simply energy

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16 October 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted to the AEMC website

Dear Mr Pierce

Reference ERC0161: Distribution Network Pricing Arrangements – Stage Consultation on draft determination

Simply Energy welcomes the opportunity to provide feedback in response to the Australian Energy Market Commission's (AEMC) draft determination on National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014. Simply Energy is a member of the Energy Retailers' Association of Australia and supports the Association's submission.

Simply Energy supports the AEMC's draft determination:

- We support the rules proposed in the draft determination and the AEMC's work on network tariff reform more broadly.
- We support the proposed changes to the annual pricing process and timelines.
- We support the transitional processes that see (Tariff Structures Statement) TSS-compliant tariffs in Victoria from 1 January 2017 and in other National Electricity Market (NEM) states from 1 July 2017.

However, we consider that the draft determination does not go far enough and that consumers would also benefit from the following:

- The pursuit of perfectly efficient network tariffs should not override consideration of the costs of achieving this outcome, and focus should be maintained on implementing cost-reflective tariffs in a way that maximises benefits for consumers.
- A cross-industry process to agree the structure of network tariff that the networks will use.
- Distributors should be required to quantify the impacts on tariffs due to their application of the jurisdictional pricing obligation principle.
- TSS consultation should be tripartite, with distributors, retailers, and consumer representatives in the room together. This will prevent development of 'siloed' positions if distributors consult with individual parties.

Simply Energy's position on network tariff reform

Simply Energy fully supports more cost-reflective network tariffs. Efficient network pricing structures, formulated within the confines of the metering technology available, are important because of the signal they provide about future investment requirements and their role in cost-reflectivity between customers. Rising network tariffs have been a strain for our customers forcing many into hardship and even disconnection. If network tariff reform can ease the pressure of future network price rises, then this will be welcomed by Simply Energy.

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The full benefits of network tariff reform will not be realised if reform results in greater numbers of network tariffs and greater diversity of tariff types across the NEM. Simply Energy would not welcome an outcome where each of the distributors adopted different tariff structures in the pursuit of economic efficiency and cost-reflectivity between customers. It would impose significant costs on us if we had to build or modify our billing systems and our customer interaction processes to accommodate a time of use structure adopted by one distributor, a demand tariff structure adopted by another distributor, a capacity tariff structure adopted by a third distributor, a critical peak pricing structure adopted by a fourth distributor, and/or some combination of all of these by a fifth distributor.

Simply Energy is concerned that network tariff reform will result in an explosion of network tariff types across the NEM. There are already too many network tariffs that we have to price and that we make available to our customers. In Victoria alone, there are dozens of network tariffs across our residential and small business customer base. It is administratively burdensome to price all of these tariffs, and the volume of tariffs is confusing for our customers.

We have heard the view expressed in some quarters that the impact on retail costs does not matter. This is a fallacy. It is not true that Simply Energy has the capacity to smooth different network tariff types across our customers, and that it is only important that the retailer sees the price signal. This view does not respect or show a great depth of knowledge of the way that our billing system and processes operate. In addition, if a retailer is expected to smooth the price signal before sending this on to the customer, then we query the value of these reforms.

The objective of network tariff reform should be to achieve more cost reflective pricing but in the least-cost manner for the end customer. The customer does not benefit from shifting costs from the network and onto the retailer.

Simply Energy believes that the industry needs to come to an agreement on the structure of the network tariff that the networks will use. There needs to be agreement that, for example, a demand tariff where customers are charged for the maximum demand they place on the network offers the best opportunity for signalling the costs of providing the network, and that all distributors in the NEM will adopt this structure. The agreement would also encompass the networks agreeing not to use other structures, such as time of use, capacity tariffs and critical peak pricing. Note that Simply Energy does not consider that the price signals under time of use tariffs are sufficiently focused for time of use tariffs to be cost reflective.

We accept that there may be circumstances where the networks may need to use a variant of the agreed standard. For example, the critical peak pricing structure can send a sharper price signal in certain circumstances. The networks may also want to experiment with new tariff innovations to deal with new or changing circumstances.

However, wider network tariff reform and the use of bespoke tariffs to meet certain circumstances requires a cross-industry process for managing their development and introduction. The TSS process will not be sufficient because the networks will not coordinate their TSSs. Instead they will act in isolation from what other networks are doing.

While a step in the right direction, the network tariff objective and principles proposed by the AEMC will not necessarily achieve an outcome that has cross-industry support because they still leave the networks with too much discretion on how they price and structure their tariffs.

As has been identified by many stakeholders, we consider that reforms will be most successful if government and industry effectively educate consumers about the need for the reforms, and provide information about

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the opportunities available to consumers if they adjust their consumption patterns under time-varying tariffs[1], potentially reducing their electricity bill while maintaining the benefit they obtain from the use of electricity.

One further point Simply Energy would like to raise is what sort of reform this will be:

- Will it be a 'big bang' reform where all consumers are 'transitioned' to new tariff structures as soon as technology is available, with education and support campaigns to manage the transition and minimise the negative consumer and media reactions we are already beginning to see?
- Or will a voluntary approach be used where consumers are offered the opportunity to move to tariffs that better reflect the costs of serving each consumer individually?

Simply Energy considers that consumer outcomes will be better under a voluntary approach to network tariff reform than under an approach that compulsorily transitions consumers to time-varying tariffs.

In the following sections, we set out our views in relation to the key areas addressed in the draft determination.

New pricing objective and pricing principles

Simply Energy supports the new pricing objective and the pricing principles set out the Draft Rule. However, we do not believe that they go far enough and would welcome additional principles that provide stricter requirements on how the distributors structure their tariffs.

The addition of a network pricing objective is a useful step forward as it provides guidance to the distributors about what their tariffs should be designed to do, and provides a framework for discussions between distributors and stakeholders about network tariffs.

We support the intent of the network pricing objective, which states that the tariffs that a distributor charges in respect of its provision of direct control services to a consumer should reflect the efficient costs of providing those services to the consumer.

However, we note that the recovery of total efficient costs principle requires that the amount of revenue recovered from each tariff must reflect the total efficient costs of providing network services to the consumers that are assigned to that tariff. Simply Energy is increasingly questioning why distributors should have investment certainty.

The Grattan Institute report "Shock to the System" puts forward the idea that distributors could be provided with a higher Weighted Average Cost of Capital (WACC) than otherwise, in return for the businesses facing some risk with respect to the future earnings from their capital investments. In our view, if distributors faced greater consequences of their investment decisions then they would be more considered about the tariff structures they develop, without having to wait for policy makers to force them to do it.

We also generally support the draft rule changes to the network pricing principles, including the strengthening of the requirement relating to the application of long-run marginal cost to network tariffs. The addition of a consumer impact principle is an overdue development, as distributors have in the past set their tariffs to meet their own objectives, in some cases with significant negative consumer impacts.

The consumer impact principle is critical, especially given the expected extent of reforms, as it places obligations on distributors to set network tariffs that consumers can understand, and to minimise the impacts

[1] Time-varying tariffs include time of use, demand, capacity, critical-peak pricing, and other non-flat tariff structures.

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of network price changes on consumers. This principle allows distributors to slowly transition consumers to cost reflective tariffs over time, which will be important if network tariff reform for residential and small business consumers is to succeed.

The jurisdictional pricing obligation appears necessary due to the possibility that jurisdictions will impose obligations on distributors that require them to apply tariffs that do not conform to the other principles. The need for this principle highlights how far the energy industry is away from genuine national regulation, despite the current national regulatory bodies having been in place for almost ten years.

We suggest that the rules relating to this principle are strengthened to promote transparency, by requiring the distributors to quantify how the tariffs charged to consumers have been affected by the application of this principle.

Network pricing process — tariff structures statement

Simply Energy supports the introduction of the tariff structures statement (TSS) as a step forward in transparency around network tariffs. The TSS should also provide some coherence and stability over time in how distributors charge for their services. Additionally, at a high level the processes developed for the TSS seem sound.

The TSS will only make a difference to consumer network tariffs if the AER is able to make it binding on distributors and it is detailed enough to ensure that tariffs remain on the pathways agreed with stakeholders and approved by the AER. The draft rules include features that promote the TSS effectively achieving this. These include the following TSS required content:

- Shows how the distributor has applied the pricing principles to develop its tariff structures
- Includes indicative pricing levels for the five year regulatory period
- Lists the tariff classes into which retail consumers will be divided during the regulatory control period
- Describes the policies and procedures the distributor will apply when assigning and reassigning consumers to tariffs
- Provides the structure for each proposed tariff
- Details the charging parameters for each proposed tariff
- Provides the pricing method that will be used to set each tariff
- Is accompanied by a pricing schedule that sets out indicative price levels for each tariff in each year of the regulatory period.

The TSS will be assessed by the AER for compliance with the pricing principles at the same time that it assesses the distributor's revenue proposal. Once approved, the pricing structures in the TSS will remain in place for each year of the regulatory period, unless an unexpected event requires a change and the AER approves that change. For this to be effective the AER needs to be given sufficient powers and discretion to reject unreasonable change requests.

Nevertheless, if the TSS process is to have practical benefits for consumers then a distributor needs to develop its five-year TSS and annual tariffs thoughtfully and cognisant of the potential consumer impacts of its decisions. The requirement for distributors and the AER to consult with consumers and other stakeholders provides some mechanisms for distributors to hear from others and develop tariffs that reflect the views of those who will be impacted by them. Additionally, the requirement for distributors to set out how they have consulted on the TSS and addressed stakeholder concerns is useful.

However, we consider that there is an opportunity to provide greater benefits for consumers by expanding the draft rules to provide for greater consistency of network tariff structures. The proposed draft rules give the

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distributors too much discretion, and consumers will get benefits from consistency if the scope of this discretion is reduced and greater consistency of tariff structures is achieved. We note that no negative impacts from consistency have been demonstrated.

Greater consistency of structures

As noted at the start of this submission, network tariff reform will be successful if it has cross-industry support. We would like to see distributors and retailers work collectively to agree on many of the details about how network reform is implemented.

There could be a role for AEMO to be responsible for developing and maintaining a body of agreed network tariff structures, to be submitted to the AER for approval, to support transactional efficiency.

The agreed tariff structures would be developed with distributors, retailers, and consumer representatives to balance the need for distributors to have flexibility over their tariffs, the need for retailer and distributor transactional efficiency, and the need for tariff structures that are appropriate for consumers.

An agreed set of tariff structures will be an important way of keeping implementation costs to a minimum, which is critical given the lack of significant overall savings available from reform.

Given that the benefits of more consistent tariff structures are clear, if distributors consider that they require more discretion to develop less consistent structures, then they need to demonstrate why this will have net benefits for consumers.

Tripartite TSS consultation

Similarly, the Tariff Structure Statement (TSS) consultation process needs to be tripartite, involving distributors, retailers, and consumer representatives together at the same time. If distributors consult with consumer representatives in the absence of retailers then retail issues will be missed, and consumer representatives and distributors may develop positions that fail to take account of retail matters. This is not a good outcome as consumers will be frustrated if retailers are unable to provide the outcomes sought by consumer representatives, which they had agreed with the distributor.

Draft rules provide sufficient flexibility

The draft rules provide sufficient opportunities for distributors to explore tariff innovation. Distributors can introduce new tariffs (that are not included in the TSS) if the expected revenue from each tariff is less than 0.5% of the distributor's annual revenue requirement and if the new tariffs together recover less than 1% of the distributor's annual revenue requirement.

Network pricing process — annual price setting process

Simply Energy strongly supports the introduction of binding timeframes for distributors to submit their price proposals each year and for the proposals to be approved and notified to stakeholders.

As we have stated in previous submissions, the current lack of binding requirements and the consequent late delivery of approved prices has led to less efficient retail price setting and the consequent negative impacts on consumers.

The timeframes proposed in the draft rule should ensure that network prices are generally approved at least six weeks before they commence. We consider that this is a reasonable minimum period for us to finalise

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retail tariffs that reflect the changes to network tariffs, which are costs that we incur that are beyond our control. A shorter period than six weeks would jeopardise our ability to develop efficient retail tariffs.

Additionally, the requirements for distributors to develop their annual pricing proposals by applying pricing levels to the tariff structures outlined in their approved TSS, and for the AER to assess the proposals against the TSS, is a useful step forward. It should give some stability to network tariffs from year to year, and changes should be consistent with the direction set out in the TSS.

However, the practical value of the TSS is highly dependent on how closely it constrains the individual tariffs. If experience shows that the TSS, and the scope of the AER's ability to determine whether annual tariffs are consistent with the TSS, are inadequate to provide the tariff consistency the rules are intended to achieve, then the rules should be strengthened immediately to achieve the intended outcome. This should be explicitly stated in the rules.

Transitional arrangements

Simply Energy supports the transitional arrangements set out in the draft rules as providing a reasonable balance between the practical challenges of developing, consulting on, and approving TSSs, and the missed opportunity if TSSs are not introduced as soon as possible.

Requiring all distributors to develop TSSs and submit them to the AER in 2015 gives sufficient time for the TSSs to be developed. While the TSS has specific new requirements, distributors have teams of pricing managers and analysts who are constantly looking at tariffs and their structures, and these teams should therefore be in a good position to develop the TSS content without needing long lead times.

Having TSS-compliant tariffs starting in Victoria on 1 January 2017 and in New South Wales, South Australia, Queensland, and the Australian Capital Territory on 1 July 2017 is realistic, and if distributors consider that consumers will benefit if TSS-compliant tariffs are introduced later, then this needs to be demonstrated.

What type of reform is network tariff reform?

However, a big question remains unanswered – what sort of reform this will be:

- Will it be a 'big bang' reform where all consumers are 'transitioned' to new time-varying tariffs as soon as technology is available, with education and support campaigns to manage the transition and minimise the negative consumer and media reactions we are already beginning to see?
- Or will a voluntary approach be used where consumers are offered the opportunity to move to tariffs that better reflect the costs of serving each consumer individually?

Additionally, the COAG Energy' Council's Rule Change Request "Aligning Network and Retail Tariff Structures for Small Customers" provides an insight into policy makers' concerns about consumer outcomes under network tariff reform, in particular the concern that in the absence of COAG's rule change, a consumer who considers that a time-varying tariff does not suit them will no longer have access to reasonably priced electricity.

With this in mind, Simply Energy considers that consumer outcomes will be better under a voluntary approach to network tariff reform than under an approach that compulsorily transitions consumers to time-varying tariffs.

The principal objection to a voluntary approach to network tariff reform is based on the research that shows that opt-in approaches (such as the opportunity to choose a tariff under which you expect to be better off

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than under your existing tariff) have lower annual take-up than opt-out or compulsory approaches, which defers the benefits of the reform.

This would be a credible objection to a voluntary approach if there were significant benefits for the community as whole that will be deferred or lost from a voluntary approach, but that is not the case with the proposed reforms.

Rational policy decisions are based on assessments of the costs and benefits of the policies. A reform policy always incurs implementation costs as it involves changes from the current state. There is also the risk of unintended consequences of the reform, compared with allowing the current state to evolve without the reform.

If the potential benefits of reform are high then this can outweigh high implementation costs and material risks, because although there will be winners and losers from the reform, overall the community will be better off. Also, some of the gains made at the community level can be provided to 'losers' from the reforms, mitigating the negative consequences for them, while still providing the 'winners' with benefits.

Unfortunately it is unlikely that there will be significant gains to consumers as a whole from network tariff reform, especially in the short term. The potential gain to consumers as whole from network tariff reforms is that improved price signals lead to reduced costs overall, as inefficient network augmentation is avoided. So much network augmentation has taken place in recent years, against a developing background of reducing electricity usage and peak demand, that future avoided augmentation costs are unlikely to be significant, compared to the level of sunk costs.

This view is supported by AEMO's 2014 National Electricity Forecasting Report (NEFR). Figure 3 of the NEFR Executive Summary shows that state maximum demand (the highest level of demand expected in each state in each year) is not expected to return to historical levels in Victoria and South Australia until after 2033-34, in New South Wales before 2022-23, and in Queensland (excluding LNG, which does not use the south-east Queensland distribution networks that make up the bulk of network costs) before 2021-22.

Given that reform cannot unlock significant savings from avoided augmentation costs, the key issue facing network tariff reform is how sunk network costs can be recovered more cost-reflectively from consumers while minimising the additional costs of making this happen.

If you have any questions concerning this submission, please contact James Barton, Regulatory Policy Manager on (03) 8807 1171.

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