

28 April 2016

Ms Paula Conboy  
Chair  
Australian Energy Regulator,  
GPO Box 520,  
MELBOURNE VIC 3001

Via email: [Qldtss2016@aer.gov.au](mailto:Qldtss2016@aer.gov.au)

## **Australian Energy Regulator Issues Papers on draft Tariff Structure Statements for Distributors in Queensland**

Dear Ms Conboy

The Energy Networks Association welcomes the opportunity to make a submission in response to the Australian Energy Regulator's Issues Paper on the draft Tariff Structure Statements of electricity distributors in Queensland.

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.

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 in Australia, 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's view that most small customer 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".<sup>1</sup> Through the COAG Energy 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.<sup>2</sup>*

<sup>1</sup> Australian Energy Regulatory Issues Paper (March 2015) *Tariff Structure Statement Proposals: Queensland electricity distribution network service providers*, p. 5.

<sup>2</sup> COAG Energy Council, Meeting Communique, 11 December 2014, p. 2



This submission provides feedback on issues raised in the AER Issues Paper on the TSS proposals of the Queensland DNSPs. These are also raised in Issues Papers relating to the TSSs of DNSPs in other jurisdictions.

## **1. Proposed Tariffs**

The Queensland distributors developed their Tariff Structure Statements (TSS) proposals after extensive customer and stakeholder consultation, meeting the requirements of National Electricity Rules and the intent of the Power of Choice reforms approved by the COAG Energy Council.

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

- reflect 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 TSS proposals are consistent with the Rules on the grounds they are necessary to achieve other requirements in the pricing principles, including the need to anticipate and manage customer impact, and the ability of customers to receive and respond to the price signal.

## **2. Diverse Approaches to Managing Customer Impacts**

ENA notes that, through consultation with their customers, DNSPs have adopted a range of different approaches to mitigating customer impact during the transitional implementation of more cost-reflective prices.

For example, numerous DNSPs have adopted “Opt In” approaches to more cost-reflective tariffs during this first TSS period. Where some DNSPs have proposed assignment of customers taking up new technologies to cost-reflective tariffs, this has been coupled with transitional measures such as a temporary period of a reduced demand charge.

The ENA considers that the diversity of such transitional approaches is appropriate given the distinct circumstances of DNSPs’ operating environments, jurisdictional regulations and consultation with customers, retailers and other stakeholders. TSS proposals have been developed by DNSPs following close consultation with their customers, recognising the need to balance the successful implementation of tariff changes which benefit all customers, with a careful transition and implementation program.

## **3. Feedback on a “Menu of Tariff Options”**

In some Issues Papers, the AER has requested feedback in relation to whether a single standard or a wider “menu of tariff options” should be available, potentially on an opt-in basis, to send stronger price signals in addition to new demand tariffs. In some, but not all, of its TSS Issues Papers the AER seeks stakeholders’ views on whether there would be merit in distributors providing a range of tariff options, some with stronger network cost signals than demand charges which might be attractive to some customers.

Queensland DNSPs have selected the optional tariffs available to customers weighing implementation requirements and the response of retailers and customers. Based on consultation with stakeholders including customer advocates and retailers, at this stage of tariff reform there are strong arguments to support simplicity to



minimise customer confusion and to assist retail marketing, rather than a broad suite of network tariff options. This approach appears consistent with behavioural economic research which finds that customers:

- will weigh financial losses more heavily and discount future (uncertain) financial benefits;
- are risk averse and have a preference for certainty;
- tend to stick to defaults as information increases; and
- find decision-making more difficult as information or options increase.<sup>3</sup>

The ENA would caution the AER against imposing additional obligations on DNSPs which mandate 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 benefit of providing a wider range of tariff options is likely to be better evaluated by DNSPs directly in consultation with their customers; and
- it does not appear that a compulsory requirement to offer a menu of more cost-reflective options is necessary. A number of TSS proposals by Australian DNSPs have proactively offered options for customers to opt in to a more cost reflective pricing option (that is, 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 other Australian DNSPs have proposed. The National Electricity Rules provides a framework in which DNSPs, in consultation with their customers, can consider the prospective need or net benefits of such options.

#### **4. Feedback on “Locational Pricing Signals”**

In some of its Issues Papers, the AER also raises the question of the introduction of locational price signals to network tariffs, noting that the method and manner of setting tariffs should have regard to “the location of retail customers ... and the extent to which costs vary between different locations in the distribution network”<sup>4</sup>. The ENA recognises that the introduction of locational signals would establish tariffs which are more cost-reflective. However, any consideration of the implementation of cost-reflective locational pricing for small customers should carefully evaluate:

- the extent of customer impact and the ability of the relevant cohort of small customers and their potential retailers to receive and respond to the price signal;
- the relative net benefits of various aspects of cost-reflectivity, including the clear priority to achieve successful take up of “first wave” cost-reflectivity such as demand-based tariffs; and
- the increasing opportunity to address locational priorities in network management through a suite of incentives and market-based tools which may also offer efficient demand response.

Full location cost-reflectivity for all customers would be likely to lead to very significant price increases for regional customers, particularly in areas of relatively low customer density. Further, some jurisdictional policy settings will prevent the network tariff locational signal being sent to customers through their retail bills, in which case the cost of creating the signal will definitely outweigh any benefit to be obtained.

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<sup>3</sup> Fredericks, E., Stenner, K., and Hobman, E., “Household energy use: Applying behavioural economics to understand customer decision-making and behaviour”, January 2015, *Renewable and Sustainable Energy Reviews*

<sup>4</sup> National Electricity Rules cl.6.18.5(f)(3) quoted in Australian Energy Regulator, *Issues Paper Tariff Structure Statement Proposals NSW Electricity Distribution Network Service Providers*, March 2016, p.37.



The ENA considers that the current first wave of tariff reform, the introduction of demand tariffs, is the precursor to a wide range of market-driven network tariff options likely to emerge in a second wave of tariff reform (see Figure 1, *Two Waves of Tariff Reform to 2025*). While the second wave measures may include pricing products (such as critical peak pricing, peak time rebates or distributed marginal pricing), Australia's incentive-based network regulatory regime should also facilitate innovative use of demand-response programs which are already emerging in the market, embedded generation or storage incentives; or "transactive energy" models. Given the existing opportunities and incentives, the ENA does not consider it necessary or desirable for the AER to consider compulsory measures to increase locational cost-reflectivity.

Figure 1: Two Waves of Electricity Network Tariff Reform

First Wave			Second Wave
Highly volumetric tariffs		Improved fixed cost recovery	Demand based tariffs
FIXED	USAGE (c/kWh)	FIXED	USAGE
			DEMAND (c/kWh)
First Wave reform PLUS			
Voluntary, localised pricing options			
<ul style="list-style-type: none"> <li>➤ Demand management storage tariff</li> <li>➤ Back-up supply charges</li> <li>➤ Critical peak pricing</li> <li>➤ Peak time rebates</li> </ul>			
Voluntary incentive (payment) options			
<ul style="list-style-type: none"> <li>➤ Embedded generation incentives, credits or feed-in tariffs</li> <li>➤ Ancillary services payments</li> </ul>			
<ul style="list-style-type: none"> <li>➖ Significant cross-subsidies between customers</li> <li>➖ Technology adoption (airconditioning, solar, storage) driven partly by cost shifting</li> <li>➖ No reward to shift consumption off-peak</li> <li>➖ No 'locational' reward to customers to reduce network costs (through demand management or embedded generation)</li> <li>➖ No incentive for new energy markets and services</li> </ul>	<ul style="list-style-type: none"> <li>➕ Reduced cross-subsidies between customers</li> <li>➕ Reduced incentive for technology adoption (airconditioning, solar, storage) to be driven by cost shifting</li> <li>➖ No reward to shift consumption off-peak</li> <li>➖ No 'locational' reward to customers to reduce network costs (through demand management or embedded generation)</li> <li>➖ No incentive for new energy markets and services</li> </ul>	<ul style="list-style-type: none"> <li>➕ Minimised cross-subsidies based on customer use of the network</li> <li>➕ Economic incentives for technology adoption based on contribution to avoided network costs</li> <li>➕ Reward to shift consumption off-peak</li> <li>➖ No 'locational' reward to customers to reduce network costs (through demand management or embedded generation)</li> <li>➖ Some incentive for new energy markets and services</li> </ul>	<ul style="list-style-type: none"> <li>➕ Minimised cross-subsidies based on customer use of the network</li> <li>➕ Economic incentives for technology adoption based on contribution to avoided network costs</li> <li>➕ Reward to shift consumption off-peak</li> <li>➕ 'Locational' reward to customers to reduce network costs (through demand management or embedded generation)</li> <li>➕ Incentives for new energy markets and services</li> </ul>

ENA: Draft Electricity Network Tariff Reform Handbook

## 5. Implications of Retailer Interaction with the Network Tariff

The AER notes that:

*"examining impacts on end-use customers by considering network tariffs is difficult as this is only one component of a customer's retail bill. The actual impact on a customer will depend on the range of tariff options that retailers make available. Retailers could decide to simply pass on the network tariff structure (e.g. Energex's three part tariff with a demand component) or package it into a range of offerings for customers."*<sup>5</sup>

Queensland DNSPs have sought, as noted above, to make their new tariffs simple and easy to understand to reflect the level of customer understanding and acceptance of cost-reflective tariffs at this stage of tariff reform. This approach is consistent with feedback the DNSPs have received from retailers and customer advocates during the development of their TSSs.

<sup>5</sup> Australian Energy Regulator, *Issues Paper Tariff Structure Statement Proposals Queensland Electricity Distribution Network Service Providers*, March 2016, p.33



However, the AER should recognise in its evaluation of TSS proposals, that the response of retailers to the network tariff is uncertain for a number of reasons. This includes, for example, that retailers will face difficulty estimating the likely response and rate of take-up by customers under an opt-in approach to network tariff reform.

Evidence was provided of the challenge of retailer "pass-through" in the course of the 2012 Commonwealth Productivity Commission Inquiry, *Electricity Networks Regulatory Frameworks*. In a 2009 study (cited by the Commonwealth Productivity Commission), KPMG determined that retailers could be reluctant to pass through price variability in tariffs, because of concerns about the complexity of tariff structures. It reported that when Ausgrid introduced a time of use network charge in 2009 "...of customers with an external retailer, only an estimated half of these faced time of use tariffs from their retailer of choice".

Competing retailers may differentiate themselves based on their ability to anticipate customer preferences for other product features such as simplicity or price stability. (This can be seen for instance in Australian energy retailers recently introducing energy pricing plans with a fixed periodic cost, such as Origin Energy's "Predictable Plan".) In a competitive retail market, the provision of such end-use product features to customers who value them need not undermine the benefits of network tariff reform, as long as the DNSP itself is not precluded from progressively implementing cost-reflective pricing. Provided the market is sufficiently competitive, there are strong drivers for retailers to offer products which more greatly reward customers who respond to the network cost signal, in addition to offering products with "insurance" features. Additionally, retailers facing a cost-reflective price signal from the DNSP might procure other demand response solutions which therefore contribute to more economically efficient network investment decisions.

The ENA recently released a draft *Electricity Network Tariff Reform Handbook* developed with KPMG, which discusses the importance of distributors engaging effectively with retailers throughout the implementation of tariff reform, identifying it as a prerequisite for success. The Handbook highlights that this is just one of the factors which are beyond the direct control of a DNSP. It would therefore be appropriate for the AER's evaluation of the Queensland DNSPs' TSS proposals to recognise the balancing of these considerations which has already been undertaken by the DNSPs in accordance with Clause 6.18.5 of the Rules.

If you have any questions regarding this submission please contact Don Woodrow or myself on 02 6272 1500.

Yours sincerely,



John Bradley  
**Chief Executive Officer**