

20 January 2016

Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Via email: AERInquiry@aer.gov.au

AER Issues Paper Tariff Structure Statement Proposals – Victorian Electricity Distribution Network Service Providers

Dear Sir/Madam

The Energy Networks Association welcomes the opportunity to make a submission to the AER in response to the issues paper *Tariff Structure Statement Proposals Victorian Electricity Distribution Network Service Providers (DNSPs)* published in December 2015.

The ENA is the national industry association representing the businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia. ENA members own assets valued at over \$100 billion in energy network infrastructure.

The implementation of cost-reflective network tariffs in a timely way, with close customer engagement, can make electricity bills fairer, avoid significantly higher electricity bills in the long term and significantly influence Australia's long-term energy productivity during a critical period of change. Detailed analysis by Energeia has previously highlighted the potential benefits of achieving timely electricity distribution network tariff reform including the potential for average residential electricity bills which are up to \$250 (in \$2014) per year lower in 2034; avoiding unfair cross subsidies of up to \$655 per year (\$2014) paid for by residential customers without distributed energy resources; and economic benefits through avoiding \$17.7 billion in unnecessary investment by 2034 and avoiding network price increases which are five times higher than necessary.

The ENA strongly supports the AER view that most network tariffs currently provide no opportunity or reason for consumers to use less electricity during peak times to manage their bills and that "...moving towards tariffs that take account of a customer's use of electricity during peak times will make pricing for electricity fairer".¹

This submission provides feedback on key issues raised in the AER issues paper on the TSS Proposals submitted by Victoria's five DNSPs. However, the recent policy announcement by the Victorian Government that it will mandate an "opt in" approach to cost reflective network pricing implementation appears to fundamentally supervene the due process of development, consultation and regulatory

¹ Australian Energy Regulatory Issues Paper (December 2015) *Tariff Structure Statement Proposals: Victorian electricity distribution network service providers*, p. 3.

assessment of TSS Proposals. ENA has therefore also raised some threshold issues for the AER to consider in relation to the regulatory process.

1. Context for TSS and Regulatory Determinations

Victorian DNSPs developed Tariff Structure Statements (TSS) Proposals after extensive customer and stakeholder consultation, meeting requirements of National Electricity Rules and the intent of the Power of Choice reforms approved by the COAG Energy Council. Through the Council, Australian Governments have previously indicated strong support for tariff reform, as reflected in the Communique of December 2014.

The Council supports tariff reform as an essential next step in this process as a means of providing better price signals to consumers and notes that new Distribution Network Pricing Arrangements will enable distribution businesses to set prices that reflect the efficient costs of providing network services to each consumer.²

The AER Issues Paper issued on 3 December 2015 reflected a timetable of tariff reform extending back to November 2012, and the transparent process of consultation by the AER on the TSS Proposals.

| Milestone | Date |
|--|-------------------|
| Victorian distributors submitted proposed tariff statements | 25 September 2015 |
| AER publishes issues paper | 3 December 2015 |
| AER public forum on proposals | 14 December 2015 |
| Stakeholder submissions due on issues paper | 20 January 2016 |
| AER draft determination on proposed tariff statements | 22 February 2016 |
| Victorian distributors submit revised proposed tariff statements | 29 April 2016 |
| AER final determination on proposed tariff statements | 29 July 2016 |

It is disappointing that the Victorian Government released its policy intention to mandate opt-in approaches to cost-reflective pricing reform, without equivalent public consultation and transparency. The Victorian Government's proposed regulatory instrument introduces an additional customer impact mitigation measure which was not included in the National Electricity Rules or at the time of the TSS proposal development. Despite its fundamental implications for the implementation of new tariffs, the Government's policy intention was released on 21st December 2015, after the submission of the TSS Proposals to the AER by DNSPs, the release of the AER Issues Paper and the holding of the AER public forum. Although the Rules explicitly provide for the DNSPs and AER to apply State legislative instruments, the timing of the Victorian Government intervention has the potential to undermine the effective contribution of all parties, including DNSPs, customers in the TSS process administered by the AER.

There is strong evidence that there are increased risks to customers in mandating an Opt In approach to introducing cost reflective prices, including:

- Empirical analysis by Brattle in international markets has highlighted that Opt In frameworks are typically unsuccessful in achieving wide penetration of tariff reform with enrolment rates typically below 25 percent³. While providing choice, 'Opt out' frameworks are more likely to

² COAG Energy Council, Meeting Communique, 11 December 2014, p. 2

³ The Brattle Group, *Rolling out residential demand charges*, Presentation to EUCI Residential Demand Charges Summit – May 2015

result in high levels of retention on cost-reflective tariffs. This is due in part to known factors which may deter customer behavior such as 'default bias'.

- Victoria has direct experience with the limited effectiveness of Opt In frameworks for Flexible Pricing. Under the Opt In framework imposed by the AMI tariff order, the take-up of flexible pricing by residential customers remains exceptionally low, even by international standards, at less than 1%. This outcome has undermined the realisation of full benefits to the Victorian community of the universal rollout of advanced metering infrastructure. A recent Victorian Auditor-General's Report⁴ noted that, while the 2011 Cost Benefit Analysis had expected potential benefits from innovative tariffs and demand management of \$778 million over 2008–28:

Collectively, these assumptions rely on 75 per cent of Victorian residential customers changing their consumption behaviour in response to incentives delivered by the AMI rollout. However, the rollout of flexible pricing offers by electricity retailers was suspended by government through a moratorium until the end of 2012. This in part has contributed to a delay in consumer acceptance and uptake of flexible pricing offers which remains very low with only 6 885 customers having accepted such an offer by December 2014. This represents approximately 0.27 per cent of customers of a total of 2 489 961 installed functioning meters as at September 2014. This is much lower than the projected 4 per cent uptake—around 100 000 households—of flexible pricing offers at 2014. On current rates of uptake, it is doubtful this 75 per cent will be achieved.⁵

A carefully managed transition to cost reflective prices can be implemented, as proposed by the DNSP TSS Proposals, without the use of opt in frameworks which provide significant risks to customers. The ENA supports the need to ensure the effective, timely implementation of tariff reform, as noted by the Consumer Utilities Advocacy Centre:

Mandating uptake of cost reflective tariffs is crucial to the success of network tariff reform. If, at the conclusion of the reform, consumers are not required to have a cost reflective tariff, they will naturally seek to avoid it where it is not in their interests; that is, consumers whose behaviour would be more expensive under cost reflective tariffs will avoid them.

The costs they are incurring will continue to be borne by the broader system, in an inequitable outcome that damages the justification for the reform. While it is vital that low income, vulnerable, and disadvantaged groups be able to afford adequate essential services, it is also crucial that people who incur high networks costs are unable to manipulate the system to avoid paying their fair share. This requires mandatory implementation of the reforms.⁶

2. Proposed new tariffs

The AER has requested feedback in relation to the **proposed new tariffs**, including the charging window; the alignment of the charging window and the benefits of network charges varying by location for small customers.

The ENA considers that the Tariff Structures Statements proposed by DNSPs represent good faith compliance with both the policy intention and requirements of the National Electricity Rules. DNSPs developed TSS Proposals which

⁴ Victorian Auditor General Office (2015) *Realising the Benefits of Smart Meters*

⁵ *ibid*, p.36

⁶ Consumer Utilities Advocacy Centre (2014), *Cost Reflective Pricing: Engaging with Network Tariff Reform in Victoria*

- reflected the requirements for cost-reflectivity in Clauses 6.18.5 e) to g), including being based on Long Run Marginal Cost;
- considered the impact on retail customers as per Clause 6.18.5 (f)
- ensured tariffs are reasonably capable of being understood by retail customers that are assigned to that tariff as per 6.18.5 (i); and
- complied with Rules and all applicable regulatory instruments as per 6.18.5 (j), as they existed at the time of lodging the TSS Proposal.

The ENA considers the departures from pure cost reflectivity identified by the AER in the Victorian TSS proposals are consistent with the Rules on the grounds they are necessary to achieve other requirements in the pricing principles. For instance, after consultation, it has been appropriate for the Victorian DNSPs to adopt a common “charging window”. Victoria’s five contiguous DNSPs service a large population within a small geographic area, which means there is significant potential to disrupt the transition by confusing customers about, for example, which of a range of five charging windows applies to them. The common charging window, and its alignment, is important to effective communications and engagement of Victorian customers in the early stages of implementing tariff reform. This reflects appropriate recognition of the need to ensure tariffs are reasonably capable of being understood by retail customers. It also facilitates implementation by retailers and supporting information to customers by Government and other stakeholders.

The AER has requested feedback in relation to whether a single standard or a **wider ‘menu of tariff options’**, potentially on an opt-in basis, should be available to send stronger price signals in addition to new demand tariffs. The ENA would caution the AER against imposing additional obligations on the DNSP which *mandates* a wider menu of tariff options for customers for the following reasons:

- Such requirements may have potential implications for complexity and transaction costs in the absence of strong evidence that they are likely to be taken up by customers or retailers. DNSPs would need to re-evaluate take up rates and parameter relativities across a wider array of tariffs and to ensure effective communication of a wider variety of tariff options. The net benefits of providing a wider range of tariff options is likely to be better evaluated by DNSPs directly in consultation with their customers.
- It does not appear that a compulsory requirement to offer a menu of more cost-reflective options is required. A number of TSS Proposals proactively offered options for customers to opt in to a more cost reflective pricing option (ie. the full demand tariff without transition). Equally, the locational targeting of network constrained areas can also be addressed through non-tariff agreements between distributors and their customers, such as the demand management initiative United Energy had proposed.
- Given the Victorian government policy announcement, the AER might also recognise the inconsistency of imposing expanded obligations on DNSPs for more complex or more sophisticated tariffs, when DNSPs remain practically unable to migrate customers to the transitional demand tariff, even where an ability for the customer to opt-out was proposed.

3. Impact Management

Businesses have sought to manage potential customer impacts in accordance with the requirements of the NER. For instance, this was reflected in the fact that the Proposals provided for:

- The gradual ramp up in the extent of cost recovery based on the demand component of the tariff over transition periods of 4-9 years;
- The ability for customers of four DNSPs to opt out of the new demand tariff within a 12 month period and the ability for customers of three DNSPs to opt-in to full demand tariffs without the transitional 'ramp up'.

The ENA notes that the effect of these transition measures provides is comparable to the approach recommended by the Consumer Utilities Advocacy Centre in its 2014 report, *Cost Reflective Pricing Engaging with Network Tariff Reform in Victoria*, which noted:

In a similar manner to the digital television switchover, network tariffs could be implemented with a staged transition of at least 18 months explaining both the need for the change, the scope of the change, and when the change will occur.⁷

However, the ENA notes that the Victorian Government's proposed regulatory instrument introduces an additional customer impact mitigation measure which was not included in the National Electricity Rules or at the time of the TSS proposal development.

4. Regulatory Determination Process

Coming as it does midway through the TSS regulatory assessment, the proposed regulatory intervention by the Victorian Government is likely to require changes to the TSS development and approval process. While complying with the Rules, the AER should seek in the Draft Determination to ensure the robust regulatory stages intended by the Rules are effectively followed, including:

- the ability for the DNSP to prepare a Tariff Structures Statement compliant with regulatory instruments;
- the ability for DNSPs and other stakeholders to be consulted on the AER's proposed decision on the compliant TSS proposal; and
- the ability for the DNSP to submit a revised TSS proposal in response to the AER's proposed decision, before the Final Determination.

The ENA welcomes the statement released by the AER on 20 January 2016 providing an undertaking for further consultation. While noting further details are to be provided, ENA notes the AER has not yet confirmed or clarified the process by which DNSPs will be provided an opportunity to respond to the AER's proposed decision on the TSS Proposals submitted by 29 April 2016.

It is therefore recommended that the AER adopts the following approach in the Draft Determination:

1. **The Draft Determination should ensure the capacity for the DNSPs to revise their TSS proposal in full, rather than partially, noting the requirements of NER Rule 6.10. 3(b).** As the AER recognised on 20 January 2016, it is likely to be necessary for Victorian DNSPs to substantially revise the TSS, given the consequences of the proposed Victorian Government instrument (eg. customer takeup of tariffs under an Opt In framework).

⁷ Consumer Utilities Advocacy Centre (2014), *Cost Reflective Pricing: Engaging with Network Tariff Reform in Victoria*

2. **Explicit Process for forthcoming Regulatory Steps.** To ensure the robust regulatory stages intended by the Rules are effectively followed, the ENA recommends the AER should make explicit in the Draft Determination that:
- The AER recognises that the introduction of the proposed amendments to the *Advanced Metering Infrastructure (AMI Tariffs) Order* would constitute an event not foreseen and a trigger for submission of an amended TSS by the businesses. This appears aligned with the intent of clause 6.18B in the Rules; or
 - If the above approach is not adopted, then the AER should set out in its Draft Determination an explicit commitment to undertake an additional step prior to the Final Determination scheduled for 29 July 2016. Specifically, the AER Draft Determination should undertake to:
 - Release a second Draft Determination (or Intended Final Determination) based on the Revised TSS Proposals for stakeholder consultation; and
 - Invite the submission of a second Revised TSS proposal from the relevant DNSP in response to the second Draft Determination.

The timeframes are particularly challenging for the AER, the DNSPs responsible for the TSS, and all stakeholders. At the time of writing the Victorian Government has announced its policy intent but the precise wording of the proposed amendments to the *Advanced Metering Infrastructure (AMI Tariffs) Order* is not yet clear, nor is its timing within February 2016. The Victorian government also flagged in its advice of 21 December 2015 to the AER regarding Distribution Network Pricing Arrangements that it would release a demand management framework during 2016. Victorian DNSPs are not yet in a position to predict the impact of this on the TSS Proposals at this time. It is unclear if these additional changes will require changes to tariffs and trigger the need for amendments to the TSS.

The ENA and Victorian DNSPs would welcome the opportunity to discuss workable options with the AER and other stakeholders to ensure a pragmatic approach to finalising the TSS in accordance with good regulatory practice.

If you would like to discuss this submission further please do not hesitate to contact me on (02) 6272 1555 or via email at jbradley@ena.asn.au.

Yours sincerely,



John Bradley

Chief Executive Officer