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16 October 2014

Via online submission

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

ERC0161: Distribution Network Pricing Arrangements—Jemena submission on draft determination

Jemena Electricity Networks (**JEN**) welcomes the opportunity to respond to the Australian Energy Market Commission's (**AEMC**'s) draft determination on the electricity Distribution Network Pricing Arrangements rule change.

The journey to date is important

The rule change builds on a range of recent reforms that have been designed to better align the policy and regulatory framework with the long-term interests of customers. This includes changes to how network revenues are determined and adjusted over time, and the role and ability of customers to participate in this decision making process.

The draft determination strengthens these reforms by highlighting how network revenues are recovered and prices are determined, and how they are likely to change over time, including a focus on:

- cost reflective network prices—through a new network pricing objective—and the constraints to more cost reflective prices and tariff structures
- meaningful and effective consultation between network business and their customers and stakeholders in designing network tariffs, including the development of a tariff structures statement (**TSS**) as part of a regulatory proposal
- transparency in how network businesses will update their tariff structures and levels of the regulatory period, with a pricing methodology outlined in the TSS
- the timing of annual changes in energy prices at the network and retail level to facilitate efficient network price signals being passed through to customers and customers' becoming active participants in the retail market.

We support cost-reflective prices and empowered customers

We support efforts to ensure network revenues and prices better reflect the costs of providing services to our customers. Our customers are currently paying for advanced metering infrastructure (**AMI**) and we are committed to ensuring customers can benefit from this investment. More cost reflective network prices will encourage more informed energy decision making by our customers and has the potential to lower network costs to all customers.

We also support efforts to empower customers to participate in the regulatory process—both as part of the development and submission of our network proposals and as part of the Australian Energy Regulator's (**AER**'s) decision-making. This is particularly important as efforts to move prices to more cost reflective levels is likely to mean changes to the way many customers are charged for use of our network. We also support efforts to provide greater transparency and predictability of future network prices.

But, we caution against changes that undermine competition and innovation

However, as policy makers have highlighted, it is crucial that regulation does not get in the way of business competition and innovation.[1] Network pricing will need to evolve as we increasingly compete against a range of other technologies and energy market players. In particular, it is crucial that:

- the network pricing objective recognises that network pricing focusing purely on cost-reflectivity may not encourage utilisation of our network and promote our customers' long-term interests
- the pricing principles are made clear to reduce potential tensions between the principles and make them more intuitive for our customers to read (refer the Energy Networks Association's (**ENA**'s) suggested changes)
- while **tariff structures** may be 'locked-in' over the regulatory period (with any amendments subject to consultation and AER approval), any pricing methodology should not unnecessarily limit our ability to update our **tariff levels**—flexibility is required to respond to changes in the market and/or customer preferences in how they use our network (subject to our consultation process being meaningful and effective, and our prices continuing to promote the pricing principles)
- the transitional arrangements recognise the extensive consultation already undertaken with customers, stakeholders and the community under the current rules.

Our detailed submission addressing these points is attached to this letter. We also support the submission from the ENA. Our submission focuses on areas we consider key or have not been raised by the ENA.

We welcome the AEMC's extensive and consultative review process, and the contribution it has made to the complex issue of network pricing reform. However, there are a range of barriers that need to be addressed beyond the National Electricity Rules, including jurisdictional constraints on pricing and metering, customer and stakeholder understanding of energy costs—including acceptance of cost reflective pricing—and a co-ordinated national approach to funding and delivering targeted assistance to customers in hardship.

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[1] Australian Government, Energy White Paper - Green Paper 2014, p viii.

We welcome the AEMC's continued involvement in this process to ensure the policy, regulatory and market framework continue to promote the long-term interests of customers.

If you wish to discuss the submission please contact me on (03) 8544 9053 or at robert.mcmillan@jemena.com.au.

Yours sincerely

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Distribution network pricing arrangement rule change—Draft determination

Submission

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1. OVERVIEW

1. Jemena Electricity Networks (**JEN**) welcomes the opportunity to respond to the Australian Energy Market Commission's (**AEMC**'s) draft determination on the electricity distribution network pricing arrangements rule change. We support the submission from the Energy Networks Association (**ENA**). Our submission focuses on areas we consider key or not raised by the ENA.

2. The draft determination builds on recent reforms designed to better align the policy and regulatory framework with the long-term interests of customers. This includes changes to how network revenues are determined and adjusted over time to encourage more informed energy decision-making, and customers' ability to meaningfully participate in this decision-making process—both when developing our regulatory proposals and as part of the Australian Energy Regulator's (**AER**'s) decision-making.

The draft rule is part of informed decision-making (refer section 2)

3. We support network revenues and prices better reflecting the costs of providing services to our customers. Our customers are currently paying for advanced metering infrastructure (**AMI**)—and we are committed to ensuring they can benefit from this investment. More cost reflective network prices will encourage more informed energy decision-making by our customers and could materially lower network costs to all customers.

4. We also support efforts to empower customers to participate in the regulatory process—particularly as efforts to move prices to more cost reflective levels are likely to change the way customers are charged for using our network. We also support greater transparency and predictability of future network prices. (**Refer section 2**).

Pricing is more than cost-reflectivity (refer section 3)

5. Network pricing must keep pace with changes in how customers source and use energy, particularly as electricity networks increasingly compete against a range of other technologies and energy market players—and the AEMC recognises this. We must strike the right balance between the certainty and predictability that customers and stakeholders require to make energy usage and investment decisions, and the flexibility that network businesses require to respond to changes in technology, market players and customer preferences. Striking this balance will ensure that network businesses, stakeholders and customers can respond to the changes in the energy market in a way that promotes our customers' long-term interests.

6. We support the transparency and improved focus on what the pricing principles should achieve that flows from a new network pricing objective. However, with changes occurring in the energy market—including from new technologies and energy market players facilitating off-grid options—there are realistic instances where efficient use of the network, and the national electricity objective (**NEO**), are better facilitated by pricing that encourages customers to maintain a connection. Focusing purely on cost reflectivity as a pricing objective may not encourage efficient *utilisation* of our network nor promote our customers' long-term interests. The AEMC could reflect this through the pricing principle that encourages residual network cost recovery in a way that encourages efficient network utilisation. (**Refer section 3**).

Pricing process and understanding the pricing methodology (refer section 4)

7. Meaningful and effective consultation between network business and their customers is important. The objectives and principles—including network price transparency, predictability and enabling a timely annual pricing process—should underpin how a tariff structures statement (**TSS**) is developed as part of a regulatory proposal. However, it is crucial that we get the right balance between predictability, flexibility and timely processes when considering the content of the TSS and the ability to update the TSS over the regulatory period.

8. We support designing, consulting and seeking approval of our proposed **tariff structures** for the regulatory period as part of the regulatory proposal.[1] We are committed to 'locking-in' these tariff structures in the TSS, and have made this commitment for our network prices as part of our Jemena Gas Network (**JGN**) access arrangement for 2015-20. These commitments to providing 'firm' tariff structures are more likely to facilitate efficient network price signals being passed through to customers and empower customers to manage their consumption to reduce their electricity bill and to actively participate in the retail market.

9. The draft determination seeks to also 'lock-in' a pricing methodology used to set each tariff in each pricing proposal—but would limit how much network businesses can vary their **tariff levels** from year to year. Price level changes over the regulatory period would then relate to matters that are outside network business' control. While we recognise the AEMC's intent to streamline the annual pricing process, a binding pricing methodology may inadvertently translate a qualitative assessment—in terms of the 'journey' from long run marginal cost (**LRMC**) calculations to tariff levels—into a quantitative or formulaic process. In combination with the high threshold to change the TSS, this creates a risk that network tariffs may not respond to changes occurring in the energy market, may require more frequent changes to the TSS to give effect to those energy market changes, or may increasingly lead to network businesses 'setting and forgetting' their network prices. Indeed, it appears at odds with:

- recent decisions made by the AEMC that seek to avoid restrictions on retailers' ability to update their prices under retail market contracts;[2] and
- the intent of motivating networks to own and actively manage their network tariffs.

10. Greater transparency and predictability of network tariff levels can be provided by requiring network businesses to detail and commit to a formulaic method for calculating LRMC, but with a detailed and communicative description (including evidence of engagement) as to how a network business has balanced the pricing principles. This includes how the network business has used the engagement process to assist with its tariff level decision making (the 'journey' from LRMC calculations to tariff levels). In our view, this provides for more informed energy decision making by providing greater transparency about how network businesses set their tariffs—including what they must consider and how the engagement process helped this balancing—and greater predictability over likely price (and relative price) changes over the period. This should not add to the AER's burden when considering annual pricing proposals as it would be up to the network business to demonstrate to the AER's satisfaction that any changes better promote the pricing principles and the NEO. We would welcome the AEMC's further consideration of this issue. (**Refer section 4**).

11. The draft determination also seeks to limit when the TSS can be updated within the regulatory period. While we recognise the AEMC's intent to provide greater certainty on tariff structures and levels, specifying this in advance carries significant risk that network prices do not evolve in line with the way customers source and use energy because 'events' may be considered foreseeable by the AER.[3] The more formulaic and prescriptive the pricing methodology, the more likely that businesses will need to update the TSS; but defined events to updating the TSS may increasingly lead to network businesses 'setting and forgetting' their network prices with the AER being responsible for when and under what circumstances to update it. Additionally, an intended outcome of cost-reflective tariffs is to achieve behavioural change. This could include material shifts in customer responsiveness or tariff take-up relative to TSS base-line expectations. These should be grounds to revisit the TSS. A focus on meaningful consultation by network businesses may achieve the AEMC's intent without the risk that network prices do not evolve in line with the way customers use energy. This was our focus for JGN's pricing. We encourage the AEMC to consider both the level of prescription in the pricing methodology and the bar for changing the TSS.

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1 See JEN submission to the consultation paper.

2 AEMC, *Retailer Price Variations in Market Retail Contracts, Draft Determination*, 31 July 14.

3 For example, stakeholders have formed different views in recent years as to whether the rapid take-up of solar PV was foreseeable.

12. We support bringing forward when annual changes in energy prices at the network and retail level are set so efficient network price signals are passed through to customers, and customers' can actively participant in the retail market.

Transitioning to new rules with care (refer section 5)

13. We support transition to the new network pricing arrangements to realise the benefits of the rule change as soon as practicable. As with some other networks, we are already consulting extensively to guide our regulatory proposal for the 2016-20 period. To avoid consultation 'fatigue' for our customers and stakeholders, we do not consider it feasible to run a further separate consultation on the new TSS arrangements following our regulatory proposal submission, particularly as our engagement has focused extensively on pricing and tariff structures.

14. Rather, we support transitional arrangements that recognise the extensive consultation already undertaken with customers, stakeholders and the community under the current rules, and that the AER recognise the timing and other limitations in network businesses submitting the initial TSS. (**Refer section 5**).

15. Table 1–1 summarises the four key areas where the AEMC could make material improvements.

Table 1–1: Summary of key improvement areas

Policy area	Draft rule	Our view
Network pricing objective	Each network tariff should reflect the efficient costs of providing network services to the consumers assigned to the tariff	Network pricing **focusing purely on cost-reflectivity may not encourage utilisation of our network** and promote our customers' long-term interests— the objective and/or pricing principles should recognise the role of 'efficient use'
Pricing Principles	A new set of principles to support the network pricing objective relating to long run marginal cost, total efficient cost recovery, consumer impact and jurisdictional obligations	No change to intent, but **the pricing principles can be clarified to reduce potential tensions between the principles and make them more intuitive for our customers** to read (refer the ENA's suggested changes)
Content of the TSS	Content of TSS to include tariff classes, tariff structures, assignment and reassignment criteria, pricing methodology and indicative prices. TSS can only be changed in limited circumstances.	While tariff structures may be 'locked-in' over the regulatory period (with any amendments subject to consultation and AER approval), **any pricing methodology should not unnecessarily limit our ability to update our tariff levels**—flexibility is required to respond to changes in the market and/or customer preferences in how they use our network (subject to our consultation process being meaningful and effective, and our prices continuing to promote the pricing principles)
Transitional rules	TSS to be submitted under the new rules by 30 June 2015	The **transitional arrangements recognise the extensive consultation already undertaken with customers, stakeholders and the community** under the current rules

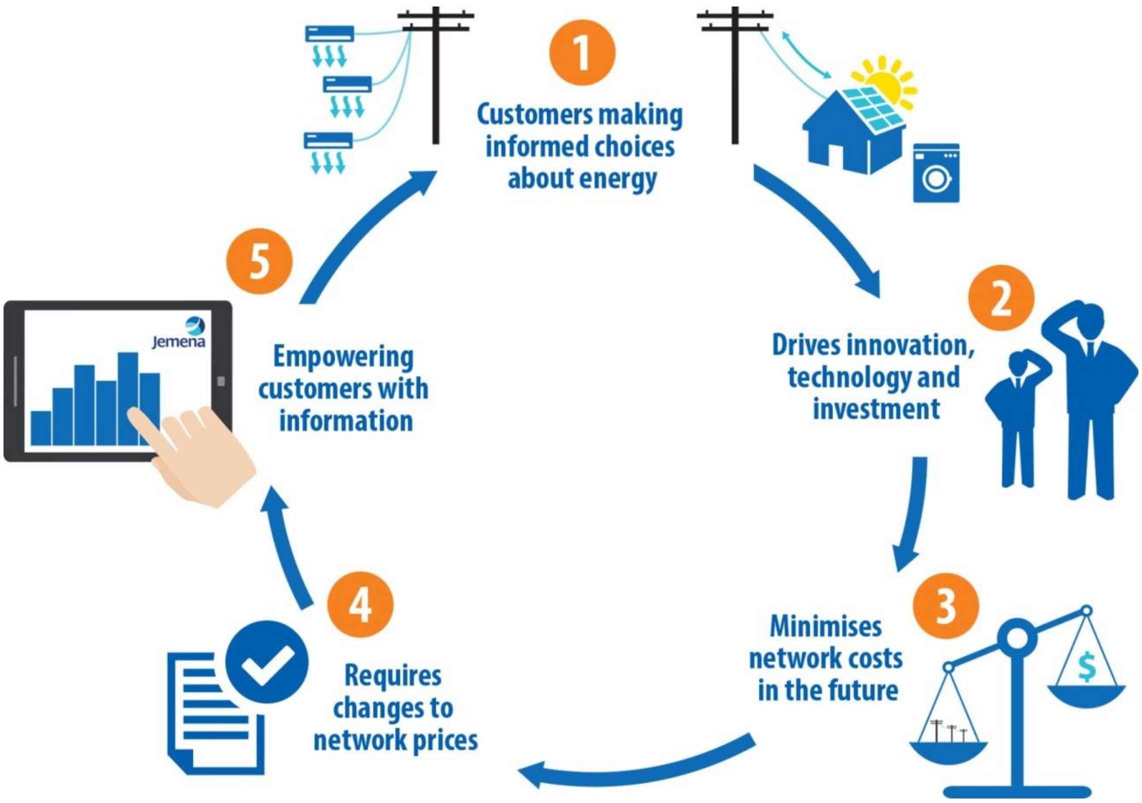
16.

2. DRAFT RULE IS PART OF FACILITATING INFORMED DECISION-MAKING

17. We are focused on ways to encourage more informed customer decision-making about the way energy is used. This can lead to innovation in new technologies and the introduction of new energy market players in previously non-contestable markets. It can also reduce peak demand and make better use of existing network infrastructure. These aspects can lower network costs and customer bills over the medium to long-term.

18. This requires changes to the way we structure prices for using our network. It also requires empowering our customers with information about their energy usage, the impacts of their investments (such as air-conditioning) on our network and the future direction of network prices they are likely to pay for using our network. (Refer Figure 2–1).

Figure 2–1: Facilitating informed energy decision-making



Source: Jemena

19. We support a final determination that facilitates the changes we consider are required to send cost reflective price signals to our customers to encourage informed energy decision-making. We are also looking to it to support the extensive engagement with the community we are undertaking to explain the benefits of cost-reflective pricing, and to understand our customers' priorities and preferences in network pricing.

3. PRICING IS MORE THAN COST-REFLECTIVITY

20. In this section we outline support for:

- a network pricing objective that does not narrowly focus on cost-reflective tariff levels at the expense of other means to give effect to the NEO
- the pricing principles—they facilitate tariff reform while enabling crucial flexibility around the methodology for estimating LRMC and recovery of residual costs.

3.1 NETWORK PRICING OBJECTIVE

21. The AEMC recognises the importance of network pricing keeping pace with the evolution in the way customers use energy, particularly as electricity networks increasingly compete against a range of other technologies and energy market players.

22. A new network pricing objective should promote transparency and improve focus. However, it is important to recognise that with changes occurring in the energy market—including from new technologies and energy market players facilitating off-grid options—there are realistic instances where efficient use of the network (and the NEO) could be facilitated by pricing that encourages customers to maintain a connection, allowing us to share our fixed costs over a larger customer base.

23. Focusing purely on cost reflectivity as a pricing objective may not encourage efficient utilisation of our network nor promote our customers' long-term interests. The network pricing objective should not rule out pricing in a manner to encourage efficient use where this might conflict—to some degree—with pure cost-reflectivity. The AEMC could give effect to this through the pricing principle that encourages residual network costs recovery in a way that promotes efficient network utilisation.

3.2 PRICING PRINCIPLES

24. We support moves toward, and rule support for, cost-reflective tariff structures and levels. The new set of pricing principles facilitates such a shift and will support arrangements to let Victorian customers benefit from their investment in smart meters. The set of principles give effect to this shift in a manner which enables network businesses to recover allowed revenue in a sensible manner, consider customer impacts and comply with jurisdictional limitations (for example, the Victorian Government AMI tariffs order in council).

25. While we support the intent of the draft determination, we consider the pricing principles could be more intuitive and written in a way that reduces potential tensions. In particular, it should be clear that the customer impact principle to 'have regard to the extent to which customers can choose the tariff they are assigned' is a matter for network businesses to consider in designing the *transition* to cost-reflective prices. For example, if a network business is transitioning all customers to a cost-reflective tariff (that is, no ability for customers to choose their tariff), this transition may need to occur over a longer period to mitigate potential price shock. However, this principle should not be interpreted as a requirement for network businesses to indefinitely offer a suite of tariff options to customers.

26. We note that the ENA has provided potential drafting suggestions to the pricing principles and we encourage the AEMC to consider these.

27. The AEMC recognises the importance of providing flexibility to network businesses to determine the LRMC and residual cost recovery methods that reflect the unique operating environments for network businesses. We do not see material advantage in undoing this flexibility via an AER guideline.

4. PRICING PROCESS AND UNDERSTANDING THE PRICING METHODOLOGY

28. In this section we outline:

- our support for a TSS and the AEMC's proposed timing
- why, after specifying the tariff structures and the LRMC methodology, the remainder of the 'pricing methodology' should be communicative and not binding
- why the threshold for changing the TSS needs to reflect the content that is binding and should not be a barrier to efficient tariff outcomes
- why the risks of customers and stakeholders relying on indicative prices needs to be clear.

4.1 WE SUPPORT A TSS AND THE PROPOSED TIMINGS

29. Engaging with our customers and stakeholders is important. Our decisions need to promote our customers' interests, so we want to engage with our customers to understand their needs and involve them in our decision-making. This includes issues related to tariff structures and related information.

30. A well designed TSS is an important element in improving our engagement with our customers and stakeholders and is likely to be a positive influence on the energy market. We see it as an extension to our current activities to better align our services and engagement to the needs of our customers and stakeholders.

31. In addition, we support bringing forward the submission of annual pricing proposals by one month as this is likely to assist retailers, customers and retail market competition. We volunteered such an initiative for JGN.

4.2 A PRICING METHODOLOGY SHOULD BE COMMUNICATIVE AND NON-BINDING

32. In addition to specifying the tariff structures, the draft determination requires network businesses to provide a pricing methodology that sets each tariff in each pricing proposal. This method must comply with the pricing principles and would limit how much network businesses can vary their **tariff levels** from year to year in response to energy market changes.

33. While we recognise the AEMC's intent to provide greater certainty in relative price levels, a binding pricing methodology may inadvertently translate a qualitative assessment—in terms of the 'journey' from LRMC calculations to tariff levels—into a quantitative or formulaic process. We would welcome the AEMC providing clarity on what is meant by a 'pricing methodology'. To do this, it should be clear what a pricing methodology is trying to achieve and what is required to achieve it.

34. The goal of the pricing methodology should be to:

1. facilitate more informed energy decision-making by providing greater transparency about how network businesses set their tariffs—including what they must consider and how the engagement process has

helped this balancing—and greater predictability as to where prices (and relative prices) are likely to move over the period[4]

2. facilitate a timely and predictable annual pricing process.

35. We consulted on and implemented a similar arrangement as part of our JGN access arrangement for 2015-20. We also committed that if there were material changes to these ‘pricing commitments’, we would engage with customers and stakeholders more than 6 months ahead of the new prices taking effect, and our annual price proposal would provide a full explanation of these changes.

4.2.1 A PRICING METHODOLOGY THAT PROVIDES TRANSPARENCY

36. Calculating LRMC values is necessarily methodical and network businesses can describe the method adopted via formulas. The balance of the pricing principles is necessarily a qualitative exercise. This means that transparency of a ‘pricing methodology’ would best be presented in a TSS as:

- a description of, and methodology for, how LRMC is calculated (along with the LRMC estimates)
- a description of how the pricing principles are balanced for each tariff (that is, how we go from LRMC estimate to tariff levels).

37. This would provide customers and stakeholders with transparent information so they can understand how each tariff is calculated and do so in a way that does not unnecessarily impact how network businesses can respond to changes in market conditions, technology and customer preferences.

38. By contrast, locking away a set of relative prices through a mathematical ‘pricing methodology’ may lead to the very situation the AEMC is trying to avoid: that tariff structures and relative levels do not keep pace with how customers use energy. It would essentially lock-in what is a qualitative assessment into quantitative formula.

39. This formulaic approach unnecessarily creates a risk that network tariffs may not respond to changes occurring in the energy market, and may lead to the very situation the AEMC is trying to avoid. It would essentially lock-in what is a qualitative assessment into quantitative formula. Technology advances, jurisdictional requirements, demand elasticities, consumption patterns and customer preferences, occurring after the process to initiate a TSS revision, might all impact what is an appropriate balance of pricing principles (refer to Box 4-1).

40. This risk is exacerbated by the draft determination’s high threshold for changing the TSS (refer section 4.3). In reality a formulaic approach may require more frequent changes to the TSS. Or in some instances it may have the opposite effect of increasingly leading to network businesses ‘setting and forgetting’ their network prices. Indeed, it appears at odds with recent decisions made by the AEMC about avoiding restrictions on retailers’ ability to update their prices under retail market contracts.[5]

41. We note the 22 October 2014 AEMC workshop on the pricing methodology. We appreciate the AEMC leading this initiative to build an understanding of a pricing methodology means. However, we would encourage an avenue for formal consultation should the AEMC’s preference be to, in effect, narrowly define or prescribe a pricing methodology.

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[4] We consulted on and implemented a similar arrangement as part of our JGN access arrangement for 2015-20. We also committed that if there were material changes to these ‘pricing commitments’, we would engage with customers and stakeholders more than 6 months ahead of the new prices taking effect, and our annual price proposal would provide a full explanation of these changes.

[5] The AEMC is currently considering a proposal from a number of consumer groups to impose a ban on retailers from changing their prices during defined-period energy contracts. However, in its draft decision the AEMC decided to improve the information given to consumers including when they will notify customers about price changes, rather than to restrict retailers’ ability to update their prices. The AEMC’s draft decisions indicates that restrictions on the movement of prices may inhibit retailers’ ability to innovate and respond to changing market conditions and could lead to poorer outcomes including higher prices for all customers. AEMC, *Retailer Price Variations in Market Retail Contracts, Draft Determination*, 31 July 14.

Box 4-1 Why a locked-in formulaic pricing methodology could be detrimental to customers

Our energy market is changing and is being driven by four broad interrelated trends:

- in contrast to previous generations (for whom energy was a 'low involvement' product), today's customers increasingly want to have more control over their electricity supply and consumption so they can better manage their energy bills
- the installation of small 'distributed' generation units (such as solar PV units) at our customers' homes and businesses has continued to grow—collectively these have become a significant source of generation
- there is greater interaction and engagement between network businesses and their customers on day-to-day matters, including as a result of changes to the national energy customer framework and the completion of Victoria's smart meter rollout
- there is growing focus on encouraging informed customer decision-making about energy to facilitate innovation in new technologies and new energy market players, reduce peak demand and make better use of existing network infrastructure, and thereby lower network costs passed on in customer bills—as well as a range of technological, policy, regulatory and industry developments that facilitate this.

Together, these trends are driving changes in the roles and responsibilities of energy market players—including our role and the services we provide and the way we interact with the community—as well as changes in the way our customers use our network and pay for our services.

We expect further changes in the way our network is used, as new technologies—such as battery storage, electric vehicles and smart grids—and new market players emerge and develop. It is challenging to predict the pace of technological development. It is more challenging to forecast how, where and when our customers will chose to use these new technologies. This has impacts not only on the design of our network, but also our tariffs.

Examples of changes requiring a rebalance of pricing principles

There are a number of potential changes that would require us to reconsider how the pricing principles are balanced. This might include:

- changes in relative customer demand elasticities that require reconsideration of how residual revenue is recovered. This could be via:
  - changes in the economic climate (for example, an economic downturn or exchange rate variation felt most sharply by a certain customer segment)
  - competitive technologies, such as the increased viability of battery storage in combination with distributed generation, allowing certain customer segments to be self-sufficient off-grid—this might mean a network business may improve the efficient use of the network by providing price incentives for customers to maintain a connection and therefore sharing fixed costs more widely
  - a rapid change in customer awareness of energy pricing and cost savings behaviours (for example following a government education campaign)
- changes to jurisdictional requirements, such as the Victorian AMI tariff order in council that requires all customers to be offered a flat tariff option. This requirement could cease, be extended or replaced with new requirements. An efficient rebalance of the pricing principles might be required to react to any change in a timely manner. For example, this could be to comply with the requirements provide incentives to move to cost reflective tariffs.
- where retailers may not pass network pricing signals through to customers—for example, retailers may package network prices such that final energy prices peak at different times to network prices, such that network price signals are diluted—this might require reconsideration of how to give effect to the customer impact (and ability to understand price signals) pricing principle.

4.2.2 FACILITATING A STREAMLINED ANNUAL PROCESS

42. We understand that the AEMC's intention to steer any AER qualitative decisions away from annual pricing proposals and for these to be made at the time of the approval of the TSS (or any revision).

43. To support this, the new rules should divide the TSS into binding and non-binding elements. This would ensure the TSS gives stakeholders and consumers the information they need while giving network businesses flexibility to make changes that best reflect the pricing principles in the NER and revenue and pricing principles in the NEL.

44. This can best be achieved via a process where:

- at the TSS approval stage (stage 1), the AER approves:
  - tariff structures comply with the pricing principles
  - the pricing methodology complies with the pricing principles and enables a customer/stakeholder to understand how tariff levels have been arrived at (including the journey from LRMC to tariff level)
- at the annual pricing proposal stage (stage 2), the AER checks:
  - tariff structures are consistent with the TSS
  - tariff levels are calculated in accordance with the price control formula
  - tariff levels are set according to the previous description of how pricing principles are to be balanced—they can only depart to the extent necessary to give better effect to the pricing principles and where this has been made transparent by the network business in its annual pricing proposal
  - that instances where actual tariffs materially vary from indicative tariffs are explained.

45. Network businesses should own their pricing decisions—and the AEMC recognises this. But a 'locked in' mathematical formula (after the LRMC calculation) provides no further information to the AER to support whether the balance of pricing principles is appropriate—only that they were appropriate at one point in time, which could be up to six and a half years earlier when the TSS is first developed for that regulatory period.

46. A communicative description of how the principles are balanced (post LRMC calculation) can focus on demonstrating the different tensions that businesses must manage for each tariff with guidance on how the business intends to manage these tensions over the regulatory period. This would provide meaningful information to the AER to approve a TSS and annual pricing proposals

47. The effect of the above breakdown in stage 1 and stage 2 is that the rules would better accommodate instances outlined in Box 4-1.

48. Allowing network businesses to make efficient changes to how it balances the pricing principles following the LRMC estimate also reduces the regulatory burden from amending the TSS. While the AER would have extra checks when reviewing the annual pricing proposal, this is unlikely to be burdensome because:

- it is unlikely that network businesses would seek wholesale changes on an annual basis (and these would be unlikely to better meet customer impact principles anyway)
- the AER could reject the change if it did not consider the network business had been transparent about the departure from the original method or had not made a clear case in terms of the pricing principles and the NEO.

49. This approach puts the emphasis on the network business to make the case for amendments.

50. Under the draft rule change, customers and stakeholders have an unprecedented level of targeted and valuable information in the TSS—including indicative prices and how network businesses balance pricing principles. Similar to the proposed national energy retail rule change[6], locking in a formulaic method inhibits whether network businesses' can effectively respond to changing market conditions (refer Box 4-1) and could lead to poorer customer price signals and make it harder for those customers to make informed decisions that support efficient network costs.

4.3 THRESHOLD FOR CHANGING TSS NOT CONSISTENT WITH BINDING PRICE METHODOLOGIES

51. The draft rule limits the ability for network businesses to amend a TSS to where:

- there is an event beyond the reasonable control of the network business and not reasonably foreseen by the network business
- the amendments would, or would be likely to, result in a TSS that materially better complies with the pricing principles and other NER requirements than the current TSS.

52. It is reasonable that any amendment must better comply with the pricing principles and other NER requirements. However, this, combined with a meaningful and effective engagement process, should be a sufficient test to amend the TSS. The first criteria above, that the event is not foreseen and is outside the reasonable control of the network business, would only serve to prevent efficient tariffs and structures from being given effect. Given the AER's intention to apply a revenue cap in future network determinations[7], this high threshold would primarily serve to penalise customers.

53. Should it seek to retain a high threshold for changing tariff structures, the AEMC should consider a lower threshold (relating to the engagement process and the proposal better complying with the pricing principles) for changes to the pricing methodology.

4.4 RISKS OF PROVIDING INDICATIVE PRICES

54. The draft rule requires network businesses to publish a full schedule of indicative network use of system (**NUoS**) charges for the remaining years of a regulatory period.

55. We recognise that customers and retailers value guidance on the future network prices. However, providing five years of indicative prices could mislead customers and stakeholders given that it is highly challenging to forecast NUoS charges, in the same way it is challenging for retailers to forecast retail prices given they have little control over network prices.

56. To satisfy the draft rule we would have to forecast many elements of NUoS—which is a significant concern. These indicative prices would invariably prove to be wrong due to the volatility of pass through items such as transmission use of system charges.

57. Customers should not rely on this information to make business or technology investment decisions without an understanding of the potential volatility between an indicative and final price. The AEMC should acknowledge these risks and caution any customer from relying on these to make investment or other decisions.

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[6] AEMC, Retailer Price Variations in Market Retail Contracts, Draft Determination, 31 July 14.

[7] See for example, AER, Preliminary positions on replacement framework and approach for Victorian businesses – May 2014.

58. In particular, the draft rule refers to indicative prices as a 'pricing schedule'. To reduce the risk that customers and stakeholders rely too heavily upon the schedule, it should, as a minimum, be called an 'indicative price projections'.

59. Sufficient tariff level certainty and predictability can be provided to customers using an approach like that used in JGN's TSS that provides:

- proposed x-factors and the expected price path for different customer groups for the regulatory period
- expectations of whether each tariff component would move more or less than the average price change for that customer group
- a clear outline of how any transition to new tariffs and/or tariff structures would occur
- bill impact information for typical customer archetypes
- commitments to engage with customers prior to varying from the above expectations
- commitments to explain within the annual pricing proposal any differences between the indicative prices and proposed prices so that these can be understood by stakeholders and customers—over time this would also enable customers and stakeholders to recognise the drivers or any variation between indicative prices and those in annual pricing proposals.[8]

60. We provided this level of detail on indicative prices to retailer, government and customer representatives at our JEN October 2014 pricing workshop. This was set out in an 'our approach to pricing' document circulated prior to the meeting.[9] We surveyed attendees whether the information in the document was a useful basis for a TSS. Approximately 95% of respondents to the survey considered it was either 'somewhat useful', 'quite useful' or 'very useful'.[10]

8 An approach where network businesses explain any variance between the statement and annual pricing proposal would be analogous to the approach that the AEMC adopted for the guidelines implemented by the AER better regulation program; the AER is not bound by the guidelines but, if the AER makes a distribution determination that is not in accordance with the guideline, it must state reasons for departing from it (refer National Electricity Rules section 6.2.8(c)).

9 Jemena Electricity Networks, 'Our approach to pricing'

10 Of 19 respondents to the survey, 4 responded as 'somewhat useful, 11 responded as 'quite useful' and 3 responded as 'very useful'.

5. TRANSITIONING TO NEW RULES WITH CARE

61. We support the need to transition to the new arrangements, recognising the desire to realise the benefits of the rule change as soon as practicable.

62. As with some other networks, we are already consulting on our upcoming price review proposal, due to the AER by 30 April 2014. This included consulting in May 2014 on application of the current pricing principles (under the existing rules) and in October 2014 on how the new principles would apply. With one engagement process there are risks for us in seeking to comply with both sets of rules. We could restart our consultation; however in light of potential consultation fatigue for our customers and stakeholders and the cost of re-running this process, offering separate consultation on TSS arrangements are unlikely to be well received or successful.

63. To resolve this, the transitional rules and final determination should recognise that network businesses may have already commenced consultation under the previous rules and that this may not be as extensive as businesses would undertake if the new rules applied from the start. Further, extending the timeframe for submitting a TSS with a new engagement program risks consultation fatigue for customers and stakeholders, some of which are trying to engage with multiple network businesses simultaneously.

64. The transitional rules should recognise timing and consultation limits on network businesses to develop an initial TSS. In particular, the transitional arrangements and AEMC draft determination should recognise that the consultation may have already commenced under previous rules when the AER considers compliance with draft rule 6.8.2.