



## **Reflecting prices and preferences:**

**PIAC submission to the AEMC's Consultation Paper  
*National Electricity Amendment (Distribution Network  
Pricing Arrangements) Rule 2014***

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**Energy + Water Consumers' Advocacy Program**



## **The Public Interest Advocacy Centre**

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights; and
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from Trade and Investment, Regional Infrastructure and Services NSW for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

## **Energy + Water Consumers' Advocacy Program**

This program was established at PIAC as the Utilities Consumers' Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- St Vincent de Paul (NSW);
- Ethnic Communities Council NSW;
- Rural and remote consumers;
- Retirement Villages Residents Association;
- Physical Disability Council NSW; and
- Affiliated Residential Park Residents Association.

# 1. Introduction

This submission responds to the Australian Energy Market Commission (AEMC) Consultation Paper for the National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014 (the Consultation Paper). The Consultation Paper is part of the AEMC's consolidated examination of similar rule change proposals submitted by the NSW Independent Pricing and Regulatory Tribunal (IPART) and the Standing Council on Energy and Resources (SCER). The AEMC began consultation on IPART's proposed rule change in mid-2013 and PIAC made a submission in response to an Initial Consultation Paper in July. The AEMC then received a similar rule change proposal from SCER. Given both proposals 'raised issues that overlap',<sup>1</sup> the AEMC has decided to consolidate the two rule change proposals.

The issues from the Consultation Paper, which PIAC wishes to raise, fall into two broad categories. Firstly, those related to increasing the place and consideration of consumers in network tariff-setting processes. These include the issue of considering the impact of tariffs on consumers and consultation with consumers about network tariff design, including the information provided by Distribution Network Service Providers (DNSPs) as a basis for this consultation.

The second category relates to the issue of more cost-reflective network tariffs. PIAC believes that while there are potential benefits from such a change to pricing structures, there may be risks to residential consumers depending on:

- how cost reflective prices are targeted to various customer classes;
- how retail offers are tailored;
- whether consumers can avoid disadvantage through a choice of product offering; and
- whether the interactions between retailers and networks deliver positive outcomes for those with limited discretionary consumption.

PIAC accepts that cost-reflective pricing of network services could be used to send price signals to consumers about where excess capacity exists in the network. However, PIAC firmly believes that residential customers in isolated regions of NSW should not face increased network charges as a result of their location, as might happen if certain cost-reflective models were adopted. In a practical sense, it is not possible for consumers to make a decision about where they consume and move their location in order to access lower energy prices.

PIAC also submits that an important aspect of the issues considered in the Consultation Paper is the fact that retailers currently have discretion about the way in which they pass on network tariffs. As a result, there is no guarantee that network tariffs, designed to send signals to consumers about the costs of certain behaviour, will be passed through by retailers in a way that preserves these signals. While PIAC understands that this issue is beyond the scope of the current review, it will nonetheless have a significant impact on the potential effectiveness of any proposed changes. PIAC, therefore, argues that it must be fully examined by the AEMC before any proposed changes are implemented.

PIAC welcomes the SCER proposal to require DNSPs to consult on their tariffs and to consider the impact of their proposed prices on consumers. However, having such a requirement does not guarantee improved outcomes for consumers. Rather, to deliver improved outcomes for residential consumers, it is important that DNSPs act in a way that benefits consumers (generally

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<sup>1</sup> AEMC, *Distribution Network Pricing Arrangements: Consultation Paper*, 14 November 2013, 21.

through lower prices). Similarly, consultation, even well-run and effective consultation, is far less valuable if networks fail to heed the results of the consultation process.

Network charges make up around 50% of a typical NSW residential electricity bill. PIAC broadly supports the aim to bring increased pricing rigour to this component, or to give consumers a chance to reduce their bills through lower consumption. However, it is difficult to give more specific support at this stage, as the many variables discussed in the Consultation Paper prevent a firm assessment of how various residential consumer groups may be affected. PIAC recommends that the later stages of this process include some worked examples of the pricing through the supply chain. This will enable stakeholders to gain a practical understanding of whether operations necessitated by potential changes can meet the objectives upon implementation. It will also provide some insight into the potential for any unintended negative consequences.

## **2. Consumers consultation and impacts**

### **2.1 Consultation on network tariff structures**

The Consultation Paper notes SCER's assertion that 'stakeholders such as end-use consumers and retailers are particularly affected by the choices that DNSPs make in relation to their tariff structures'.<sup>2</sup> For example, where these prices change, consumers may wish to vary their consumption behaviour in response to this change. However, decisions such as investing in new appliances often cannot be made and implemented in the short term, meaning consumers require a greater degree of certainty about future prices in order to plan their responses accordingly. Currently, information about tariff structures that is made available contains 'the least amount of detail about how network prices will impact a consumer',<sup>3</sup> making such decisions difficult.

To overcome this issue, the proposals by SCER and IPART both seek to achieve:

- greater consultation in the development of network tariffs; and
- greater pricing certainty regarding network tariff structures and network tariff pricing.<sup>4</sup>

### **2.2 DNSP Pricing Structures Statement**

Both rule change proposals 'seek to achieve this consultation and pricing certainty through the concept of a document, developed in advance of the annual network pricing process'.<sup>5</sup> The so-called Pricing Structures Statement (PSS) would set out network tariffs in advance of the annual pricing process and would be able to serve as the basis for consultation with end users and other stakeholders.

PIAC supports the introduction of an annual PSS. One of the hurdles that must be overcome when seeking to engage consumers about matters related to energy network price determinations is that the issues are both extremely complex and not well understood by many consumers. PIAC believes that in order to provide a basis for meaningful consumer engagement, the PSS will need to have a reasonable level of detail. Accordingly, PIAC recommends that the

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<sup>2</sup> Ibid, 11.

<sup>3</sup> Ibid, 27.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

PSS should be accompanied by a plain language summary/explanation to assist engagement with end users who are not familiar with the issues in question.

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**Recommendation 1**

*PIAC recommends that the DNSPs be required to produce both an annual Pricing Structures Statement and an accompanying summary/explanation written in plain language and accessible to consumers who are not familiar with energy network regulation.*

However, as noted in the Consultation Paper, the effectiveness of the PSS will depend to a large extent on the two key variables.<sup>6</sup> Firstly, the extent to which the document is binding or is able to be varied by DNSPs. Secondly, the content of the PSS and the amount of detail that it provides on network tariffs. In both cases, there is a trade-off between the value of certainty from consumers and the risk to DNSPs from a lack of flexibility.

### **2.2.1 The binding nature of the PSS**

The Consultation Paper notes that there are two broad elements to the question of how binding the PSS is on DNSPs. The first is how often DNSPs can alter the PSS and the second is whether the PSS is binding on final tariff levels.<sup>7</sup>

#### **2.2.1.1 Timetable for a new PSS**

The Consultation Paper notes that if a PSS that is developed at the start of a regulatory control period remains in force for five years, and DNSPs cannot vary their tariffs during this time, there is a risk that DNSPs will under-recover their required revenue.<sup>8</sup> However, the variability or otherwise of the PSS is not the only factor in this equation. Transmission network service providers (TNSPs), for example, are only able to vary their prices at the start of a determination period.<sup>9</sup> Similarly, under a weighted average price cap, DNSPs' prices are largely fixed for the period of a price determination. Alternatively, under a revenue cap, DNSP prices are adjusted annually in line with revisions in demand forecasts. Under this scenario, it would be impractical for the PSS to be more binding than the overall method of price control put in place by the AER.

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**Recommendation 2**

*PIAC recommends that DNSPs be required to produce a PSS each year before their annual tariff variations and that this PSS is developed in time to allow it to be used as a basis for consultation in developing tariffs for the upcoming year.*

#### **2.2.1.2 Scope for DNSPs to deviate from PSS**

The second variable is the extent to which the PSS is binding on network prices. In this instance, there is a trade-off between certainty for retailers and consumers on one hand and risks for DNSPs on the other. That is, if DNSPs are bound by the PSS, there are potentially financial risks for them.

PIAC takes the view that broad accuracy in a timely manner is more useful to consumers than complete accuracy at a later stage or a binding price that includes a risk premium. Accordingly, PIAC recommends that DNSPs should be able to make one adjustment to their tariffs within a

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<sup>6</sup> Ibid, 30.

<sup>7</sup> Ibid, 34.

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

small percentage of the price contained in a PSS, without penalty. The maximum permitted quantum of this variation should be determined by the AEMC, with input invited from all interested stakeholders.

In addition, where DNSPs vary their prices from the PSS within the permitted margin, they should be required to publicise this price change and the reason for it. This should appear on the homepage of the DNSP's website.

As previously noted, DNSPs will also be constrained by the overall price controls put in place by the AER, limiting the risk to consumers from a PSS that is not completely binding on DNSPs.

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### **Recommendation 3**

*PIAC recommends that DNSPs be able to make one variation to prices contained in their PSS within a small percentage without penalty.*

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### **Recommendation 4**

*PIAC recommends that the AEMC determine an appropriate band within which DNSPs can deviate from the annual prices in their PSS. This process should include the opportunity for stakeholders to provide input.*

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### **Recommendation 5**

*PIAC recommends that where DNSPs vary their prices from their annual PSS, they should be required to publish a statement outlining the variation and the reasons for it on the home page of their website.*

## **2.2.2 Content of the PSS**

SCER's rule change request outlines a number of proposals about information that the PSS could contain. This includes issues related to:

- how DNSPs have met the pricing principles;
- expected trends in costs;
- how customer consultation and certain constraints have shaped DNSP tariffs; and
- expected customer impacts by class.<sup>10</sup>

PIAC supports all SCER's proposed inclusions in the proposed PSS. PIAC would especially welcome a requirement for DNSPs to show how consumer consultation has influenced proposed tariffs. The Consultation Paper notes that currently there is 'no requirement [for DNSPs] to consult on network tariff structures or on network tariff pricing levels'.<sup>11</sup> Both SCER and IPART have noted in their rule change proposals that this lack of consultation, including in relation to annual tariff variations, means that DNSPs do not receive valuable information on the potential effectiveness of the proposed network prices, including the extent to which consumers may respond to intended pricing signals.<sup>12</sup>

PIAC is strongly in favour of requiring DNSPs to increase their levels of consumer engagement. However, PIAC also submits that participating in the consumer engagement processes of DNSPs must be worthwhile for consumers and their representatives. Given the complexity of network

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<sup>10</sup> AEMC, above n 1, 43.

<sup>11</sup> Ibid, 37

<sup>12</sup> Ibid.

pricing arrangements, engaging meaningfully in these processes can require a significant investment of time and resources on behalf of consumers and their representatives.

PIAC recommended in its submission in response to the AEMC's Initial Consultation Paper for IPART's rule change proposal that DNSPs be required to show how they have considered feedback from residential consumers in developing their network pricing proposals and annual variations to network tariffs. PIAC, therefore, recommends that the PSS be required to include information on how customer consultation has shaped DNSP tariffs, as well as the other requirements contained in SCERs rule change request.

### ***Recommendation 6***

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*PIAC recommends that DNSPs be required to include in their PSS all the information proposed by SCER in its rule change request.*

#### **2.2.2.2 Specific details of tariff information in the PSS**

The Consultation Paper canvasses a number of levels of detail about tariffs that could be included in the PSS. In order of increasing level of detail, a PSS could contain information about:

- tariff structures (eg flat, including-block, time of use);
- charging elements, such as fixed and variable tariff components and the cost each component seeks to recover;
- the way network costs are allocated to each charging element; and
- the level of each tariff component in a given year.<sup>13</sup>

PIAC agrees with the AEMC that the greater the level of detail provided to consumers, the stronger the foundation for consumer engagement. PIAC, therefore, favours requiring DNSPs to include information in their PSS in the four categories outlined above, thereby providing consumers with the maximum amount of detail about their annual prices.

In addition, retailers and consumers will seek to respond to tariffs as soon as they have the necessary level of confidence that tariffs are set for a given period. Accordingly, the earlier this confidence is gained (possibly through the publication of a PSS), the sooner consumers can make decisions about their own investment and consumption. However, PIAC also notes that consumers are unlikely to believe they have such certainty until they know how network tariffs will be passed through to residential consumers' bills by their retailer.

PIAC also notes that if DNSPs were required to produce detailed tariff documents well in advance of tariffs taking effect, DNSPs may bear increasing risk (subject to how binding the PSS is on them). Where possible, suppliers generally respond to uncertainty by including a risk premium in their prices. As a result, consumers pay higher prices to offset the risk to the supplier of lower prices or volumes in the future. However, PIAC submits that in the case of the regulated monopolies of DNSPs, the AER seeks to set DNSP revenue at efficient levels. Under these circumstances, PIAC submits that the DNSPs should not need—or be able to—include a premium in network tariffs to compensate for the risk of having to finalise their prices further in advance.

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<sup>13</sup> Ibid, 31.

### ***Recommendation 7***

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*PIAC recommends that DNSPs be required to include in their PSS tariff information outlining: tariff structures; charging elements; cost allocation to different charging elements; and tariff levels.*

## **2.3 Consideration of the impact of network tariff changes on consumers**

SCER notes in its rule change proposal that any move to cost-reflective pricing will potentially expose some consumers to ‘new and different network tariff structures’.<sup>14</sup> Currently, the network pricing principles in the National Energy Rules (NER) require DNSPs to ‘have regard to whether a consumer is able or likely to respond to network price signals’.<sup>15</sup> According to the Consultation Paper, SCER suggests that this requirement may be interpreted by DNSPs to mean that network tariffs should be set in a way that ‘matched the price responsiveness of consumers [rather than] ‘considering the impact ...[on] those with a limited capacity to respond to proposed pricing options.’<sup>16</sup>

Like SCER, PIAC is extremely concerned about the possibility that network costs will be shifted onto those with little or no discretion to respond to price signals by varying their consumption. Currently, the flat fixed charge, which most residential consumers pay, limits the ability of consumers to reduce their bills through reducing consumption.

SCER’s proposed solution to this issue is to replace the existing distribution pricing principle with a requirement for DNSPs to ‘have regard to how their proposed tariff structures and prices may impact on different classes of consumers’.<sup>17</sup> In addition, SCER suggests that DNSPs will need to engage in appropriate consultation to meet this requirement.

PIAC welcomes an increased requirement on DNSPs to consider the impact of their prices on different consumer groups. However, PIAC submits that it is important that network tariffs are set in a way that allows all consumers to respond to price signals and reduce their bills through lowering consumption. This is not possible if DNSP tariffs are set in a way that mean fixed charges are a large proportion of a consumer’s bill. PIAC, therefore, recommends that DNSPs be required to set network tariffs in a way that allows all consumers to reduce their energy bills through lower consumption.

### ***Recommendation 8***

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*PIAC recommends that DNSPs be required to develop tariffs that allow all consumers to reduce their energy bills through lower consumption.*

#### **2.3.2 Multiple network tariffs for each class**

PIAC submits that there is merit in requiring DNSPs to develop multiple network tariffs that may align with customer requirements. For instance, a network tariff for consumers with high consumption profiles due to large-scale air conditioning systems. This would potentially create scope for retailers to package a range of offers, reduce cross subsidies and increase product innovation. In this situation, PIAC anticipates that as part of a suite of options, DNSPs could offer

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<sup>14</sup> AEMC, above n 1, 15.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

a tariff that presents a ‘safe haven’ option for those consumers with little discretionary usage (ie, an offer with modest fixed and variable components in recognition of their modest use of the system).

PIAC notes that NER states that a DNSP’s pricing proposal must ‘set out the proposed tariffs for each tariff class.’<sup>18</sup> PIAC recommends that the AEMC consider whether this provision allows DNSPs to produce multiple tariffs within a tariff class, and what amendments to the NER or other instruments may be necessary to encourage DNSPs to offer multiple tariffs within a tariff class.

### **Recommendation 9**

*PIAC recommends that the AEMC examine the issue of DNSPs offering multiple tariffs within tariff classes, including the issue of whether this is permitted within the current NER and what action might be required to encourage DNSPs to make such offerings.*

## **2.4 Timing of tariff changes**

Another aspect of the consolidated rule change relates to the timing of the release of network tariffs. SCER’s rule change proposal would ‘allow earlier notification of approved annual network tariffs’ but does not provide details about how the timing should be altered.<sup>19</sup> The timing of the approvals process is, however, dealt with in some detail in IPART’s proposal. This includes a timeline for the approval of transmission network prices, consideration of DNSPs’ pricing proposals by regulators and approval of those proposals.

In its response to the AEMC’s Initial Consultation Paper, PIAC raised concerns about IPART’s proposal to allow the Australian Energy Regulator (AER) only 20 business days to approve DNSP’s proposed prices.<sup>20</sup> In particular, PIAC is concerned that the proposal to set a limit on the time the AER has to approve DNSP pricing proposals may mean it is not able to scrutinise these proposals as closely as it can under current arrangements. The Consultation Paper notes that the proposed requirement would take away the flexibility currently afforded to the AER in assessing DNSPs’ pricing proposals and would ‘limit the AER’s ability to request further information from the DNSP on their modelling or data, unless the process had commenced much earlier’.<sup>21</sup> In addition, there are ‘risks from the AER having to approve network prices within a limited timeframe,’<sup>22</sup> including an increased possibility that inflated revenue proposals will not be challenged. In PIAC’s view, these risks are increased by the fact that the AER must approve annual pricing proposals of eight DNSPs at the same time.<sup>23</sup>

PIAC notes that in its submission in response to the AEMC’s Initial Consultation Paper, the AER suggested a 30 business day limit with an additional provision that would allow the AER more time to scrutinise a complicated proposal if needed (described as a ‘stop the clock’ provision).<sup>24</sup> PIAC believes this proposal strikes an appropriate balance between providing certainty about the timetable for the approvals process and avoiding the risk that the AER will not be able to properly scrutinise a DNSP proposal.

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<sup>18</sup> NER cl 6.18.3 (b) (2).

<sup>19</sup> AEMC, above n 1, 12.

<sup>20</sup> Santow, E, *PIAC Submission to AEMC on Distribution Network Pricing Arrangements: Consultation Paper* (Letter to John Pierce), 3 July 2013, 2.

<sup>21</sup> AEMC, *Distribution Network Pricing Arrangements: Consultation Paper*, 6 June 2013, 21.16.

<sup>22</sup> *Ibid*, 8.

<sup>23</sup> *Ibid*, 15.

<sup>24</sup> AER, *Rule changes: Annual network pricing arrangements. AER submission to consultation paper*, 2013, 3.

PIAC also notes that any movement forward in the timetable for the AER's approval of DNSP prices will require a similar adjustment to the timetable for setting TNSP prices. Once again, it is critical to effective regulation of monopoly services, in the long-term interests of consumers, that the AER has sufficient time to undertake this task. It is also important that DNSPs have timely access to all of the information they need to develop tariffs in line with their cost structures.

As previously stated, network prices have a significant impact on final bills for residential consumers, representing around 50% of a typical small customer's bill in NSW, according to IPART.<sup>25</sup> It is therefore extremely important that DNSPs' pricing proposals are carefully assessed.

### **Recommendation 10**

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*PIAC recommends that the AEMC develop a timetable for the approval of annual DNSP prices that allows the AER at least 30 business days to scrutinise pricing proposals, with the option to take additional time if required.*

## **3. Cost-reflective network tariffs and new network pricing principles**

### **3.1 Potential losers from the introduction of cost-reflective pricing**

Before making any comment on elements of the proposed rule change that relate to the introduction of more cost-reflective pricing, PIAC wishes to highlight that such a change may pose dangers for certain consumers. Given electricity is an essential service, PIAC is wary about any changes that would lead to increases in prices for groups of residential consumers. As previously stated, the SCER rule change proposal aims to strengthen the 'guidance on DNSPs to set cost reflective network tariffs'.<sup>26</sup> The Consultation Paper further states that that consumption decisions are affected by the choices consumers make about when, where and how they consume energy.<sup>27</sup>

PIAC has concerns about the possibility that cost-reflective pricing would be used as an argument to charge dramatically higher network prices to consumers who live in rural, regional and remote areas. Residents in the Essential Energy area of NSW already pay higher prices than their counterparts in the two more urban-based NSW network areas, and a change to more 'cost-reflective' pricing may compound this effect significantly. PIAC, therefore, argues that the principle of cost-reflective pricing should not extend to charging residential customers based on their relative isolation from generation assets and the associated cost of transporting energy to them.

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<sup>25</sup> IPART, *Review of regulated retail prices and charges for electricity from 1 July 2013 to 30 June 2016: Final report*, 2013, 18.

<sup>26</sup> Ibid, 54.

<sup>27</sup> Ibid, 54.

### 3.2 LRMC as a basis for network pricing

The current distribution pricing principles contained in the National Electricity Rules require DNSPs to ‘take into account the long run marginal cost for the service’.<sup>28</sup> However, SCER’s proposal notes that ‘this discretionary principle has not led to DNSPs setting efficient network tariffs’ based on LRMC.<sup>29</sup>

To address this issue, SCER’s proposed rule change contains amendments to the network pricing principles to place an obligation on DNSPs to set cost reflective network tariffs through the use of LRMC as the basis for those tariffs. LRMC would be used as the basis for the variable component of network tariffs. The Consultation Paper states that this would ‘signal to consumers the future (or avoidable) costs of providing network services’.<sup>30</sup> For example, a lower variable component of tariffs in certain areas would signal to consumers that excess capacity exists in certain parts of the grid, meaning the LRMC of extra consumption is low.

PIAC accepts that there is some merit in sending these signals to consumers. However, PIAC takes the view that such signals will, in all likelihood, only be followed by large industrial users. Even in these cases, given the transaction costs of relocating existing production, PIAC anticipates that only new industrial facilities would be in a position to base decisions about their location to take up advantageous energy tariffs.

PIAC does not believe that residential consumers will move around the National Energy Market (NEM), or even within different network areas, in search of areas of high excess network capacity. Apart from the reality of residential consumers having lives in particular areas that they are not inclined to leave, in a pure economic sense the cost of relocation would outweigh and benefits from lower prices.

### 3.3 Recovery of residual network costs

While SCER has proposed that LRMC be used to recover variable costs, the Consultation Paper notes that ‘residual sunk costs of the network must also be recovered, otherwise the financial sustainability of the DNSP may be compromised’.<sup>31</sup> SCER has proposed retaining the existing network pricing principle that states that a DNSP should recover expected revenue with ‘minimum distortion to efficient patterns of consumption’.<sup>32</sup>

The Consultation Paper notes that this can be done through two possible approaches: Ramsey pricing and postage stamp pricing.<sup>33</sup> SCER has suggested that multiple approaches could be permitted in the NER.

At this time, PIAC is not in a position to suggest which approach is best or whether it should be mandatory. However, PIAC would like to highlight that there is a need to analyse how various options will work in practice—taking account of the current regulatory framework, the timelines and the resources at hand. This is a necessary step in highlighting any unintended consequences that may impact on the intention of the Rule Change.

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<sup>28</sup> NER cl 6.18.5 (b) (1).

<sup>29</sup> AEMC, above n 1, 56.

<sup>30</sup> Ibid, 54.

<sup>31</sup> AEMC, above n 1, 63.

<sup>32</sup> Ibid; NER cl 6.18.5 (c)

<sup>33</sup> AEMC, above n 1, 64.

Additionally, if the outcome of this rule change requires the AER to determine the best course of action for each regulatory reset, or that it produces a guideline, it is important to assess whether the AER has sufficient time and resources to undertake this task in a manner that produces a quality outcome. While PIAC understands that flexibility in the NER may be beneficial, time and resource constraints and information asymmetries often mean processes are constrained in achieving outcomes that are in consumers' best interests.

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### **Recommendation 11**

*PIAC recommends that the AEMC examine and report on the effects and price impacts of DNSPs using different methodologies to recover residual revenue.*

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### **Recommendation 12**

*PIAC recommends that if the AER is required to determine the approach DNSPs must adopt to recover residual revenue, the AEMC should ensure the AER is given a reasonable timeframe to do so. PIAC also recommends that the AER be given additional resources where rule change decisions increase its responsibilities.*

## **3.4 Compliance with jurisdictional instruments**

One of the additional changes to the distribution pricing principles proposed by SCER is the inclusion of a requirement for DNSPs to comply with jurisdictional instruments when developing their network tariffs and prices.<sup>34</sup> The Consultation Paper notes that if the pricing principles related to the use of LRMC were to become mandatory, as proposed by SCER, it may create circumstances where DNSPs cannot comply with both requirements. The AEMC suggests that the NER should state that where this is the case, jurisdictional requirements take precedence over the use of LRMC in developing network tariffs.<sup>35</sup>

PIAC recommends that where jurisdictional instruments have taken precedence in the development of network tariffs that the DNSP include this information in its PSS. DNSPs should include a calculation of the price impact of using jurisdictional instruments over the distribution pricing principles. This would create a transparent process and increase consumers' ability to understand the framework the DNSPs must adhere to in developing their prices.

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### **Recommendation 13**

*PIAC recommends that if DNSPs must adhere to jurisdictional instruments over the distribution pricing principles, this information, including its price impact, should be included in the PSS.*

## **3.5 Changes to side constraints on tariff changes**

Currently, there are various constraints on increases to network tariffs within a regulatory control period. These relate to issues including the rebalancing of tariffs within a tariff class as well as overall increases. These provisions, known as side constraints, 'are intended to limit the magnitude of tariff changes from year to year, thereby reducing price shocks for consumers'.<sup>36</sup> Side constraints do not exist in the year that one regulatory control period ends and another commences.

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<sup>34</sup> Ibid, 65.

<sup>35</sup> Ibid, 66.

<sup>36</sup> Ibid, 71.

In its rule change request, SCER has proposed 'extending the application of existing side constraints so they apply across regulatory periods.'<sup>37</sup> This requirement would reduce the possibility of bill shock in the transition from one regulatory period to the next. Importantly, it would also 'aim to ensure that the prevailing prices at the end of each regulatory period form the basis of those at the beginning of the next period.'<sup>38</sup>

PIAC believes that SCER's proposal would help place downward pressure on prices and, therefore, be positive for consumers. PIAC notes that the Consultation Paper asserts that other elements of SCER's proposed rule change may have the effect of requiring DNSPs to meet side constraints at the start of a regulatory control period, meaning an explicit provision may not be necessary. For example, 'implementing a PSS may itself allow sufficient regulatory control over the movement of prices between periods to make further side constraints unnecessary.'<sup>39</sup>

While PIAC understand the logic behind minimising duplicative regulatory measures, in this instance PIAC believes consumers would be best served by the inclusion of an explicit requirement as proposed by SCER. This measure would create greater certainty for consumers that price shocks will be kept as low as possible from one regulatory control period to the next.

#### ***Recommendation 14***

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*PIAC recommends that side constraints on network tariffs be applied from one regulatory period to the next, as proposed by SCER.*

### **3.6 Sending network pricing signals through retail tariffs**

PIAC notes that because end users pay for network services through their retailers, there is no guarantee that a network tariff will be passed through in a way that sends the intended price signals to consumers. As the Consultation Paper notes, the 'extent to which efficient price signals will result in lower future network costs will depend on a number of factors, for example, the extent to which these signals are passed through by retailers in retail tariffs.'<sup>40</sup>

Retailers have discretion to re-design network tariffs in developing the prices that are offered to consumers. PIAC submits that the AEMC should, therefore, consult with retailers about the likelihood that retailers will pass through network tariffs to consumers in a manner that aligns with the intention of this rule change process. PIAC takes the view that it will be necessary to monitor future retail offerings to assess whether this outcome is achieved. If it is not achieved, amendments to the regulatory framework may be required.

#### ***Recommendation 15***

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*PIAC recommends that the AEMC consult with retailers about the likelihood that retailers will pass through network tariffs to consumers in a manner that aligns with the intention of this rule change process.*

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<sup>37</sup> Ibid, 72.

<sup>38</sup> Ibid.

<sup>39</sup> Ibid.

<sup>40</sup> Ibid, 53.

### ***Recommendation 16***

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*PIAC recommends that if the Rules are changed to encourage cost reflective network pricing, the AEMC monitor retail offers to assess whether products on offer in the retail market contribute to or diminish the benefits of cost-reflective network prices.*

## **4. Conclusion**

PIAC offers qualified support for a number of the proposals contained in the Consultation Paper. PIAC would welcome a requirement for DNSPs to consult with consumers in designing their tariffs. PIAC also believes that the production of an annual PSS by DNSPs would benefit residential consumers of energy. The PSS should contain all the types of information suggested by SCER, including statements about how the DNSP has complied with network pricing principles and incorporated feedback from consumers in its proposal.

PIAC notes that a move to completely cost-reflective network pricing has significant potential to disadvantage some consumers, especially those living in isolated areas of NSW. Nonetheless, PIAC sees the potential benefit in sending signals about where excess capacity exists in the network. PIAC anticipates that these signals would only be followed by industrial users looking to develop new facilities, given the difficulty in relocating for residents or existing production facilities.

PIAC notes that a key aspect of this issue is the extent to which retailers pass through any cost signals to end-users. While PIAC understands that this issue is considered to be out of scope for this review, it will have a significant impact on the effectiveness of any new network tariffs. Accordingly, PIAC believes that the AEMC should consider the issue as part of this review.

Finally, PIAC looks forward to the next stage of this process and encourages the AEMC to develop some practical examples of how various proposals would work through the whole supply chain, from TNSPs to end users. A cost benefit analysis of the gains made by cost reflective pricing versus the costs to retailers of any systems changes would be particularly useful in guiding the next phase of this process.