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19 December 2013

Australian Energy Market Commission
PO Box A2449
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www.aemc.gov.au (reference code ERC0161)

Consultation Paper – National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014

We appreciate the opportunity to comment on the Australian Energy Market Commission (AEMC) Consultation Paper – National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014.

Introduction

EnergyAustralia has a substantial commitment to and stake in the Australian energy sector. We are one of Australia's largest energy companies, supplying gas and electricity to nearly 2.8 million households and businesses. We also own and operate a diverse range of generation and storage facilities across the east coast of Australia.

Although we are not a direct investor in energy network infrastructure, our generation portfolio and customer base stand to benefit significantly from the most efficient energy delivery system possible and we will of course bear the consequences of an inefficient one. To avoid excessive network infrastructure costs in the future it is critical that policy-makers address any shortcomings in the current regulatory framework governing network pricing.

EnergyAustralia supports the stated objectives of the proposed rule change request: to encourage more cost reflective networking pricing; and to provide greater consultation and certainty for retailers and their customers in the development of this pricing. We do however consider that adequate notification to retailers of significant changes to tariff structures and final changes to tariff levels will not be achieved by the proposed rule change request. Without sufficient notification, retailers are unable to convey more sophisticated/complex pricing signals to their customers and the potential value of more cost reflective network pricing is likely to be diminished as a result. With adequate notification retailers are in a strong position to offer customers responsive and innovative energy offers that reflect network pricing as it evolves towards a more cost reflective model.

Network pricing reform is urgent

Network tariffs are a key cost component of final prices offered to energy consumers. As recently reported by the Grattan Institute ... "[s]ince 2006 the average household has reduced power use by more than seven per cent ... [but] in that period the average household power bill has risen more than 85 per cent: from \$890 to \$1660 a year".¹ Network charges comprise about half the average power bill and it is widely accepted that the current network pricing model has not provided the right incentives for 'least cost' usage and provision of network infrastructure services. The Productivity Commission and others

¹ Grattan Institute, *Shock to the System – Dealing with falling electricity demand*, December 2013.

have attributed the inefficiency to several factors associated with incentives established by the regulatory framework governing network businesses.²

A key factor relates to the fact that network pricing signals received by most households and small businesses fail to reflect the true cost of system peaks which vary by location, time of day, time of year and on individual extreme temperature days. This is a result of typically flat, volume-based network pricing structures, which in some cases is further distorted by the recovery of solar feed-in-tariffs and metering infrastructure incapable of signalling 'when' customers' energy consumption occurs. This has driven underlying cross subsidies throughout the customer base between 'peaky' and flatter profiled energy users, unnecessary investment in the network and underutilisation of existing infrastructure.

We note that as part of the AEMC Power of choice review, Frontier Economics estimated that economic cost savings of peak demand reduction in the NEM is likely to be between \$4.3 and \$11.8 billion over the next ten years equating to between 3 and 9 per cent of total forecast expenditure on the supply side. Frontier Economics also found that the majority of these savings occur in the network sector given the current over supply of wholesale generation and relatively conservative view of demand growth.³

We also note that some commentators are pointing to the potential longer term consequences of continually rising network prices, particularly as grid energy demand growth stagnates. As described by the Grattan Institute ... "[t]he 'death spiral' is a term used to describe the situation where declining demand, technology changes and rising prices may interact in a way that induces large numbers of consumers to disconnect from the network. In that case the whole funding model of Australia's regulated power networks is under threat. ... As growing numbers of users disconnect, consumption would fall and prices rise further, and the vicious circle this creates would increase the incentive for other users to leave the network. Networks could be left with billions worth of unused assets. Governments would face intense pressure to help bear the cost and consumers would face the cost and inconvenience of managing a 'stand-alone' power system in their business or home".⁴

Achieving an 'orderly' transition to cost reflective pricing

A transition from the traditional network pricing model to a more cost reflective approach is necessary to address excessive network infrastructure costs in the future and to ensure that customers have access to the most affordable long term provision of energy. However, from a retailer/customer perspective there are practical considerations that are imperative to achieving an effective. The following conditions are absolutely necessary to facilitate an 'orderly' transition that captures the potential benefits of cost reflective pricing:

1. competitively determined pass-through of network charges by retailers to their customers – retailers are in the best position to design final energy offers that serve their customers based on all input costs, including network tariffs;
2. steady progress toward the roll out of the lowest cost sources of advanced metering across jurisdictions – it is imperative to achieving the benefits of cost reflective pricing that retailers and their customers have the necessary information to respond to price signals and that this is delivered competitively;
3. minimum standards to be established in the National Electricity Rules for engagement between network service providers and retailers (and their customers) – that ensure adequate consultation and advanced notice of significant changes to tariff structures and final changes to tariff levels; and
4. government support for vulnerable customers exposed to unacceptable price/cost increases as a result of more cost reflective network pricing – in the form of community service obligations/ out-of-market transfers.

² See Productivity Commission, *Electricity Network Regulatory Frameworks*, Productivity Commission Inquiry Report, No.62, 9 April 2013.

³ AEMC, Final Report, Power of choice review – giving consumers options in the way they use electricity, 30 November 2012 (p. vi).

⁴ Grattan Institute, *Shock to the System – Dealing with falling electricity demand*, December 2013.

The proposed rule change request does not ensure adequate notification

As reflected in our response to the AEMC Consultation Paper on National Electricity Amendment (Annual Network Pricing Arrangement) Rule 2013, EnergyAustralia supports the concept of a 'document', in advance of the annual network pricing process, to improve consultation on the development of network tariffs and pricing certainty with respect to changes in network tariffs.

However we do not concur that improvements in consultation alone will serve to deliver adequate notification regarding changes to network tariffs. The consolidated rule change request being considered does not explicitly provide for adequate notice to retailers (and their customers) of significant changes to tariff structures; and final changes to tariff levels. The value of cost reflective network pricing signals is diminished to the extent that retailers have insufficient time to adjust final energy offers in response to changing network tariff structures and levels. Without sufficient time retailers may be forced to over-simplify network tariffs, delay full recovery of costs and/ or limit customer engagement on the impacts, all of which would network pricing signals to customers and reduce potential benefits. We note that the provision of adequate notice to retailers is likely to become even more critical in this regard as the sophistication/ complexity of network pricing evolves towards a more cost reflective model.

EnergyAustralia requests that an amendment be made to the proposed rule change request. The amendment comprises two components:

- a minimum notice period of 2 months for notification of final network tariff levels to be an explicit part of the annual pricing process; and
- a minimum notice period of 12 months for notification of significant changes to tariff structures (which could be part of the proposed Pricing Structure Statement process).

Conclusion

EnergyAustralia looks forward to participating in the remainder of the AEMC's consolidated rule request process. Please contact me on (03) 8628 1183 if you have any questions in relation to this submission.

Regards

signed for

Steven Wright

Strategic Policy