6 May 2015

Mr John Pierce
Chairman
Australian Energy Market Commission,
PO Box A2449,
Sydney South NSW 1235

Aligning Network and Retail Tariff Structures for Small Customers (ERC0175)

Dear Mr Pierce

The Energy Networks Association (ENA) appreciates the opportunity to make a submission to the Consultation Paper on the National Electricity Amendment (Aligning Network and Retail Tariff Structures for Small Customers) Rule 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.

ENA understands that the AEMC is bound by the rule change process. However, we are concerned that this Rule change request is being progressed although it has been effectively superseded by more comprehensive changes to the distribution network pricing arrangements within the National Electricity Rules (NER) which have been in effect since 1 December 2014. At the same time as this Rule change is to be considered, network businesses are currently engaged with stakeholders in the implementation of the new rules, in particular in designing network tariffs to be submitted in Tariff Structures Statements later this year.

It is ENA's view that the proposed Rule change raises no new issues that were not considered and addressed thoroughly in the Distribution Network Pricing Arrangements Rule change. During that rule change process there was an opportunity to consider approaches recommended in earlier reviews including the AEMC's Power of choice review, and the recommendations of the National Smart Meter Consumer Protections Review.

The final rule resulted in changes to the NER that will have greater long term benefits for consumers than the proposed Rule change. The final rule was developed as a result of extensive stakeholder participation over more than twelve months, through seven stakeholder workshops, four expert consultant reports and more than 75 submissions. Subsequently the changes to the NER as a result of the final rule have been endorsed by the Council of Australian Government's Energy Council, and in the Australian Government's Energy White Paper.

In addressing the issues raised by the proposed Rule change, ENA considers that the changes made to the NER under the Distribution Network Pricing Arrangements Rule change sufficiently meet the objectives of the Rule change, without compromising the network pricing objective in the NER. On this basis, ENA considers that the AEMC should determine not to make the proposed rule.

The ENA would be pleased to clarify or provide further detail on any of these issues. You can contact me on 02 6272 1555 or jbradley@ena.asn.au or Lynne Gallagher on 02 6272 1515 or lgallagher@ena.asn.au.

Yours sincerely,

John Bradley

Chief Executive Officer

ENA Submission on Aligning Network and Retail Tariff Structures Rule Change (the proposed Rule change)

1. Background

The proponent of the Rule change is the Senior Committee of Officials of the Council of Australian Government's (COAG) Energy Council. According to the Rule change request the intention of the proposed Rule change is "to support choice of tariff structures for small customers as jurisdictions move to flexible pricing." The proposed Rule change will achieve this by amending the National Electricity Rules (NER) to require:

- networks to make available a network tariff for customers that has the same structure as the retail tariff set by a jurisdiction (applying to standing offers);
- retailers to assign the customer to the network tariff with the same structure; and
- the Australian Energy Regulator (AER) to only approve an annual pricing proposal if the network has offered a network tariff that matches the prescribed retail tariff.

Jurisdictions are able to prescribe retail tariff structures for standing offers to small customers with an interval meter under the National Energy Retail Law (only jurisdictions that have adopted the National Energy Customer Framework) or under state or territory legislation, prescribing the structure of all retail tariffs as the Victorian Government has done under the Advanced Metering Infrastructure (AMI Tariff) Order.

Note that as retail price regulation has been removed in Victoria, South Australia and NSW, there are no regulated offers and electricity retailers are free to set their own prices. The Queensland Government has recently announced that it has deferred deregulation of electricity prices in the southeast Queensland for 12 months, to allow for a public inquiry.

2. ENA Response to the proposed Rule change

The proposed Rule change request was submitted in June 2014, prior to the Australian Energy Market Commission (AEMC) making its Draft Determination (August 2014) and a Final Determination (November 2014) on the Distribution Network Pricing Arrangements Rule change. Accordingly, the COAG Energy Council may not have been aware that the AEMC was progressing changes to the distribution pricing principles that would address the issue of potential price shocks and provide scope to transition customers over a period of time.

It is ENA's view that the proposed Rule change should not be made by the AEMC, as the proposed changes are superseded by the Distribution Network Pricing Arrangements Rule change and:

- are contrary to the network pricing objective, resulting in inefficient pricing that will entrench unfair cross-subsidies and higher average electricity bills in the future;
- will increase the volatility of electricity prices for customers, due to the inappropriate allocation of risks to distribution networks;
- impose an additional regulatory burden on distribution networks, that will ultimately be borne by customers; and

- are not in the long term interests of consumers of electricity as required by the National Electricity Objective.

3. Issues raised by the proposed Rule change

ENA considers that the recent changes made to the pricing rules under the Distribution Network Pricing Arrangements Rule change sufficiently meet the objectives of the proposed Rule change, without compromising the network pricing objective in the NER.

ENA has addressed the two specific objectives raised by the proposed Rule change:

- the need to manage the transition to more cost reflective pricing;
- avoiding retailers adding a risk premium to flat rate retail tariffs to account for misalignment of prescribed retail tariffs and network tariffs.

It is ENA's view that the customer impacts principle within the NER is a better approach than the opt-in framework that is supported by the proposed Rule change. The customer impacts principle allows networks to transition customers over a period of time, giving these customers an opportunity to understand and respond to price signals to reduce the potential impacts on their bill. As the customer impacts principle *supports* the network pricing objective within the NER it is a far superior approach to the options considered at a much earlier time. This includes the AEMC's Power of choice review and the National Smart Meter Consumer Protections Review, which proposed to allow some if not all customers to opt-in to more efficient network pricing.

Rather than allowing customers with an advanced meter to opt-in, the ENA supports the distribution pricing principles in the NER which provide for networks to assign customers to cost-reflective network tariffs.

Under opt-in frameworks, such as the Victorian AMI Tariff Order, the evidence is that few customers with advanced meters choose to opt-in to cost-reflective network pricing, notwithstanding that most people who are currently on flat rates could be better off. According to The Brattle Group opt-in participation rates for cost-reflective pricing in the US are as low as 1 percent,[1] which is consistent with the experience in Victoria where almost all customers have smart meters and have remained on flat tariffs.

Analysis for the ENA by Energeia has shown that, if cost reflective tariffs are not progressed:

- cross-subsidies to early adopters of technology could increase from $120 annually to as much as $655 annually, by 2034;
- average electricity bills could be substantially higher ($250 annually by 2034), because of the future network costs needed to meet peak demand;
- increases in electricity prices could be five times higher than necessary by 2034.[2]

These risks to the long-term interest of consumers are significantly increased under the Proposed Rule Change, compared to the final rule recently made by the AEMC.

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[1] The Brattle Group, *Managing the Benefits and Costs of Dynamic Pricing in Australia*, October 2012, p. 26

[2] ENA Position Paper, *Towards a National Approach to Electricity Network Tariff Reform*, December 2014, p. 21

As a result of the Distribution Network Pricing Arrangements Rule change, the NER requires networks to develop network tariffs, in consultation with customers and retailers, that are consistent with the network pricing objective and the distribution pricing principles. The practical effect of the proposed Rule change is that jurisdictions would be responsible for designing tariff structures, rather than networks in consultation with stakeholders.

According to the AEMC, in making the final rule they took the view that efficiency and innovation in network pricing are best achieved by networks "owning their prices", i.e. having the flexibility to design network tariffs in consultation with customers and retailers. ENA considers that it is appropriate that networks should own their prices, and that they are in a better position than jurisdictions or regulators to develop and consult on network pricing proposals that best suit their consumer and network characteristics.[3]

In respect of retail tariffs the final rule did not regulate how network prices should be passed on to consumers by retailers. The AEMC's final rule argued that competitive market pressures should be sufficient to lead retailers to design tariffs that reflect customer preferences, including how they recover the costs of network services.[4] Therefore under the Distribution Pricing Arrangements Rule change framework, networks would assign customers to cost-reflective network tariffs, and retailers would manage the pass through of the network tariff depending on the risk they wish to assume.

Retailers currently assume the potential risk of under-recovery of revenue from tariff misalignment when they do not fully pass through the network tariff into the retail tariff. While competitive market pressures may result in retailers aligning retail and network tariff structures, in practice retailers may be influenced by other factors in choosing the extent to which the network tariff is passed through. For example the Productivity Commission found that a time of use network charge with significant variation in peak and off-peak periods is usually translated into much smaller price relativities at the retail level.

> *"For example, in New South Wales, Origin Energy's peak retail energy prices for residential customers in the Ausgrid network area are only around four times those of the off-peak rates (Origin Energy 2012). Accordingly, a ten-fold price differential at the network side was more than halved when expressed in retail prices."*[5]

To the extent that retailers may require a risk premium to be recovered from customers on a retail tariff that does not pass through the cost-reflective network tariff, ENA agrees with AEMC's view expressed in the Consultation Paper that this is appropriate. Customers that choose these tariffs are electing to pay the same rate regardless of when they use electricity. While a retailer may offer the customer that product, and may recover its costs in doing so, it would be perverse to compromise the efficiency of the network tariff structure.

In the remainder of this submission ENA has addressed the specific questions in the Consultation Paper.

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[3] AEMC, Final Determination, Distribution Network Pricing Arrangements Rule change, November 2014, p. 158

[4] AEMC, Final Determination, Distribution Network Pricing Arrangements Rule change, November 2014, p. 29

[5] ENA Submission to the AEMC Draft Determination, October 2014, p.2

4. ENA responses to specific questions

Question 1 (a)

Do the changes made to the pricing rules under the Distribution Network Pricing Arrangements Rule change sufficiently meet the objectives of the COAG Energy Council's rule change request? Why/why not?

Response

Yes the changes to the pricing rules under the Distribution Network Pricing Arrangements Rule change sufficiently meet the objectives of the COAG Energy Council's rule change request, without compromising the network pricing objective in the NER.

Question 1 (b)

How should interactions between the proposed Rule change request and the Distribution Network Pricing Arrangements rule change be addressed?

Response

The proposed Rule change should not be made, as it conflicts with the network pricing objective and the distribution pricing principles in the NER which are in the long term interests of consumers.

Question 2 (a)

If the proposed Rule change were to be made, when should it take effect? What implementation issues, if any, should be considered?

Response

The proposed Rule change should not be made.

Question 2 (b)

If the proposed Rule change were to be made, what transitional arrangements should be considered, if any, to enable it to take effect prior to the full implementation of the Distribution Network Pricing Arrangement rule change?

Response

The proposed Rule change should not be made.

Question 3 (a)

What is the efficient allocation of risk between retailers, DNSPs and consumers with respect to network and retail pricing?

Response

As a general principle, to achieve efficiency, risks should be allocated to those who are best able to manage them. Where network prices are not cost-reflective there is a misalignment of network prices and costs, which increasingly places a burden of volatility in network charges on customers because of the under and over recovery of network revenue. The Distribution Network Pricing Arrangements in the NER represent a more appropriate allocation of risks for all stakeholders.

Question 3 (b)

To what extent do retailers currently bear the risks of retail and network tariff misalignment? How would this risk profile change, if at all, if the proposed rule was made?

Response

Retailers currently assume the potential risk of under-recovery of revenue from tariff misalignment when they do not fully pass through the network tariff into the retail tariff. While the AEMC has taken the view that competitive market pressures could be expected to result in retailers aligning retail and network tariff structures, retailers may be influenced by other factors in choosing the extent to which the network tariff is passed through.

Question 4 (a)

What are the implications of this proposed Rule change request, if made, in relation to a DNSP's ability and incentives to develop its own network prices?

Response

The proposed Rule change requires networks to make available a network tariff that matches the prescribed retail tariffs and that retailers have the right to assign customers to the matching network tariff. The effect of the proposed Rule change is that jurisdictions, and not networks, will be responsible for network tariffs. This has been evident in Victoria, where networks may offer their own network tariffs, but these have not been offered to customers.

Question 5 (a)

Would the proposed Rule change, if made, facilitate predictable outcomes for DNSPs, retailers and consumers? How would this compare against the likely outcomes under the Distribution Network Pricing Arrangements rule change?

Response

The outcomes for customers would be less predictable under the proposed Rule change than under the Distribution Network Pricing Arrangements in the NER. Under the NER networks are required to develop a Tariff Structures Statement, in consultation with their customers and retailers, that detail the tariffs structures that apply for the regulatory period. As retailers and not networks will assign customers to a tariff under the Rule change, networks will need to forecast the number of customers likely to be assigned to the matching retail tariff, to ensure that the tariff only recovers efficient costs. To the extent that these forecasts are inaccurate, there will be under or over-recovery of revenue. This means that the proposed Rule change is likely to increase volatility in network prices, resulting in greater price shocks for customers compared with the outcomes if the proposed Rule change was not made.

Question 6 (a)

What costs are likely to be incurred by DNSPs, retailers and the AER in implementing the proposed Rule change?

Response

Administrative and compliance costs are likely to be significantly higher for networks and the AER under the proposed Rule change, to the extent that amendments are likely to be required to the Tariff Structures Statement submitted by networks as part of the regulatory determination process. This could significantly add to costs, in needing to re-open and develop a new TSS. Retailers may also have additional costs, in circumstances where networks offer both prescribed tariffs and a cost-reflective network tariff, which could be passed through to the customer.

Question 6 (b)

What system or procedure would need to be established to enable DNSPs to assign small customers who elect the mandated standing offer to the corresponding network tariff?

Response

The proposed Rule change is likely to impose new systems costs, and procedures, for retailers to assign customers to particular network tariffs.

Question 6 (c)

How do electricity retailers in Victoria notify DNSPs that a small customer should be assigned to a particular network tariff? What costs, if any, were incurred in facilitating this notification?

Response

This question is more appropriately answered by retailers that operate in Victoria.