Energy Retailers Association of Australia
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19 December 2013

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Sir/Madam,

RE: National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014 Consultation Paper

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide feedback in response to the Australian Energy Market Commission's (AEMC) *National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014 Consultation Paper* (the Consultation Paper).

The ERAA represents the organisations providing electricity and gas to almost 10 million Australian households and businesses. Our member organisations are mostly privately owned, vary in size and operate in all areas within the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas.

The ERAA supports many of the proposals contained in the Consultation Paper, and agrees there is scope to improve current network price setting processes. The ERAA supports the proposals regarding consultation, although amendments to these processes do not reduce the need for changes to the timing of annual network pricing processes. The ERAA also supports the move to more cost-reflective network tariffs, whilst noting that some proposals contained in the Consultation Paper may be difficult to implement.

Changes to the timing of the annual network pricing process

The ERAA and its members have previously provided input into the rule change request from the Independent Pricing and Regulatory Tribunal (IPART) (referred to as 'the IPART rule change request'). This includes submissions to the *National Electricity Amendment (Annual Network Pricing Arrangements) Rule 2013 Consultation Paper* on 4 July 2013, and to IPART's *Network price changes – IPART's proposed changes to National Electricity Rules and National Gas Rules Consultation Paper* on 31 August 2012. The ERAA strongly supported this proposal, agreeing with IPART that the proposed amendments would be in the long-term interest of consumers.

The current annual network pricing arrangements do not provide certainty for retailers, customers or regulators. The National Electricity Rules (NER) only allow one month between the finalisation of determinations and the notification of network prices. Retailers closely follow any changes to network prices and usually aim to update retail prices at the same time that network prices take effect. If there are no delays and the final network prices are very similar to the draft prices (in level and structure), they are usually released in very late May or early June (except in Victoria where they are released in very late November or early December). This timing can leave a mere week for tariff setting and two to three weeks for IT system updates. If there are delays then retailers must fit their re-pricing activities into a much shorter amount of time. Even if final network prices are received at the earliest possible date, retailers still must rush retail price setting decisions, delay the date that retail prices come into effect or alternately base pricing decisions on draft network tariffs.

The ERAA does not believe the current arrangements are consistent with the National Electricity Objective (NEO). Pricing uncertainty is not in the best interest of customers as it introduces a risk that retailers will not set efficient and cost-reflective prices. Retailers must amend their prices to reflect changes in network tariffs. If they are not able to do so, they could risk significant losses. This risk is ultimately passed on to customers in the form of higher prices. The ERAA does not believe that this is the most efficient allocation of risk. These short timeframes reduce the ability of retailers to provide clear pricing messages, potentially increasing customer confusion and reducing customer confidence. Allowing for a reasonable timeframe would mean retailers would be able to better communicate information on price changes to customers. Distributors are better placed to manage this risk as they have access to more accurate and detailed information sources. These include changes to overall volumes and usage amongst different segments and geographic locations.

The negative impacts of the current arrangements have become larger over time as the retail energy market has evolved. This has resulted in an environment where:

- retailers are no longer integrated with distributors
- more retailers are operating in multiple contestable jurisdictions within the NEM
- contestable retail markets are becoming increasing competitive and retailers must consider pricing attractiveness and competitive position as well as input costs
- network pricing approvals more often are delayed, complex or result in appeals due in part to the increasing focus on network price increases and the introduction of new tariffs.

Consultation

As network costs make up approximately 35-50 per cent of retail energy bills for small customers, retailers need to maintain close working relationships with networks to understand costs and obtain timely and reliable information on network pricing. However, many distributors are restricted or prohibited from discussing the details of network tariff reviews undertaken with the Australian Energy Regulator (AER). This restricts the ability of retailers to appropriately respond to the adverse impacts of delays to the approval of network prices. The negative impacts of pricing uncertainty relate to both price level and price structure. For example, if there are changes to the fixed charge element of a tariff between draft and final network prices, retailers may not have provided efficient pricing signals to their customers. Whilst distributors engage with retailers, the effectiveness of this consultation varies greatly. The ERAA believes that consumers would benefit from a requirement for networks to undertake formal consultation on pricing with retailers.

As a general principle, distributors should have to share more information, and consultation on network prices should be an ongoing process – this could be done ahead of the distribution pricing process and need not take any additional time in the annual pricing process. Retail pricing risk could be reduced if distributors provided advanced guidance on pricing strategy, any rebalancing approach and proposed changes to tariff structures. The ERAA therefore supports further consultation on a distributor's proposed tariff structures, as recommended in the rule change request from the Standing Council on Energy and Resources (SCER) (referred to as 'the SCER rule change request'). However, any changes to consultative approaches need to be considered in addition to timing changes.

Changes required - timeframes

The ERAA supports the publication of final network prices two months prior to retail prices are due, as proposed under the IPART rule change request. This change will provide retailers with sufficient time to incorporate the level and structure of relevant network tariffs. SCER's original rule change request stated that "Changes to the timing of the pricing proposal process may also be required as a result of these changes."[1] Bringing forward the

[1] SCER (2013), *IPART rule change request,* p.12

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annual pricing process would benefit consumers with or without the introduction of a Pricing Structure Statement. Whilst the ERAA supports improvements to consultation processes, it would not reduce the need for a binding timeframe.

Should network pricing publication dates be amended, retailers will be able to more accurately set their retail tariffs, ensuring that customers no longer face the current pricing risks. These benefits, for example, could be achieved through variations to current procedures, whereby prices could be set earlier, and over a longer period. As outlined earlier, the certainty regarding prices will enable retailers to set more accurate tariffs, and where appropriate incorporate network price signals properly as part of the setting of in retail tariffs.

The Consultation Paper raises three issues relating to the publishing final network prices two months prior to retail prices are due. The ERAA does not consider these issues to be material or insurmountable.

1. *The requirement to include a Consumer Price Index (CPI) figure from the March quarter in network tariffs to be introduced in July*

As CPI has a relatively low volatility, CPI could be calculated using data from the previous year.

2. *The requirement to publish transmission prices earlier*

As the forecasts used to calculate transmission prices have a relatively low volatility, prices could be calculated with a similar level of accuracy earlier utilising an additional month of forecast. Any discrepancies could be adjusted for in later years.

3. *Challenges relating to the first year of the access arrangement period*

Should there be a requirement for distributors to provide an indicative pricing statement two months before prices apply, retailers will be better informed when developing retail tariffs.

Reforms to distribution pricing principles

The ERAA supports the transition towards cost-reflective tariffs, and sees the principles put forward in the Consultation Period as appropriate. Cost-reflective price signals enable consumers to make informed decisions regarding demand-side participation and energy efficiency measures. As part of any such transition, retailers must be able to tailor products to best suit the needs of a variety of customers.

The Consultation Paper discusses SCER's proposal to strengthen obligations and guidance around the use of Long-Run Marginal Cost (LRMC) to set cost-reflective network tariffs. The ERAA believes that there are a number of challenges to practically implement the requirement to base network tariffs on LRMC. These include a lack of available data, significant changes to enabling technologies, increases to consultation requirements, as well as a risk of increased complexity for consumers. Requiring distributors to set cost-reflective network tariffs in accordance with LRMC is just one method of encouraging cost-reflectivity, and should be compared against other approaches that seek to achieve the same outcome.

Whilst Victoria has achieved a high rate of smart meter penetration under their Advanced Metering Infrastructure rollout, most small customers in the NEM do not have smart meters. This means that the majority of customers are unable to respond to the signals being provided by cost-reflective tariffs. Whilst other NEM jurisdictions have indicated their support for a market-driven approach to smart metering, this may take some time to implement. Until there is widespread use of smart metering by small customers, it will be difficult to introduce new pricing structures such as locational or capacity-based network tariffs. In the case of locational pricing, it may be difficult to ensure the accuracy of network prices, whilst also

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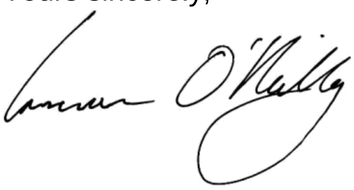
introducing a very large number of network (and thus retail) tariffs. This may introduce complexity and increase customer confusion. These changes would also require significant consultation processes, the costs of which would likely outweigh the benefits. Given the uncertainty surrounding this approach, the ERAA recommends that a rigorous evaluation of the impacts of adopting LRMC is undertaken prior to the potential publication of a draft rule determination in August 2014.

The ERAA recognises that distributors have the potential, for customers on interval meters, to better reflect the costs of providing network services by changing the structure of their tariff composition through adjustments in the variable and fixed components. The ERAA would support a gradual transition of this kind, ensuring the consumer impacts of these changes are taken into account. Whilst the ERAA recognises that this is not a true reflection of LRMC pricing, this could be seen as a transitionary measure until smart meters are widely deployed in the market – which provides distributors with more flexibility to introduce tariffs that better reflect costs. Irrespective, the AEMC must recognise that retail tariff choice ultimately rests with consumers.

Should you wish to discuss the details of this submission, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely,



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