



Australian Energy Market Commission

CONSULTATION PAPER

National Electricity Amendment (Aligning Network and Retail Tariff Structures for Small Customers) Rule 2015

Rule Proponent
COAG Energy Council

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**RULE
CHANGE**

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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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1 Introduction

On 25 June 2014, the Council of Australian Governments' (COAG) Energy Council submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) for the alignment of electricity network and retail tariff structures.

Under the proposal, if a state or territory government requires retailers to offer a standing offer with a prescribed tariff structure to small customers with an interval meter¹ in its jurisdiction, then the distribution network service providers must make available to retailers a network tariff with a consistent structure to that standing offer.

This consultation paper has been prepared to facilitate public consultation on the rule change request, and to seek stakeholder submissions.

This paper:

- sets out the background to, and a summary of, the rule change request;
- sets out a proposed assessment framework to be used by the Commission in assessing the rule change request;
- identifies a number of questions and issues to facilitate consultation on this rule change request; and
- outlines the process for making submissions.

Submissions to this consultation paper are due by no later than 7 May 2015.

¹ An interval meter records consumption over half hour intervals, or potentially over shorter periods. These metering installations can be used to provide information about the timing of a consumer's consumption. These metering installations are either manually read at the premises or remotely read using a communications network.

2 Background

The COAG Energy Council's rule change request has implications for the current network and retail pricing arrangements. To assist stakeholder understanding of these implications, this chapter provides an overview of the current arrangements that are pertinent to any assessment of the merits of the rule change request. This is intended to provide some context to both the issue that the COAG Energy Council has identified and the solutions that it has proposed.

This chapter sets out:

- a summary of the current arrangements for network and retail pricing;
- the National Energy Retail Law (NERL) clause that enables jurisdictions to require retailers to make available a standing offer with a prescribed tariff structure for small customers with an interval meter; and
- the Victorian flexible pricing arrangements.

2.1 Network and retail pricing arrangements

2.1.1 Network pricing arrangements

Network charges are a key cost component of the retail prices offered to consumers, comprising around 50 per cent of residential electricity prices.² Network charges are made up of the costs of transporting and distributing electricity from generators to consumers via transmission and distribution networks. These costs are generally combined by distribution network service providers (DNSPs) into a single network charge that is passed through to retailers to recover from their customers as part of the retail electricity price (this is discussed further in section 2.1.2).

The network tariffs³ that apply for a specific DNSP in any particular year depend on the revenues that the DNSP is allowed to earn in that year and the control mechanism that applies to the DNSP, as determined by the Australian Energy Regulator (AER) in its regulatory determination.⁴ The National Electricity Rules (NER) also set out requirements that DNSPs must comply with in the design of network tariffs.⁵ Network tariffs must be approved by the AER annually.

² AEMC, Final Report, 2014 Residential Electricity Price Trends, 11 December 2014, p.vi.

³ In this paper, the term "network tariffs" is used as a generic term to refer to both structure and pricing levels of DNSPs' charges. Where specific reference is made to the structure of tariffs, the term "tariff structures" is used and the term "pricing level" is used to refer to the level of prices.

⁴ NER clause 6.2.5(b). The AER has the option, subject to considering relevant criteria, to apply control mechanisms from a range that includes a revenue cap, a price cap, a weighted average price cap or an average revenue yield approach.

⁵ These provisions are outlined in Part I of Chapter 6 of the NER.

Recent amendments made by the AEMC to Chapter 6 of the NER, as a result of the Distribution Network Pricing Arrangements rule change, have changed how network tariffs are set and the process by which they are approved.⁶ These amendments, which will progressively come into effect in all jurisdictions from 2017, include significant changes to both the distribution pricing principles and the network pricing process. This consultation paper considers the rule change request in the context of the new pricing arrangements.

The pricing principles

Under the NER, the pricing structures of a DNSP are guided by the network pricing objective. This objective is that the tariffs that a DNSP charges in respect of its provision of direct control services⁷ to a retail customer should reflect the DNSP's efficient costs of providing those services to the retail customer.⁸

The network pricing objective is supported by a set of five pricing principles.⁹ These are that:

- The revenue expected to be recovered from each tariff class must be greater than the avoidable cost and less than the standalone cost of the service (standalone and avoidable cost principle).¹⁰
- Each network tariff must be based on the long run marginal cost (LRMC) of providing the service.¹¹ LRMC is a measure of the network costs caused by using more energy, or the costs that could be saved by using less energy. Network tariffs based on this measure may provide signals to consumers about the costs of using the network (LRMC principle).
- The revenue expected to be recovered from each network tariff must: reflect the DNSP's total efficient costs of providing services to the consumers assigned to that tariff; permit the DNSP to recover its expected revenue in accordance with its regulatory determination; and must be recovered in a way that minimises distortions to the pricing principles (total efficient cost principle).¹²
- DNSPs must also give effect to a consumer impact principle when developing their tariffs.¹³ This principle requires DNSPs to consider the impact on

⁶ AEMC, Distribution Network Pricing Arrangements Final Rule Determination, November 2014.

⁷ A direct control network service is an electricity network service for which the price of the service, or revenue to be earned from the service, must be regulated under a distribution determination. See section 2B of the NEL.

⁸ NER Clause 6.8.15(a).

⁹ These are set out in NER clause 6.8.15(e) to (j).

¹⁰ NER clause 6.8.15(e).

¹¹ NER clause 6.8.15(f).

¹² NER clause 6.8.15(g).

¹³ NER clause 6.8.15(h)(i).

consumers of changes in network charges and set tariffs that consumers are reasonably capable of understanding (consumer impact principle).

- Network tariffs must also comply with any jurisdictional pricing obligations imposed by state or territory governments (jurisdictional pricing obligation principle).¹⁴

The network tariffs set by DNSPs must comply with the pricing principles.¹⁵ However, DNSPs are able to depart from the three principles for standalone and avoidable cost, LRMC, and total efficient costs, to the extent necessary to meet the consumer impact and jurisdictional pricing obligation principles.¹⁶

In addition to the pricing principles, changes to the pricing levels of network tariffs must comply with the 'side constraints' provisions in the NER.¹⁷ These provisions limit the magnitude of price changes within a tariff class from year to year.

The network pricing process

The Distribution Network Pricing Arrangements rule change introduced a two stage network pricing process.¹⁸

- In the first stage, which occurs alongside the regulatory determination process, DNSPs are required to develop a Tariff Structure Statement (TSS). In its TSS, each DNSP must outline the tariff classes, tariff structures, policies and procedures for assigning consumers to tariffs, and the approach to setting tariff pricing levels that it proposes to apply over the next regulatory control period.¹⁹ The TSS must be accompanied by a schedule of indicative price levels.²⁰ The TSS is assessed for compliance with the pricing principles by the AER in conjunction with the DNSP's regulatory proposal.²¹
- In the second stage, which occurs on an annual basis prior to the commencement of each regulatory year in the relevant period, a DNSP must develop an annual pricing proposal that details the pricing levels that the DNSP proposes to apply to each of the tariff structures outlined in its approved TSS.²² The AER is required to assess the DNSP's annual pricing proposal against the approved TSS

14 NER clause 6.8.15(j).

15 NER clause 6.8.15(b).

16 NER clause 6.8.15(c).

17 NER clause 6.8.16.

18 AEMC, Distribution Network Pricing Arrangements Final Rule Determination, November 2014.

19 NER clause 6.18.1A(a).

20 NER clause 6.18.1A(e).

21 NER clause 6.12.3(k).

22 NER clause 6.18.2(b)(2).

and the control mechanism as specified in the AER's regulatory determination for the DNSP.²³

As part of the first stage of the network pricing process, DNSPs are required to describe how they have consulted with retailers and consumers on the design of the network tariffs they have proposed to implement over the next regulatory control period.²⁴ DNSPs must also describe how they have sought to address any relevant concerns raised as a result of this engagement.²⁵

In determining the tariff classes that consumers are proposed to be assigned to, DNSPs are required to have regard to the nature and extent of a consumer's usage, the nature of the connection and the type of metering that is available at a consumer's premise.²⁶ Under the NER, DNSPs must treat consumers with a similar connection and usage profile on an equal basis.²⁷

DNSPs are able to amend their approved TSS during a regulatory control period under limited circumstances, subject to the approval of the AER.²⁸ To amend a TSS, a DNSP must demonstrate that an event occurred that was beyond its reasonable control and which could not have been reasonably foreseen at the time the TSS was approved.²⁹ Further, the DNSP must demonstrate that the proposed amendments to the TSS would, or would be likely to, result in a TSS that better complies with the pricing principles.³⁰

The TSS amendment process occurs outside of the annual pricing process. In order to get an amendment through in time for a particular regulatory year, a DNSP is required to submit its amended TSS to the AER at least nine months before the commencement of that year.³¹ In turn, the AER must publish its decision at least four months before the commencement of the relevant regulatory year.³²

The Distribution Network Pricing Arrangements rule change³³ also introduced new timeframes for the annual network pricing process. Under the new arrangements:

- all DNSPs must submit a proposed annual pricing proposal to the AER at least three months before the commencement of the next regulatory control year; and³⁴

23 NER clause 6.18.8(a)(1).

24 NER clause 6.8.2(c1a).

25 Ibid.

26 NER clause 6.18.4(a)(1).

27 NER clause 6.18.4(a)(2).

28 NER clause 6.18.1B(d).

29 NER clause 6.18.1B(b)(2).

30 NER clause 6.18.1B(b)(5).

31 NER clause 6.18.1B(a).

32 NER clause 6.18.1B(e).

33 AEMC, Distribution Network Pricing Arrangements Final Rule Determination, November 2014.

34 NER clause 6.18.2(a)(2).

- the AER must decide on a DNSP's annual pricing proposal within 30 business days of receipt.³⁵

This should provide retailers and consumers with at least six weeks notification of annual network tariffs.

2.1.2 Retail pricing arrangements

Retailers supply electricity to small customers under either a standing offer or a market offer (detailed in the next section). Small customers are generally defined as any residential customer or any business customer consuming less than 100 megawatt hour (MWh) a year.³⁶

The NERL and the National Energy Retail Rules (NERR) regulate the terms and conditions of standard retail contracts and prescribe some minimum terms and conditions of market retail contracts, under the National Energy Customer Framework (NECF). The NECF has been adopted in all states and territories in the National Electricity Market (NEM), with the exception of Queensland and Victoria.³⁷ In Victoria jurisdictional requirements regulate the arrangements for retail contracts.

This rule change request only relates to standing offers for small customers with an interval meter, where a state or territory government has prescribed the structure of that standing offer in accordance with section 22(1a) of the NERL.

Regulatory arrangements for standing offers and market offers

Standing offers are made to small customers by the relevant designated retailer.³⁸ A designated retailer for a small customer is either the local area retailer where there is no existing connection, or the financially responsible retailer where there is an existing connection.³⁹

A standard retail contract is a contract between a retailer and a small customer that takes effect when a customer accepts a retailer's standing offer. A standard retail contract acts as a default retail contract in situations where a consumer has never accepted a market offer, or switched retailer, or where a consumer has moved into a

³⁵ NER clause 6.18.8(c3).

³⁶ NERL sections 5 and 6; and NERR clause 7. The upper consumption threshold for small business customers has been varied in some jurisdictions. In South Australia, the upper consumption threshold is 160 MWh (SA NERL regulations clause 5); while in Tasmania, it is 150 MWh (Tas NERL regulations clause 7).

³⁷ NECF is scheduled to commence in Queensland on 1 July 2015.

³⁸ NERL sections 22(1) and 31.

³⁹ NERL section 2(1). Under the NERL, a local area retailer is a retailer that has been nominated by a participating jurisdiction for: the geographical area (or part area) of the jurisdiction; specified premises or a specified class of premises; or specified customers or a specified class of customers. Whereas, a financially responsible retailer is the retailer who is the financially responsible market participant responsible for the premises under the NER. The financially responsible retailer has responsibility to pay for energy consumed at that connection point in the wholesale market.

new premise without signing a new retail contract. A consumer can also choose to be supplied by a retailer under a standing offer. Retailers are able to vary the tariffs and charges under a standard retail contract from time to time, but no more than once every six months.⁴⁰

In contrast, a market offer may be offered by any retailer to any small customer. Market retail contracts set out the terms and conditions on which a retailer will provide retail services to a customer. The contract terms, tariffs and charges of a market retail contract are subject to limited minimum requirements.⁴¹ There is no restriction on the number or size of price variations under market offers.

The proportion of consumers on either a standing offer or market offer differs across the states and territories depending in part on the level of retail competition.

Process for setting tariffs for standing offers and market offers

In states or territories where there are no electricity retail price controls, retailers can determine the price and structure of all retail tariffs, including for standing offers.⁴² Where retail price controls exist, the relevant jurisdictional regulator determines the maximum price that can be charged under a standing offer.

Retailers recover network charges from consumers through retail tariffs.⁴³ As network charges are the largest component of a retail price, the structure of retail tariffs usually have significant regard to the structure of the relevant network tariff.

A retailer can identify the network tariff that a consumer has been assigned to by a DNSP by querying the database for National Meter Identifier (NMI) standing data.⁴⁴

Implications of metering arrangements for small customers

Depending on the type of meter installed at a small customer's premises and the range of retail tariffs offered by retailers operating in their local area, a small customer can choose a standing offer or a market offer that has either:

- a flat tariff structure; or
- a flexible tariff structure which could include, for example, a time varying or time of use (TOU) tariff structure or a capacity based tariff structure.

⁴⁰ NERR, schedule 1 clause 8.2(b).

⁴¹ These minimum requirements are set out in the NERR.

⁴² Retail prices in New South Wales, Victoria and South Australia are deregulated. Retail prices in South East Queensland will be deregulated from 1 July 2015.

⁴³ Retailers also recover a number of other input costs through the retail tariffs they charge consumers, including generation cost and green scheme amounts.

⁴⁴ The database for NMI standing data is managed by the Australian Energy Market Operator (AEMO). AEMO procedures govern access to this database and the sharing of information related to a consumer's NMI between registered participants.

A flat tariff structure has a volume (or consumption) based charge that does not vary depending on the time of day or by location.⁴⁵ Flat tariff structures include inclining block tariffs where a consumer is charged more for each block of consumption. This contrasts with flexible tariff structures where charges may vary depending on when consumption occurs during the day or the capacity of a consumer. For instance, a TOU tariff may apply a different charge during peak and off-peak periods within a day.

Consumers that have an accumulation meter⁴⁶ at their premises can only choose a retail contract that has a flat tariff structure. This is because an accumulation meter cannot measure a consumer's consumption in sufficient detail to derive the time of day that consumption occurred, as is necessary for time varying tariff structures. This compares with consumers that have an interval or advanced meter at their premises, who may be able to choose a retail contract that has either a flat or TOU tariff structure.⁴⁷

2.2 Amendments to the National Energy Retail Law

In November 2013, the Standing Council on Energy and Resources (SCER)⁴⁸ amended the NERL to enable a state or territory government to require retailers to offer a standing offer with a prescribed tariff structure to classes of small customers with an interval meter in its jurisdiction.

As this provision operates under the NERL, it only applies in jurisdictions that have adopted the NECF.⁴⁹ At present, no state or territory government has enacted a local instrument under the NERL to require retailers to do this in their jurisdiction.

2.3 Flexible pricing arrangements in Victoria

In June 2013, flexible pricing arrangements were introduced in Victoria as part of the Advanced Metering Infrastructure (AMI) program in that state. Under the AMI program, advanced meters were installed in almost all Victorian homes and small

⁴⁵ However, a flat network tariff may vary depending on the season.

⁴⁶ Accumulation metering installations only record the total amount of electricity used over a specified period. Consumption data is generally retrieved manually from the metering installation at a consumer's premises periodically, typically every three months to match the retailer's billing cycle. This data does not record when electricity is used.

⁴⁷ The AEMC is currently considering a rule change that would facilitate a consumer and market-led approach to the deployment of advanced meters where consumers drive the uptake of technology through their choice of products and services. A draft determination and draft rule were published on 26 March 2015. See: <http://www.aemc.gov.au/Rule-Changes/Expanding-competition-in-metering-and-related-serv#>.

⁴⁸ Predecessor to the COAG Energy Council.

⁴⁹ See section 2.1.2 as to where the NECF has been adopted.

businesses by DNSPs. The roll-out was completed in June 2014.⁵⁰ Approximately 2.8 million advanced meters were installed across the state.⁵¹

The Victorian Government introduced flexible pricing arrangements through a Victorian Order in Council on 19 June 2013.⁵² Under these arrangements, retailers must make available to all domestic customers,⁵³ a standing offer with a flat tariff structure (flat AMI retail tariff).⁵⁴ Domestic customers are also able to elect to opt-in to a market offer retail contract with a time of use structure (flexible AMI retail tariff), but must provide their explicit informed consent to the retailer to place them on it.⁵⁵

DNSPs are required to offer at least one flat AMI distribution tariff and one flexible AMI distribution tariff.⁵⁶ Under the AMI Tariff Order, a DNSP must assign a domestic customer in accordance with a retailer's direction, so that the structure of the retail tariff and network tariff is aligned.⁵⁷

50 <http://www.smartmeters.vic.gov.au/about-smart-meters/end-of-rollout>.

51 Ibid.

52 Advanced Metering Infrastructure (AMI Tariffs) Order, 19 June 2013.

53 The AMI Tariffs Order defines a domestic customer as a customer who purchases electricity principally for personal, household or domestic use at a supply point. The AMI Tariffs Order distinguishes between a domestic customer and a small business customer.

54 AMI Tariffs Order, clause 6.

55 AMI Tariffs Order, clause 7(1)(a).

56 At least one of its flexible AMI distribution tariffs must be consistent with the common form distribution tariff set by the Victorian Government in the schedule to the AMI Tariffs Order. AMI Tariffs Order, clause 9(1)(2).

57 AMI Tariffs Order, clause 10.

3 Details of the rule change request

The COAG Energy Council's rule change request seeks to amend Chapter 6 of the National Electricity Rules (NER) to place new obligations on distribution network service providers (DNSPs) with respect to network pricing. These obligations would be triggered by a state or territory government enacting a local instrument under section 22(1a) of the National Energy Retail Law (NERL).

Specifically, the rule change request proposes that, where a state or territory government declares that retailers must make a standing offer with a prescribed retail tariff structure to small customers with an interval meter in its jurisdiction:⁵⁸

- DNSPs must offer a network tariff with a structure that matches the structure of that standing offer;⁵⁹
- DNSPs must allow a retailer to assign a small customer to this network tariff where that customer has chosen that standing offer;⁶⁰ and
- the Australian Energy Regulator (AER) must only approve a DNSP's annual pricing proposal if it includes a network tariff that matches the structure of that standing offer.⁶¹

The rule change request relates to the structure of network tariffs only. Under the rule change request, DNSPs would maintain discretion over the level of network tariffs.⁶² This would mirror the arrangements in the NERL, where retailers are able to set the price of the standing offer that is mandated by a state or territory government, subject to any retail price regulation that may apply in that jurisdiction.

The COAG Energy Council implies that the intention of the rule change request is to enable small customers with an interval meter to choose to be supplied electricity under a flat retail tariff. It considers that the rule change, if made, could enable state or territory governments to 'support the introduction of more complex network tariff structures' in their respective jurisdictions.⁶³

The COAG Energy Council's rule change request does not include a proposed rule.

3.1 Rationale for the rule change request

The COAG Energy Council's rationale for its rule change request are summarised below:

⁵⁸ In accordance with Clause 22(1a) of the National Energy Retail Law.

⁵⁹ COAG Energy Council's rule change request, 25 June 2014, p.2.

⁶⁰ Ibid.

⁶¹ Ibid., p.3.

⁶² Ibid., p.4.

⁶³ Ibid., p.8.

- The COAG Energy Council notes that more widespread availability of interval meters and advanced meters⁶⁴ will enable DNSPs and retailers to offer cost reflective tariff structures, to the benefit of all consumers in the long term.⁶⁵ However, as these tariff structures will effectively unwind some of the cross subsidies prevailing in existing flat tariff structures, this transition needs to be managed to enable consumers to adjust to the new pricing arrangements.
- To manage the potential impact on consumers from the transition to cost reflective tariff structures, the COAG Energy Council suggests that some jurisdictions may seek to mandate that a standing offer with a prescribed tariff structure be offered by retailers to small customers with an interval meter. Such an approach has been adopted in Victoria.⁶⁶
- COAG Energy Council suggests that jurisdictions may seek to mandate a particular standing offer to facilitate choice of retail tariffs for small customers with an interval meter.⁶⁷
- The COAG Energy Council notes that, in general, retailers endeavour to match the structure of the retail tariffs they offer to their consumers to the structure of DNSPs' network tariffs charged to consumers.⁶⁸ In a situation where a state or territory government requires retailers to make a standing offer with a prescribed tariff structure to small customers in its jurisdiction, retailers' ability to do this would be constrained. In this situation, it is likely that a retailer would add a risk premium to its retail tariff to account for the potential risk of under recovery of network costs.⁶⁹
- To address this potential outcome, the COAG Energy Council has proposed a rule change that, if made, would impose an obligation on DNSPs to offer a network tariff with a structure that matches the prescribed structure of the standing offer that a retailer is required to offer under the jurisdictional instrument.
- The COAG Energy Council considers that the rule change, if made, would give retailers a reasonable opportunity to recover the network charge for those small customers. As a consequence, retailers would reduce the risk premium they would otherwise apply, resulting in lower charges under the mandated standing offer.⁷⁰

64 Advanced meters are remotely read interval metering installations that can also provide a range of advanced metering services beyond simply measuring electricity consumption or generation. The services available depends on the functionality of the advanced metering installation.

65 Ibid., p.6.

66 Ibid., p.7.

67 Ibid.

68 This is discussed in section 2.1.2.

69 Ibid.

70 Ibid.

- The COAG Energy Council notes that while such a rule change, if made, may transfer revenue risk from retailers to DNSPs, DNSPs would be better placed to manage this risk over a comparatively larger customer base than retailers. Additionally, under the existing regulatory framework, the COAG Energy Council considers that DNSPs are able to adjust the amount of revenue they recover on a yearly basis, so as to account for any previous over or under recovery of revenue.⁷¹

⁷¹ The COAG Energy Council notes that this depends on the type of control mechanism applied to the DNSP by the AER. COAG Energy Council's rule change request, 25 June 2014, p.7.

4 Assessment Framework

The AEMC must assess proposed changes to the National Electricity Rules (NER) based on whether the proposed rule will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO), as set out under section 7 of the National Electricity Law (NEL).

The NEO states:⁷²

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.”

Based on a preliminary assessment of the rule change request, the relevant aspect of the NEO to be considered for this rule change request is the promotion of efficient investment in, and operation and use of, electricity services for the long term interests of consumers with respect to price.

To determine whether the proposed rule, if made, is likely to promote the NEO, the following criteria may be considered as part of the AEMC’s assessment of the rule change request:

- **Efficient allocation of risk.** To achieve efficiency, risks should generally be allocated to the parties best placed to manage them. This has the potential to minimise the cost of managing risk and reduce the risk to future investment. In turn, this may lead to efficient prices for consumers over the longer term. The nature and allocation of the risks that are caused by both the issue identified in the rule change request and its proposed solution, and consideration of which party is best placed to manage such risks, will be assessed.
- **Efficient network prices.** Network tariff structures that signal to consumers a DNSP’s future costs of providing network services are likely to lead to more efficient use of, and investment in, the distribution network. An efficient network price provides consumers with the opportunity to make an efficient decision in relation to use of the network and investment in technologies to manage their use. A consumer’s response to efficient network prices provides signals to DNSPs about when and where to potentially invest in the network. Therefore, consumers who respond to network price signals can not only potentially reduce their own network charges, but also potentially contribute to lower future network costs more broadly. The degree to which the rule change request assists in promoting efficient network prices will be assessed.

⁷² See s. 7 of the NEL.

- **Predictable outcomes for consumers, retailers and DNSPs.** Predictable outcomes support confidence in, and credibility of, markets and supporting regulatory arrangements. For DNSPs and retailers, confidence in the regulatory arrangements may encourage them to actively participate, and invest in, the market, which promotes efficiency. Similarly, if the prices that consumers face are relatively simple, transparent and predictable, this provides consumers a reasonable opportunity to decide whether to respond to those signals, and manage their costs. The degree to which the rule change request is likely to support predictable outcomes for DNSPs, retailers and consumers will be assessed.
- **Administrative and compliance costs.** Changes to the NER should not create any unnecessary compliance and administrative burden for stakeholders. A rule that is complex to administer, difficult for stakeholders to understand, or imposes unnecessary risks, is less likely to achieve its intended purpose or will do so at a higher cost. Consideration will be given to whether the administrative and compliance burden created by the rule change request is likely to be proportionate to the benefits it is seeking to achieve.

The proposed rule will be assessed against the relevant counterfactual of not making the proposed change to the NER. That is, against whether any additional benefits, beyond those achieved by the Distribution Network Pricing Arrangements rule change, would be achieved by requiring DNSPs to offer a network tariff that matches a mandated standing offer.

5 Issues for Consultation

This chapter identifies a number of issues for consultation that appear to be relevant to this rule change request. The issues outlined below are provided for guidance.

Stakeholders are encouraged to comment on these issues as well as any other aspect of the rule change request, or this consultation paper, including the proposed assessment framework.

5.1 Interaction with the Distribution Network Pricing Arrangements rule change

As set out in section 2.1.1, the Distribution Network Pricing Arrangements rule change made substantial changes to the way that DNSPs set and structure network prices. These changes require DNSPs to set network tariffs with greater reference to the costs caused by the usage decisions of individual consumers. The changes also give retailers and consumers greater certainty with respect to the structure of network tariffs over the regulatory control period and a greater indication of likely price paths.

This section outlines some of the objectives achieved through the new rule introduced under the Distribution Network Pricing Arrangements rule change.

The new rule requires DNSPs to set cost reflective network prices. Cost reflective network prices may provide signals to consumers so that they can make informed decisions about how they use electricity by allowing them to compare the value they place on using the network with the costs of doing so. Some consumers are likely to choose to adjust their behaviour in response to network pricing signals. This is likely to be to the benefit of all consumers, as it may reduce the costs that the DNSP incurs, ultimately leading to lower overall network charges.

The new rules explicitly recognise that cost reflective network pricing may have greater impacts on some consumers. To address this, the rules include a consumer impact principle. This principle requires DNSPs to consider the impact that cost reflective network prices may have on consumers, and transition them to these prices in a way that manages potential shocks. Further, under this principle, DNSPs are required to set network tariffs that consumers are capable of understanding.

The new rules also recognise that state or territory governments may place pricing obligations on the DNSPs within their jurisdictions. Certain governments may put in place obligations with which DNSPs must comply if they have particular objectives that they wish to pursue with respect to network pricing.

The new rules provide a framework that facilitates transparency in relation to the choices DNSPs make in the design of their network tariffs. This framework means that whenever a DNSP varies its proposed network tariffs from those that are cost reflective, they must do this only to the minimum extent necessary in order to manage impacts on consumers or comply with jurisdictional pricing obligations. This requires

DNSPs to outline the trade-offs they have made and the rationale behind their decisions.

The new pricing principles are supported through a new network pricing process. As outlined in section 2.1.1, DNSPs are required to develop a TSS that outlines how they will apply the pricing principles in their tariff classes, tariff structures and approach to setting the pricing levels of network tariffs. This process gives the AER oversight over how DNSPs will meet the pricing principles over the regulatory control period, including how they will transition consumers to cost reflective network tariffs.

One of the key benefits of the TSS being in place for the regulatory control period⁷³ is that it will provide retailers with more advanced notification of both the structure and pricing level of network tariffs. This may alleviate some of the risks that could potentially lead some retailers to include risk premiums in their retail tariffs as a risk management measure. Under the new rules, retailers have greater access to the tariff structures and likely pricing levels that a DNSP will apply over the regulatory control period. Further, changes made to the timing of the annual network pricing process will give retailers earlier notification of the pricing levels of annual network tariffs. This gives retailers more certainty across the regulatory control period and provides retailers with an opportunity to plan how they could best incorporate network tariffs into retail tariffs.

The new rules also provide for greater engagement between DNSPs, retailers and consumers. This allows retailers an opportunity to provide feedback on the network tariffs that a DNSP proposes to apply. The rules require DNSPs to demonstrate how they have taken views expressed as part of this consultation into account in the design of their network tariffs. As such, the intent of this consultation is to stimulate greater discussion between DNSPs, retailers and consumers so that DNSPs gain access to better information that could allow them to develop more robust network tariffs, that retailers can implement and consumers can understand and respond to.

The COAG Energy Council's rule change request was submitted before the Distribution Network Pricing Arrangements rule change was finalised. As such, the direct interactions between the rule change request and the Distribution Network Pricing Arrangements rule change were not considered. However, the new rules appear to address many of the concerns that are raised in the rule change request.

The remainder of this chapter considers the interaction between the rule change request and the new rules.

⁷³ As outlined in Section 2.1.1 a DNSP may seek an amendment to the TSS in limited circumstances, subject to the approval of the AER.

Question 1 Interaction with the Distribution Network Pricing Arrangements rule change

- a. Do the changes made to the pricing rules under the Distribution Network Pricing Arrangements rule change sufficiently meet the objectives of the COAG Energy Council’s rule change request? Why/why not?
- b. How should interactions between the rule change request and the Distribution Network Pricing Arrangements rule change be addressed?

5.1.1 Transitional arrangements for the Distribution Network Pricing Arrangements rule change

The Distribution Network Pricing Arrangements rule change set out a transitional timeframe for the implementation of the new rules. This timeframe is set out in Table 5.1 below.

Table 5.1 Transitional timeframe for implementation of Distribution Network Pricing Arrangements⁷⁴

Process	VIC DNSPs	NSW, QLD, SA and ACT DNSPs	TAS DNSPs (no transitionals)
Proposed TSS due to the AER	25 September 2015	27 November 2015	31 January 2016
AER draft decision on TSS	22 February 2016	1 July 2016	30 September 2016
Revised proposed TSS due to AER (approx) ⁷⁵	29 April 2016	2 September 2016	5 December 2016
AER final decision on TSS	29 July 2016	30 January 2017	30 April 2017
Prices based on new rules take effect	1 January 2017	1 July 2017	1 July 2017

The proposed rule change would need to fit with the new pricing rules under Chapter 6 of the NER. Therefore, if the proposed rule change were to be made, it may be

⁷⁴ See chapter 6 of the Distribution Network Pricing Arrangements final determination for a comprehensive explanation of transitional arrangements. Available: <http://www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements>.

⁷⁵ DNSPs are able to submit a revised proposed TSS no later than 45 business days after the AER's draft decision.

prudent to delay its commencement until the full implementation of the new pricing rules in 2017.

Question 2 Timeframe for implementation of proposed rule change

- a. **If the proposed rule change were to be made, when should it take effect? What implementation issues, if any, should be considered?**

- b. **If the proposed rule change were to be made, what transitional arrangements should be considered, if any, to enable it to take effect prior to the full implementation of the Distribution Network Pricing Arrangement rule change?**

5.2 Efficient allocation of risk

If a state or territory government enacts a local instrument that requires a retailer to offer a standing offer with a prescribed tariff structure, the proposed rule change could transfer the risk associated with the recovery of a DNSPs' allowable revenue from retailers to DNSPs.

As noted by the COAG Energy Council, this may be a more efficient allocation of risk, as DNSPs have a larger customer base over which they can spread the risk.⁷⁶ DNSPs may also have mechanisms by which they can adjust network tariffs if they have either over or under recovered their allowable revenue. This depends on the control mechanism selected by the AER. DNSPs on price caps are not able to adjust network tariffs to account for an over or under recovery of revenue. However, if DNSPs are continuously adjusting the level of their network tariffs to account for an over or under recovery of allowable revenue, this may result in greater network tariff volatility, resulting in greater price shocks for consumers.

Further, the potential inclusion of a risk premium in the mandated standing offer by retailers may not necessarily be an inefficient outcome. For example, if small customers with an interval meter choose to respond to cost reflective network pricing signals by electing a less cost reflective retail tariff, it may be appropriate that they share some of the risk that a retailer must manage. In this instance, small customers who elect to be supplied under this retail tariff structure will not receive the full network pricing signals about when to consume electricity. As a result, they may cause greater network costs that need to be recovered from all consumers.

⁷⁶ COAG Energy Council's rule change request, 25 June 2014, p.7.

Question 3 Efficient allocation of risk

- a. **What is the efficient allocation of risk between retailers, DNSPs and consumers with respect to network and retail pricing?**
- b. **To what extent do retailers currently bear the risks of retail and network tariff misalignment? How would this risk profile change, if at all, if the proposed rule was made?**

5.3 Efficient network prices

The COAG Energy Council implies that the intention of its rule change request is to facilitate choice for small customers with an interval meter to be supplied under a flat retail tariff. However, the NERL allows for a state or territory government to prescribe in a local instrument that retailers must offer any type of prescribed tariff structure, including more cost reflective tariff structures. This could include specifying the time bands of a TOU tariff or the structure of a capacity based tariff. Therefore, in order to achieve the intent of this rule change request, namely aligning network and retail tariff structures for small customers, the proposed rule, if made, would similarly not limit the ability of a state or territory government to require a DNSP to make available a particular network tariff.

Should a jurisdiction require a DNSP to offer a particular network tariff, this could result in network tariffs that are not cost reflective. This applies regardless of the type of network tariff that a jurisdiction requires a DNSP to offer. This is because the drivers of a DNSP's costs depend on the individual DNSP's particular circumstances, and it is unlikely that a single network tariff would be able to accurately signal the costs of providing network services to small customers across all networks in a jurisdiction.

If the network tariff that the DNSPs are required to make available is a flat network tariff, as implied by the rule change request, this could be in contrast to the requirement that DNSPs provide signals to consumers about efficient use of the network, depending on the characteristics of the network, and in particular, the LRMC estimate for that network.

Further, if DNSPs are required to make available particular network tariffs to small customers with an interval meter, there may be an additional risk that they may only offer the required tariff, even if an alternative tariff structure would better reflect their operating costs. This has generally been the outcome of the arrangements currently in place in Victoria.⁷⁷ Despite DNSPs being able to offer network tariffs with a structure different from the AMI flexible network tariff, in practice, only one DNSP has offered an alternative cost reflective network tariff.

⁷⁷ The Victorian arrangements are outlined in section 2.3.

Therefore, the effect of the rule change request, if made, may be less efficient network prices by removing the ability of DNSPs to design network tariffs that reflect their individual circumstances and drivers of costs or reducing their incentives to do so.

Question 4 Efficient network prices

- a. **What are the implications of this rule change request, if made, in relation to a DNSP's ability and incentives to develop its own network prices?**

5.4 Predictable outcomes for consumers, retailers and DNSPs

By enabling retailers to assign small customers with an interval meter to the required network tariff, more predictable outcomes are supported for retailers. However, this could create revenue risk for DNSPs. As DNSPs may be required to make available a network tariff that is less cost reflective, they would need an accurate forecast of the number of customers likely to be assigned to this tariff in order to ensure that the tariff recovers only efficient costs.⁷⁸ Without accurate information in relation to customer numbers, there is a risk that DNSPs may either over or under recover efficient costs.

Under the rule change request, DNSPs maintain discretion over the level of the network tariff they are required to offer. Subject to the side constraints mechanism, which limits the extent to which average prices per tariff class can move within regulatory control period, DNSPs could vary the level of the required network tariff. This could have a material impact on the retailer and, if the retailer does not receive sufficient notification of this price change, could result in the retailer including a price risk premium in its standing offer as a consequence.

As noted in section 5.3, the required network tariff may not provide adequate signals to small customers in relation to the costs of using the network. This may mean that these customers do not respond to network pricing signals, contributing to higher network costs in the longer term. This would not contribute to predictable outcomes for DNSPs or consumers.

Question 5 Predictable outcomes for consumers, retailers and DNSPs

- a. **Would the proposed rule change, if made, facilitate predictable outcomes for DNSPs, retailers and consumers? How would this compare against the likely outcomes under the Distribution Network Pricing Arrangements rule change?**

5.5 Administrative and compliance costs

The interactions between the proposed rule change and the Distribution Network Pricing Arrangements rule change could lead to significantly higher administrative

⁷⁸ Under the pricing principles, DNSPs are required to recover from each tariff, the efficient costs of providing services to consumers assigned to that tariff. See section 2.1.1.

and compliance costs for DNSPs and the AER. Higher administrative and compliance costs incurred by DNSPs could result in higher network charges for all consumers.

As noted in section 5.1, under the new rules, DNSPs are prevented from introducing new tariff structures, or from changing their policies and procedures for assigning consumers to tariffs, during a regulatory control period, unless they follow the prescribed process to seek amend to their TSS. To amend a TSS, DNSPs must consult with retailers and consumers on their proposed amendments, develop an amended TSS, and submit the proposed amended TSS to the AER at least nine months before the commencement of the relevant regulatory control year.⁷⁹ This process could be costly for a DNSP, depending on the nature of the change proposed. A DNSP could be required to do this every time a jurisdiction requires it to offer a particular network tariff.

Requiring a DNSP to go through an amendments process where a jurisdiction requires it to offer a particular tariff may also increase the administrative burden on the AER. Under the new pricing rules, the AER is required to assess, and approve, a DNSP's amended TSS if it meets certain criteria.⁸⁰ While a jurisdictional requirement to offer a particular network tariff may meet these criteria, the AER would need to assess the proposed amendment to determine whether to allow the amendment.

If a DNSP does not receive sufficient notice of a requirement to offer a particular network tariff to amend its TSS, the AER may be forced to allow a DNSP to be in breach of either the rule requirement that the annual pricing proposal be consistent with the TSS, or the rule requirement that the DNSP make available the network tariff required by the state or territory government, in its approval of the annual pricing proposal.

Similar issues could arise if the AER is required to refuse to approve an annual pricing proposal unless the DNSP includes the network tariff required by a jurisdiction, as proposed in the rule change request.

Alternatively, an exemption to the requirement that these network tariffs be included in the TSS may need to apply in order to implement this rule change request. This could have implications on the transparency and integrity of the TSS process. It may also undermine the certainty granted to retailers and consumers through the TSS.

The proposed rule change could also impose costs in relation to the need for new systems and procedures to enable retailers to assign small customers to a particular network tariff.

As noted in section 2.1.2, a retailer is able to access information in relation to the network tariff a small customer has been assigned to through NMI standing data. However, DNSPs do not have access to information in relation to the retail tariff that a

⁷⁹ For example, if a DNSP wanted to change a tariff structure in year three of the regulatory control period, it would have to submit its proposed amendment at least nine months before the commencement of that year.

⁸⁰ The criteria for amending a TSS is outlined in section 2.1.1.

small customer has elected to be supplied under. In order to implement this rule change request, a new system or procedure may need to be put in place to allow DNSPs access to information in relation to the retail tariff a small customer has selected to enable them to assign that customer to the correct network tariff.

As noted in section 2.1.1, the new pricing principles require DNSPs to comply with any jurisdictional pricing obligations. This principle recognises that state or territory government may pass a jurisdictional law to require DNSPs to make available a network tariff with a particular structure.

Question 6 Administrative and compliance costs

- a. **What costs are likely to be incurred by DNSPs, retailers and the AER in implementing the proposed rule change?**
- b. **What system or procedure would need to be established to enable DNSPs to assign small customers who elect the mandated standing offer to the corresponding network tariff?**
- c. **How do electricity retailers in Victoria notify DNSPs that a small customer should be assigned to a particular network tariff? What costs, if any, were incurred in facilitating this notification?**

6 Lodging a submission

The AEMC has published a notice under section 95 of the NEL for this rule change proposal inviting written submission. Submissions are to be lodged online or by mail by 7 May 2015 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the AEMC's Guidelines for making written submissions on Rule change proposals.⁸¹ The AEMC publishes all submissions on its website, subject to a claim of confidentiality.

All enquiries on this project should be addressed to Emma Fishburn on (02) 8296 7800.

6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the AEMC's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code "ERC0175". The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the AEMC will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

6.2 Lodging a submission by mail

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: ERC0175.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the AEMC will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

⁸¹ This guideline is available on the Commission's website.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMI	Advanced Metering Infrastructure
COAG	Council of Australian Governments
Commission	See AEMC
DNSP	distribution network service provider
LRMC	long run marginal cost
MWh	megawatt hour
NECF	National Energy Customer Framework
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NERL	National Energy Retail Law
NERR	National Energy Retail Rules
NMI	National Meter Identifier
SCER	Standing Council on Energy and Resources
TOU	time of use
TSS	Tariff Structure Statement