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19 December 2013

Zaeen Khan
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Kahn,

NATIONAL ELECTRICITY AMENDMENT (DISTRIBUTION NETWORK PRICING ARRANGEMENTS) RULE 2014 – CONSULTATION PAPER

Ergon Energy Corporation Limited (EECL), in its capacity as a Distribution Network Service Provider in Queensland, and Ergon Energy Queensland Pty Ltd (EEQ), in its capacity as a non-competing area retail entity in Queensland, welcome the opportunity to provide a submission to the Australian Energy Market Commission on its *Distribution Network Pricing Arrangements Consultation Paper*.

Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact either myself on (07) 3851 6416 or Trudy Fraser on (07) 3851 6787.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jenny Doyle'.

Jenny Doyle
Group Manager Regulatory Affairs

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Enc: Ergon Energy's submission



Submission on the *Distribution Network Pricing Arrangements Consultation Paper*

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Australian Energy Market Commission

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This submission, which is available for publication, is made by:

Ergon Energy Corporation Limited and Ergon Energy Queensland Pty Ltd
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Introduction

Ergon Energy Corporation Limited (EECL) and Ergon Energy Queensland Pty Ltd (EEQ) welcome the opportunity to provide comment to the Australian Energy Market Commission (AMC) on its *Distribution Network Pricing Arrangements Consultation Paper* (Consultation Paper).

This submission is provided by:

- EECL, in its capacity as a Distribution Network Service Provider (DNSP) in Queensland; and
- EEQ, in its capacity as a non-competing area retail entity in Queensland.

In this submission, EECL and EEQ are collectively referred to as 'Ergon Energy'.

Ergon Energy in principle supports changes to the National Electricity Rules (NER) that advance cost-reflective network pricing, subject to our concerns with practicability and compliance risk being addressed in any changes. Ergon Energy is a member of the Energy Networks Association (ENA), the peak national body for Australia's energy networks. The ENA has prepared a comprehensive submission addressing the AEMC's Consultation Paper. Ergon Energy is fully supportive of the arguments contained in their submission.

In response to the AEMC's invitation to provide comments on the Consultation Paper, Ergon Energy has focused on the questions raised in the Consultation Paper. Ergon Energy is available to discuss this submission or provide further detail regarding the issues raised, should the AEMC require.



Table of detailed comments

Question(s)	Ergon Energy Response
<i>Assessment Framework</i>	
1. What other considerations should be included in the assessment framework?	Ergon Energy supports the use of efficient pricing, stakeholder engagement, predictability, allocation of risks and regulatory burden as criteria for assessing the concepts of efficiency. Furthermore, Ergon Energy supports the additional considerations suggested by the ENA, such as effectiveness; revenue sufficiency; pricing simplicity and transparency; and flexibility to address the different characteristics of the networks and the needs of customers in complying with the network tariff pricing framework.
<i>Balancing consultation and pricing certainty objectives in the network pricing framework</i>	
2. Does figure 6.1 reflect the key components of how network tariff structures and pricing levels are determined by DNSPs?	The diagram appears to focus on the use of long run marginal cost (LRMC) setting of tariffs and charging components, and omits the linkage to the price control mechanism, and to considerations outside of the pricing principles, such as the need for pricing simplicity and stability.
3. How often are network tariff structures likely to change during a regulatory period, and what are some of the reasons for that change?	DNSPs set network tariffs in line with their network tariff strategies. This strategy may require a number of tariff structure changes within a regulatory period in order to successfully manage the transition to cost reflective tariff structures (for customers, retailers and DNSPs). There may also be unexpected changes to structures, application and pricing due to changes in economic conditions or technology.
4. What level of information on network tariff structures and network tariff pricing levels should be included in a network tariff structures document to assist retailers and consumers to understand and respond effectively to changing prices and structures over the regulatory period?	Electricity retailers need a good understanding of the structure and price of network tariffs in order to: <ul style="list-style-type: none"> • establish retail product offerings; • estimate forward tariff revenue and cost of goods sold; • predict customer behaviour and associated consumption patterns (in response to network price signals); • have the necessary operating systems to implement the tariff structure; and • prepare communication and education materials for customers in

	<p>advance of the implementation of tariff changes.</p> <p>In order to achieve the above, a document that details forward price trends would be useful, with at a minimum, a percentage change between years over the regulatory period. A percentage change would allow retailers to identify key customer segments likely to be impacted by increased network charges and prepare accordingly (e.g. prepare complementary products, increase communications to targeted segment etc.).</p> <p>The document would also need to outline proposed changes to network tariff structures including details of any transitional arrangements for moving to the new tariff structures.</p> <p>However it is not possible to provide information with absolute certainty on network tariffs (both structures and levels) in advance of the annual pricing process and therefore it would be inappropriate for the pricing structures statement (PSS) to be binding on networks. Rather, it should be used to support customer and retailer engagement.</p> <p>Ergon Energy supports the development of a stand-alone document that is readily accessible on DNSP's websites outlining potential prices and structures over the regulatory period.</p>
5. Should DNSPs be able to vary their network tariff structures during the regulatory period? Why or why not?	Preventing DNSPs from responding to changing market conditions and customer behaviour is unadvisable, especially during a period which is likely to see market reform and transformation. Therefore, Ergon Energy supports DNSPs being able to vary network tariff structures throughout the regulatory period provided that appropriate customer and stakeholder consultation has been undertaken.
6. If a document on network tariff structures is put in place, should this be an indicative document or should the DNSPs be required to apply it in their annual pricing proposals?	Ergon Energy supports a document which is indicative only, and not binding on annual pricing proposals.
7. If a document on network tariff structures is binding on the DNSP, should it be able to be verified and under what circumstances? If so, should it be verified outside or within the annual network pricing process?	Ergon Energy believes the document should not be binding, and therefore there is no need to provide for a variation approval process.
<i>Implementation of a pricing structures statement</i>	
8. Should DNSPs be required to consult with stakeholders before submitting their proposed pricing structures statement to the AER for approval through the regulatory determination	Ergon Energy supports consultation on the development of the PSS. Customers are best placed to advise on whether they have the ability to respond to the proposed change. Having greater transparency of future network tariff structures

process?	<p>and pricing levels should also improve consumer confidence in making an investment in changing their load profile. Engagement between DNSPs and retailers will be a key component of the process.</p> <p>Notwithstanding, Ergon Energy supports the ENA submission that there should not be separate guidance for consultation with customers on network tariffs. This consultation stage should be integrated with network regulatory proposal / determination processes, leveraging off the Australian Energy Regulator's (AER) Better Regulation Customer Engagement guideline. Furthermore, the AER should not be required to approve the PSS as it should not be a compliance document but rather a tool to support customer and retailer engagement.</p>
9. Is consultation necessary if DNSPs seek to amend their approved pricing structures statement during the regulatory period as opposed to at the time of the regulatory determination? Are there any circumstances where amendments to the network tariff structures in the annual pricing process should be exempt from consultation on amendments to the previously approved pricing structures statement?	<p>Ergon Energy agrees with the ENA that DNSPs should not be required to seek approval to amend their proposed PSS during a regulatory period. However, it could be appropriate to require DNSPs to update and amend their PSS document and consult with stakeholders on the PSS, to ensure consistency with the tariff structures and network pricing levels in the annual pricing proposals.</p>
10. Is it necessary for the AER (as opposed to the DNSP) to consult with stakeholders before approving any proposed amendments to the pricing structure statement sought by the DNSP?	<p>Ergon Energy believes that DNSPs are best placed to engage with their key stakeholders. As discussed above, the AER should not be required to approve the PSS.</p>
11. Should the AER be required to provide guidance on the consultation process for DNSPs? Should the guidance be binding on the DNSPs?	<p>Ergon Energy does not believe that separate guidelines are required, given the recently released Consumer Engagement Guideline and Explanatory Statement under the AER's Better Regulation program, and concurs with the arguments contained in the ENA's submission in support of this position. Further, Ergon Energy agrees with the ENA that the Guidelines should not be binding on DNSPs.</p>
12. Does the PSS need to be approved?	<p>Ergon Energy does not believe the PSS should be a compliance document. Therefore, Ergon Energy agrees with the ENA that if the AER is required to approve the PSS its assessment should be against the criteria that it has met the information requirements and the requirements for stakeholder engagement; not for compliance with the distribution pricing principles.</p>
13. Should the AER be able to amend a DNSP's PSS? If the AER does not approve a DNSP's proposed pricing structures	<p>Ergon Energy does not believe that the AER should be able to amend a DNSP's PSS. The AER should not have a role in designing network tariff structures. The</p>

statement, what arrangements would be suitable for default network tariff structures?	AER should be restricted to ensuring that the PSS meets the approval criteria as discussed in question 12 above.
14. What are the risks to the annual pricing process if DNSPs do not comply with their approved pricing structures statement or are late submitting a full pricing proposal?	Ergon Energy supports the ENA's proposal that the PSS is non-binding, and therefore there is no compliance risk.
15. How should DNSPs be incentivised to comply with their approved pricing structures statement in their annual pricing proposals? How should compliance incentives be balanced against the financial risk for DNSPs and certainty for stakeholders?	As above, Ergon Energy supports the ENA's proposal that the PSS is non-binding. Notwithstanding, Ergon Energy does not agree with the compliance incentives proposed in the Rule change for the reasons outlined in the ENA's submission.
16. Should DNSPs include forecasts of their expected changes in network tariff pricing levels in the pricing structures statement?	Ergon Energy supports the inclusion of forecast expected changes. However, it should be noted that these are indicative only and treated as such.
17. Should any changes to the network tariff pricing levels included in the pricing structures statement be subject to consultation? If so, what level of materiality should apply to the change?	Ergon Energy supports consultation on changes to the PSS, where these changes could have a material impact on customers in a subsequent annual pricing proposal. Ergon Energy agrees with the matters raised by the ENA on this issue.
18. Should a pricing structures statement process be introduced as soon as possible? If so, what risks are there from having it in place before the next regulatory determination period?	Ergon Energy believes the requirement for a PSS should apply to the next full determination process commencing following completion of the Rule change process to avoid duplication of existing arrangements. As explained by the ENA, the timing required by a DNSP to implement the necessary changes will depend on whether it is an engagement document or a compliance document.
19. Does the AER consultation guideline need to be in place before a PSS can be implemented?	Refer to the response to Q11 above.
<i>Changes to the timing of the annual pricing process</i>	
20. If a PSS framework were implemented, would this reduce the timing pressures for the DNSPs, the AER and retailers that have arisen from the first year and subsequent year annual pricing process?	Ergon Energy believes that the PSS is unlikely to reduce the timing pressure in the annual pricing process, on the basis that it is not possible to provide information on network tariffs (structures and levels) in advance of the annual pricing process, with any certainty.
<i>Reforms to distribution pricing principles</i>	
21. What would be the likely impacts on customers of making an LRMC approach mandatory?	Ergon Energy agrees that, in principle, the LRMC of the network is the appropriate pricing signal to guide customers' consumption decisions. This

	should result in an economically efficient outcome, whereby customers mitigate their demand to the level where the cost of supply matches the customers' preparedness to pay. However, there may be practicality issues with the Rule change proposed by SCER.
22. What would be the impacts on DNSPs of making an LRMC approach mandatory? Does it result in increased compliance risk?	Ergon Energy supports the ENA position that mandating a LRMC approach will reduce network flexibility in setting tariffs. However, given that networks are already required to take LRMC into account in the setting of tariffs, there may not be increased compliance risk in mandating LRMC. However, the full impact of the current Rule change is unclear. Notwithstanding, the ENA suggests, and Ergon Energy agrees, there is potentially an increased compliance risk in circumstances where jurisdictional requirements are inconsistent with tariffs calculated by reference to LRMC.
23. How limited will DNSPs be in basing prices at LRMC if they must first comply with jurisdictional instruments?	The proposed mandating of a LRMC approach is likely to cause conflict between complying with jurisdictional instruments. Ergon Energy supports the ENA proposal that any potential conflict is resolved as part of the Rule change and not left to be addressed by the AER, and that this could be done by stating that network tariffs must comply with the relevant principles, including the mandating of LRMC, to the maximum extent possible allowed by jurisdictional requirements.
24. Should LRMC be defined? If so, what level of detail would be appropriate?	Ergon Energy suggests that the concept of LRMC within the NER be sufficiently broad to allow customer tariff averaging and geographic averaging, as market conditions permit. This is on the basis that applying the LRMC on a regional, supply point or feeder point basis would require the development of additional models, introducing significant administrative complexity, customer communication issues and costs.
25. Should one methodology apply to calculating LRMC or should multiple methodologies be allowed? Which is/are the most appropriate methodology(ies)?	Ergon Energy believes that DNSPs should have the capacity to use a range of well accepted economic methodologies for calculating LRMC and to choose between multiple approaches to recover residual costs.
26. Should the AER be required through a guideline to specify the methodologies of calculating and applying LRMC?	It would be inappropriate for the NER to specify the precise nature of the methodology used to determine a DNSP's LRMC for the purposes of network pricing.
27. What is the impact of coincident peak demand on network costs and how are these additional costs currently recovered in network tariffs?	Coincident peak demand impacts on network capital costs through the need for augmentation to meet demand growth. The recovery of these costs depends on the availability of advanced metering.
28. How should LRMC pricing reflect additional costs	Ergon Energy agrees that it is appropriate to consider additional costs

<p>associated with coincident peak demand and what are the practical impediments to DNSPs adopting tariffs that reflect coincident peak demand?</p>	<p>associated with demand at times of greatest utilisation of the distribution network. However, this should not be mandatory. As noted in the Consultation Paper, the extent to which DNSPs can implement time-based or demand-based pricing is limited by the metering technology in place and jurisdictional policies. Ergon Energy suggests the current drafting of the Rule change is unclear on what is meant by 'have regard to' the additional costs associated with demand at particular times, and believes this is a risk for customers with simple Type 6 accumulation meters who are currently facing simple tariffs with fixed and anytime energy components. .</p> <p>As such, Ergon Energy recommends amending clause 6.18.5(b)(2) to read: '<i>must be determined having regard to <u>available information about:</u></i>'</p> <p>This change will help ensure that DNSPs are able to gradually adjust network tariffs over time to reflect the LRMC of coincident peak demand where appropriate as more customers have advanced metering infrastructure in place.</p>
<p>29. How important are locational pricing signals for distribution networks? Are locational pricing signals for some types of customers more important than others?</p>	<p>Ergon Energy suggests that LRMC should apply to tariffs on either a whole network or on a broad geographic basis. Although distributional costs are strongly dependent upon location, the imposition of local pricing, as proposed by the AEMC, is not necessarily the most appropriate solution for the reasons outlined in the response to Q30 below.</p>
<p>30. What are the practical impediments to DNSPs adopting tariffs that reflect locational pricing signals?</p>	<p>Deriving location-based LRMCs requires allocating shared network costs to individual customer classes in different geographic areas, which tends to get more difficult the smaller the areas become. Accordingly, it is appropriate that this principle remains one to which DNSPs only need to 'have regard' when setting network tariffs.</p> <p>As with tariffs signalling the effect of coincident peak demand on network costs, Ergon Energy believes that without undertaking the analysis, it may be impossible to 'have regard' to how the LRMC of providing network services may vary by location. As drafted, the Rule change suggests that the DNSP must undertake the relevant analysis and only deviate from locationally-different LRMCs if it can explain why uniformity should be preserved. Ergon Energy proposes the Rule change be amended to clarify that DNSPs need only have regard to available information.</p>
<p>31. Is an additional principle required to further encourage network prices which are based on the drivers of network costs to the maximum extent possible?</p>	<p>It is not clear what is meant by an obligation to require network tariffs to be based on the 'drivers' of network costs to the maximum extent possible. While in principle this appears unobjectionable, to the extent this requires DNSPs to:</p>

	<ul style="list-style-type: none"> • allocate customers to more sophisticated (for example, Time of Use or demand-based) tariff structures without their consent; or • allocate customers to tariff structures that require new metering infrastructure, <p>On the basis that it is peak demand/consumption that are the true ‘drivers’ of network costs, then it would be inappropriate. In any event, Ergon Energy does not believe that additional principles are required as basing tariff structures on the drivers of network costs is a fundamental to setting cost-reflective network tariffs.</p>
32. What are the pros and cons of using a Ramsey pricing approach or a postage stamp pricing approach?	<p>Ergon Energy believes the key advantage of Ramsey pricing is that it helps to maximise economic efficiency in conditions when first-best pricing is not feasible. Two key disadvantages of Ramsey pricing which are most commonly cited include:</p> <ul style="list-style-type: none"> • Lack of information about customers’ demands – without accurate information about customers’ demands for the service(s) in question, it is not possible to implement Ramsey pricing rigorously; and • Equity concerns – Ramsey pricing often means charging higher prices to those customers with few alternatives but to purchase the service in question from the business in question. Customers with fewer alternatives are often poorer than those with more options. Further, it is often considered unfair to charge higher prices for ‘essential services’ – such as health care – with inelastic demand. <p>The first of these concerns may be somewhat over-stated given that unregulated businesses are frequently capable of identifying and offering discounts to high elasticity of demand consumers.</p> <p>The key advantage of postage stamp pricing is its simplicity and transparency. The key disadvantage of postage stamp pricing is to the extent that postage stamp prices depart from Ramsey prices, postage stamp pricing involves some compromise with respect to the achievement of allocative efficiency.</p> <p>It should be noted that in practice, most DNSPs in the National Electricity Market apply postage stamp prices that vary across different customer tariff categories. Generally, higher ‘fixed’ charges apply to large business customers than small household customers. As the willingness-to-pay of large business customers for network access will tend to be higher than the willingness-to-pay of small residential customers, it will often be the case that Ramsey pricing and postage stamp pricing will converge for practical purposes. Accordingly, there may be</p>

	little to be gained by prescribing one approach in the NER to recovering residual network costs to the exclusion of other approaches.
33. Are there any other pricing approaches that should be considered to recover residual network costs?	Ergon Energy believes DNSPs should have the flexibility within the NER to choose between multiple approaches to recover residual costs and to take account of network costs and customer preferences.
34. Should an approach or approaches be specified in the NER or the AER guideline?	Ergon Energy supports the ENA proposition that the NER provide the scope to allow individual networks to choose between alternative approaches.
35. What jurisdictional instruments or requirements could limit the ability of a DNSP to comply with any requirements to base tariffs on LRMC (including where that LRMC may vary with customer location or with different local peak demands)?	The Queensland Government's Uniform Tariff Policy ensures that all customers of a similar type who access regulated retail tariffs pay the same regardless of where they live. Further, the network cost component of the retail tariff for all small customers is based on the Energex network tariff even in Ergon Energy's network area.
36. What are the potential impacts of a NER requirement for DNSPs to comply with jurisdictional instruments?	Refer to the response to Q23 above.
37. Should a requirement for DNSPs to take into account the impact of tariffs on consumers be included in the pricing principles?	Ergon Energy agrees the pricing principles should include a requirement to take into consideration customer impacts. This permits DNSPs to take account of existing metering infrastructure and to practice Ramsey pricing where appropriate.
38. If a requirement is included, does the proposed principle provide enough guidance on how it is to be complied with, or would an AER guideline be useful?	Ergon Energy agrees the requirement should be clearly specified and stated in the principles. This principle should be clarified beyond doubt in the NER and not the Guidelines.
39. If a requirement is included, does the proposed principle conflict with other principles within the NER?	Refer to the responses to questions 38 and 39 above.
40. Should network tariffs reflect transmission pricing signals? If so, what would the most appropriate way to achieve this for different types of network customers?	Ergon Energy does not support the pass through of transmission prices to smaller residential and business customers.
<i>Changes to how tariff classes are determined</i>	
41. Is the change to a mandatory requirement to group customers into tariff classes likely to achieve the desired outcomes?	Ergon Energy does not support the introduction of a mandatory requirement.
42. Is the change to a mandatory requirement to group customers into tariff classes likely to result in inconsistencies within the NER or with any jurisdictional instruments or	As per question 41.

requirements?	
<i>Changes to the operation of side constraints</i>	
43. Is the proposal to apply side constraints across regulatory periods likely to materially benefit consumers by protecting them from price shocks?	Ergon Energy acknowledges the benefits to customers from applying side constraints to minimise price shocks. However, side constraints may also limit the effectiveness of the required change by lengthening the period in which the price change is to be applied. This may limit the realisation of what the DNSP is trying to achieve. An appropriate balance between the benefit to the DNSP and market from immediate introduction of new pricing signals, and the financial impact on customers must be considered.
44. Is the proposal to apply side constraints across regulatory periods likely to lead to inconsistencies with other requirements in the NER?	Ergon Energy shares the ENA's concerns that the application of the side constraint between regulatory periods requires clarification.
45. Are there likely to be implementation issues in applying side constraints across regulatory periods?	Refer to the responses to Q43 and 44 above.
46. Should network tariffs of customers with interval meters or other types of time-based meters be subject to side constraints?	Refer to the responses to Q43 and 44 above.