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Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted electronically

Dear Sir/Madam,

Re: Aligning Network and Retail Tariff Structures for Small Customers Rule Change (ERC0175)

Background

Red Energy welcomes the opportunity to respond to the Australian Energy Market Commission's (the Commission) Aligning Network and Retail Tariff Structures for Small Customers Consultation Paper.

Red Energy is a 100% Australian owned and operated subsidiary of Snowy Hydro Ltd. Red Energy currently retails electricity in Victoria, NSW, and South Australia and is one of the larger second tier retailers in the NEM.

In 2013, the National Energy Retail Law (NERL) was amended to enable a state or territory to require retailers to offer a standing offer with a prescribed tariff structure to classes of small customers with an interval meter in its jurisdiction.

As this provision applies under the NERL, it relates to jurisdictions that have adopted it. At this stage, no state or territory government has enacted a local instrument under the NERL to require retailers to undertake this action in their jurisdiction.

The rule change requests proposes that where a state or territory government declares that retailers must make a standing offer with a prescribed retail tariff structure to small customers with an interval meter in its jurisdiction:

1. Distribution Network Service Providers (DNSP) must offer a network tariff with a structure that matches the structure of that standing offer;
2. DNSPs must allow a retailer to assign a small customer to this network tariff where that customer has chosen that standing offer; and
3. the Australian Energy Regulator (AER) must only approve a DNSPs annual pricing proposal if it includes a network tariff that matches the structure of that standing offer.

The rationale for the Council of Australian Government's (COAG) rule change appears to be to facilitate the orderly management of the transition to cost reflective pricing. With a potential transition to cost reflective network tariffs some jurisdictions may mandate that retailers offer standing offers with a prescribed tariff structure to small customers with an interval meter to help prevent tariff shock.

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Where a state or territory government requires retailers to make a standing offer with a prescribed tariff structure to small customers the ability of a retailer to match the structure of the retail tariffs they offer to their consumers with the structure of the DNSPs network tariffs is constrained.

A potential strategy that a retailer may adopt if this rule change is not enacted and a jurisdiction declares that retailers must make a standing offer with a prescribed retail tariff structure to small customers with an interval meter is to add a "risk premium" to their retail tariff to account for the potential risk of under-recovery of network costs.

Recommendation

Red Energy supports the rule change as proposed by COAG. The rule change proposal would result in:

- the allocation of risk to the party that is best placed to manage it;
- more predictable outcomes for both retailers and consumers; and
- compliance with the Commission's Distribution Network Pricing Arrangements (DNPA) pricing principles. [1]

In the next section, we outline our reasons for supporting the rule change.

Findings

Red Energy considers that the rule change put forward by COAG is consistent with the National Electricity Objective (NEO).

The Commission applies the following criteria in its consultation paper to help it determine whether the rule change proposal is consistent with the NEO. This includes:

- the efficient allocation of risk;
- predictable outcomes for retailers;
- predictable outcomes for consumers;
- efficient network prices.

We provide our views on the criteria explored by the Commission below to justify our support for the rule change.

1. Efficient allocation of risk

Where a local instrument is enacted by a jurisdiction that requires a retailer to offer a standing offer with a prescribed tariff structure, then the proposed rule change would have the effect of transferring the risk associated with the recovery of a DNSP's allowable revenue from retailers to DNSPs.

Red Energy considers that DNSPs are best placed to manage this risk for the following reasons:

- DNSPs have a larger customer base over which they can spread the risk so this represents a lower risk for them.

[1] AEMC, Distribution Network Pricing Arrangements Final Rule Determination, November 2014.

- DNSPs are capable of mitigating the risk of both an under or over recovery of revenue in a more efficient manner than retailers.

  For example, under a revenue cap where a distributor does not recover its required revenue component in year 1 (Y) it is able to recover that revenue under-recovered in Year 2 (Y +1).

Some parties may raise concerns that this will cause excessive tariff shock are ill warranted. As rebalancing pricing constraints limit the amount that tariff components are able to increase in distribution tariffs on a year to year basis.

Alternatively where a distributor is regulated under a price cap or an average revenue yield, it is entirely possible that the DNSP could potentially over-recover on a particular class of tariffs. This would allow it to make up for the loss of revenue from being forced to apply a network charge that matches the network charge in the standing offer of the prescribed tariff structure.

2. Predictable outcomes for retailers

The rule change would create more predictable outcomes for retailers.

Absence of this rule change where a jurisdiction declares that retailers must make a standing offer with a prescribed retail tariff structure to interval metered small customers then a retailer may choose to apply a "risk premium" to these standing offers should the DNSP failed to offer a network tariff with a structure that matches the structure of that standing offer.

The Consultation Paper correctly notes that retailers may add a risk premium to mitigate the potential risk of under-recovery of network costs in these circumstances. A key problem for a retailer in this regard would be to determine the quantum of the "risk premium" that it should apply to the prescribed retail tariff structure.

A prudent retailer would most likely apply a "high" risk premium to standing offers with a prescribed retail tariff structure where the network and retail tariff were not matched to mitigate this risk. It would be forced to do this because of its restricted ability to pass on price increases for standing offers to once every six months.

This restricted nature of a retailer's ability to adjust the pricing of standing offers for "exogenous shocks" like reductions in demand potentially brought on by a sudden uptake of solar panels could impact a retailer's profitability. Therefore, a retailer would most likely be forced into applying an "excessive" risk premium. This would lead to inefficiently high standing offers and be inconsistent with the NEO.

Conversely if a retailer applied a "low" risk premium to ensure that it recovered its network charges where a DNSP failed to offer a network tariff with a structure that matches the structure of the prescribed standing offer then there is a high probability that the retailer may not recover its required revenue.

A key risk for a retailer that chooses to apply a "low" risk premium in these circumstances is that it ends up under-recovering its required revenue for at least six months. In extreme circumstances, this can lead to retailer failure.

3. Predictable outcomes for consumers

This rule will help facilitate predictable outcomes for consumers.

If a local instrument is enacted by a jurisdiction that requires a retailer to offer a standing offer with a prescribed tariff structure, the DNSP will be required to match the distribution tariff in the prescribed tariff structure.

COAG Energy Council argues that the rationale for the rule change is to enable small customers with an interval meter to choose to be supplied electricity under a flat tariff.

The introduction of the Commission's DNPA whose principal aim is to introduce cost reflective network pricing can potentially create tariff shock to small customers. Where a jurisdictions chooses to mandate a particular form of standing offer, it is assumed that this is to provide consumers with choice of their network tariff and can be seen as provide a form of consumer protection against the "tariff shock" that is associated with the introduction of cost reflective pricing.

4. Efficient network prices

The Commission's DNPA rule change allows DNSPs to depart from implementing cost reflective pricing.

In the first instance, it would appear as though this rule change may not be compliant with the DNPA rule change. The DNPA rule change requires network tariffs to comply with the three principles of standalone and avoidable cost, LRMC and total efficient costs. This rule change appears to restrict a DNSP from implementing cost reflective prices.

However, under the DNPA rule change, DNSPs are free to depart from the cost reflective pricing principles where they are required to meet jurisdictional pricing obligations.

In fact, the DNPA Final Rule Determination states that where a conflict exists between the requirement to implement a cost reflective distribution tariff and the need to meet the jurisdictional obligation that the DNSP would be required to meet the jurisdictional obligation.[2]

Therefore, if the intention of this rule change is to enable small customers with an interval meter to be supplied electricity under a flat retail tariff [3] to help some consumers to adjust to the new pricing principles[4] then it is entirely consistent with the DNPA rule determination.

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[2] AEMC, Distribution Network Pricing Arrangements Final Rule Determination, November 2014. p.24
"A requirement to set network prices on a cost reflective basis could create a conflict with jurisdictional pricing obligations where those obligations require prices to be set to achieve some other objective. DNSPs could be placed in the position of having to comply with one requirement and thereby being unable to comply with the other. In recognition of this potential conflict, the **final rule explicitly addresses the need for DNSPs to meet jurisdictional obligations."**

[3] AEMC National Electricity Amendment (Aligning Network and Retail Tariff Structures for Small Customers) Rule 2015 – p.10 "The COAG Energy Council implies that the intention of the rule change request is to enable small customers with an interval meter to choose to be supplied under **a flat retail tariff**."

[4] AEMC National Electricity Amendment (Aligning Network and Retail Tariff Structures for Small Customers) Rule 2015 – p.11 – "The COAG Energy Council notes that more widespread availability of interval meters and advanced meters will enable DNSPs and retailers to offer cost

A DNSP would be required to match the distribution tariff in the prescribed tariff structure that a retailer was required to offer under a standing offer for it to comply with the DNPA rule determination.

We recognise that the DNSPs tariff may not be cost reflective; it would still be consistent with the Commission's DNPA rule change because it will be compliant with jurisdictional pricing obligations.

Conclusion

Red Energy supports the rule change proposal put forward by the COAG Energy Council, considers that it is consistent with the NEO and, as such should be made.

If the Commission accepted this rule change it would result in:

- the allocation of risk to the party that is best placed to manage it;
- more predictable outcomes for both retailers and consumers; and
- compliance with the Commission's Distribution Network Pricing Arrangements (DNPA) pricing principles.

We thank the Commission for the opportunity to respond to this rule change. Should you have any further enquiries regarding this submission, please call Con Noutso Wholesale Regulatory Manager on 03 9976 5701.

Yours sincerely

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

reflective tariff structures, to the benefit of consumers in the long term. However, as these tariff structures will effectively unwind some of the cross subsidies prevailing in existing flat tariff structures, this transition needs to be managed to enable consumers to adjust to the new pricing arrangements. "