



4 July, 2013

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Khan.

Annual Network Pricing Arrangements, Consultation Paper, 6 June 2013
(ERC0149)

Powercor and CitiPower (the businesses) welcome the opportunity to respond to the proposed rule change published by the AEMC on Annual Network Pricing Arrangements.

The businesses question the need for this rule change noting that:

- The Victorian, South Australian and Queensland jurisdictions (from 2015 onwards) do not, or will not, have retail price regulation in place. The businesses note that the jurisdictional process for incorporating network tariffs into and approving retail tariffs is therefore not a national issue
- The proposal for customer engagement is appropriately dealt with under the AEMC's "Powercor of Choice" strategy and the AER's customer engagement guideline
- DNSP's cannot add any more certainty to future price directions than it already does due to the lack of control over cost inputs mandated upon it from upstream process
- The intention to create more time for a jurisdictional regulator to approve retail tariffs does not necessarily improve the quality of outcomes and more importantly can better be managed through alternative solutions, in particular the unbundling of tariffs, ie. displaying network and retailer components separately on the end customer bill. This removes the time constraints IPART has on its approval processes.

The proponent's proposal to shift the timing requirements of network charging approvals can result in value dilution caused changes in processes.

Notification of annual network price changes

It is not until the components that go into developing network prices are finalised that DNSP's can notify retailers and customers of network tariff

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only a handful of days to notify interested parties. Any earlier notification will require:

- The DNSP to qualify network prices changes as estimates
- Amend the process to use earlier inputs but true up for actual inputs in later years
- Undertake one off amendments to the process to account for earlier inputs

The businesses wish to highlight that the consequences of amending the pricing proposal process, and in particular the use of an alternative CPI value, has consequences on the RAB roll forward process affecting the economic value of DNSP assets. Clause 6.5.1(e)(3) of the Rules requires that the RAB be indexed by actual inflation consistently with the method used for the indexation of the control mechanism for standard control services. Therefore, any adjustment to the method for indexation of prices will also need to apply to the method for indexation of the RAB.

Statement of expected price trends

The proposed change recommends additional criterion for granting approvals on consistency with the statement of expected price trends, the business are strongly opposed to this.

The objective of the recommendation is to have some certainty around forward prices however this presumes DNSP's have full knowledge of it's cost components and has a high degree of control over them.

Within the network price there are 4 components (i) standard control services, (ii) designated pricing proposal charges, (iii) jurisdictional cost recovery schemes and (iv) pass through amounts. The amounts (ii) through (iv) are cost recovery components determined by factors outside of a DNSP's control and therefore the DNSP should not be held accountable for variances in the forecasts for these components.

Further, the majority of rate change for the standard control services is determined by the X-factor and CPI which are well known by industry participants and jurisdictional regulators well in advance of final prices being approved.

The controllable and known components the DNSP is accountable for are of a low proportion and adds virtually no value in a notification process.

The businesses have responded to each of the questions raised in the AEMC's position paper in the attached pages.

If the Commission wish to discuss any of this submission, please do not hesitate to contact me on 03 9683-4469.

Yours sincerely

[signed]

Matthew Serpell
Manager, Network pricing

1. Is the assessment framework presented in this consultation paper appropriate for assessing this rule change request?

The framework is consistent with the national electricity objective, however the businesses seeks assurance that the assessment of the efficient allocation of risk must ensure that DNSP's do not have their allowed revenue or RAB values reduced.

Additionally the businesses note that some aspects of the proposed change merely shift risk and cost from retailers to DNSP's, this is not in line with the NEO and therefore solution for overall efficiency must be pursued in preference to those sought by the rule proponent.

2. Are there any other key dates or inputs in the pricing process for TNSPs and DNSPs?

For Victorian DNSP's, operating on a calendar year basis for tariff setting purposes, have the following dependency dates:

- RIN template - submission to the AER by 30 April each year.
- Transmission costs - released no later than 15 May each year.
- September quarter CPI - issued around the 3rd week of October by the Australian Bureau of Statistics.
- License fees - released by the Victorian Department of Treasury around September each year. This is used for determining the L-Factor in the WAPC formula.
- For the initial pricing proposal, the final determination from the AER is known around October of the year prior to the commencement of the regulatory control period.

The main issue is then a potential double count of inflation. This current method, assumes inflation is based on the September quarter; if the method was changed to June quarter there would be a one-off double counting of the July-Sept quarter in the transition year resulting in an economic benefit or detriment to the DNSP.

3. Other than the question of timing, are there any other differences in the regulatory arrangements in Victoria which are relevant for the purposes of this rule change request?

License Fees for services provided by the Victorian Essential Services Commission are charged to DNSP's which is then recovered through the L-Factor as determined by the AER in it's price review determination.

With the removal of retail price caps in Victoria the imperative for timing, whilst important for retailers, is reduced relative to many inter-state counterparts where the jurisdictional regulators add an overly to the price setting process.

4. What are the risks in requiring TNSPs and in particular, DNSPs to publish their annual prices earlier than currently required? What are the consequences of these risks and can these risks be adequately managed if the proposed rule is made?

If the submission date for pricing proposals is made earlier then the risks of not recovering the allowable revenue effectively move from retailers to DNSP's, this does not achieve the rule change objective of reducing overall risk, rather it is merely reallocates risk to DNSP's. To reduce overall risk other corrective measures need to be implemented.

The earlier the submission date the greater the risks faced by DNSP's. For RIN data and transmission cost components the pricing proposal submission date could be brought a number of months without financial consequence. For CPI and license fees on the other hand the impacts of submitting earlier than the current time frame can be material, for example, in the 2012 year CPI for Victorian DNSP's shifted in the June quarter from 1.6% to 2.0% by September.

The most significant impacts is the AER's final determination for a regulatory control period in which highly material consequences would occur if pricing proposals were submitted ahead of their final determination outcomes.

5. Should the AER have a set timeframe in which to assess all DNSP annual pricing proposals?

The DNSP's believe the AER should be afforded sufficient time to undertake a proper assessment of pricing proposals to ensure the best outcomes for consumers.

Having said that, in years where there is no structural changes to prices the time for assessment has historically been less than those years where structural changes have occurred, this is due checking being more straight forward. In years where structural changes to tariffs occurs more time should be afforded, this also applies to the year after the structural change has occurred due to the lagged effects of estimating Qt-2 values. The businesses do not see that a response time frame of 20 days to be inappropriate for the AER to assess pricing proposals in a year where no structural changes occur, however more time should be afforded in those pricing years where structural reform occurs.

6. Is anything else involved in the AER approving a DNSP's annual pricing proposal? How much time should be allocated to the AER for this assessment/approval?

The AER primarily undertakes a compliance review against audited data and assesses reasonable estimates¹ when considering tariff structure changes. In years where there is no assessment of reasonable estimates the check is more compliance driven and should be completed relatively quickly.

7. How much time do retailers and jurisdictional regulators require for notification of network prices before finalising retail tariffs and notifying customers?

The businesses are not in a position to respond to this question.

8. Is the proposed notification of two months sufficient?

This is best responded to by the retailer regulators and retailers who rely on this data. Quantitative evidence should be provided by these parties to demonstrate that such a change has a material benefit to end consumers.

¹ Appendix E.1, "Final decision, Victorian electricity distribution network service providers, distribution determination 2011-2015," (October 2010)

9. What type of consultation on level and structure of network prices would be useful to consumers/consumer groups and what benefit would there be?

Given the relatively fixed constraints on tariff levels consultation should not be onerous, should focus on tariff structure changes, focus on price levels to the extent that they are known and controllable and qualified as estimates where control or certainty is not known.

10. How much scope would there be for consultation on proposed annual network prices?

Annual prices changes are relatively fixed (X-factors and CPI movements) or uncontrollable (Designated Pricing Proposal Charges and Jurisdictional Schemes) and therefore the ability of DNSP's to take on board the response to customer feedback is heavily constrained. Consequently consultation should be constrained to structure issues.

11. How useful is the current statement of expected price trends to retailers and consumers?

The businesses are not in a position to respond to this question as it is the retailers and jurisdictional regulators that use this information for their own purposes.

12. What influences the statement of expected price trends?

The key components that influence standard control service component includes X-Factor, as determined by the AER in its final determination and CPI. Other factors only have a minimal impact on standard control service pricing.

DNSP's are unable to comment on price trend relating to the components of Jurisdictional Cost Recovery Schemes, Designated Pricing proposal Charges and Pass Through amounts as these are determined by parties other than the DNSP and therefore cannot comment on influencing factors.

13. Should a DNSP's approval of its annual prices be linked to how accurately it can track the statement?

Such a test is a highly subjective and more often than not is determined by factors outside of the DNSP's control. As noted in the response to q12, all components are determined by parties other than the DNSP and therefore is unable to predict with any accuracy all components of its pricing.

For example, AEMO pricing for TUoS non-locational component decreased by 54% in the 2013/14 year. This level of volatility (contributing to Designated Pricing proposal Charges) is inconceivable to a DNSP in setting a forward price trend, especially due to the relatively fixed nature of AEMO operations. Being assessed on factors outside of its control is an inappropriate test.

14. What are the key dates in the initial year pricing process of TNSPs and DNSPs?

The release date of the final determination is around 2 months prior to the commencement of the regulatory control period. Without this information any tariff proposals will be materially erroneous and cannot be verified by the AER as compliant.

15. What is the best option to manage the first year pricing issue? Is it necessary to keep timings for the first year and subsequent years the same?

The risk of recovering revenue in the initial year is highly material should the pricing proposal submission date pre-date the final determination. Further, under the current process the AER is unable to assess compliance without the final determination being released.

Any suggestion of bringing forward the EDPR process to accommodate longer notification periods for pricing proposals in the initial year should not be pursued as the degree of currency in the final determination is quickly diminished which goes against the NEO objective. Alternative solution should be investigated first.