ENA

REFORMS TO DISTRIBUTION PRICING PRINCIPLES

GARTH CRAWFORD, PRINCIPAL ADVISOR, ECONOMIC REGULATION

AEMC PUBLIC FORUM, 27 NOVEMBER 2013

Outline

- Questions
- Initial observations
- Ensuring shared expectations
- Accounting for differences
- Some early suggested principles for pricing rule-making

Some questions to consider…

- What does prices "based on" LRMC actually mean?
- Can any chosen definition of LRMC in the rules be practically implemented by networks?
- Are stakeholders clear on how transitions to LRMC based pricing would occur, and over what timeframe?
- Is it clear to the AER what its obligations are under the rule change?
- How will the fact that there are different ways to calculate LRMC be accommodated?

Initial observations

- Networks support and share the goal of moving to more cost-reflective pricing arrangements in the long-term interests of all consumers
- Importance of shared expectations of the effect of rule changes
- The ‘starting point’ for networks differs, as does the potential efficient destination → market and network conditions differ
- Critical that Rules provide clear and effective guidance on pricing issues

Shared expectations

- Key test
  - do consumers, governments, networks and the AER have shared expectations of what new distribution pricing principles may result in when implemented?
- This rule change process needs to address this question, with:
  - Empirical examples of LRMC estimates
  - Broad analysis of the likely consumer impacts of changes in the pricing principles
  - Clear ‘line of sight’ of likely ‘hard cases’ and how these will be handled

Shared expectations

- Regardless of the detailed design of the tariff process, it is critical that AER shares its views early on how it might interpret possible rules (including LRMC)
- Consequences of divergent expectations
  - Adverse price ‘surprises’ for consumers
  - Pricing outcomes which may be considered as unfair or unacceptable by the broad community
  - Regulatory uncertainty and risk for networks making proposals
  - An undermining, rather than strengthening of the legitimacy, of the price setting process

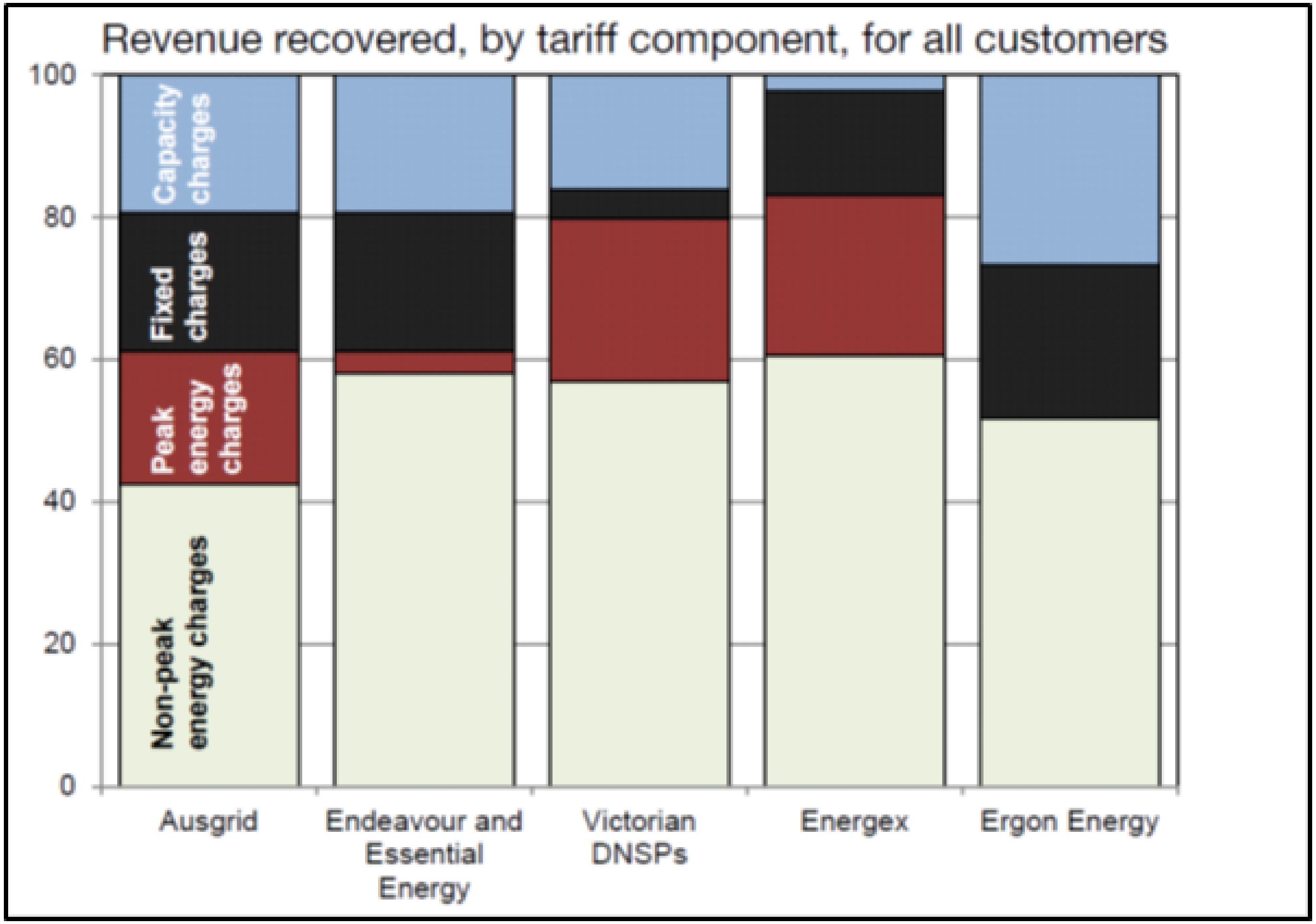
Shared expectations – example of views

"Cost-reflective, time-based pricing may see distribution businesses recoup a significant proportion of their revenue from those drawing on the system during peak demands. Other things being equal, they will then be less reliant on revenues from fixed charges and usage tariffs during non-peak periods. If this rebalancing is appropriately translated into retail electricity prices, those who:

- Continue to use large amounts of power at peak times will face considerably higher bills
- Were already low users at peak times, or those willing and able to respond to the price incentive to economise on peak period consumption, will experience lower bills – or at least lesser increases."

Productivity Commission *Review of Electricity Network Regulation*, April 2013, p.451

Networks start from different positions…



…the journey may also be on different paths

…the journey may also be on different paths

- Within the goal of greater cost reflectivity there are likely to be a range of different tariff design solutions possible
- Goal of the rule change is to ensure consumers voices are better heard in tariff setting processes
- Networks face different markets, consumer priorities, demand patterns, asset utilisation conditions
- Not obvious given the above that a single prescriptive uniform national set of tariff is the 'best' outcome

Case study – multiple models and the rules

- There are multiple legitimate economic approaches to estimating LRMC for network services
- Reasonable minds can differ on which of these should apply, and how they are implemented
- This is not a new situation for the *National Electricity Rules* to confront
- History and rule processes to date suggest that hard coding a single “correct” model, or allowing a regulator to simply select the “best” model and ignore alternatives, are solutions we should be skeptical about

Some suggested principles

- Legally binding rules should be internally consistent (avoiding ‘conflict of laws’)
- Rules should be be sufficiently clear and certain to enable regulated firms to make a proposal
- Prescribing a single “best” economic model where reasonable minds can differ not an appropriate role for rules
- Rules should seek to guide on the reconciliation of - not just list - conflicting objectives and factors