

Draft Rule Determination

National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014

1. Introduction

This submission is a response from Grattan Institute to the Draft Rule Determination released on 28 August 2014 by the Australian Energy Market Submission. This brief submission is structured to make some general observations and specific comments/recommendations. It should be read in conjunction with our detailed analysis and specific recommendations for network tariff reforms as published earlier this year: *Fair pricing for power*. This report can be found at:

<http://grattan.edu.au/wp-content/uploads/2014/07/813-fair-pricing-for-power.pdf>.

Grattan Institute offers to engage further with the Commission on the matters raised in the submission and on any other aspects of the Draft Determination where we could usefully add value.

2. General observations

The journey on which the Commission is embarking with this Draft Determination is one of the most important and significant in the recent history of electricity network regulation. It is critical that the objectives as laid out by the Commission remain firmly in focus and that completing the journey does not become mired in process and incrementalism spread over decades. The history of energy market reform in Australia is already littered with the wrecks of the ships that foundered on such rocky shores.

There is a natural tendency on the part of regulatory bodies to err in favour of investors to ensure that adequate investment occurs to ensure a reliable supply. Indeed, we would agree that reliability is generally more highly valued than price as a general principle and at the margin. However, in our view, the recent history of regulatory outcomes suggests that this tendency has gone too far. In the period ahead, it would be desirable to steer the regulatory ship more towards the shore of the consumer.

Many industry stakeholders are firmly supportive of network tariff reform, as is the COAG Energy Council. The technical aspects of the reforms will not be uniformly defined and supported however, although the fundamental principle of cost-reflectivity seems to have widespread support. Achievement of the desired outcome of effective and efficient network investment will not be achieved through the technical rule changes alone. It is equally, if not more important, that rule changes are designed and implemented in a way that brings the whole industry and consumers on the journey. Much of the benefit of this reform will only be delivered if consumers are able to make well-informed decisions on the way they use electricity. Behavioural economics will be as important as traditional economics in making this a reality. This necessity is recognised by the Commission in its Draft Determination, but cannot be overemphasised.

3. Specific Comments/recommendations

3.1 The nature of the problem

In our view, the central problems with the existing network tariff structure is that it is not fair and it delivers prices that are too high. It is essential the rule changes that emerge from the current determination actually address these two problems.

3.2 Timescale

The Draft Determination envisages an implementation over more than one regulatory period, i.e., five years and more. We recognise the challenges involved. However, the need for reform is urgent, and this timetable is not sufficiently urgent. We suggest that a more expeditious approach be adopted.

3.3 Long run marginal costs

While we support the principle of recovery of efficiently incurred costs, we are concerned that the Draft Determination does not seem to address the question of investments that have been made in the past and are now surplus to efficient delivery of electricity. We suggest that the Final Determination needs to address this issue. Alternatively, the issue of redundant assets should be addressed specifically and separately to the rule change determination for network pricing.

3.4 Tension in the principles

The principles that are proposed in the Draft Determination are sound in themselves. However, inherent tension that exists in some cases and specifically in regard to an expressed concern about the impact of higher fixed costs. In our view, this is both desirable and unavoidable if the problems in the current system are to be addressed.

While the analysis referenced in the Draft Determination indicates that most consumers will be better off with tariffs that better reflect costs, and this surely means higher non-volume costs, the analysis also clearly recognises that there will be losers. Consumers value possible losses more highly than possible gains. This is not a sound reason for fudging on the necessary reforms. It is a sound argument for clear articulation of the case for reform and for a robust process for dealing with the impact on vulnerable consumers. This latter point is in the context of the well-documented position that most low-income consumers will actually benefit from more cost-reflective tariffs. The Draft Determination also documents that position.

3.5 The issue of disadvantaged consumers

The Draft Determination recommends review by governments of energy concession and hardship schemes. Presumably this is to help these households deal with the possible price increases by adjusting their concessions frameworks. While this would help reduce the impact of the price increases and structural changes, it would not be the most efficient means for assisting concessions households.

Energy concession payments are usually paid as a credit on a household's energy bill; as such, a concession household will pay a lower price for their energy than other households. Because of this, the price signals from their energy bills are muted for concession households. This reduces the incentive for these households to adjust their energy use in response to price signals, increases or otherwise.

An alternative approach would be to abolish energy concessions, and incorporate these payments into the broader welfare payments received by low-income households. We are not advocating that the level of financial support is decreased, but that the household gets the choice as to how to use that financial support. We also recognise that such changes are outside the remit of the Commission.

Under the current concessions framework, the household has no option but to use their energy concessions payment to pay for their energy bills. If this payment were to be included in their broader welfare payment, the household could still use it to help pay off their electricity bills. Alternatively, and preferably, they could respond to better targeted price signals by reducing their consumption and spending their payment on goods or services that they value more highly.

3.6 The role of the DNSPs and the AER

The Draft Determination provides for a high level of control by the DNSPs in setting both the structure and level of electricity network prices. In principle, this is desirable. However, as evidenced by the history of recent years, this can easily lead, in our view, to regulatory capture.

We are concerned that there is excessive DNSP discretion in the Draft Determination. First, there seems to be recognition, including by way of clear examples, that the cross-subsidies created by the current tariff should be removed, but less clarity of how this should be achieved. Second, there seems to be less emphasis on the need to introduce prices, such as critical peak prices, that could be strongly expected to reduce peak demand. In our view, both of these outcomes of pricing reforms must be more prescriptive in the principle or powers of the AER if the desired outcomes are to be achieved.

3.7 The two-step process should be two-way

The proposed two-stage network pricing process is a positive change.

The Draft Determination envisages that annual reviews should allow the DNSPs to propose changes in levels, and possibly, changes in the tariff structures where changing circumstances warrant. We have, in previous published reports, noted that the regulatory process is far too unresponsive to changing market circumstances, specifically the cost of equity and debt and the level of demand. Therefore, we support this recommendation and further recommend that this review should be two-way in that the AER should also be able to propose and implement changes in both the structures and levels of the tariffs where changing circumstances mean that the tariffs are no longer consistent with the principles.

Finally, we support the recommendation in the Draft Determination that the AER should be able to impose changes to tariff structures and levels where the DNSP proposals are inconsistent with the principles.