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Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

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National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014: Draft Rule Determination (ERC0161)

AGL Energy (AGL) operates across the energy supply chain and is located in Queensland, New South Wales, South Australia and Victoria. It is a significant retailer and generator of energy with around 3.8 million retail electricity and gas customers as well as investments in coal-fired electricity generation, gas-fired electricity generation, renewables and upstream gas extraction.

AGL welcomes the opportunity to comment on the Distribution Network Pricing Arrangements Draft Rule Determination (Draft Determination) released by the Australian Energy Market Commission (AEMC) on 28 August 2014.

AGL support the intent and drafting of the rule changes contained in the Draft Determination, especially the refinement of the network pricing process, including the:

- **Tariff Structure Statement (TSS):** To be consulted upon and then approved by the AER This will inform how the DNSPs set annual tariffs throughout the regulatory period and will increase transparency with regard to the methodologies for constructing network charges and most importantly, signal the intent of DNSP's to change and modify tariffs structures over the period;
- **Consultation on annual network price changes**: This process, in conjunction with the consultation on the TSS itself, will allow customers and retailers to have input into the development of annual network tariffs by the DNSPs.

  It is important that stakeholders, including electricity retailers, are consulted on changes to the structure of network prices or new network prices before they are finalised. AGL notes that a number of DNSPs are already informing retailers, to varying degrees, of material changes to network tariffs; and
- **Enforced timeframes for network price notification**: as recognised by the AEMC, the current timeframes for network price changes are insufficient to support retail energy markets and the guarantee that network tariffs will be notified at least 6 weeks prior to commencement is a significant step forward.

AGL note that the draft rules requires the TSS to be accompanied with a price schedule of indicative price levels for each year of the regulatory period. This would be an enhancement on the statement of expected price trends currently produced by DNSPs and AGL is encouraged that it will be updated annually. However, AGL would query whether the requirement will result in DNSPs updating the indicative prices with its latest information. To date, DNSP's statements of expected price trends are usually based on X-Factors from the regulatory determination and are usually redundant as a guide for future price movements, especially under revenue cap regulation.

AGL encourages the AEMC to ensure that DNSPs updates of indicative price levels would use the latest information on energy consumption, over/under revenue adjustments, cost pass throughs etc.

AGL is also supportive of the Draft Determination's enabling of network tariff reform. The implementation of more cost reflective network pricing is essential to rectify current inefficient pricing signals and to better reflect utilisation of the network and accommodate alternative technologies. To that end, AGL generally agrees with the:

- **Network pricing objective:** requiring DNSPs' to target network tariffs that are more cost reflective and reflect the efficient cost of supplying network services;
- **Need for efficient cost recovery:** requiring DNSPs to minimise price distortions to the recovery of each network tariffs efficient cost to serve; and
- **Transitioning of network tariffs:** by requiring consideration of the impacts on consumers.

However, AGL continues to have concerns with the rule change that mandates that network prices be based on long run marginal cost (LRMC). Although, the economic foundation for such a requirement is sound, AGL believe the difficulties in practice make it unsuitable to mandate that network tariffs must be constructed based on LRMC.

AGL feel that LRMC calculations are a necessary and essential guide for structuring and setting network tariffs but the current rules already require its consideration in price setting. AGL acknowledge that many DNSPs have given scant reference to LRMC to date but a rule may further commitment without mandating it as the predominant pricing input. AGL's general concerns regarding the rule include:

- LRMC is highly dependent on demand growth forecasts and under the current environment of reducing or flat demand, it will not provide a significant contribution to tariff recovery. The recovery of the residual costs will be the significant methodology so mandating LRMC as the basis for network tariffs is largely redundant, and not a costless exercise;
- It may have unintended consequences by preventing DNSPs from adopting other tariff measures – that conflict with adhering to LRMC - that would also address efficient pricing and revenue recovery;
- LRMC calculations are inherently complex. NERA has identified the many key problems with estimating LRMC including addressing excess network capacity, that averaging of LRMC across a network encourages inefficient pricing and investment decisions, specifying realistic demand increments and the complexity of pricing for more accurate location specific LRMC. These issues are not resolved and individual DNSPs will address differently with contradictory results; and
- Given these issues, and in the absence of better metering technology, AGL expects that compliance with the mandatory LRMC rule will largely result in DNSPs' only being able to adhere to it in principle. This is no change from the current requirement so the costs of this rule are likely to outweigh any benefits.

This rule change is of concern to many participants and the Draft Determination recognises that all networks, bar one, are against the requirement. Their objections should be given weight given they best understand the complications of estimating a network LRMC.

If you have any queries or wish to discuss this matter further, please contact me on (03) 8633 6207 or Patrick Whish-Wilson on (07) 3403 2426.

Yours sincerely,

[redacted]

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