



PO Box 4136
East Richmond VIC 3121
T 131 806
F 1300 661 086
W redenergy.com.au

PO Box 632
Collins St West VIC 8007
T 1300 115 866
F 1300 136 891
W lumoenergy.com.au



15 December 2016

Ms Rachel Armstrong
Advisor
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted electronically

Dear Ms Armstrong,

Re: National Electricity Amendment (Participant derogation - NSW DNSPs revenue smoothing) Rule 2016 (ERC0201)

Introduction

Red Energy (Red) and Lumo Energy (Lumo) welcome the opportunity to respond to this Participant Derogation (the derogation).

The proposed changes to the National Electricity Rules (NER) seek to smooth the recovery of revenue adjustments that may result at the conclusion of current legal proceedings. Specifically, the proposed derogation allows any resulting adjusted revenue amounts to be recovered over two regulatory periods rather than one. This approach aims to minimise pricing volatility for consumers.

First impression of the derogation suggests that it aims to minimise pricing volatility. Tariff shock, especially if it is unexplained, can have significant impacts on the affordability of electricity and a serious impact on consumer confidence and trust in the market.

Nevertheless, a more careful examination of the rule change highlights that it is important for the Australian Energy Market Commission (the Commission) to address some pertinent questions when deciding whether to approve this derogation. These questions relate to whether:

- there is currently a legitimate need for the rule change; and
- the rule change is consistent with the revenue and pricing principles in the National Electricity Law (NEL).

If the Commission validates these questions then we would not object to this derogation.

Is this rule change necessary?

Red and Lumo consider this derogation may be premature. The proposed changes to the NER seek to smooth the recovery of revenue adjustments that may result at the conclusion of current legal proceedings. Specifically, the proposed derogation allows any resulting adjusted revenue amounts to be recovered over two regulatory periods rather than one.

The derogation itself assumes that adjustments to Distribution Network Service Providers (DNSP) revenues will need to be made in order that they are smoothed out following the outcome of the legal proceedings.

There is significant uncertainty associated with the precise outcome of the legal proceedings. Specifically, it is sufficiently unclear whether adjustments to network revenues will be required as a result of any legal proceedings. As such, if the outcome of the legal proceedings can not be predicted with any level of certainty, it raises questions regarding whether this derogation is required.

To highlight this further, assuming the AER appeal to the Federal Court is successful the following questions remain unclear. In terms of the impact on network charges, would this mean network charges remain unchanged? Would it mean that network charges need to be adjusted up or down? Alternatively, would the appeal court simply refer the matter back to the AER for it to remake a revised revenue determination? Or would there be no change at all to the AER's Final decisions? All of these outcomes are possible, yet difficult to predict with any certainty.

Given the uncertainty associated with the AER's legal proceedings we consider it prudent for the Commission to wait until these proceedings have finished before deciding on this derogation.

Does the revenue smoothing rule change breach the revenue and pricing principles in the NEL?

Red and Lumo consider that any revenue smoothing derogation that avoids required network price adjustments in favour of revenue smoothing may breach the revenue and pricing principles in the NEL.

We have concerns that the following key revenue and pricing principles may be breached if the Commission approves this derogation:

***Principle number 1** - A regulated network service provider should be provided with a reasonable opportunity to recover at least the **efficient costs** of providing direct control services.*

***Principle number 2** - A price or charge for the provisions of a direct control service should allow for a **return commensurate with the regulatory and commercial risks** involved in providing the service to which that price charge relates.*

Red and Lumo consider that a one off full adjustment to network charges as a result of legal proceedings would be more consistent with both of these principles.

For example, consider the situation where an increase to network charges is required as a result of a judicial appeal. A one off full adjustment to network charges (as opposed to the use of a mechanism that smooths in higher prices over years) would allow the rule change proponents to immediately recover their *efficient costs* and recover a return commensurate with their *regulatory and commercial risk*.

The alternative approach that smooth out network price increases over a few years would fail to comply with these revenue pricing principles during the transitional period. In essence, DNSPs would continue to under-recover their regulated revenues over the

transitional pricing period during the time when the revenue smoothing process was in place.

Alternatively, consider the scenario where there was a need to adjust network charges downwards as a result of a judicial appeal. A once-off full adjustment to network charges (as opposed to the use of a mechanism that smooths in lower prices over years) would immediately re-adjust network tariffs that were over-compensating the rule proponents. As a result, DNSPs revenues would be immediately adjusted so that they only earn their *efficient costs* and recover a corresponding return commensurate with their *regulatory and commercial risk*.

The alternative approach that smooth out network price decreases over a few years would not comply with these revenue pricing principles during the transitional pricing period. In essence, DNSPs would continue to over-recover on their regulated revenues over the transitional pricing period during the time when the revenue smoothing process was in place.

Conclusion

Whilst Red and Lumo are not in principle opposed to a change that allows DNSP revenue smoothing to avoid price shock for customers, however, there must be a legitimate need for the rule change before it is approved. That is, the Commission must be certain that there will be an adjustment to NSW DNSP price changes, and the rule change must comply with the revenue and pricing principles in the NEL.

Red and Lumo are yet to be convinced that both of these questions have been answered adequately. Therefore, at this stage, we prefer that the amendment is not made.

About Red and Lumo

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria and New South Wales and electricity in South Australia and Queensland to approximately 1 million customers.

Red and Lumo thank Commission for the opportunity to respond to this consultation. Should you have any further enquiries regarding this submission, please call Con Noutso, Regulatory Manager on 03 9976 5701.

Yours sincerely

A handwritten signature in black ink, appearing to be "Ramy Soussou". The signature is stylized with loops and a long horizontal stroke at the end.

Ramy Soussou
General Manager Regulatory Affairs & Stakeholder Relations
Red Energy Pty Ltd
Lumo Energy Australia Pty Ltd