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Australian Energy Market Commission
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Distribution Network Pricing Arrangements Rule change

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Australian Energy Market Commission (AEMC) Distribution Network Pricing Arrangements Rule change, draft determination.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 36 electricity and downstream natural gas businesses. These businesses own and operate some $120 billion in assets, employ more than 51,000 people and contribute $16.5 billion directly to the nation's Gross Domestic Product.

The esaa believes it is important to have rules that support the development of cost reflective tariffs and commend the AEMC for its extensive consultation to develop the package of pricing objective, principles and process. While these changes will improve the transparency and operation of the network tariff setting process, it is not clear that the current rules have been the most significant barrier to tariff reform.

Until the necessary metering infrastructure is rolled-out, networks will have limited options to implement cost reflective tariffs. The success of the shift in tariff structures away from the current reliance on volume based charging will only be successful if governments not only don't block change, but help in informing households of the reasons for change and the implications of change.

Pricing objective and principles

The esaa broadly supports the pricing objective and principles. esaa agrees the key is for network prices to reflect the efficient costs of providing network services to each customer. The principles set out by the AEMC will require a distribution network service provider (DNSP) to make trade-offs when setting tariffs. While using the principles is a useful way to make any trade-off transparent, the drafting of the principles and their interpretation by the Australian Energy Regulator will be important.

Use of LRMC and how to address the residual

Of particular concern is how the objective of using long run marginal cost (LRMC) is balanced against the need to limit the impact on consumers of price changes. It will be important that the rules afford a reasonable degree of latitude to DNSPs to manage these conflicting principles. One element of this may be that the residual will, in many cases, be the greater part of the total costs that a DNSP can recover. What is not yet clear is how constraints on allocating this residual apply, in particular the requirement not to distort the price signal generated by the use of LRMC. There may be value in clarifying this further in the final rule. In doing so, it would be preferable to allow greater rather than less flexibility and to rely on the consultation processes to ensure that DNSPs deliver tariffs that meet the needs of their own business, retailers and customers.

Pricing process

The tariff structure statement (TSS) and price setting process should create sufficient time for retailers to set their tariffs each year. To afford retailers more time in the annual process, networks will be required to provide some certainty to retailers and customers, by giving up flexibility on what can be changed unilaterally during the five year regulatory period.

While the effectiveness of the two part tariff setting process depends on certainty, the proposed threshold to amend the TSS, an unforeseen event, seems to be very high. As a DNSP would need to go through a consultation and approval process akin to the original TSS, placing such a high threshold to start a process seems excessive. Given the time and costs involved in making an amendment, a DNSP is unlikely to embark on a change lightly.

Tariff reform is required because energy is changing and will continue to do so. It is important that the TSS is not so fixed that it prevents a DNSP from making a change that would be advantageous to customers.

The esaa would welcome more detail on the content of the proposed pricing methodology. The appropriateness of whether the methodology should be fixed as part of the TSS for five years depends on the proposed content. If the methodology set out the process by which a DNSP converts its LRMC estimates into final prices, it may be appropriate for it to apply in the way suggested by the AEMC. If, on the other hand, the AEMC intends the methodology to be more formula driven, it raises the question as to whether this would effectively set, in advance, prices for the five year regulatory period.

Timing

esaa agrees there is an inherent tension in trying to balance the timing aspect of annual pricing approval process, as the process involves a chain of interdependent pricing steps. The AEMC's approach to shift part of the process to the start of the regulatory reset period creates some additional time, which affords retailers greater time to set their tariffs. The proposed timing for each step will require greater use of forecasts by DNSPs and TNSPs. While revenue for networks will not be affected, due to the use of revenue caps, it may increase the volatility of prices for customers directly connected to the transmission network.

If you have any questions relating to this submission, please contact Fergus Pope on 03 9205 3107 or by email to fergus.pope@esaa.com.au.

Yours sincerely

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