

16 October 2014

Australian Energy Market Commission  
PO Box A2449  
Sydney South, NSW, 1235



Dear Sir/Madam

**Energex Submission in response to AEMC Draft Determination (Distribution Network Pricing Arrangements)**

Energex Ltd (Energex) welcomes the opportunity to provide a submission in response to the Australian Energy Market Commission's (AEMC's) Draft Determination in relation to two distribution pricing rules change requests submitted by the COAG Energy Council and the Independent Pricing and Regulatory Tribunal of NSW (IPART).

Energex's response to the AEMC's Draft Rule and supporting explanatory material in its Draft Rule Determination is provided in Attachment 1.

As indicated in our response to the AEMC's Consultation Paper, Energex supports the overarching objective of this rule change process, which is to achieve more cost reflective electricity network tariffs and empower customers through engagement.

Energex is also generally supportive of the Draft Rule, although it considers that more consideration is required by the AEMC in relation to the practical application of the new distribution pricing principles in the following areas:

- should the AER fail to provide extended transitional deadlines, then inadequate time is provided for Energex to meaningfully engage with our customers in relation to the development of the proposed Tariff Structure Statement (TSS), especially given the significant engagement programs that relevant stakeholders are already undertaking to prepare the regulatory proposal;
  - this problem may be compounded by the seemingly limited circumstances in which a Distribution Network Service Provider (DNSP) can make changes to its tariffs and tariff structures during a regulatory period once the TSS is approved;
  - Energex seeks clarification on the degree to which new tariffs (not included in the approved TSS) that satisfy the network pricing objective

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and pricing principles can be proposed by a DNSP in a revised TSS submitted during the regulatory period; and

- it is unclear how the Australian Energy Regulator (AER) will measure the nature and outcomes of Energex's customer engagement on its TSS, given the potential for that engagement to reveal irreconcilably different viewpoints amongst stakeholders on more cost reflective network tariff structures, which is concerning given the AER will have the power to substitute its own TSS for that proposed by a DNSP at the start of each regulatory period;; and
- the very narrow circumstances in which a DNSP can propose a change to its approved TSS during a regulatory period, could unduly restrict the flexibility of a DNSP to make changes to tariffs that are consistent with the network pricing objective and principles and undermine the Commission's intent that DNSP should 'own' their network tariffs.

Energex considers that customer engagement is an important step in the tariff development process ensuring that customer feedback and preferences are adequately understood and incorporated where appropriate. However, Energex also recognises that engagement does not mean that consensus between different market participants can always be achieved.

Energex also considers that while prescribing LRMC is relatively straightforward, achieving greater cost reflectivity in network tariffs in practice will be a far more difficult and time consuming process.


While the AEMC has gone some way to recognise the difficulties that will emerge in moving to more cost reflective network tariffs, including the proposed new customer impact and jurisdictional pricing obligation principles, these do not address the detail of network tariff reform where the true challenges and difficulties will present.

Moreover, the key linkage between distribution and retail electricity prices, including the flow through of network price signals into retail tariffs, does not appear to be considered within the Draft Rule Determination. In Energex's view, the apparent underlying assumption in the Draft Rule Determination that more cost reflective network tariff structures will closely align with retail tariffs should be subject to much closer scrutiny than has so far been undertaken during this rule change process.

Energex looks forward to further participating in this rule change request process.

Should you have any queries in relation to our submission, please contact Candice Hincksman, Acting Network Pricing Manager, on [candicehincksman@energex.com.au](mailto:candicehincksman@energex.com.au) or (07) 3664 5982.

Yours sincerely



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# Energex

**Attachment 1:  
Submission in response to AEMC Draft Determination  
Distribution Network Pricing Arrangements**



positive energy



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## Approvals

| Name              | Title                                 | Signature | Date |
|-------------------|---------------------------------------|-----------|------|
| Candice Hincksman | Network Pricing Manager               |           |      |
| Neil Andersen     | Group Manager<br>Regulatory & Pricing |           |      |

# 1 Executive Summary

As noted in our response to the Australian Energy Market Commission's (AEMC's) Consultation Paper<sup>1</sup> in relation to the COAG Energy Council's and the Independent Pricing and Regulatory Tribunal of NSW's (IPART's) distribution pricing rule change requests, Energex supports the overarching objective of this rule change process, which is to achieve more cost reflective electricity network tariffs and empower customers through engagement. To the extent that any such new network tariff structures and levels were subsequently to be reflected in retail electricity tariffs, Energex considers that this would deliver more efficient and equitable outcomes for consumers as far as their use of the electricity network is concerned.

However, while supportive of the intent of the Draft Rule, Energex has concerns about the practical implications of a number of aspects of it that, if not addressed prior to implementation, will hinder Energex's ability to meet the overarching cost reflectively intent. These concerns can be summarised as follows:

- inadequate time has been provided for Energex to engage with our customers in relation to the development of the proposed new Tariff Structure Statement (TSS), which is likely to result in a compromised engagement process;
  - this problem will be compounded by the limited circumstances in which a Distribution Network Service Provider (DNSP) can make changes to its tariffs and tariff structures once the TSS is approved;
- it is unclear how the AER will measure the nature and outcomes of Energex's customer engagement in relation to its TSS, given the potential for that engagement to reveal irreconcilably different viewpoints of stakeholders in relation to more cost reflective network tariff structures;
  - there is the potential for the AER to determine that a DNSP has given inadequate consideration to customer impacts and, as a result, rejects a DNSP's proposed TSS, which will weaken the DNSP's ownership of network pricing reform as intended by the Commission;
- more explanation is required from the AEMC in relation to the practical interaction of the proposed new pricing principles, including how DNSPs will reconcile contrary Chapter 6 National Electricity Rules and jurisdictional obligations 'to the extent necessary';
- there is a lack of consideration of whether or not there is likely to be an effective flow-through of more cost reflective network tariffs into retail electricity tariffs, including due to the potentially different commercial drivers of DNSPs and retailers.

Finally, Energex notes that the proposed new Rules will impose ongoing new compliance obligations on DNSPs, including in applying the prescribed LRMC pricing rule, developing the TSS, developing and administering cost reflective price paths, and that these associated costs have not been adequately recognised in the AEMC's Draft Rule Determination.<sup>2</sup>

More detailed comments in relation to the AEMC's Draft Rule Determination and Draft Rule are provided in the remainder of our submission. For ease of readability, Energex has aligned the structure of our submission with the chapter structure of the AEMC's Draft Rule Determination.

<sup>1</sup> AEMC (2013), National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014, Consultation Paper, November

<sup>2</sup> AEMC (2014), National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014, Draft Rule Determination, August

## **2 Chapter 1 – Distribution network pricing rule change requests<sup>3</sup>**

Energex has no comment to make on the contents of this chapter.

## **3 Chapter 2 – Draft rule determination<sup>4</sup>**

Energex supports the analytical framework that the AEMC has used to assess the two rule change requests.<sup>5</sup> However, Energex considers that the AEMC has failed to adequately quantify the incremental administrative costs associated with the greater regulatory burden imposed on DNSPs under the Draft Rule. Energex does not consider that the potential size of the benefits of network tariff reform absolves the AEMC from fully assessing these costs.

In addition, Energex does not agree that DNSPs have been given 'significant' time through the proposed transitional arrangements to prepare for the Draft Rule changes.<sup>6</sup> This particularly relates to the time frame for customer engagement in relation to the development of the first TSS. This issue is discussed further in Section 7 (Chapter 6) below.

## **4 Chapter 3 – Overview of new network pricing objective & pricing principles<sup>7</sup>**

In an overarching sense, Energex notes that it is unclear if the proposed network pricing objective and pricing principles in the Draft Rule apply to distribution use of system (DUOS) tariffs or Network Use of System (NUOS) tariffs. In practice, Energex assumes that the new Chapter 6 provisions will apply to NUOS tariffs because designated pricing proposal charges (DPPC) relating to the transmission network are recovered through distribution tariffs. The DPPC will form part of the 'residual' costs that need to be recovered after the LRMC pricing rule has been applied.

A further issue that arises is to what extent any price signals built into the DPPC must be preserved in the NUOS tariffs given the overarching network price objective.

Similarly, given the Draft Rule will apply to the pricing of direct control services, Energex queries the appropriateness of the additional prescription being applied to the setting of prices for standard control services (SCS) also being applied to alternative control services (ACS). In Energex's view, ACS pricing is generally much simpler and formula driven than for SCS (eg. no really detailed cost allocation in relation to 'residual costs' is required). Generally ACS are subject to AER-approved price caps/price paths over each five year regulatory period. As a result, it is not clear to Energex that all of the new prescriptive requirements in relation to SCS pricing are necessary for ACS services and if applied would impose an additional administrative burden on DNSPs for no obvious benefit.

Energex seeks clarification from the AEMC on these points.

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<sup>3</sup> AEMC Draft Rule Determination, pp 1-5  
<sup>4</sup> AEMC Draft Rule Determination reference, pp 6-12  
<sup>5</sup> AEMC Draft Rule Determination pp 13-21  
<sup>6</sup> AEMC Draft Rule Determination, p 9  
<sup>7</sup> AEMC Draft Rule Determination, pp 13- 21

## 4.1 Outcomes under current pricing principles

Energex questions the AEMC's view that the main reason why DNSPs have 'not developed network prices in accordance with the policy intent of the current pricing principles' is because of the lack of firm obligations in a number of the existing pricing principles'.<sup>8</sup> In Energex's view, the most important reason is that there are a number of practical market-driven constraints associated with transitioning to more cost reflective network tariffs, including metering constraints and jurisdictional requirements.

Similarly, the primary reason that Energex has not systematically reflected LRMC in its tariffs for the large majority of its residential and small customers is because these customers are on flat tariffs and a LRMC price signal is of limited value in facilitating efficient network usage. Energex does not consider that this approach is inconsistent with current Chapter 6 distribution pricing principles or the Draft Rule. In Energex's view, prescribing the use of LRMC price signals in network tariffs in Chapter 6 will not change this situation in the short or medium term. Only when the binding market-driven constraints for smaller customers are removed, including metering, will this situation change.

## 4.2 Proposed new network pricing objective

Energex supports the establishment of a network pricing objective to guide DNSPs when developing network prices. However, Energex seeks clarity about the reference in the proposed objective to network prices reflecting 'the efficient costs of providing those [direct control] services to the retail customer'.<sup>9</sup>

Energex considers that the reference to an individual retail customer in the objective could be read to imply a false impression about the construction and precision of network tariffs. Moreover, a DNSP does not control the level and structure of the retail tariff that a retail customer pays. In contrast to the network pricing objective, the proposed pricing principles in the Draft Rule are expressed in terms of tariff classes. Energex considers this drafting to be a more accurate reflection of the construction of network tariffs.

With the exception of the largest customers on Energex's network (with consumption greater than 4 GWh per annum), who each receive an individually calculated tariff, all other customers are grouped into tariff classes that broadly reflect the efficient costs associated with the provision of direct control services to those customers within the tariff class.

Energex's main concern with the network pricing objective as drafted is that its interpretation could create an unrealistic and unachievable goal as far as network tariffs are concerned. Energex suggests that this objective should be re-drafted in terms of the 'efficient costs of providing those [direct control] services to retail customers assigned to the relevant network tariff'.

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<sup>8</sup> AEMC Draft Rule Determination, p 14  
<sup>9</sup> AEMC Draft Rule, p 13



### 4.3 Proposed new network pricing principles

Energex' views on the proposed new pricing principles are set out below.

#### *LRMC distribution pricing rule*

Energex argued in its response to the AEMC's Consultation Paper that it does not support prescription of LRMC as a distribution pricing rule because it will reduce network price flexibility for limited demonstrable benefits. No evidence has been provided in the Draft Rule Determination regarding the purported benefits of this prescription (as opposed to retention of the status quo) to change our view.

It is apparent from paragraph 6.18.5(f) of the Draft Rule that the primary impact of prescribing the LRMC pricing rule will be the associated additional compliance costs imposed on DNSPs in the context of the development of the TSS, including demonstrating how each of paragraphs 6.18.5f(1) to 6.18.5f(4) have been addressed.

#### *Avoid cross subsidies between tariff classes*

Energex supports the retention of avoidable cost price floors and stand alone cost ceilings for each tariff class in the network pricing principles as set out in paragraph 6.18.5(e) of the Draft Rule. These price floor and ceilings expressed at the tariff class level will prevent cross subsidies between customers across tariff classes.

#### *Three-part total efficient cost recovery principle*

Energex supports paragraph 6.18.5(g) of the Draft Rule, which provides for DNSPs to recover the full efficient costs of serving retail customers, while minimising distortions to the price signals for efficient usage.

#### *Consumer impact principle*

Paragraph 6.18.5(h) of the Draft Rule establishes what the AEMC refers to as the consumer impact principle.

Contrary to the AEMC's view<sup>10</sup>, Energex notes that the objective of moving to more cost reflective network tariffs is likely to result in significant price changes for some consumers, including those with poor load factors. In light of this likely outcome, Energex agrees with and supports scope for network price paths to be developed to enable the most affected customers to transition to fully cost reflective tariffs.

Energex also notes that while a DNSP's proposed time frame for transitioning would be subject to the consumer impact principle, including as part of a DNSP's customer engagement process, it is not clear how a lack of agreement amongst stakeholders about the timing of the DNSP's proposed price path would be taken into consideration by the AER as part of the TSS approval process. Energex seeks clarity from the AEMC on this point, including whether the AER can refuse to approve a DNSP's proposed TSS based on the outcomes of its customer engagement (assuming that the engagement

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<sup>10</sup> AEMC Draft Rule Determination, p 21

has been undertaken in accordance with the AER's Consumer Engagement Guideline for Network Service Providers).<sup>11</sup>

More generally, transitioning to more cost reflective network tariffs is likely to be a long process in certain cases and the consumer impact principle provides no assistance in determining the duration of this transitioning. Rather, this will ultimately be a matter for the AER to determine as part of the approval of the TSS and Annual Pricing Proposal. Moreover, given the political sensitivity of electricity pricing, it is highly likely that jurisdictional obligations will be imposed in relation to the development of any cost reflective network price paths.

In the context of minimising the impact of changes in network tariffs each regulatory year, as provided for in paragraph 6.16.6(h) of the Draft Rule, Energex seeks clarity from the AEMC regarding its expectations about the potentially different treatment of retail customers that can choose the network tariff to which they are assigned as opposed to those that have no such choice. Energex's view is that the protection inherent in paragraph 6.16.6(h) should apply only in relation to the latter non-voluntary cases.

In a general sense, Energex assumes that annual price changes for each tariff class will need to be made in accordance with the side constraint rules on tariffs for standard control services as set out in clause 6.18.6 of Chapter 6. Beyond this, Energex assumes that the primary responsibility for managing tariff impacts for retail customers who voluntarily nominate to move to a different retail tariff (and by implication its different underlying network tariff) is the retailer, who will advise the customer regarding his/her choice. Energex seeks further clarity from the AEMC on this point.

Additionally, Energex seeks clarity from the about how DNSPs can meet the requirements of both the LRMC and customer impact principle obligations when there must necessarily be a degree of trade-off between them. Energex notes that there is a potential for conflict between these principles and is concerned that this conflict could lead to a TSS submission being rejected on these grounds.

#### *Principle on meeting jurisdictional pricing obligations*

Energex considers that there will be a number of constraints on the development of more cost reflective network prices, particularly for residential and small business customers and this is not adequately recognised in the Draft Rule Determination.

The most important of these practical binding constraints are the lack of advanced metering and jurisdictional obligations. Also, Energex is concerned that there is little reason to assume that retailers have a significant commercial incentive to always pass on a price signal built into a network tariff (or even adopt a new network tariff), primarily because the commercial drivers of DNSPs and retailers will not always be aligned. For example, localised network constraints are unlikely to be of any genuine commercial concern to a retailer, nor is the network impact of solar PV units sold by retailers. Energex has no control over how retailers present price signals to customers and is concerned that such price signals may be blunted or hidden through bundling or repackaging of tariffs by retailers for customers.

Energex's primary concern is the AEMC's apparent expectation that DNSPs must develop cost reflective network prices regardless of these practical and binding market constraints and then explain why and how actual tariffs diverge from the cost reflective ones. Unless the practical binding constraint

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<sup>11</sup> AER (2013), Consumer Engagement Guideline for Network Service Providers, November

is removed, Energex would appear to face the situation of incurring significant administrative costs of developing hypothetical tariffs that may never be used.

#### *Use of LRMC*

Energex supports the AEMC's proposal to allow DNSP's to choose the methodology that they use to calculate LRMC rather than prescribing a methodology in Chapter 6 or an AER guideline.

As the AEMC notes, this is an important element of DNSP's being able to take into account their specific network characteristics, as well as take responsibility for the tariffs they develop. Moreover, the obligations placed on DNSPs in terms of the TSS and customer engagement will mean that the reasons for a DNSP's choice of LRMC methodology will be transparent. Energex supports the AEMC's proposed high level definition of the LRMC.

## **5 Chapter 4 – Expected outcomes for consumers<sup>12</sup>**

Energex agrees with the AEMC that the nature of winners and losers from any move to more cost reflective network tariffs will depend on customer load profiles and the way in which the 'residual' allowable revenue is recovered (given the latter is by far the largest proportion of allowable revenue that will be recovered by Energex in the 2015-20 regulatory control period).

In light of this situation, Energex queries the customer tariff impacts presented in the AEMC's case studies, which appear to significantly under-estimate the number of 'losers' from the transition to more cost reflective network tariffs, particularly in the short to medium term. In this regard, Energex notes that the duration of the medium term is not revealed by the AEMC or its consultant. If this duration is around 5 to 6 years, Energex struggles to understand the apparently highly favourable balance of 'winners' and 'losers' of network tariff reform.

In Energex's view, the material financial benefits of network tariff reform are only likely to be revealed in the long term. In the short term to medium term, Energex envisages that it will need to utilise a mix of both tariff and non-tariff (demand management) options to manage peak demand issues that will present on the network.

To provide greater certainty to our customers, Energex agrees with the AEMC that it is possible to develop indicative network tariff levels by tariff class for 5 years as part of the TSS. Energex supports the annual update of indicative prices being an Attachment to the TSS (not formally part of it).

However, it should be noted that network tariffs are inherently more volatile under revenue cap control mechanisms than weighted average price cap mechanisms given that prices are the variable that must change in response to volume fluctuations to ensure the revenue cap is not breached. The only way this situation can be avoided (or mitigated) is through much greater use of fixed or capacity based charging by DNSPs. Consequently, there will be always be variations between indicative and actual network prices by tariff class under a revenue cap control.

This variation associated with the revenue cap control mechanism is in addition to the extra variability that will be caused by the earlier development of transmission use of system tariffs.

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<sup>12</sup> AEMC Draft Rule Determination, pp 22-41

## 6 Chapter 5 – Network pricing process (Chapter 5)<sup>13</sup>

Energex supports the overarching objective of this rule change process, which is to achieve more cost reflective electricity network tariffs and to empower customers through engagement.

However, as noted above, Energex is particularly concerned about how the outcomes of customer consultation will be taken into consideration by the AER given that there will not always be agreement amongst DNSPs, retailers and customers. Energex believes that successful engagement is demonstrated in the way that due regard is given to stakeholder concerns and feedback and expects that this can be achieved through appropriate engagement. However, clarification is sought from the AER in terms of how such engagement and balancing of stakeholder feedback will be assessed.

Under the Draft Rule, Energex must demonstrate that it has adequately consulted with retailers and customers and addressed their concerns in regards to structures and concepts in the development of network tariffs. Given the likely divergence of stakeholder views on network tariffs it is unclear how the AER will assess the outcomes of any consultation process.

In the context of customer engagement, Energex will only engage on tariffs that will be commercially sound from a network perspective in the future. To this end, Energex has determined that this will exclude tariffs determined without consideration of customer's peak demand.

Within the set of network tariffs that are determined to be commercially sound, Energex will engage with customers on any suitable elements of tariff design and implementation and will accommodate customer preferences to the maximum extent possible. However, Energex does not consider that it will always be possible to satisfy all customer concerns at all times.

Energex envisages the risk that the customer engagement process associated with the TSS could be interpreted by some stakeholders as a reason to seek the implementation of new tariffs that reflect their preferences but Energex does not judge to be commercially sound. Alternatively, Energex may propose new tariffs or tariff structures that cannot be implemented due to market-based limitations, such as metering capability or lack of retailer support.

In terms of the content of the TSS, Energex supports the matters that must be included in the document, subject to the AEMC clarifying the content of the 'pricing methodology' that will be used to set each tariff in each year of the relevant regulatory control period'.<sup>14</sup> Energex considers the first four matters the AEMC proposes must be included in the TSS, including the customer tariff assignment approach, and tariff structures and charging parameters, will form key parts of a network 'pricing methodology'. The only significant matter not covered by the AEMC's proposed TSS content that could be expected to form part of a pricing methodology is the method used to allocate efficient costs to tariff classes (ie primarily how the 'residual' costs will be recovered).

Energex notes that in presenting indicative prices for each tariff for the next regulatory period in an Attachment to the TSS, actual prices can be expected to diverge from these prices each year under the revenue cap control mechanism favoured by the AER. This issue is discussed further later in our submission.

<sup>13</sup> AEMC Draft Rule Determination, pp 42-74

<sup>14</sup> AEMC Draft Rule Determination, p 58

Energex supports scope for a DNSP to be able to amend the TSS during the course of a five year regulatory period in order to respond to changing market circumstances. However, the proposed thresholds for changes based on events beyond a DNSP's control and which could not have been reasonably foreseen appear to be so tight that it will be very difficult to make any such changes. Given interpretation of these criteria will fundamentally require the exercise of judgement by DNSPs and the AER, Energex would like the AEMC to expand and provide illustrative examples on what type of events could be considered to meet its criteria for re-opening a TSS. For example, would changing the defined peak period time for a ToU Demand tariff from 4.00pm – 8.00pm to 6.00pm - 9.00pm to capture a changing peak meet the criteria? Would introduction of a new electric vehicles tariff (not previously included in the TSS) meet the criteria? Depending on interpretation of these criteria, Energex considers that reasonable incremental changes to tariff structures could be unduly constrained undermining the network pricing objective.

Fully understanding the narrowness of the circumstances in which a TSS can be re-opened also has important implications for the timing of the proposed transitional arrangements for this distribution pricing rule change and is discussed further in our submission below.

Energex strongly supports the proposed exemption in the Draft Rule that will allow a DNSP to introduce trial tariffs that were not identified in the approved TSS. Energex considers that this will facilitate network tariff innovation.

Energex also supports the application of the merits review in relation to the approval of the TSS. This includes because of the uncertainty around how the outcomes of customer engagement will feed into the TSS approval process and the very tight constraints that will apply in relation to changes to the TSS during the five year regulatory period.

## **7 Chapter 6 – Transitional arrangements<sup>15</sup>**

Energex is particularly concerned about the timeframes proposed for the Queensland and South Australian DNSPs to prepare and submit their TSSs to the AER for network tariff structures that will not apply until 2017-18. The key dates are:

- 14 November 2014 – the AEMC's final rule determination will be made in relation to the distribution pricing rule change requests;
- 30 June 2015 – a DNSP must submit its TSS to the AER;
- 29 February 2016 – the AER must make its draft decision on the DNSP's TSS within 8 months of its submittal;
- 29 April 2016 – the DNSP must submit a revised TSS 45 business days after the AER's draft decision; and
- 30 October 2016 – the AER must make its final decision in relation to the DNSP's TSS that will apply from 1 July 2017.

Energex considers that the transitional timeframe outlined above will not allow meaningful customer engagement in relation to the TSS. Energex considers that this will undermine a critical element of the initial stage of the network tariff reform process.

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<sup>15</sup> AEMC Draft Rule Determination, pp 75-84



As the initial TSS is due for submission to the AER by 30 June 2015, Energex will need to have completed all customer consultation and engagement by April 2014, allowing for further time to make final decisions on tariff structures and communicate engagement outcomes to stakeholders prior to submission of the TSS. Resources working on this engagement are also heavily involved in the customer engagement on Energex's 2015-20 Regulatory Proposal. Energex considers that the date by which a DNSP must submit its TSS to the AER for the first time should be extended by six months to 30 December 2015.

It is possible that the AER may not approve new tariffs that are included in the TSS submitted on 30 June 2015 due to inadequate customer engagement. Whilst the Draft Rule allows for some flexibility to amend a TSS between regulatory periods it is unclear if re-engaging customers on a tariff that was not approved would meet the requirement to amend the TSS. Energex seeks clarity on this point and is concerned that, if re-engagement is required to achieve improved customer outcomes in the draft TSS submission, that sufficient time is not available to do so effectively.

The Draft Rule is also unclear on the engagement required for existing network tariffs. Energex does not plan to engage on existing tariff structures. However, Energex will engage stakeholders on how to best transition to LRMC-based tariff structures.

Finally, Energex considers that the wording of the AEMC's Draft Rule Determination is unclear as to whether or not new more cost reflective tariffs could be implemented between the time of the rule change becoming binding (November 2014) and the first year in which the TSS is applied, that is, 1 July 2017. The relevant text in the AEMC's Draft Rule Determination implies that this is not the case - 'DNSPs may be able to start planning and developing their new tariffs from the release of the draft rules.'<sup>16</sup> Energex considers that this drafting should be clarified by the AEMC.

## **8 Appendix A1 – Efficient pricing of distribution network services<sup>17</sup>**

Energex supports flexibility in the choice of methodology to estimate LRMC and agrees that there is no clearly superior methodology to estimate it in the context of distribution pricing.

As previously noted in our submission, Energex is opposed to the prescription of LRMC as a pricing rule, because it will remove DNSP's judgement in applying LRMC price signals in tariffs having regard to binding market constraints and likely customer receptiveness to such signals.

Energex also notes that the AEMC has not adequately addressed the issue of how LRMC price signals built into network tariffs will flow through into retail tariffs with any degree of certainty.

## **9 Appendix A2 – Sending efficient network pricing signals<sup>18</sup>**

As noted earlier in our submission, the AEMC's analysis that DNSPs have not had sufficiently strong regulatory obligations to send LRMC-based price signals to consumers is simplistic and presumes the Chapter 6 regulatory framework is more important than the market circumstances that DNSPs face in their respective jurisdictions in determining network tariffs.

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<sup>16</sup> AEMC Draft Rule Determination, p 79

<sup>17</sup> AEMC Draft Rule Determination, pp 87-97

<sup>18</sup> AEMC Draft Rule Determination, pp 98-107

Energex supports the incorporation of the proposed guidance to DNSPs in calculating and applying LRMC through the factors set out in the Draft Rule.

## **10 Appendix A3 – Recovering total efficient network cost<sup>19</sup>**

Energex strongly disagrees with the AEMC that there is little transparency over how total efficient costs are currently allocated to network tariffs because network tariffs are not based on LRMC.<sup>20</sup> Energex's Annual Pricing Proposal explains in detail the cost allocation approach that is used to establish our network tariffs.

Energex also presumes that the AER understands and is satisfied with Energex's cost allocation methodology (including recovery of residual costs) given its approval of Energex's Annual Pricing Proposals in the current regulatory period.

Energex agrees with the AEMC that there is not one efficient method of allocating total efficient costs to network tariffs and that this will depend on each DNSP's network and consumer characteristics. As a result, Energex supports the Draft Rule not prescribing a specific approach to recovery of residual costs. Energex notes that The Brattle Group report commissioned by the AEMC provides good analysis of the practical challenges faced by DNSPs in recovering residual costs.<sup>21</sup>

## **11 Appendix A4 – Consumer impact principle<sup>22</sup>**

Energex considers that more cost reflective network tariffs cannot practically be developed in a precise manner, it requires many judgements to be made in relation to achieving equitable or 'fair' changes and for varying stakeholder interests to be balanced. Energex is concerned that the AEMC's Draft Rule Determination significantly under-estimates the difficulty and timeframes within which more cost reflective distribution prices can be achieved.

In light of this, Energex seeks clarity about how the consumer impact principle will interact with the network price side constraints under Clause 6.18.6 of Chapter 6 when transitional cost reflective network price paths need to be developed by DNSPs (and ultimately be approved by the AER). In practice, it would appear that any such transitional network price paths would need to, at a minimum, comply with the side constraint provisions.

Furthermore, based on the outcomes of a DNSP's customer engagement, Energex queries whether a stricter price threshold than that implied by the side constraint threshold could be proposed by a DNSP and/or be approved by the AER under the consumer impact principle.

<sup>19</sup> AEMC Draft Rule Determination, pp 108-121

<sup>20</sup> AEMC Draft Rule Determination, p 113

<sup>21</sup> The Brattle Group (2014), Structure of Electricity Distribution Network Tariffs: Recovery of Residual Costs

<sup>22</sup> AEMC Draft Rule Determination, pp 122-129

## 12 Appendix A5 – Jurisdictional obligations<sup>23</sup>

Energex considers that the Draft Rule fails to give primacy to jurisdictional pricing obligations as intended by the COAG Energy Council.

Moreover, the construction of the Draft Rule, specifically paragraph 6.18.5(c), provides for divergence from the Chapter 6 pricing principles, ‘only to the extent necessary’. In other words, the pricing principles take precedence and the jurisdictional obligation represents divergence from these principles that must be defended by a DNSP.

Given the clear inconsistency with the COAG Energy Council’s intent, Energex considers that the AEMC should amend the Draft Rule to clearly state that jurisdictional obligations take precedence over compliance with the Chapter 6 pricing principles.

For example, Energex considers that paragraph 6.18.5(j) of the Draft Rule could be amended as follows: ‘A tariff must comply with the Rules and all applicable ~~regulatory~~ *jurisdictional* instruments. *To the extent of any inconsistency between the Rules and applicable jurisdictional instruments, the latter shall take precedence*’.

Moreover, Energex does not consider that a DNSP should be required to set out the trade-offs it has made between the cost reflectivity principle and jurisdictional pricing obligations in the TSS as proposed by the AEMC. Rather, it should be sufficient to simply note the jurisdictional obligation and how this impacts on the determination of a DNSP’s tariff classes and associated tariffs structures.

For example, Energex does not intend to develop LRMC-based tariffs on a locational basis because this would be inconsistent with the Queensland Government’s Uniform Tariff Policy. Energex does not believe that its TSS needs to go beyond this simple explanation nor attempt to justify or explain the Uniform Tariff Policy.

## 13 Appendix A6 – Tariff classes<sup>24</sup>

Energex supports no changes being made to the existing rules regarding the assignment of retail customers to tariff classes.

## 14 Appendix A7 – Side constraints<sup>25</sup>

Energex supports the side constraints not being applied across regulatory periods.

Energex also supports removal of clause 6.18(e) of Chapter 6, which will clarify that side constraints also apply in relation to retail customers with interval meters.

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<sup>23</sup> AEMC Draft Rule Determination, pp 130-134

<sup>24</sup> AEMC Draft Rule Determination, pp 135-140

<sup>25</sup> AEMC Draft Rule Determination, pp 141-149