COAG
Energy Council
Senior Committee
of Officials

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear ~~Mr Pierce~~ John

COAG Energy Council Officials have agreed to submit a rule change request to the Australian Energy Market Commission on aligning network and retail tariff structures where a retailer is required by a jurisdiction to offer a prescribed tariff structure as part of the standing offer.

This rule change request has been developed based on recommendations made by the National Smart Meter Consumer Protection and Safety Review. The rule change request supports amendments made in November 2013 to the National Energy Retail Law to allow jurisdictions to specify that particular retail tariff structures must be offered as a standing offer tariff.

The rule change proposal and associated draft rule are attached for your consideration.

Sincerely

**Martin Hoffman**
Chair
COAG Energy Council Senior Committee of Officials

Enc
17 June 2014

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# Aligning Network and Retail Tariff Structures for Small Customers

## Rule Change Request

## June 2014

## 1. Name and address of the rule change proponent

COAG Energy Council

COAG Energy Council Senior Committee of Officials

COAG Energy Council Secretariat

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Canberra ACT 2601

## 2. Description of the proposed rule change

The proposed rule change seeks to support choice of tariff structures for small customers as jurisdictions move to flexible pricing. This is especially important as advanced metering technology becomes available which enables a wide range of alternative pricing structures based on time of consumption or maximum capacity.

The rule change seeks to amend the National Electricity Rules (NER) so that where a jurisdiction requires that retailers offer a specified tariff structure as a standing offer retail tariff to a certain class of customers then:

(a) Distribution Network Service Providers (DNSPs) will be required to make available to that class of customer a network tariff with the same structure as the specified retail tariff; and
(b) Where a customer chooses the specified retail tariff, retailers will be able to select the network tariff with the same structure.

Under this rule change DNSPs would continue to be:

- responsible for designing their tariffs in accordance with the Rules and their individual circumstances
- able to offer a variety of tariffs to retailers
- responsible for allocating customers to particular tariff classes[1] (but not necessarily a particular tariff within that class where prescribed retail tariffs are selected by the customer).

The rule change supports recent changes to the National Energy Retail Law (NERL) which enables jurisdictions to stipulate that retailers must offer particular standing offer tariff structures to small customers with an interval meter. This is intended to facilitate consumer choice in the transition to flexible pricing, including, ensuring certain flexible tariffs are offered and providing the ability for consumers who wish to remain on a 'flat' retail tariff[2] to do so.

The rule change proposal would add an additional condition for the approval of a distribution pricing proposal, where a jurisdiction requires a particular tariff structure to be offered as a standing offer retail tariff for a specified class of customer. In these circumstances, the Australian Energy Regulator

[1] 6.18.3 and 6.18.4 of the NER

[2] For the purposes of this rule change a flat network tariff is defined as a volume based tariff that does not vary depending on the time of day. The rates associated with flat tariffs may vary depending on the season.

(AER) would only be able to approve the distributor's pricing proposal if a network tariff structure is offered within the pricing proposal which matches the prescribed retail tariff structure.

The rule change proposal promotes the National Electricity Objective (NEO) by assisting in the transition to more cost reflective network charges in a way that maintains customer choice and minimises the potential for price shock for customers. The rule change reduces the risk of tariff misalignment for retailers when they are required to offer a particular tariff structure to consumers, helping to keep standing offer tariffs as low as possible. The rule change is related to other proposed regulatory changes connected to the transition towards more cost reflective pricing. In particular:

- proposed changes to the distribution pricing rules to provide better guidance on the setting of distribution tariffs and the consultation processes networks will be required to undertake with consumers and retailers
- proposed changes to implement a competitive framework for the provision of metering services which will support a market-led, voluntary rollout of advanced metering in jurisdictions where a mandatory rollout is not underway.

These changes are discussed in more detail in section 3 below.

The proposed rule change is also consistent with proposals by the Australian Energy Market Commission (AEMC) in their Power of Choice review which suggested that medium and small customers should be able to either remain on, or choose a, flat network tariff as part of the transition to more cost reflective pricing.[3] The Productivity Commission[4], in its Electricity Network Regulatory Frameworks Review also supported the AEMC's proposal that people can opt into time-varying tariffs, or choose to remain on a flat tariff (that would then rise over time as non-peaky users selected time-varying tariffs).

### Details of the rule change

The proposed rule change specifically seeks to amend Chapter 6 of the NER in order to place new obligations on DNSPs. These obligations will only apply for DNSPs operating in jurisdictions where a local instrument has been enacted which applies section 22(1a) of the NERL[5]. Application of this section enables jurisdictions to require that retailers offer particular standing offer tariff structures to customers with an interval meter.

This rule change would require that DNSPs make available a network tariff with the same structure. For example, where a jurisdiction requires that retailers provide a flat standing offer tariff structure, or particular type of time of use tariff, then this rule change will require DNSPs to make a similar tariff structure available to retailers for the same class of customers.

Retailers will, in effect, be able to select a similar network tariff structure for any customer who chooses one of the prescribed standing offer retail tariffs. This includes circumstances when a new customer moves into a premise and where a customer is placed on a flat retail tariff as part of a

[3] Australian Energy Market Commission 2012 Power of choice review - giving consumers options in the way they use electricity, Final Report, 30 November Sydney.

[4] Productivity Commission 2013 *Electricity Network Regulatory Frameworks*, Report No. 62, Canberra.

[5] These are the new clauses inserted as a result of the passage of the Statutes Amendment (Smart Meters) Bill 2013 in November 2013

hardship programme. The distributor would not be able to refuse a retailer request to reassign a customer to the network tariff which aligns with the prescribed standing offer retail tariff which the customer has chosen or been placed on.

The rule change adds an additional requirement on the approval of distribution pricing proposals. Where a jurisdiction has specified that the standing offer retail tariffs must include a tariff of particular structure under section 22(a1) of the NERL, the AER would only be able to approve the network's pricing proposal if the proposal allows for a retailer to choose a network tariff which aligns with the specified retail tariff structure for the required class of customers. The class of customers would be defined by the jurisdiction, and may cover one or more of the distributors proposed tariff classes. For example, a jurisdiction may require retailers to offer a flat standing offer retail tariff to all residential customers. The distributor would then be required to offer a flat network tariff in each tariff class which has residential customers as members.

The rule change does not propose to change how the level of the tariff is determined.

## 3. Background to the rule change

In its communique[6] of 14 December 2012, the Standing Council on Energy and Resources (SCER) agreed to develop the market settings to allow for jurisdictions to provide consumers with the option to move to time-varying pricing. This agreement was informed by two separate, though related, pieces of work: the AEMC Power of Choice Review, and the *National Smart Meter Consumer Protection and Safety Review – Officials' Report* (consumer protection review)[7].

The underlying intent of these reviews was to move towards more cost reflective network and retail tariff structures. This will reduce cross subsidies between consumers, and lead to more efficient consumption decisions in the longer term.

### Smart meter consumer protections

The consumer protection review was developed as a result of a decision in December 2007 by the Ministerial Council on Energy (MCE) to review consumer protection and safety arrangements for services enabled by smart meters and ensure they remained appropriate for each jurisdiction.

The consumer protection review found that, given the importance of the network tariff structure in influencing the shape of retail tariff offerings, it was important to consider whether there should be a change to network tariff arrangements to support the development of appropriate retail tariff structures for smart meter customers.

The review recommended that small customers with interval or smart meters should be given an effective choice of retail tariffs. This could be implemented by requiring that retailers, where they are required to offer a standing offer tariff, to offer a flat standing offer tariff to small customers.

### The AEMC Power of Choice review

In the Power of Choice review the AEMC proposed that flexible retail pricing options should be facilitated through the introduction of cost reflective network prices. Under the AEMC proposals,

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[6] scer.govspace.gov.au/files/2012/12/Final-SCER-Communique-14-December-2012.pdf.
[7] https://scer.govspace.gov.au/files/2012/11/Smart-Meters-Officials-Report.pdf

customers would be transitioned to new tariff structures depending on the size of their energy use, with medium and small customers able to either remain on, or choose, a flat network tariff as part of the transition to more cost reflective, time-varying pricing.[8]

This would be achieved by placing consumers into three consumption bands:

- Large residential and small business customers above a defined annual consumption threshold would be required to have a flexible network tariff as part of their retail price offer.
- Medium residential and small business consumers would transition to retail pricing offers that included a flexible network tariff but would be able to opt out and remain on their existing retail pricing structure.
- Small consumers with consumption below the small consumer threshold would remain on their existing retail price structure but would be able to opt in to a flexible retail price offer.

## Productivity Commission, review of electricity network regulatory frameworks

The Productivity Commission, in its Networks review[9] supported the AEMC's proposal that people could opt into cost-reflective tariffs, or choose to remain on a flat tariff (that would then rise over time as non-peaky users selected cost-reflective prices).

## Introduction of flexible pricing in Victoria

In mid-2013 the Victorian Government, as part of its smart metering program, introduced flexible pricing. Under these arrangements, the customer's network tariff can be chosen by the customer's retailer in order to align the structure of the retail and network tariffs. This applies to all retail tariffs, not just standing offer retail tariffs. As part of these changes, consumers are able to remain on a flat retail tariff if they wish.

As the Victorian changes have not been in place for very long, the effects on the number and types of tariffs that networks might offer, the implications for retail tariff design and the availability of effective choice for consumers are still uncertain. As more information and analysis becomes available this will inform future policy development.

## Statutes Amendment (Smart Meters) Bill 2013

Although SCER did not explicitly accept the consumption band model proposed in the Power of Choice review, it did agree that it was appropriate that consumers be given a choice of retail tariffs, including the option to remain on a flat retail tariff if they wished. This would assist consumers to manage the transition towards more cost reflective prices at a pace which suited their individual circumstances.

In May 2013 SCER agreed to the introduction of the *Statutes Amendment (Smart Meters) Bill 2013*. This Bill was passed by the South Australian Parliament on 14 November 2013. The Bill amended the

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[8] Australian Energy Market Commission 2012 Power of choice review – giving consumers options in the way they use electricity, Final Report, 30 November Sydney.

[9] Productivity Commission 2013 *Electricity Network Regulatory Frameworks*, Report No. 62, Canberra.

NERL to enable jurisdictions to stipulate particular retail tariff structures that must be included in a retailer's standing offer for small customers that have an interval or smart meter.

The Bill also contains provisions to apply if the National Energy Retail Rules (NERR) are amended in the future to prescribe particular tariff structures for a retail standing offer. These provisions would allow jurisdictions to opt into this rule being applied in their jurisdiction.

The objective of this rule change proposal is to align the NER with these recent legislative changes and support customer choice during this transition to flexible pricing by aligning network tariffs to prescribed retail tariff structures.

### Relationship with other rule change proposals

This rule change proposal complements other rule change proposals which have been submitted by SCER in response to the Power of Choice review.

These include reform of the distribution pricing arrangements, which was submitted to the AEMC by SCER in September 2013. This rule change proposal seeks to:

- improve the clarity of, and strengthen existing pricing principles in the NER for DNSPs to ensure they develop and set prices based on Long Run Marginal Cost. This will encourage the introduction of more cost reflective, flexible pricing options.
- enable the AER to have sufficient time and opportunity to review DNSP's pricing proposals and requested variations in pricing structures to ensure the DNSP pricing arrangements are consistent with the amended pricing principles
- improve the existing consultation requirements for DNSPs so that retailers and consumer groups have a greater opportunity to consider and influence network charges and the structure of those charges.

The rule change proposal also complements proposed changes to establish a competitive framework for the provision of metering services in states where a widespread roll-out of advanced meters is not underway. The metering rule change proposal, submitted to the AEMC in October 2013, seeks to support a market-led, optional rollout of advanced meters by creating a new Metering Co-ordinator role, and ensuring that no party has the exclusive right to provide a particular type of meter unless a jurisdiction prescribes otherwise. Within the proposed framework, jurisdictions will be able to decide when a meter must be installed in defined situations through new and replacement metering policies.

## 4. Nature and scope of the issues that the rule change request will address

The widespread introduction of interval and smart meters will enable networks and retailers to move towards more cost reflective network and retail pricing structures. Over time this will provide a net benefit to consumers, through the provision of price signals to individual consumers that better reflect the cost of providing electricity at different times and locations. This will lead to more efficient consumption choices and more efficient network investment.

However, network tariffs for most small consumers are currently flat tariffs, as most small residential customers have accumulation metering. The transition to more efficient pricing structures as smart meters are rolled out will benefit consumers in the long run, but some individuals or groups of consumers are likely to be worse off in the short term as cross subsidies are unwound. Managing the transition in a way that enables consumers to adjust to new arrangements will be important for consumer acceptance.

As part of this transition, some jurisdictions may wish to ensure consumers have a choice of retail tariffs which support the transition to flexible pricing. As has occurred in Victoria, this could involve retailers being required to offer a particular type of time of use tariff, and maintain a flat tariff for those who wish to remain on it.

Retailers generally follow similar tariff structures to the network tariff available, as this minimises the risk of under recovery of the network tariff component of their costs. Therefore while retailers are free to structure their tariffs as they choose, fundamental departures from the underlying network tariff are rare.

Should the structure of network and retail tariffs differ, for example where customers have a flat retail tariff but a flexible network tariff, retailers will face a risk of divergence between costs and revenue which they would be expected to price into the flat tariff offer. This risk premium would be reduced if the retailer had the ability to align any prescribed retail tariff with a similarly structured network tariff.

## 5. How the rule change request addresses these issues

The rule change requires that network companies offer a choice of network tariffs to retailers which align with prescribed retail tariff structures in jurisdictions which require it.

Where a particular retail tariff structure is required by a jurisdiction, this introduces a constraint on the tariffs offered by retailers, as the specified tariff structure must be offered. The rule change would apply the same obligation on distributors, requiring distributors to offer retailers a network tariff structure that aligns with the tariff structure the retailer is obliged to offer. This will enable retailers to align their prescribed tariff structures with underlying network tariffs enabling them to better manage the risk of misaligned tariffs created by a jurisdictional requirement.

Aligning the tariff structure for prescribed tariffs, gives the retailer a reasonable opportunity to recover the network charge for that customer. In the absence of this requirement, retailers would apply an additional risk premium to the required tariff. Depending on the structure of the network tariffs and the required retail tariff, this risk premium could be substantial, and increase tariffs across the board as retailers seek to reduce significant price shock for those customers on the standing offer.

Aligning tariff structures between the retail and network tariffs may reduce any risk premium the retailer would otherwise need to apply to manage the risk of misaligned tariffs. By aligning tariff structures, the resulting standing offer will be lower, as a result of no or minimal risk premium needing to apply to ensure network charges are recovered.

While it could be argued that aligning tariffs structures transfers the revenue risk to distributors, the distributors are better placed than retailers in managing this risk, being able to spread the risk over a larger customer base than retailers. The regulatory framework also generally allows for network tariffs to be adjusted for over or under recovery of revenue, depending on the method determined by the AER in the relevant distribution determination.

It is noted that less cost-reflective tariffs, such as a flat tariff, are likely to increase over time, which will provide an incentive for customers to switch to more flexible cost reflective tariff options. Some customers however, may prefer to choose the simple structure for a higher price, rather than a more complex structure and a potentially lower price, and this is not necessarily an inefficient outcome.

Although it may impose a constraint on tariff design, by ensuring the continued availability of existing familiar tariff structures, the practical effect is similar to the current constraint of having to offer a tariff that can be supported by accumulation meters. As any widespread replacement of accumulation meters with interval or smart meters will occur over a period of time, distributors will have to continue to offer tariffs that accumulation meters support, even under proposed new distribution pricing principles. Initially, as it is expected that any flat tariff structure a jurisdiction is likely to require would be the continuation of an existing tariff structure, this is unlikely to impose a significant additional burden on distributors.

It is noted that this mechanism could also enable jurisdictions to support the introduction of more complex network tariff structures. In this case, alignment is desirable to maintain the price signals and enable customers to trial new complex tariff structures.

Under the proposed rule, where a jurisdiction requires a particular tariff structure to be offered as a standing offer retail tariff for a specified class of customer as defined by the jurisdiction, the Australian Energy Regulator would only be able to approve the distributor's pricing proposal if the same required network tariff structure is offered, subject to meeting all other requirements in the Rules.

Under the proposed rule, a distributor would not be able to refuse a request from a retailer to assign a customer to a particular network tariff that corresponds to the prescribed standing offer retail tariff the customer is on. When a customer moves off the standing offer, the retailer would inform the network who may then assign them to the appropriate network tariff.

While the proposed rule requires a specific tariff structure to be offered, it does not propose to alter how price levels should be determined, which is the subject of the distribution pricing rule change request.

The AEMC is asked to consider consequential rule changes that may be required as result of the proposed rule.

## 6. How the proposed rule will or is likely to contribute to the achievement of the National Electricity Objective

The National Electricity Objective is set out in section 7 of the National Electricity Law. The NEO states:

*"The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to-*

*a. Price, quality, safety, reliability and security of supply of electricity; and*
*b. The reliability, safety and security of the national electricity system".*

The proposed rule would contribute to the achievement of the NEO by ensuring that the necessary transition to more efficient network and retail prices is managed in an orderly way which maintains consumer choice and minimises price shocks for individuals or particular groups of customers.

The proposed rule would contribute to keeping the standing offer as low as possible, by providing retailers with the opportunity to recover network charges for the required tariff structure without the need for an additional risk premium.

## 7. AEMO's declared network functions

The proposed rule will not affect the Australian Energy Market Operator's declared network functions.

## 8. Expected benefits, costs and impacts of the proposed rule

The benefits of this proposal should be seen as part of a suite of measures which assist in the transition to more cost reflective pricing over time. The key benefit of the proposed rule is managing the transition to new tariff structures by supporting consumer choice, and increasing the support for new tariff structures.

### *Impact on retailers*

This rule change will minimise the risks for retailers which could arise as a result of a misalignment of network and retail tariffs and will result in lower price adjustments or price shock for customers. The rule change supports more choices for consumers in tariff structures. Retailers would need to engage with distributors in tariff design.

Retailers may incur some additional costs in requesting the appropriate network tariffs from distributors.

### *Impact on DNSPs*

This change will have the greatest impact on DNSPs. They will need to develop the appropriate network tariff options to align with required retail tariff structures as part of their pricing proposals. The proposed rule would impose a constraint on network tariff design, which is likely to entail the effective continuation of an existing tariff structure (i.e a flat tariff). In particular they will face reduced certainty in assigning customers to particular tariffs and possibly associated revenue volatility. However, distributors will still be able to allocate customers to a particular tariff class, even if they cannot assign customers who choose a prescribed retail tariff to a particular network tariff within that class.

Costs may be incurred in developing processes for retailers to request the appropriate network tariff based on their customers' choice of standing offer retail tariffs.

### *Impact on consumers*

This rule change will support the transition to flexible pricing, by enabling small consumers who have an interval meter to choose between different retail offers, including choosing from a range of prescribed retail standing offers, where jurisdictions provide for this. It would also assist in minimising price rises for all consumers.