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Australian Energy Market Commission
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Dear Mr Pierce

Submission to IPART proposed rule change - Annual Network Pricing Arrangements

Please find attached the Australian Energy Regulator's (AER) submission to the Australian Energy Market Commission's (AEMC) Consultation Paper in relation to National Electricity Amendment (Annual Network Pricing Arrangements) Rule 2013.

If you would like to discuss any aspect of this submission please contact John Skinner, Director, Network Operations and Development, on (02) 9230 3855.

Yours sincerely



Andrew Reeves
Chairman
Australian Energy Regulator



Rule changes - Annual network pricing arrangements

AER Submission to Consultation Paper

July 2013

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1 Introduction

We welcome the opportunity to comment on the AEMC's Consultation Paper on the proposed changes to the National Electricity Rules (NER) pertaining to annual network pricing arrangements. This rule change was proposed by the Independent Pricing and Regulatory Tribunal of New South Wales (IPART) in September 2012.

We support more timely electricity network pricing outcomes and greater stakeholder engagement / consultation in the network tariff setting process. As such, we welcome IPART's proposal to bring forward the submission date for network tariff proposals. That said, certain implementation issues will need to be addressed as noted later in this submission.

However, we are of the view that all other aspects of IPART's proposal should be considered together with the broader package of pricing reforms arising from the AEMC's Power of Choice review. We understand that these are currently with the Standing Council on Energy and Resources (SCER) for consideration and that rule change processes are expected to be commenced later this year.

A number of recent reviews, including the AEMC's Power of Choice review, have identified a need for wide-ranging reforms to the network tariff setting process, to improve price signals and empower consumers to make more efficient decisions. As recommended in the Power of Choice review, these reforms include:

- Amendments to the pricing principles upon which Distribution Network Service Providers (DNSPs) set network tariffs – to ensure more cost reflective prices.
- The introduction of stakeholder consultation requirements upon DNSPs in relation to the tariff setting process – to ensure that network tariffs are targeted, transparent and understood.

These important and broader reforms arising from the Power of Choice review have a number of inter-linkages with specific aspects of IPART's rule change proposal. This makes it difficult to consider IPART's proposal in isolation. For example:

- Determining a suitable fixed timeframe for the AER's tariff reviews will be influenced by whether we will need to consider distributor compliance with more detailed economic pricing principles and consultation requirements as per the Power of Choice recommendations.
- Requiring the AER to develop a pricing guideline dealing only with consultation requirements around the quantum of network tariffs is less likely to facilitate meaningful stakeholder involvement than if it also dealt with issues in relation to tariff structure and strategy as per the Power of Choice recommendations.

This submission to the AEMC's consultation paper is structured as follows:

- Measures to ensure more timely pricing outcomes – including the timing of annual and initial tariff reviews, and timeframes for AER tariff reviews.
- Stakeholder consultation in relation to network tariffs – including the Statement of Expected Price Trends document, and AER pricing guideline.

2 Ensuring timely pricing outcomes

We recognise that the timeframes within which electricity network prices take effect each year often create difficulties for various stakeholders, including retailers, consumers and jurisdictional regulators (where price regulation still exists). Many of these groups have sought earlier notification of changes in the level/quantum of network prices to facilitate their own processes. These include the setting of retail offers, financial year business budgeting, or setting of regulated retail prices.

As such, we support the proposal to bring forward the submission date of annual network tariff proposals, subject to certain implementation issues being addressed (discussed further below). However, we consider that the other measure proposed to facilitate more timely outcomes, namely the proposal to fix a timeframe in the NER for AER tariff reviews, could more usefully be considered together with the broader Power of Choice recommendations. Rule changes arising from the Power of Choice recommendations will ultimately determine the extent of matters to be addressed in AER tariff reviews and therefore the length of time that they might be expected to take.

2.1 Annual pricing proposals

Bringing forward the timing of annual network pricing proposals and therefore the likely completion date of tariff reviews is likely to result in more timely pricing outcomes. We consider that this is also a reform that could feasibly be introduced in isolation of the other aspects proposed by IPART. We therefore support bringing forward the following:

- the date by which Transmission Network Service Providers (TNSPs) need to publish their prices by two months (from 15 May to 15 March);
- the date by which DNSPs need to submit their annual pricing proposals by one month (from 1 May to 1 April).

While supporting these proposals, we note that bringing forward these timeframes might create a number of specific impacts that will need to be managed, by both the AER and network service providers. While service providers are best placed to comment on the nature of these impacts, the following will need to be considered if this change is to be made:

- The extent of any revenue or cash flow risk created by service providers' forecasts in annual pricing proposals needing to be made earlier in the year.
- Changing the Consumer Price Index (CPI) used in AER regulatory determinations. This would need to be adjusted in some cases (e.g. from March-to-March to December-to-December).
- The input of the Service Target Performance Incentive Scheme's S-Factor into transmission pricing. Bringing forward the timing of published transmission prices will constrain the time in which the AER will have to undertake the task of assessing S-Factors. Timeframes for these reviews will be constrained to less than six weeks.¹ A shorter timeframe raises similar challenges to those set out in section 2.3 below. Namely, circumstances often arise requiring the AER to seek further information or other requests from businesses. We are currently already looking to streamline and improve the efficiency of our approach to annual performance reporting of TNSPs, which among other things, is intended to achieve more timely conclusion of S-Factor reviews. Other options to address these challenges, such as the possibility of shifting from calendar year to financial year assessments, might also need to be considered. We also note that any substantive change to the timing of the performance

¹ These reviews are currently undertaken on a calendar year basis.

recording or reporting regime will require the formal amendment of the scheme and the TNSP Information Guidelines.

2.2 Initial year pricing proposals

While IPART's proposal has sought to bring forward the timing of annual pricing proposals, it has not specifically addressed the issue of the timing of the initial year's pricing proposal. While it is likely to be feasible to bring forward the timing of annual pricing proposals, the solution for dealing with the timing of initial pricing proposals is less clear.

The timing of the initial year's pricing proposal is dependent on the finalisation of the AER's regulatory determinations. The initial year pricing review is currently undertaken subsequent to the determination. We do not envisage that the timing or length of these determinations would be altered. Indeed, the recently introduced NER Chapter 6 network regulation rule changes envisage a longer and not shorter regulatory determination process.² As such, the only remaining options to ensure timely outcomes with respect to initial pricing proposals might be to rely on the following during the regulatory determination process:

- Effective stakeholder consultation on the price path relating to the level (i.e. quantum) of network tariffs.
- Having DNSPs provide indicative network tariff levels during the regulatory determination process. For example, these could be constructed on the basis of:
 - acceptance of the DNSP's regulatory proposal or revised proposal, or
 - the AER's draft decision;

The option of using the draft decision or the revised regulatory proposal figures might provide the most certainty for DNSPs. They could later be adjusted following conclusion of the AER's final decision and the AER's network tariff review.

These apparent difficulties with bringing forward the initial network tariff review would be lessened under the pricing reforms recommended in Power of Choice. This is because tariff consultation would be undertaken within the timeframe of the AER's regulatory determination. The AEMC should carefully consider these interactions in deciding whether to proceed separately with the IPART proposals.

2.3 AER review timeframes

Fixing a timeframe for the AER to undertake its tariff reviews creates greater certainty as to the length of reviews and timing of network pricing outcomes. However, at this time, it is difficult to determine a suitable time-limit for the AER to make its annual network pricing decisions. The length of time required will heavily depend on the nature of more detailed distribution pricing rules that are expected to be introduced as per the Power of Choice recommendations.

The Power of Choice recommendations envisage the AER undertaking a more detailed tariff review than currently provided for in the NER. We also expect that these new arrangements will present a substantial change in current operations for some DNSPs (and stakeholders). The changes may therefore require a period of adjustment, in particular, in designing more efficient network tariffs and

² AEMC, *Information sheet – Final rule determination, Economic Regulation of Network Service Providers*, 29 November 2012, p.2.

consulting formally with stakeholders. For example, the Power of Choice recommendations require the AER to assess DNSP compliance against the following:

- More detailed and binding economic pricing principles, designed to ensure greater requirement / guidance to set tariffs reflective of underlying cost drivers.
- Detailed requirements for DNSPs to consult with retailers and consumers on both the quantum and structure of network tariffs.

We consider that, even under the current set of pricing rules with only broad economic principles and no consultative requirements, that IPART's proposed fixed timeframe of 20 business days for the AER to complete tariff reviews is challenging. To date, we have generally required approximately 20-30 business days to complete tariff reviews, in situations where no significant problems have been encountered. However, circumstances have often arisen that have meant that the reviews have taken longer than 30 business days. These include where:

- A proposal has not effectively complied with the NER. Issues of non-compliance have included:
 - Proposals based on inaccurate or unsupported forecasts. This has been of particular significance recently with introduction of new time of use or flexible pricing, where take up rates need to be estimated in the absence of any historical usage profiles.
 - Proposals based on potential success in ongoing regulatory appeals processes.
 - Proposals submitted late.
- A substantial change in circumstances has occurred post the original submission.
 - On a yearly basis we generally receive at least one revised tariff proposal several weeks after the original 1 May deadline. This is often the result of circumstances such as subsequent tribunal decisions being made and altering the AER's approved recoverable allowances, jurisdictional government directives, or changes in final transmission network prices from those initially expected.
- Identification of substantive errors or missing information.
 - Pricing proposals have at times been submitted with incomplete information, requiring additional information to be requested by the AER. At times, it has taken DNSPs one or two weeks to provide the requested information.

If a timeframe is to be fixed in isolation of the Power of Choice reforms, we are of the view that an alternative to the 20 day time limit should be to have a two part requirement in the NER. This would operate as follows:

- Fix the AER's timeframe at 30 business days if there are no exceptional circumstances. This time-limit is consistent with the approval deadlines in the majority of gas access arrangements decided under the National Gas Rules (NGR).
- Introduce 'stop-the-clock' or other provisions allowing the AER further time if significant issues (such as those identified above) are encountered during the approval process. This approach is employed in a number of gas access arrangements under the NGR. For example, the Amadeus gas access arrangement approved by the AER in 2011 allows the 30 business day period to be extended for time taken by the AER to obtain information from the pipeline service provider, obtain expert advice or consult about the notification.

3 Stakeholder consultation

We recognise the need for greater stakeholder engagement/consultation in the network tariff setting process. This complements the new requirements in relation to price determinations now established in the NER.³ The need for consultation will increase further if greater cost reflectivity and time variability in network prices is introduced as per the Power of Choice recommendations. For many stakeholders, this would result in new and innovative approaches to pricing.

Currently, the NER pricing arrangements do not formally provide for any consultative process by DNSPs in designing, applying or changing their network tariffs. We have identified, on occasions, that customers have not been adequately consulted with by either the DNSP or retailer when tariffs have been changed. While IPART's proposal has sought to improve stakeholder involvement, the proposal focusses solely on arrangements relating to the quantum of network tariffs. We consider it difficult to achieve meaningful stakeholder involvement if issues in relation to network tariff structure and strategy (as proposed in Power of Choice) are separated from this process.⁴ As such, while we support DNSPs needing to consult in developing a Statement of Expected Price Trends, and the role of an AER guideline in facilitating this process, these issues should ideally be considered together with the Power of Choice reforms. We also consider that binding DNSPs to this statement presents a number of challenges – this is discussed below.

3.1 Statement of Expected Price Trends

The current requirement on DNSPs to prepare a Statement of Expected Price Trends can serve a useful role in providing stakeholders with a reasonable expectation of the movement in the level of network prices. However, we would suggest the current application of these statements might be too high level and need to specify more detailed tariff level information. IPART has also sought to improve the value of this statement by requiring DNSPs to consult with stakeholders in its development. We support this proposal, noting the importance of ensuring that stakeholders sufficiently understand and are consulted on the information presented in the statement.

IPART has also sought to give the statement greater prominence by seeking to bind DNSPs to it, by requiring that the AER's tariff approval criteria include the requirement for pricing proposals to be consistent with this statement. This proposal could present a number of challenges given various circumstances that can and often do arise and which mean that a DNSP's tariffs do not end up as initially envisaged. For example:

- Demand might shift from what was initially forecast by the DNSP.
- Cost pass-through events might arise, requiring DNSPs to recover additional expenditures from what was provided for at the time of the AER's regulatory determinations.
- Other circumstances could arise such as interventions by jurisdictional governments, or delayed outcomes due to ongoing merits or judicial review appeals.

It is not clear how IPART's proposal would accommodate these unforeseen circumstances. Addressing this issue might require consideration of the following:

³ The changes recently introduced to Chapter 6 of the NER include measures designed to encourage more stakeholder involvement in the AER's regulatory determination processes. AEMC, *Economic Regulation of Network Service Providers and Price & Revenue Regulation of Gas Services*, Final Position Paper, 29 November 2012, pp.viii-ix.

⁴ This refers to issues such as the design and structure of tariffs and their individual components - such as changes in tariff classes and whether tariffs are reflective of efficient costs, and how DNSPs intend to apply or manage any transition to new types of tariffs - such as time of use tariffs to consumers.

- The ideal level of detail of the values set out in the statement, for which tariff level consistency would be assessed against. If information is presented at a high level the occurrence of exceptional circumstances (as set out above) might not significantly impact on the information in the statement, particularly in relation to trends in prices. However, having information at too high a level might reduce the value of the statement itself.
- If the approach of binding DNSPs to this statement is adopted, this might require the development of criteria allowing consideration of specified exceptional circumstances outside of a DNSP's control.

3.2 AER pricing guideline

We recognise that the nature of consultation/engagement or format of information required by various stakeholders in relation to the quantum of price will likely differ between stakeholders. These issues might be addressed by DNSPs consulting with their stakeholders and developing targeted approaches. There might also be merit in the AER developing a guideline which seeks to specify some of the details around how DNSPs should consult with stakeholders. This will serve to ensure that DNSPs are provided sufficient guidance on overall expectations as they seek to involve stakeholders, say in developing their Statements of Expected Price Trends. The guideline is something that we would look to develop with input from retailers and consumer groups.

It should also be noted the AER is currently developing, as part of its Better Regulation program, a separate (non-mandatory) consumer consultation guideline. This guideline aims to inform network businesses of our expectations on the strategies and approaches they should adopt in engaging and consulting with their customers in preparing their expenditure applications as part of their five yearly revenue determinations. This consumer engagement guideline would cover our expectations on engagement in general, and would serve to inform the AER's approach to developing more detailed engagement requirements specifically customised to tariff reviews as part of a pricing guideline.

However, we note that the AEMC's Power of Choice review has recommended a far broader role for an AER pricing guideline, including:

- Setting out consultative requirements in relation to the development and modification of a statement of network tariff structures and strategy.
- Guidance around the interpretation of the economic pricing principles and how they should be reflected in network tariffs.

Given anticipated rule changes to introduce broader roles for an AER pricing guideline around tariff design and structure/strategy, we do not see merit in requiring the AER to develop, at this time, a guideline that would only deal with consultation in relation to the statement of expected price trends.