NEWS

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New rules for cost-reflective distribution network prices

Distribution Network Pricing Arrangements – Final Determination

The National Electricity Rules will be changed from 1 December 2014 to require regulated network companies to structure their prices to better reflect the consumption choices of individual consumers.

Under these changes, network prices will reflect the costs of providing the electricity to consumers with different patterns of consumption.

The new rules follow extensive consultation over the past year, and take into account submissions received when the draft rules were released in August.

AEMC Chairman John Pierce said the prices we pay for electricity would actively respond to the different ways people choose to use it under these new rules.

“These changes put consumers at the centre of future decision-making about energy,” he said.

“By having prices that reflect the costs of different patterns of consumption, we are giving consumers clearer choices as we develop a more efficient, incentive-based network regulation framework.

“Today there is far greater diversity in the way consumers use electricity,” Mr Pierce said.

“Two households might look the same, with similar incomes and family size, but because of the appliances they have and the different lifestyles they lead, they will consume electricity in very different ways.

“Network pricing reforms are one of the AEMC’s building blocks to help consumers see the dollar value of their electricity consumption choices, so they can more actively participate in Australia’s electricity market.

“It’s about people being able to see the value of their choices such as decisions to set thermostats differently on air conditioners; or to choose appliances with higher energy ratings,” he said.

Charges recovered from different consumers will more accurately reflect individual usage. The key factor that will determine how much consumers pay is their individual usage pattern or load profile.

“Under these changes, we estimate around 70-80% of consumers would have lower network charges in the medium term,” Mr Pierce said.

These savings would come from a combination of two effects:

- upfront savings for people with flat load profiles who use proportionately less energy at peak times of the day; and
- lower overall network costs and lower average network charges generated by small consumption changes made by people who use a high level of electricity at peak periods. They will not only save money for themselves but help reduce peak demand and consequent need for infrastructure investment.

Network businesses need to start consulting on new tariffs and submit draft proposals to the Australian Energy Regulator in late 2015 for new prices that would be phased in from 2017.

The rules announced today are focussed on maximising the potential of changing consumption patterns as an alternative to network investment and to facilitate better-informed consumer choices.

"Research undertaken since the draft rules were released for public consultation in August shows network prices are likely to be lower in the long run with cost-reflective prices," Mr Pierce said.

"Research shows average residential charges could reduce by $28 to $145 per year. Households which use power at a steady rate through the day will receive the biggest benefits.

"Based on Victorian trials, we also found a small business could save up to $2,118 or 34% of its total annual electricity network charges by using less electricity at peak times for just 20 hours per year when networks are congested," he said.

The new incentive based regulatory framework also requires greater consumer consultation on setting prices that the networks can charge, and greater transparency of the impact on consumers of network pricing decisions, with information on revenues and prices to be published at the same time.

"This rule change will not actually set new network prices – that is a role for the networks themselves and the AER. It does create a new requirement that reveals the cost of people's energy choices," Mr Pierce said.

"Once the new rule commences on 1 December 2014 network businesses need to start consulting on their new tariffs and submit draft proposals to the AER in late 2015 for new prices that will start no later than 2017."

Mr Pierce said networks are required to consider the impacts of price changes on consumers and could gradually transition consumers to new price structures.

"This is part of our Power of Choice reforms that allows consumers to drive the way the energy sector develops. It means the prices individual consumers pay will more closely reflect the way they use electricity," Mr Pierce said.

"Whatever the pattern of future demand, technology, generation and pricing, this is a significant step towards a market that can respond so consumers benefit."

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27 November 2014

About the AEMC

We are the independent body responsible since 2005 for providing policy advice to Australian governments on the electricity and gas sector. We make energy market rules which are applied and enforced by the Australian Energy Regulator (AER).

AEMC Power of Choice Review reforms

The Distribution Network Pricing Arrangements rule change is part of a reform program initiated by the COAG Energy Council following the AEMC's Power of Choice recommendations to help consumers participate more effectively in energy markets. Reforms to simplify the process for consumers to switch retailers, to access information about their consumption in easy-to-read, affordable reports and provide options for people who want to use smart technology, are also underway.

About the economic regulation of distribution network companies

Electricity distribution businesses build, own and operate the poles and wires required to transport electricity to where it's needed. Massive costs involved in providing extensive networks mean these businesses operate as natural monopolies in the regions they service.

The AEMC makes the National Electricity Rules used by the Australian Energy Regulator (AER) to set revenues that network businesses can earn as well as the maximum prices they can charge over five year regulatory periods.

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In 2012 the AEMC made new rules to improve the AER's capacity to develop efficient processes for setting overall revenues and prices for regulated network companies so consumers don't pay more than necessary for reliable supplies of electricity and gas.

The 2012 rules changed how the AER determines allowed rates of return for regulated businesses; clarified AER powers on reviewing and amending network business proposals for expenditure allowances; introduced new capital incentives for efficient capital expenditure; new annual benchmarking reports on the relative efficiencies of network businesses; and requirements for more community consultation on the regulatory determination process.

The new rules announced today are focussed on arrangements encouraging distribution companies to maximise the potential of changing consumption patterns as an alternative to network investment and to facilitate better-informed consumer choice.

Ends

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NEWS

Potential business savings from electricity reforms

Distribution Network Pricing Arrangements – Final Determination

Small businesses will have the opportunity to reduce their electricity network charges by up to 34 per cent and save a potential $2,000 under changes to the National Electricity Rules from 1 December 2014.

Reforms to how regulated network companies charge for their services mean that companies which can shift at least some of their electricity use from peak to non-peak periods will be able to directly benefit in terms of lower prices.

The changes were announced today by the Australian Energy Market Commission (AEMC) as part of its Power of Choice reform program to help business and residential consumers improve the way they use energy and access new technology.

AEMC Chairman John Pierce said under the new distribution network pricing rules, electricity network prices would reflect the costs of providing the electricity at different times.

“These changes put small businesses at the centre of decision-making about energy,” Mr Pierce said.

“If network charges are higher or lower at different times of the day business consumers will be able to see the value of their choices such as decisions to set delay energy intensive activities; or to choose appliances with higher energy ratings,” he said.

“Based on recent Victorian trials, a small business could save up to $2,118 or 34% of its total annual electricity network charges by using substantially less electricity at peak times for just 20 hours per year when networks are congested.

“The trials also found that substantial savings were recorded by a significant number of small businesses which reduced their peak usage by just over 50 per cent.

“This rule change will not actually set new network prices – that is a role for the networks themselves and the AER. But it will create a new framework that reveals the true cost of people’s energy choices,” Mr Pierce said.

“Once the new rule commences on 1 December 2014 network businesses need to start consulting on their new tariffs and submit draft proposals to the AER in late 2015 for new prices that would be phased in from 2017.”

Mr Pierce said networks are required to consider the impacts of price changes on consumers and could gradually transition consumers to new prices over five years or more if necessary.

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INFORMATION

New rules for distribution network pricing

Publication of final determination and final rule

The AEMC has made a final rule that requires network prices to reflect the efficient cost of providing network services to individual consumers so that they can make more informed decisions about their electricity usage.

What did we decide in the final determination?

In the final determination, we have set a new pricing objective for distribution businesses so prices reflect the efficient costs of providing network services to each consumer. This will allow consumers to compare the value they place on using the network with the costs of using it.

The distribution businesses must comply with four new pricing principles to achieve this objective:

- Each network tariff must be based on the long run marginal cost of providing the service. If consumers choose to take actions that will reduce future network costs, such as by reducing peak demand, then they will be rewarded with lower network charges. Network businesses will have flexibility about how they measure long run marginal cost.
- The revenue to be recovered from each network tariff must recover the network business' total efficient costs of providing services in a way that minimises distortions to price signals that encourage efficient use of the network by consumers.
- Tariffs are to be developed in line with a new consumer impact principle that requires network businesses to consider the impact on consumers of changes in network prices and develop price structures that are able to be understood by consumers. Consumers are more likely to be able to respond to the price signals that network prices are designed to send if they can relate their usage decisions to network price structures and sudden price changes are avoided. Network businesses can gradually phase-in new price structures.
- Network tariffs must comply with any jurisdictional pricing obligations imposed by state or territory governments. But if network businesses need to depart from the above principles to meet jurisdictional pricing obligations, they must do so transparently and only to the minimum extent necessary.

The final rule also retains the existing pricing principle that is designed to avoid cross-subsidies between different classes of consumers, for example residential and business consumers. This principle requires the level of network prices for a tariff class to be between the avoidable cost of not providing the service and the stand-alone cost of providing the service to the relevant consumers. The existing side constraints, which limit annual price movements within a tariff class, are also retained.

The final rule and determination also clarify how the pricing objective and principles work together.

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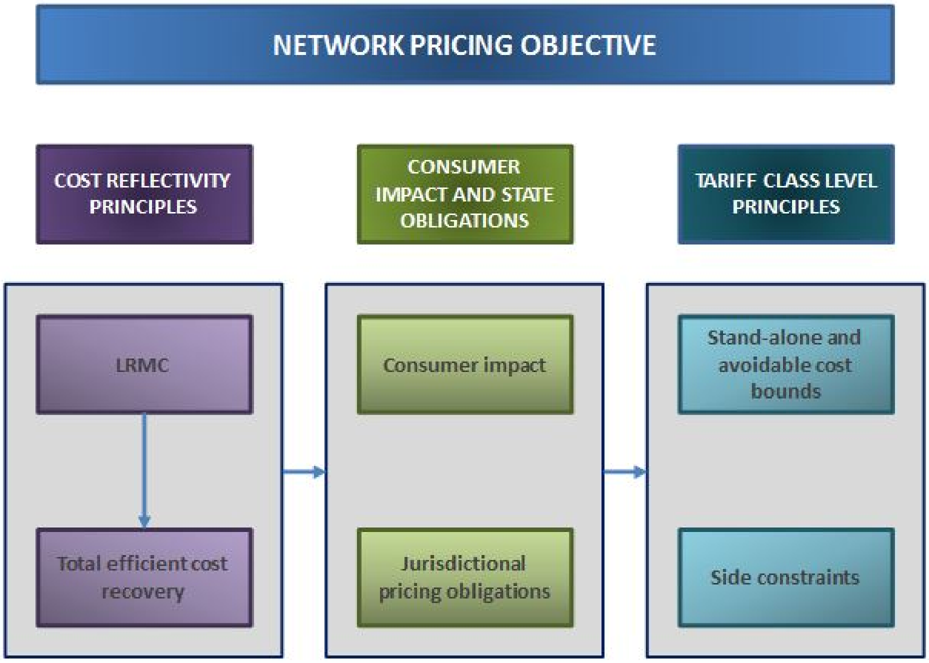
This change puts consumers at the centre of future decision-making about energy.

It means the prices we pay will reflect the actual costs of providing electricity at different times.

Network businesses must comply with the principles in a way that contributes to the objective. If there is a conflict between the principles, the final rule specifies the order of priority of the principles and the extent of businesses' ability to depart from one of the principles to resolve that conflict.

The relationship between the pricing objective and pricing principles is summarised in the following diagram.



How will the change impact the way prices are set?

The final rule contains a new process and new timeframes for setting network prices to improve certainty, timeliness and transparency for consumers and retailers.

Distribution businesses will be required to:

- Develop a tariff structure statement for approval by the AER as part of their five-year regulatory reset process. The price structures to apply for the regulatory period will be approved as part of this process. Price levels will continue to be approved annually, but an indicative pricing schedule will give consumers and retailers more information about likely price levels over the regulatory period.
- Demonstrate to the AER how they have consulted with consumers and retailers in developing their price structures.
- Notify consumers and retailers of final network prices at least six weeks before they commence, allowing them to better prepare for price changes.

When do the final rules commence?

Network prices, based on the new pricing objective and pricing principles will start no later than 2017.

Network businesses will shortly need to commence consulting with retailers and consumers on the network prices that they propose to apply from 2017. Under the final rule, network businesses will need to submit their initial tariff structure statement to the AER by late 2015.

New prices are likely to be phased in from 2017 but the rules allow for a gradual transition to avoid price shocks.

Building on the 2012 network regulation reforms

These changes form part of the ongoing reform of network regulation, which includes significant rule changes made in November 2012 to better equip the regulator to set efficient revenues for network businesses.

This final determination does not change the rules regarding how much revenue network businesses may earn in total. Instead, it is the next step in the reform process and relates to how network businesses divide up that total amount of revenue into network prices that apply to individual consumers.

AEMC Power of Choice Reform Program

This rule change is the second rule change completed as part of a reform program identified by the 2012 AEMC Power of Choice Review to help consumers participate more effectively in energy markets. The first rule change addressed the regulations that allow customers access to information about their energy consumption.

The AEMC is currently assessing a series of other Power of Choice rule changes: expanding competition in metering and related services; AEMO obtaining better demand side participation information; and reform of the demand management embedded generation incentive scheme.

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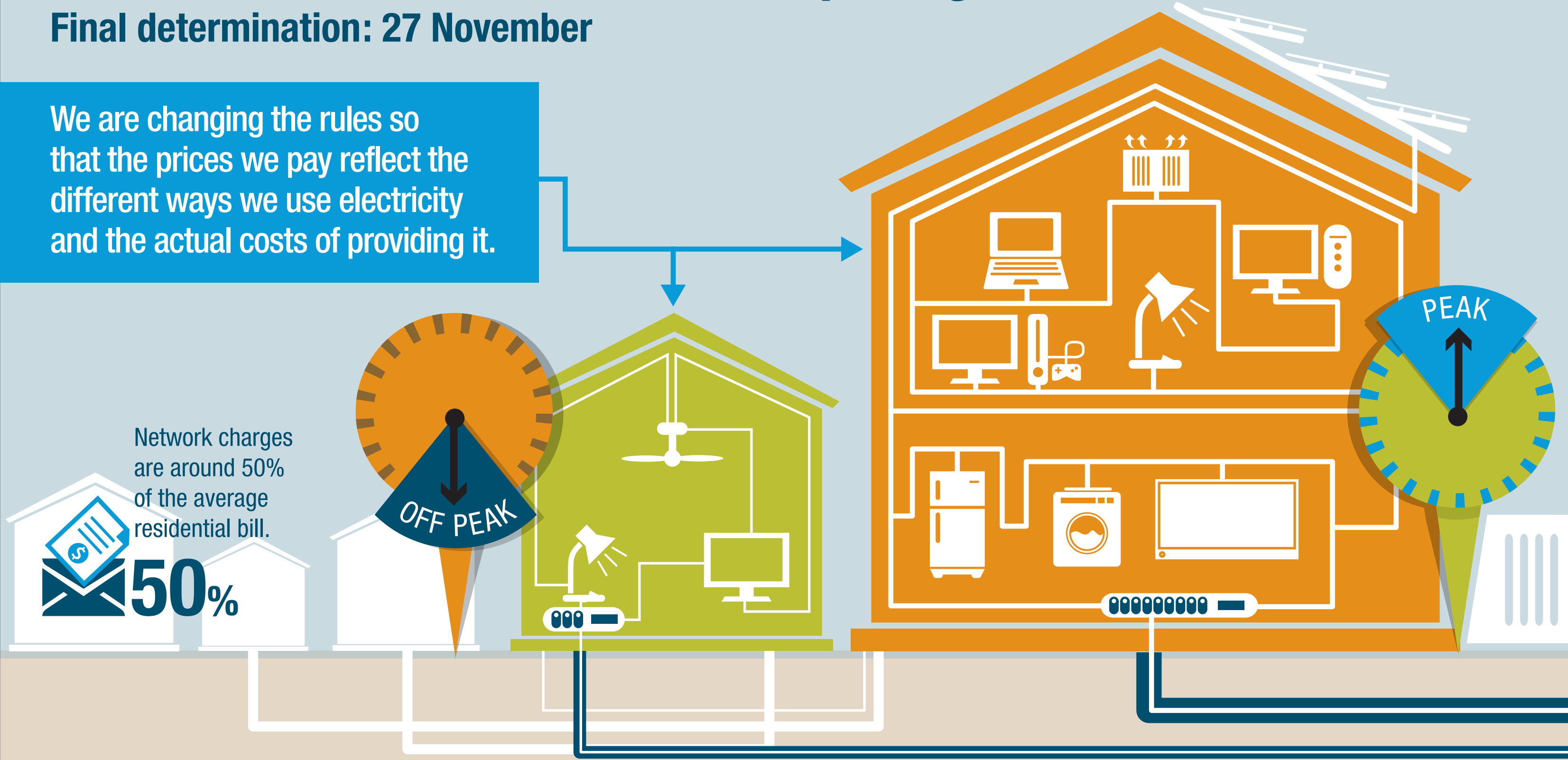
27 November 2014

New rules for distribution network pricing

Final determination: 27 November

We are changing the rules so that the prices we pay reflect the different ways we use electricity and the actual costs of providing it.



Putting consumers in the driving seat

The way we pay for power has to keep pace with our modern lifestyle. When prices reflect how much it costs to use different appliances at different times, consumers are able to make more informed decisions.

OUR CHANGES

We want everyone, from heavy industry to small customers, to be able to make clearly informed decisions about how they use electricity. We want consumers to use electricity when the value of services to them is greater than the costs of supplying it.

Why: It means that the right information on costs will be available to help people choose the energy services that are right for them – no matter what the energy supply industry looks like in the future. Changing the way networks charge is the best way to reduce the risks involved in trying to guess the pattern of future demand.

- More consumer consultation on how network prices are structured
- Network prices that reflect each consumer's usage
- Clear instructions for networks on the requirements to apply when determining how to structure network prices
- Earlier notification of network prices to allow retailers and consumers to better prepare for price changes

HOW CONSUMERS WILL BENEFIT

We have set up the right rules for the future so:

- The prices we pay reflect the decisions we make
- Everyone can make informed decisions on how and when they use electricity as new technologies evolve

POWER OF CHOICE

These rules are part of the AEMC's overall Power of Choice program to give customers better information about how they use energy and how different choices might help reduce power costs. Under these rules people will pay according to how much electricity they use – and when – reflecting the different costs of supplying electricity at different times.

Poles and wires reform