

Australian Energy Market Commission

ERC0161

National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014

Submission lodged electronically

24 January 2014

Arrium Submission to the Public Consultation on Distribution Network Pricing Arrangements

Arrium welcomes the proposed Distribution Network Pricing Arrangements rule change proposal and broadly supports the key changes suggested by IPART and SCER which we believe will provide end users with better price signals, greater cost certainty, information in a more timely manner and will increase accountability of DNSPs. Further, we would like to see the changes proposed for the DNSPs extended to the TNSPs.

About Arrium

Arrium is an ASX listed international mining and materials company with sales revenue for the 2013 financial year of \$6.841 billion, and approximately 10,000 employees globally (8,500 in Australia).

The company was spun out from BHP in 2000 as OneSteel when it was almost entirely a domestically focussed steel manufacturer and distributor. The company has subsequently focussed on growing its resource based businesses and now has significant Mining and Mining Consumables businesses, as well as its Steel & Recycling business.

Arrium Mining currently exports approximately 12 million tonnes of hematite ore to China per annum from its mining operation in South Australia.

Arrium Mining Consumables includes Moly-Cop grinding media, the largest supplier of grinding media (grinding balls and grinding rods) in the world, servicing the fast growing global mining industry, particularly the copper, gold and iron ore sectors. The business has leading grinding media market positions in South America, North America and Australasia supplying around 950 thousand tonnes of product per annum.

Arrium Steel includes our integrated OneSteel business that is the Manufacturing, Distribution and Recycling businesses. We are the premier manufacturer of long steel products, structural pipe and tube, and wire products in Australia; the leading distributor of structural steel and reinforcing products in Australia with around 200 sites across the country; and a significant supplier of scrap metal to foundries, smelters and steel mills in Australia and internationally.

Arrium is a significant energy user, using over 40 PJ of energy in FY13, predominantly in the National Energy Market states.

Overview of Arrium's Concerns about Current Methods of Setting Network Tariffs

1. Tariff Structures

Arrium has been surprised in recent years by the inconsistent approach by DNSPs in their approach to setting network tariffs and the tariff structures adopted. As a very large energy user with significant ability to respond to price signals, we have been frustrated with the approach by many DNSPs to increasingly weight their tariff structures towards fixed costs, either via a fixed daily fee, or via some long term measure of maximum demand. This approach seems to us to contradict the claim often made by DNSPs that their costs are heavily driven by peak demand, as they provide no incentive for large users to manage demand on critical peak days.

For example, between FY11 and FY12, the network tariff for one of our sites with a maximum demand of approximately 60 MVA and total annual consumption of 230 GWh changed in the following ways:

Network Tariff Component	Change from FY11 to FY12
Peak \$/MWh	Reduced by 77.27%
Shoulder \$/MWh	Reduced by 73.42%
Off Peak \$/MWh	Reduced by 6.12%
Capacity \$/kVA	Increased by 2.53%
Network Access \$/day	Increased by 357.05%

This resulted in the fixed daily charges for this site going from 12% of the total network cost to 50% of the network cost in a single year. The increase in fixed cost, accompanied by a reduction in peak and shoulder volume charges, reduces the price signal to avoid consumption during peak periods. This may result in further network investments being required earlier than would otherwise have been the case.

Further, such variations in tariff structures creates significant uncertainty which undermines business cases for energy efficiency and load shifting strategies, as the savings which may be available via such actions cannot be guaranteed beyond the current tariff year.

.. DNSPs should bear some risk of inefficient investment decisions not being fully recovered by volume or demand charges. DNSPs are compensated for risk, so it is only appropriate that they bear some. Investment decisions will be more efficient if the DNSP is not guaranteed that their costs will always be recovered.

2. Notice of Tariff Changes

Arrium conducts its annual budgeting process in January. At this time we request forecasts of expected tariff changes for up to the next five years from the network operators who supply our major sites. While the DNSPs are helpful in providing the information which is available, the fact that the network tariffs are not approved until a few weeks before they are to apply, and that even the five year pricing proposals are only approved a matter of months before they commence, makes it very difficult for us to budget for such a large cost to our business.

Further, anomalies in the way the tariff rates are calculated can result in large deviations from the pricing path at a tariff level which are unforeseen. For example, between 2011 and 2012 the network costs at one of our sites increased by 36.8%, compared to the expected price path at the time of an increase of 3% plus the change in CPI. This resulted in a significant unbudgeted cost increase for the year. The larger than expected increase was caused by a number of factors, and exacerbated by the time lag for the consumption figures which are used to calculate the volume charges, so that a relatively high network charge was divided by a relatively low consumption figure resulting in a much higher tariff rate. This was followed by an 8% reduction in network costs in the following year.

These large and unplanned for swings in costs from year to year are very difficult for businesses to manage. A better approach would have been for the network operator to have been required to consider the impacts of these costs changes from year to year on end users and to smooth the increase over two years instead of having a very large increase in one year followed by a decrease in costs in the next. The right of DNSPs to recover costs each year should be balanced against the reasonableness of expecting businesses to be able to manage these cost variations.

3. Approach to Individually Calculated Tariffs

The network operators do not have consistent approaches to the use of individually calculated tariffs for large customers. They range from having some level of individually calculated charge for sites with demand exceeding 4 MW in Queensland, to DNSPs not being open for discussions regarding individually calculated tariffs for a site with demand exceeding 30 MW in Victoria. We believe there should be a consistent approach across the NEM with a minimum threshold set at a level which encourages the use of individually calculated network tariffs so as to minimise cross-subsidisation.

There is also quite a large scope for DNSPs to determine what they will charge individually calculated customers, and these charges often do not appear to be cost reflective. For instance, currently the maximum amount the DNSPs can charge for an individually calculated tariff is the amount which it would cost to provide network access to that customer in

isolation. In most cases, this will clearly be much higher than the actual cost to provide network services, creating quite a high cap on prices. Further, in many cases large energy users have been in their current location with largely the same energy requirements as they have now for decades. The fact that these businesses have seen their costs escalate sharply over the last five years or so demonstrates there has been some level of cross-subsidisation occurring within various distribution networks. This is clearly neither equitable nor desirable in an environment that is already extremely challenging for many large users.

There is currently no transparency regarding how these tariff levels are set, nor any accountability to the Regulator to ensure these charges are reasonable and cost reflective.

4. Measures of Demand

Across the NEM, different network operators use a number of measures of short and long term demand. These different demand measurements have varying levels of effectiveness as price signals, and in some cases become essentially fixed costs.

In Victoria in particular, the use of contract demand measurements which reflect the highest demand ever reached at a metering point provide no incentive for businesses to aim for demand reductions. Even where a permanent change is made at a site, the time lag before this change is reflected in network costs is 12 months from the date an application is made to reset demand (not from the date of demand reduction), with the demand then reset at the highest demand reached during the 12 month waiting period.

Another concern is the use of arithmetic demand rather than coincident demand by some network operators. In our view, arithmetic demand does not fairly reflect the actual costs of supplying network services to a site, and can cause significant cost impacts where load is shifted from one feeder to another during a month. These cost impacts can occur even where the shift between feeders was instigated by the network operator. In cases where capacity is set on a rolling 12 month basis, a single instance of swapping load between feeders can result in a significant increase in costs to the customer, with no discernible impact on the costs incurred by the network operator.

This argument is supported by the fact that other network operators in comparable regions charge similar users for the maximum simultaneous demand reached each month (rather than arithmetic demand).

In setting network tariff structures, it is important that the AER considers these different measures of demand and how they impact on actual costs for energy consumers. A goal of the increased focus on network tariff structures should be to standardise the measures of demand and ensure that the measures used are reflective of the costs to the network operator and provide an incentive to reduce demand.

Attached is Arrium's response to the specific questions raised in the consultation paper. We thank you for providing the opportunity for us to provide our views and participate in this process. For any information about this submission, please contact Karen Brock on 02 4935 4070.

Kind Regards,



Karen Brock

Strategic Sourcing Manager - Energy

Arrium Mining and Materials

Annexure - Responses to Questions Raised in the Consultation Paper

Arrium has not responded to all questions raised in the Consultation Paper. Our comments focus on the impacts on large energy users and other customers.

Q1 – What other considerations should be included in the assessment framework?

- a) Increased consistency between network operators - In the interests of making the workings of the DNSPs and their charges more comprehensible for end users, we would like to see an increased level of consistency between network jurisdictions in the types of charges applied. For instance, different measures of demand used by different DNSPs in different tariffs include peak demand, maximum demand, peak capacity, additional demand, authorised demand and contract demand in various combinations of kW or kVA measurement and even simultaneous vs arithmetic. The equity of these different measures should be investigated, especially in regard to how they impact actual costs of servicing different customer groups. In our view, these confusing and overlapping measures of demand make network charges difficult to comprehend for the vast majority of end users, (reducing the effectiveness of any price signals as they are not properly understood) and are not reflective of actual costs.
- b) Cross subsidisation minimised - A further aspect which should be included in the assessment criteria is the extent to which the rule change will minimise cross subsidisation between customer groups, as pricing cannot be truly efficient where one group of network users is not receiving an appropriate price signal because their costs are being borne by another group of network users.

Q2 – not answered

Q3 – not answered

Q4 – 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?

As a minimum:

- a) The cost components of each tariff and their weighting within each tariff
- b) The changes in expected revenue by customer class in each year of the regulatory period.

Q5 – Should DNSPs be able to vary their network tariff structure during the regulatory period? Why or why not?

The tariff structures should be set for at least the duration of the regulatory period. Allowing changes within a timeframe shorter than the regulatory period undermines the purpose of the Pricing Structures Statement (PSS). Current levels of uncertainty around changes in tariffs and their costs components leads to price shocks for end users and undermines investments made in energy efficiency and load shifting as the savings cannot be relied upon for longer than the current tariff year. To allow changes to the PSS within the Regulatory Period provides little improvement from the current situation.

Q6 – 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?

The document should be binding. This will ensure the DNSPs are vigilant in ensuring the information in the document is correct which will increase its reliability for end users. Only in exceptional circumstances should the DNSP be able to divert from the document, and only then with the approval of the AER.

Q7 – If a document on network tariff structures is binding on the DNSP, should it be able to be varied and under what circumstances. If so, should it varied outside or within the annual network pricing process?

The document should only be varied in exceptional circumstances, for example an extreme change in demand pattern which could not reasonably have been foreseen by the DNSP and which will be detrimental to end users if not

addressed. Approval from the AER to vary or not apply the document must be granted, and the DNSP must be able to demonstrate that the change is in the interests of end users as well as the DNSP.

Q8 – Should DNSPs be required to consult with stakeholders before submitting their proposed pricing structures statement to the AER for approval through the regulatory determination process?

It is our view that consultation will result in a better outcome for both end users and the DNSPs as it will allow the DNSPs to better understand the circumstances and sensitivities of their customers. Care must be given in consultation processes to ensure that differing viewpoints are given their due merit as end users will have limited resources to respond to consultations compared with organisations with more vested interests.

There should also be consultation by AER to ensure the final PSS has taken stakeholders' views into account and to allow final comments on the proposed PSS.

Q9 – 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?

Consultation is not necessary as long as the DNSPs are only able to amend their PSS in prescribed circumstances and the amendment is approved by the AER. As stated previously, this should only occur in extenuating circumstances where the change is in the best interests of end users, as the risk of the effectiveness of the PSS must be borne by the DNSP that prepared it, not by end users who are relying on it in good faith to be applied.

Q10 – 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?

There should be consultation to determine whether the changes proposed by the DNSP are in fact in the interests of end users. There could possibly be a hierarchy of circumstances under which changes can be requested, some of which may be approved without consultation if they are not controversial and others that may require consultation. It is important that there is transparency and publication of any proposed changes to the PSS.

Q11 – Should the AER be required to provide guidance on the consultation process for DNSPs? Should the guidelines be binding on the DNSPs?

Yes, the AER should provide binding guidelines. The process should be consistent across the NEM to make it easier for stakeholders to participate. Information obtained in any submissions should be made available in full to the AER to assist in determining whether the submissions have been taken into account by the DNSP, and to assist in their assessment of the PSS.

Q12 – Does the PSS need to be approved?

Yes, the PSS must be subject to independent review and approval by a body with the expertise and resources to determine whether it meets the criteria.

Q13 – Should the AER be able to amend a DNSP's PSS? If the AER does not approve a DNSP's proposed pricing structure statement, what arrangements would be suitable for default network tariff structures?

The AER should have the power to amend the PSS in the interests of preventing DNSPs from deliberately frustrating the process by repeatedly making unsuitable proposals. Defaulting to the previous PSS is not an ideal solution as it could be used as a deliberate strategy by DNSP to retain an old PSS if it is likely to result in a better outcome for them. Reverting to a previous PSS can still be an option for the AER without it being the default option.

Q14 – not answered

Q15 – 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 risks for DNSPs and certainty for stakeholders?

As noted above, the PSS should be binding and only able to be varied in exceptional circumstances with the approval of the AER. DNSPs should bear the financial risks associated with the PSS as it is their responsibility to prepare the document, they have better information than third parties relying on the document, and certainty for these third parties who make decisions in good faith based on information provided in the PSS is essential as they should not be expected to bear the risk of the PSS not being adhered to.

Q16 – Should DNSPs include forecasts of their expected changes in network tariff pricing levels in the PSS?

Yes. This information should be provided by tariff.

Q17 – Should any changes to the network tariff pricing levels included in the PSS be subject to consultation? If so, what level of materiality should apply to the change?

No consultation should be required for changes in pricing levels provided that the change is within the rules and any conditions imposed by the AER, and does not involve any changes to tariff structure or result in making one tariff more expensive relative to another (unless it results in reduced cross-subsidisation). AER can determine whether changes are reasonable and within the rules and decide whether or not to approve.

Q18 – Should a PSS be introduced as soon as possible?

The timeframes for the usual regulatory process as provided in Table 7.1 of the AEMC Consultation Paper are acceptable for the introduction of a PSS.

Q19 – Does the AER consultation guideline need to be in place before a PSS can be implemented?

Yes. A PSS should not be implemented without appropriate consultation. Any consultation needs to be in line with the guidelines developed by the AER.

Q20 – not answered

Q21 – What would be the likely impacts on customers of making an LRMC approach mandatory?

We currently do not have sufficient information about DNSPs' LRMC to answer this question. It would depend on whether the LRMC would be locational. If so, is this fair to existing customers in locations where pressure on the network is caused by new users? If LRMC is greater than average cost, is it fair that these costs are passed through before investments are made, and could this lead to over-recovery by the DNSP? This approach could result in charges which are a reflection of potential costs rather than actual costs.

Q22 – not answered

Q23 – not answered

Q24 – Should LRMC be defined? If so, what level of detail would be appropriate?

Yes, LRMC should be defined.

Q25 – not answered

Q26 – Should the AER be required through a guideline to specify the methodology or methodologies of calculating LRMC?

Yes, this would be helpful and ensure consistency

Q27 – not answered

Q28 – not answered

Q29 – not answered

Q30 – not answered

Q31 – not answered

Q32 – not answered

Q33 – not answered

Q34 – Should an approach or approaches be specified in the NER or an AER guideline?

The approach or approaches should be specified in an AER guideline.

Q35 – not answered

Q36 – not answered

Q37 – Should a requirement for DNSPs to take into account the impact of tariffs on consumers be included in the pricing principles?

Yes, as long as all classes of consumer groups are treated equally and any cross subsidisation is avoided.

Q38 – not answered

Q39 – not answered

Q40 – Should network tariffs reflect transmission pricing signals? If so, what would be the most appropriate way to achieve this for different types of network customers?

Yes, network tariffs should reflect transmission pricing signals, especially for large users.

Q41 – Is the change to a mandatory requirement to group customers into tariff classes likely to achieve the desired outcomes?

In our view, most network operators already group customers into tariff classes quite effectively. The exception to this is in having an appropriate grouping for individually calculated tariff customers for very large users in Victoria.

More useful would be a requirement to provide more than one tariff option for each tariff class so that end users can select a tariff with pricing signals they are able to respond to.

Q43 – not answered

Q44 – not answered

Q45 – not answered

Q46 – Should network tariffs of customers on interval meters or other types of time-based meters be subject to side-constraints?

If side constraints apply they should apply equally to all customer groups. To not apply this principal will result in some customers bearing a disproportionate share of network costs. The constraint should apply at the total revenue level.

