek to minimise substantial changes to existing structures or the introduction of unforeseen tariffs, for example. This will benefit our customers to some degree through reduced operating costs, more efficient allocation of risks and retail prices that are better able to reflect underlying network tariffs.

Furthermore, some of the pressures to complete repricing activities within a retail price regulated context have been alleviated in the short term and will virtually be removed over the medium term through the positive initiatives of the majority of State Governments with respect to price deregulation.

EnergyAustralia recognises that the AEMC's proposal in relation to the annual approval process is an improvement on current arrangements. Similarly, EnergyAustralia welcomes the AEMC's recommendations regarding the TSS process and how it provides a basis for the AER to assess annual pricing proposals. However, EnergyAustralia previously recommended and continues to recommend a firm two month period between the finalisation and effective dates for network tariffs. This remains a more reasonable period of time than the proposed six weeks for EnergyAustralia to perform the full range of activities identified in the table above (including regulatory obligations), particularly as the number and complexity of network tariffs is likely to increase in the future.

More effective engagement between networks and retailers through the TSS process, combined with the AEMC's recommendation that the AER have specific regard to the indicative tariffs outlined in the TSS when assessing annual pricing proposals, are both positive developments. However, the prices in the TSS are necessarily indicative and reflect best available information and estimates at that time. Enhanced consultation at the commencement of a regulatory period is not an effective substitute for adequate notification of final tariffs in each year of the regulatory period.

The AER will effectively act as retailers' (and other stakeholders') proxy through this process, ensuring that DNSPs are setting tariffs in a manner consistent with the approved TSS. It is very important that the AER has regard to what was envisaged – and what resulted from effective engagement between DNSPs and retailers – in the approved TSS. Even so, the potential for approved tariffs to significantly differ from draft tariffs remains, hence our preference for a two month notification period.

In terms of the timeframes for approvals, we note the AEMC's recommendation for the AER to be granted 30 business days to consider and approve network tariffs, with no mechanism to 'stop the clock' in the event of delays. EnergyAustralia welcomes the introduction of a firm commitment and recommends that the approval period commence from the scheduled lodgment date, irrespective of whether a DNSP has lodged a draft proposal on time. Furthermore, the approved tariffs should be published or at least made available to retailers immediately after approval, rather than relying on DNSPs to publish tariffs within five days of approval.

We recognise there will be some interaction between DNSPs and the AER as part of the approval process as the AER will provide DNSPs with an opportunity to address deficiencies in proposed tariffs. Similarly, DNSPs will have scope to adjust prices throughout the regulatory period to recover allowable revenue, which may mean significant change if actual demand differs substantially from forecasts.

However, this interaction needs to be incorporated into the 30 business day timeframe; a longer timeframe or flexibility for either DNSPs or the AER to depart from a prescribed timeframe will contribute to costs and generate inefficiencies, as described above. It is inappropriate for retailers and their customers to bear additional risks and / or costs if DNSPs have not been able to meet the scheduled dates for lodgment. As noted in our submission to

the Consultation Paper, DNSPs will have a strong incentive to submit complete pricing proposals to the AER that are consistent with their approved TSS if they and the AER are subject to binding timeframes for approval. Similarly, the AER will be encouraged to appropriately prioritise and resource the assessment process.

Finally, the AEMC rightfully notes that there are many dependencies – such as jurisdictional determinations – within the distribution network pricing process that impact on the ability of DNSPs and the AER to publish final tariffs within an adequate timeframe. While the AEMC has taken positive steps to increase the time available to retailers to factor in approved tariffs, some of these factors fall outside the NER and cannot be directly addressed through this determination process. Therefore, we encourage the AEMC to consider how it might engage with jurisdictional governments and regulatory agencies to ensure their processes are consistent with and complementary to this Draft Determination.

Tariff Structure Statement

The proposed rules provide DNSPs with considerable discretion when developing tariff structures and tariff levels. Therefore, EnergyAustralia welcomes the AEMC's proposal to require DNSPs to demonstrate how they have engaged with retailers to develop their TSS and that the AER will be obligated to have explicit regard to this issue in their assessment and approval. The TSS will assume great significance, particularly as the AEMC envisages that the annual approval process will be a more mechanical process with the AER effectively auditing the proposal against the approved TSS, the applicable control mechanism and side constraints.

The TSS should provide a mechanism for clarifying how DNSPs will structure their cost reflective tariffs and over what timeframe this might occur; this includes the introduction of new tariffs at any stage during the regulatory determination period. One objective of this process should be to allow sufficient time for retailers to consider what is being proposed, to engage with their various customer segments and to structure retail products accordingly. As mentioned, this is necessary to ensure customers understand the structure of and rationale for revised tariffs and can adjust their consumption behavior accordingly.

The Draft Determination enables each DNSP to interpret and calculate Long Run Marginal Cost (LRMC) and to then develop and assign tariffs that are best suited to their individual characteristics, in terms of level and location of demand across the network, age of infrastructure, expected demand growth and population density, for example. This is appropriate but will have important implications.

EnergyAustralia notes there has been considerable focus on what more 'cost reflective' tariffs might look like, including the various methodologies for calculating LRMC and the alternative mechanisms for the recovery of residual costs; this is reflected in analysis undertaken by the AEMC's consultants, NERA and the Brattle Group, for example.

Furthermore, DNSPs will differ in their respective interpretations of the AEMC's proposed 'consumer impact' pricing principle. Despite the AEMC's guidance, each DNSP will presumably be able to make its own judgment about matters such as the appropriate trade-off between cost reflectivity and minimisation of consumer impact, an appropriate pace of transition, and the various customer segments' ability to understand how and why network tariffs have and will change.

As the AEMC notes, some networks may choose to introduce cost reflective tariffs very gradually, over more than one regulatory period, for example. EnergyAustralia is aware that some DNSPs are planning to recover a greater proportion of costs through the fixed component of network tariffs while others are considering more complex tariff structures.

As a result, it is highly likely that tariffs will differ substantially across networks in terms of locational granularity, peak pricing and definition of peak or the speed with which they move towards more 'cost reflective' pricing. The potential increase in the number and diversity of tariffs also has operational considerations for retailers, which further reinforces the need for adequate notification of annual tariffs.

Consultation with retailers in the early stage will ensure DNSPs appreciate the impact on retailers and their customers of different tariff strategies – including their complexity and volume – and transitional arrangements. This includes operational considerations, such as the time required and the processes (including system changes) that retailers must perform in order to pass through network tariffs in retail products and in a form that is comprehensible to all customer segments.

In terms of consultation processes, EnergyAustralia agrees that it should not be prescribed. Rather, AER should consider outcomes in terms of how DNSPs have sought retailer contributions on tariff options and how they have subsequently taken stakeholder consultation into account as they have prepared their TSS. We agree with the AEMC that the consultation process should not operate as an 'educational exercise' but rather, that it should provide retailers with a real opportunity to provide meaningful input into the development of network tariffs.

There are numerous issues and factors on which retailers would seek direction or clarification and we would expect the AER to consider how DNSPs have addressed them through the TSS consultation process. These include:

- long-term tariffs strategies;
- where input costs are going and if the DNSP expects prices to be set at the price path level or if, not approximately how much higher or lower do they expect the price change to be;
- immediate price-setting approaches and rebalancing – for example:
 - does the DNSP have a focus on increasing fixed costs or are these already relatively cost-reflective,
 - do they expect higher or lower than average price increases for any particular tariffs,
 - will they be reducing and or adding blocks and, if so, what thresholds will be used,
 - will they be applying any constraints or widening the gap between peak and off peak price levels,
 - will any tariffs be priced preferentially to others, etc.
- tariff plans for new or closed tariffs – particularly:
 - what the structure of new tariffs look like – and will this include any new elements such as time-of-use, seasonal, critical peak pricing, or capacity charges,
 - how any new tariffs were derived, and

- the expected benefits of the new tariff,
 - when and how the new tariff will be implemented (including any changes to metering or meter data);
- movement of customers is expected between different tariffs during the regulatory period – for example:
 - will customers on an obsolete tariff be transitioned gradually to other common tariffs,
 - if so, over what period and will customers be moved preferentially based on consumption level or consumption patterns,
 - will retailers be able to request or reject any tariff movements?
- any issues or challenges that the DNSP is facing with changing customer behaviour or with retailers' processes and to discuss with stakeholders how these can be addressed

EnergyAustralia previously recommended to the AEMC that DNSPs provide this information on a 'periodic, at least annual' basis. However, this information will presumably inform the preparation of each TSS and by implication, the indicative tariffs against which the AER will assess proposed tariffs in each year of the regulatory period; any significant departure would then require a DNSP to submit a revised TSS or result in the rejection or amendment of annual tariff proposals.

If you require any further information with regard to this submission, please contact me on (03) 8628 1479 or via email at geoff.hargreaves@energyaustralia.com.au.

Yours sincerely,



Geoff Hargreaves
Regulatory Manager, Retail