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A few words.

19 December 2013

**Mr John Pierce**

**Australian Energy Market Commission**

**PO Box A2449**

**Sydney South NSW 1235**

Lodged (online): http://www.aemc.gov.au

**National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014, Consultation Paper (Reference ERC0161)**

Dear Mr Pierce**,**

AGL Energy (AGL) welcomes the opportunity to comment on the Distribution Network Pricing Arrangements Consultation Paper (Paper) released by the AEMC on 14 November 2013.

AGL operates across the energy supply chain and has investments in gas and electricity retailing, coal-fired electricity generation, gas-fired electricity generation, renewables and upstream gas extraction.

## Summary

AGL again expresses its support for the proposed rule change in respect of an improved process for the setting of network tariffs (***Proposed Process Rule***). AGL has previously expressed its concerns about the timing of approval processes for resetting annual network prices as these can have a significant financial and operational impact on AGL and its customers[1]. This submission complements our view expressed in these previous submissions, that additional time will be required for retailers to effectively implement new, or changes in, annual network tariffs. The additional time required is particularly critical if distributors are required to adopt cost reflective pricing principles which could broaden the type, range and complexity of network tariffs.

AGL notes that the proposed rule in respect of the tariff setting methodology (***Proposed LRMC Rule***) has only recently been included in this consultation process. AGL has a number of concerns with the Proposed LRMC Rule which are articulated below. AGL is firmly of the view the Proposed LRMC Rule should be decoupled from the Proposed Process Rule, and be treated as the subject of a further, separate consultation. This consultation should involve detailed modelling of the outcomes of any such rule change, and an inquiry as to whether the proposed rule does provide the most effective approach to cost reflective pricing.

[1] AGL submission to IPART Consultation dated 31 August 2012 and AGL submission to 2013 AEMC Consultation dated 12 July 2013.

## Detailed Submission

### Tariff setting process

AGL generally supports the consolidated request of the rule change proposal from the Standing Council on Energy and Resourced (SCER) and the Independent Pricing and Regulatory Tribubal (IPART) because of our view that the changes will improve the process associated with network and retail price resets. The change will:

- Allow customers and retailers to have more say in the development of network tariffs through required consultations by the distribution businesses;
- Enhance the distribution pricing framework to provide a higher level of certainty in the pricing structure and possibly a more predictable movement of pricing levels;
- Require a Pricing Structure Statement to be approved by Australian Energy Regulatory (AER) that is somewhat binding on howdistribution businesses set annual tariffs throughout, and possibly across, the regulatory periods; and
- Support the intent of SCER's rule change proposal in moving towards cost reflective network tariffs that may provide customers the opportunity to influence decisions on the recovery, and future increase, of network costs.

### Tariff setting methodology

A move towards more cost reflective tariffs is generally supported for a variety of good, well-documented, reasons. However, AGL is concerned that the rule change submission by SCER on Distribution Network Pricing Arrangements has resulted in a consultation around the annual price resetting process, for which the first round submissions showed strong support, being conflated with the more substantial issue of tariff setting methodologies. This Proposed LRMC Rule requires substantial changes to the NER and should not, in our opinion, have been consolidated into a consultation process that was underway.

With respect to the content of the Proposed LRMC Rule , AGL is concerned that the rule change proposal is contemplating the making of rules that will mandate the use of long run marginal costs (LRMC) in setting distribution tariffs. AGL raises the following concerns with this current form of the proposal.

<u>Likely impact of Proposed LRMC Rule</u>

AGL understands that there has not been any modelling or detailed analysis as to how the Proposed LRMC Rule would actually impact customer bills once applied. Specifically, a particular tariff is being mandated without any attempt at identifying impacts on customer types, customers with different profiles, or retailers' abilities to reflect such tariffs, etc. AGL is of the view that in order to provide a basis for proper consideration and consultation, the application of the rule should be modelled, and these results made public in the consultation process. Unintended impacts on customers, retailers, and distributors and perverse outcomes might be identified, and avoided, through a rigorous modelling effort.

<u>Cost benefit analysis</u>

A major change such as the one proposed by SCER should also be accompanied by an identification and evaluation of the costs and benefits of such a change. This would allow stakeholders to fully consider the issues and implications of the proposed changes. Further, a cost benefit analysis is required under S92 (1) of the National Electricity Law (NEL) and detailed in Regulation 8 of the National Electricity (South Australia) Regulations which states that a rule change request must contain *inter alia* 'an explanation of the expected benefits and costs of the proposed change and the potential impacts of the change on those likely to be affected'.

Are there other constraints that might nullify this change?

AGL would also like to further understand whether the current rules (which require LRMC to be taken into account) have been the most significant barrier to tariff reform. A particular solution in the form of the Proposed LRMC Rule is being prescribed before the problem has been clearly articulated and examined for root cause.

Is LRMC the only cost-reflective tariff?

Notwithstanding the general acceptance of cost reflectivity as a desirable attribute in tariffs, AGL would appreciate the opportunity to understand how the Proposed LRMC Rule has been identified as providing the best approach. AGL suggests that prior to progressing this further, a broader range of options should be explored. Focusing on a very narrow definition of economic efficiency (i.e. long-run marginal cost or LRMC) may risk not giving sufficient weight to the fact that determining the LRMC for different customer types and customers with different profiles (who use a shared network) is complex and involves many decisions that entail trade-offs. AGL does not currently understand how the proposed rule change can provide a framework in which such trade-offs can be evaluated.

In brief, AGL supports the Proposed Process Rule change that will initially resolve the primary issue of inadequate consultations by distribution businesses with retailers and customers in setting or changing network pricing structure and levels. This is a necessary first step in promoting more effective and efficient linkages between the distribution tariff setting process and the process for retailers or other service providers in implementing them. The Proposed LRMC Rule is one that needs modelling and extensive quantitative analysis, along with a robust business case, before consideration.

Please contact me on 03 8633 6077 or Kong Min Yep on 03 8633 6988 if you wish to discuss this matter further.

Yours sincerely,

Beth Griggs
**Head of Energy Market Regulation**