ActewAGL
for you

16 October 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
Email: aemc@aemc.gov.au

Dear Mr Pierce

Submission on the Distribution Network Pricing Arrangements Draft Rule Determination

Thank you for the opportunity to respond to the Australian Energy Market Commission's Distribution Network Pricing Arrangements Draft Rule Determination.

ActewAGL Distribution recognises the benefits of cost-reflective tariffs and appreciates the importance of engaging with customers so that customers can understand and respond to our network tariffs and ActewAGL Distribution can understand and respond to customers' needs and preferences.

However, ActewAGL Distribution has concerns regarding the proposed transitional arrangements. In addition, some aspects of the draft rule changes may limit the flexibility that Distribution Network Service Providers need to develop and implement network tariffs to meet the current and future needs of customers and respond to changing markets and technologies. The draft changes may also unnecessarily complicate the network price setting and approval process, particularly where requirements are unclear and potentially conflicting.

The attached submission sets out our comments on these and other matters arising from the draft rule determination. ActewAGL Distribution also supports the Energy Networks Association's submission.

ActewAGL Distribution looks forward to continuing engagement with the Commission throughout the rule change process. Please contact Usman Sadaat, Manager Regulatory Affairs, on (02) 6248 3806 if you would like to discuss any aspect this submission.

Yours sincerely

David Graham
Director Regulatory Affairs and Pricing

ActewAGL Distribution response to draft determination on network pricing rules

Submission to the Australian Energy Market Commission

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ActewAGL for you

1 Introduction

ActewAGL Distribution welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC's) *Draft Rule Determination, National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014* (draft determination). ActewAGL Distribution is a public-private partnership owned equally by ACTEW Distribution and Jemena Networks. ActewAGL Distribution owns the electricity distribution network in the ACT and gas distribution networks in the ACT and the adjoining areas of New South Wales and in Shoalhaven.

ActewAGL Distribution recognises the benefits of cost-reflective tariffs and appreciates the importance of engaging with customers, so that customers can understand and respond to our network tariffs, and ActewAGL Distribution can understand and respond to customers' needs and preferences. Current and past consumer engagement by ActewAGL Distribution is supported by studies into customer willingness to pay (WTP) for changes in service levels willingness to pay (WTP).

Customers in the ACT are already offered a range of cost reflective tariffs which include time-of-use and demand or capacity components, where the required metering technology is in place. More than 50 per cent of the total load in the ACT (and 80 per cent of the non-residential load) is now subject to time-of-use or controlled load (off-peak) charges. Time-of-use tariffs have been the default tariffs for all new customers since October 2010.

The application of maximum demand and capacity tariffs in most of our commercial tariff options has further strengthened incentives for efficient use of the network resulting in improved load factors. The tariff structure is subject to ongoing review to ensure that the needs and preferences of our customers are met and any emerging network issues are addressed in the most efficient and effective way.

ActewAGL Distribution agrees with the AEMC's comment:

> *It is important that distribution businesses develop prices that best suit the particular circumstances of their network and their customers, after consultation with consumers and retailers, and subject to oversight by the AER.*[1]

However, some aspects of the draft rule changes may limit the flexibility that DNSPs need to develop and implement network tariffs to meet the current and future needs of customers and to respond to changing markets and technologies. ActewAGL Distribution is also concerned that the draft changes would unnecessarily complicate the network price setting and approval process, particularly where requirements are unclear and potentially conflicting.

[1] AEMC 2014, Draft rule determination, p. vi

ActewAGL Distribution supports the Energy Networks Association's (ENA) submission on the draft determination. This submission provides further comments on matters of particular concern for ActewAGL Distribution.

The following sections of this submission contain ActewAGL Distribution's main comments and concerns in relation to:

- The transitional arrangements;
- The pricing principles; and
- The tariff structure statement (TSS).

2 Transitional arrangements

ActewAGL Distribution does not support the transitional arrangements set out in the draft determination. The proposed requirement for the initial tariff structure statement (TSS) to be submitted by 30 June 2015 will seriously undermine the integrity and effectiveness of the TSS process and create a range of practical problems for consumers and DNSPs. ActewAGL Distribution therefore urges the AEMC to reconsider its transitional timetable. The due date for the initial TSS should be extended by at least 6 months.

The draft rules (Part E) require the TSS to be developed, submitted and reviewed in parallel with the regulatory proposal for the 5 year regulatory period. The AEMC explains in the draft determination that this integrated process will "minimise the consultation burden" and:

> *"facilitate greater consumer understanding of how planned investment in the network impacts on network costs, recovered through network tariffs. This link is important to getting consumers to understand how and why they should respond to network pricing signals."*[2]

ActewAGL Distribution expects that, particularly for the initial TSS, considerable time and effort will be required for engagement, as DNSPs, consumers and retailers need to understand and respond to the new set of pricing requirements.

However, under the transitional arrangements set out in the draft determination, the TSS process will be decoupled from the regulatory determination process, and the consumer engagement must be undertaken in a significantly compacted timeframe. DNSPs would be required to submit the first TSS on 30 June 2015, just 7 months after the scheduled time for the release of the AEMC's final determination.

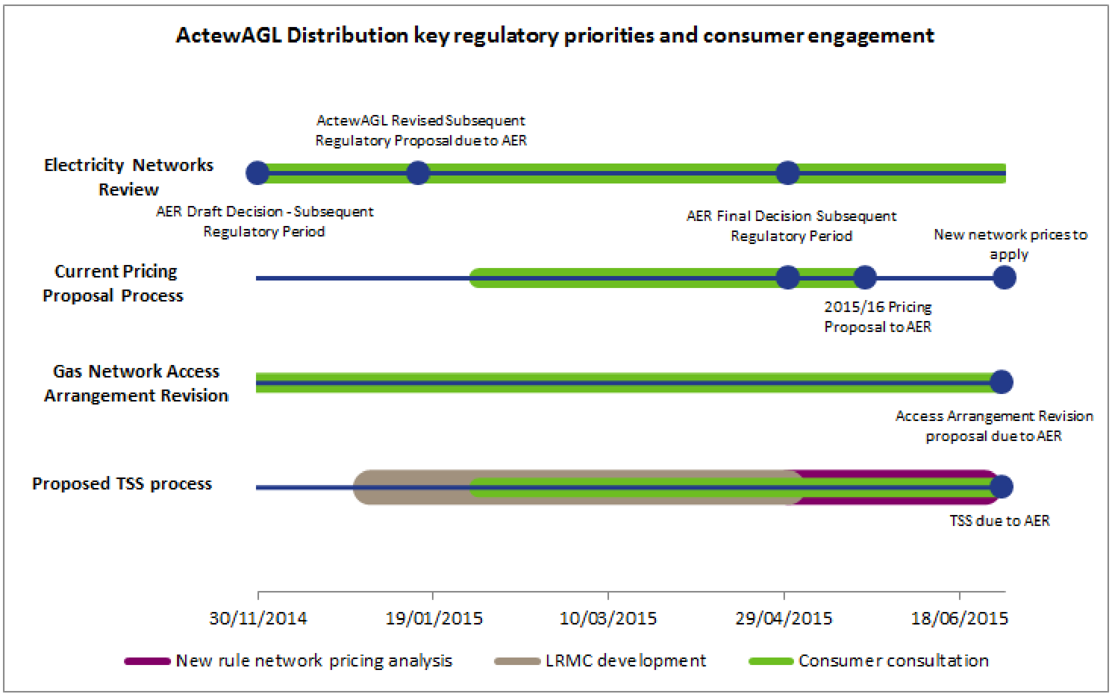
The AEMC says that the transitional arrangements are needed "so that the benefits from the new rules can be realised as soon as possible".[3] However, ActewAGL Distribution considers that

[2] AEMC 2014, Draft rule determination, pp. 57-58

[3] AEMC 2014, Draft rule determination, p. 75

any potential benefits of early implementation must be balanced against the likely costs, for DNSPs, consumers and retailers, of an unnecessarily rushed initial TSS process.

The potential problems and costs of the proposed timing of the initial TSS should be considered in the context of the wider regulatory timetable for ActewAGL Distribution in 2014 and 2015. An indicative timetable of key regulatory priorities and possible customer engagement is provided below.



The AEMC's proposed timing of the initial TSS would create a range of problems:

- *Transitional arrangements will place an unreasonable and unnecessary burden on consumers and retailers.* Extensive engagement will be required as this will be the first TSS process. The short transitional period would put unreasonable pressure on consumers and retailers to understand all the requirements, and to be in a position to provide considered input to the development of the TSS. There is a significant risk of excessive consultation burden. There is also potential for overlapping consultation processes that could create customer confusion and undermine the benefit of consultation and engagement. For example, the 2015/16 and 2016/17 annual pricing proposals will be based on the pricing principles in the current rules, while engagement in 2015 will be on pricing under the new rules. There will be additional pressures on ACT consumers, because ActewAGL Distribution will be concurrently engaging on the 2016-

21 gas network Access Arrangement proposal, which must also be submitted to the AER on 30 June 2015.

- *Practical issues for DNSPs*. To enable meaningful engagement, DNSPs will need to have proposed new or revised LRMC methodologies and models in place well before the consumer engagement begins. As an indication of the time needed, ActewAGL Distribution's previous LRMC study, produced by external consultants, was commissioned in November 2009 with a draft report completed in January 2010 and a final report produced in April 2010. There would be insufficient time for this under the draft transitional arrangements. In addition, ActewAGL Distribution's TSS will need to incorporate outcomes from the AER's final distribution determination, which is not expected until late April 2015. It will not be practically feasible to incorporate key elements of the final determination, such as required price paths, and undertake meaningful engagement and address any relevant concerns, in just 2 months (May and June). The compacted timeframe for the initial TSS would put at risk DNSPs' ability to properly develop the TSS and take "ownership" of tariffs, as intended by the AEMC.[4]

- *Specific issues for ActewAGL Distribution*. ActewAGL Distribution will also be preparing and engaging on its proposed gas network Access Arrangement at the same time it is engaging on and developing its TSS for the electricity network. This will create significant resourcing pressures for ActewAGL Distribution and consumers. In the draft determination the AEMC comments that its proposed timetable "is reasonable and does not materially disadvantage any particular DNSP".[5] However, ActewAGL Distribution and our customers would be disadvantaged by the requirement to submit the TSS on 30 June 2015.

[4] AEMC 2014, Draft rule determination, p. 102

[5] AEMC 2014, Draft rule determination, p. 78

3 The pricing principles

The draft rules include a new network pricing objective, at clause 6.18.5(a), and a new set of principles relating to long run marginal cost (LRMC), customer impacts, recovery of efficient costs and compliance with jurisdictional requirements.

Although ActewAGL Distribution supports the broad pricing objective in clause 6.18.5(a) and the , revised wording proposed by the ENA.

It should be noted that some of the policy principles are in conflict. Therefore, drafting changes are necessary to either remove conflicts where possible or ensure that there is appropriate guidance for network businesses as to how to resolve any remaining conflicts.

ActewAGL Distribution considers that the draft rules need to be much clearer on both the hierarchy and ordering of the pricing principles that DNSPs "must" satisfy and may "have regard to" in setting tariffs and determining the nature and extent of departures from LRMC pricing.

Additionally, the need to balance the factors listed and to depart from the mandatory requirements in clauses (e) to (g) "*only to the extent necessary* to give effect to the pricing principles set out in paragraphs (h) to (j)" (emphasis added) raises several potential issues and tensions.

3.1 LRMC as the basis for tariffs

Draft clause 6.18.5(f) says that each tariff "must be based on" LRMC, "with the method of calculating such cost and the manner in which that method is applied to be determined having regard to" specified factors. The AEMC explains in the draft determination that LRMC "should be the starting point for tariff design".[6]

ActewAGL Distribution supports the use of tariffs based on LRMC on the condition that the draft rule resolves the conflicts between mandating LRMC, minimising customer impacts and jurisdictional obligations. Some of these conflicts are addressed in this submission but a detailed explanation of these conflicts and drafting recommendations that would remove the inconsistencies is covered in the ENA submission.

ActewAGL Distribution supports the AEMC's approach of not prescribing LRMC methodology. The flexibility for DNSPs to determine the way in which they calculate and apply LRMC, together with the scope to depart from strict LRMC pricing levels and structures, as specified in the other pricing principles (discussed below) represents a reasonably practical approach to LRMC pricing.

[6] AEMC 2014, Draft rule determination, p. 103

One of the factors that DNSPs may have regard to in determining the LRMC method and its application is whether customers “are able to receive and respond to price signals”.[7] ActewAGL Distribution interprets this to mean that the metering technology that the customer has is relevant. This is an important consideration, as the scope to apply many cost reflective tariff options, such as demand or capacity charges will depend on the benefit of doing so and the must exceed the cost of metering technology. . ActewAGL Distribution believes that it would be more appropriate to include this factor as part of the consumer impact principles, rather than in relation to the calculation and application of LRMC. ActewAGL Distribution supports the proposed drafting provided as part of the ENA submission.

3.2 The customer impact principles

The AEMC explains in the draft determination:

> *The pricing principles address the potential impacts on consumers of a transition to new network prices. They require network businesses to develop price structures that consumers are capable of understanding, and allow network businesses to minimise the impacts of price changes by gradually moving to new network prices over several years.*[8]

The customer impact principles (in clause 6.18.5(h)) are intended to play a key role in allowing DNSPs to manage the transition to tariffs based on LRMC. DNSPs:

> *may depart from the cost reflectivity principles to the extent necessary to meet this consumer impact principle.*[9]

ActewAGL Distribution supports the inclusion of a principle which recognises the need to manage customer impacts and to allow for a “reasonable period of transition (which may extend over more than one regulatory control period)”.

However, the drafting of the rules raises some issues. For example, while the AEMC says in the draft determination that DNSPs “may depart” and the principles “allow” the network businesses to minimise impacts (see quotes above), the draft rules say that the DNSPs “**must** minimise the impact on retail customers of changes in tariffs from the previous regulatory year...” [10] (emphasis added), having regard to specified factors.

ActewAGL Distribution considers that, rather than DNPS be required to ‘must minimise’ the impacts on retail customers, thy should be required to “take into account” impacts on retail customers of changes in tariffs. .

[7] Draft clause 6.18.5(f)(2)

[8] AEMC 2014 Draft rule determination, p. i

[9] AEMC 2014, Draft rule determination, p. v

[10] Draft clause 6.18.5(h)

The draft rules also specify that tariffs may depart from the cost reflective requirements in clauses 6.18.5(e) to (g) “only to the extent necessary” to comply with the consumer impact principles “relevant regulatory instruments”. This creates potential issues in terms of compliance, because the draft rules appear to permit departures from the mandatory principles, whereas in approving the TSS the AER must be reasonably satisfied that the TSS complies with all the pricing principles. To address this potential conflict, the drafting should be amended to clarify that what is permitted is deviation from the LRMC starting point in specific circumstances, not deviation from the mandatory principles in 6.18.5(e) to (g). ActewAGL Distribution supports the proposed drafting provided as part of the ENA submission.

3.3 Recovery of efficient costs

ActewAGL Distribution believes it is critical for the rules to recognise the need for DNSPs to recover efficient costs. The new cost recovery principles in the draft rules include three elements:

1. The revenue recovered from each tariff must reflect the DNSP’s total efficient costs of serving the customers assigned to that tariff (clause 6.18.5(g)(1)); and
2. The revenue expected to be received from all tariffs must permit the DNSP to recover the expected revenue for the relevant services in accordance with the applicable distribution determination(clause 6.18.5(g)(2));
3. DNSPs must recover their allowed revenue in a way that minimises distortions to LRMC based prices (clause 6.18.5(g)(3)).

ActewAGL Distribution considers the second element to be the core cost recovery principle. As such, it should be separated out as a specific clause. The other two clauses should provide guidance on how adjustments “should be designed” to allow the allocation of revenue requirement to tariff classes.

ActewAGL Distribution supports the proposed drafting provided as part of the ENA submission on both of these points.

4 The TSS – required content and scope to amend

ActewAGL Distribution believes that a TSS can play a valuable role in providing a transparent basis for consumer engagement and facilitating informed decision making by consumers. However, the required content and the limited scope to amend the approved TSS raise some concerns for ActewAGL Distribution.

4.1 Required content

ActewAGL Distribution considers that the TSS should provide information on proposed tariff structures and indicative tariffs for the regulatory period. The purpose should be to provide consumers, retailers and other stakeholders with an indication of expected pricing over the period, given the information available at that time.

ActewAGL Distribution has three main concerns with the binding content of the TSS. These concerns cover the charging parameters, the pricing schedule and the pricing methodology.

ActewAGL Distribution believes that charging parameters should be subject to change within a regulatory period to promote efficient cost recovery. The ability to change charging parameters depend on a number of factors that may be outside the control of a DNPS. For example, as the ENA has highlighted in its submission, these include:

- a network may initially set the time period for monthly maximum demand, but the customer response to the tariff may support a change to a different time;
- a network may introduce a critical peak price, but weather events may change the timing of the critical event days, over the regulatory period;
- the take-up of time of use tariffs (and the revenue raised) will depend on the availability of advanced meters ;
- changes in technology on a given network are likely to change the demand elasticities over time with respect to each network tariff.

As a result, DNPS must have the flexibility to change charging parameters within the regulatory period without being bound by the TSS.

ActewAGL Distribution supports the draft requirement (in clause 6.18.1A(e)) that the TSS must include:

> *"a pricing schedule which sets out, for each tariff for each regulatory year of the regulatory control period, the indicative price levels determined in accordance with the tariff structure statement"*

However, it is not possible, or reasonable, to provide consumers and retailers with certainty about price levels for the 5 year regulatory period. Hence, the pricing schedule should be non-binding.

ActewAGL Distribution is also concerned about the requirement (in clause 6.18.1A(a)(5)) to include a binding “pricing methodology” in the TSS. Pricing methodology is not defined in the rules. There are various ways in which the pricing methodology could be defined or described. For example, the methodology could be described in terms of formulae that set out, for each tariff, how the LRMC is determined and how departures are determined (for example to allow DNSPs to recover costs or manage customer impacts, as permitted under the pricing principles). This prescriptive and potentially formulaic approach would severely limit the flexibility of DNSPs to alter relative prices during the regulatory period.

Therefore, ActewAGL Distribution supports the ENA position that the tariff classes and tariff structures would be binding but the following information in the TSS should be included in the TSS but would not be binding:

- The charging parameters for each proposed tariff;
- Policies and procedures for assigning and reassigning customers from one tariff to another;
- The pricing methodology;
- The pricing schedule.

4.2 Limited scope to amend an approved TSS

ActewAGL Distribution considers that the limitations and conditions on amending a TSS set out in the draft rules involve a high degree of uncertainty and regulatory discretion and reduce the ability of DNSPs and their customers to respond to rapidly changing markets and technologies.

For example, the draft rules specify that to amend a TSS, there must be an event that is beyond the “reasonable control” of the DNSP, which could not have been “reasonably foreseen” by the DNSP at the time the TSS was approved. Further, the DNSP must demonstrate that amendments to the TSS that are proposed in response to this event would, or would be likely to, result in a TSS that materially better complies with the pricing principles and other NER requirements than the DNSP’s current TSS.[11]

ActewAGL Distribution is concerned that the conditions under which the TSS may be amended involve a high degree of uncertainty and regulatory discretion. Matters such as whether the events could have been “reasonably foreseen” and whether the amended TSS would “materially better comply with the pricing principles” are likely to be difficult to establish. DNSPs must establish “to the reasonable satisfaction of the AER” that the conditions in clause 6.18.1B(d) are met. This is likely to require detailed submissions and involve uncertain outcomes.

[11] AEMC 2014, Draft rule determination, p. 65

Additionally, it is unclear whether “reasonably foreseen” is an appropriate test. Pre-emptively responding to a foreseeable event may not meet the network pricing objective. The most appropriate response to the event may not be known until it occurs.

There is also uncertainty about when the triggers for certain changes may apply. Draft clause 6.18.1C allows DNSPs to notify the AER and affected parties of a “new proposed tariff”, which is outside the approved TSS, subject to an “individual threshold” and a “cumulative threshold”. The thresholds relate to the forecast revenue from the relevant tariff, as a percentage of the total revenue requirement.

However, what qualifies as a “new tariff” is not clear. For example, would changes to time bands for TOU represent a new tariff? Would making a certain tariff the default tariff for new customers (as ActewAGL Distribution did with the time-of-use tariff in 2010) constitute a new tariff?

ActewAGL Distribution understands that the AEMC’s intention in limiting changes to the TSS is to provide greater certainty for consumers and retailers.[12] However, greater certainty (to the extent that is possible) should not be given priority over the need for DNSPs to offer new cost reflective tariffs and meet the network pricing objective.

By limiting the scope for DNSPs to amend the TSS, the draft rules would undermine the ability of DNSPs to respond to changing circumstances by adjusting existing tariffs or introducing new cost reflective tariffs. For example, during the 2009-14 regulatory period ActewAGL Distribution made changes to its tariff offerings in response to developments in electric vehicles and the uptake of solar PV systems.[13] The need for these changes would have been difficult to anticipate in 2008, when the TSS would have been submitted (if the proposed rules had applied then).

Looking ahead, there are major uncertainties facing DNSPs and these may have implications for the tariffs that DNSPs may seek to offer. For example, the impact of the proposed new rules to promote competition in metering is difficult to predict at this stage. If there is a high degree of take-up of new metering technology by residential customers, DNSPs may want to offer new tariff options such as demand or capacity tariffs. Under the draft rules, DNSPs would need to go through the process of convincing the AER that these changes meet all the requirements and thresholds in clause 6.18.1B(d), as discussed above.

ActewAGL Distribution considers that instead of the conditions set out in the draft rules, the rules should provide scope for DNSPs to initiate amendments to the TSS if they have consulted with customers and have support for the amendment, and the amendment complies with the pricing principles.

[12] AEMC 2014, Draft rule determination, p. 65

[13] The option to have electric vehicles metered separately from normal residential load was introduced in 2011; and the buy-back arrangements for customers with small PV systems (less than 30kW) were changed in 2013.

Examples of how the binding nature of the TSS reduces pricing flexibility

The new rules and the binding TSS may have a significant impact by preventing ActewAGL Distribution from responding to changing circumstances as rapidly as it has in the past. Examples of timely tariff responses to changing circumstances in the past include:

1. Following discussions with *Better Place Australia* in February 2012, ActewAGL Distribution made changes to network pricing rules on 1 July 2012 to facilitate the introduction of electric vehicles by allowing two readings from a single meter. This was to allow electric vehicles to be metered separately from the usual residential load.
2. ActewAGL Distribution began installing interval meters on a new and replacement basis in about April 2007. A residential time of use network charge was introduced for 2007/08.

In future, the falling cost of PV systems together with the developments in battery technology may cause households and businesses by-passing the network. ActewAGL Distribution needs the pricing flexibility to respond rapidly to this and other changes in the competitive environment. The binding nature of the TSS could hamper it from competing.

As noted above, changes to network tariffs are dependent on the metering stock. In the absence of changes to the metering stock, the new network pricing rules may not result in significant changes to the suite of cost reflective tariffs that ActewAGL Distribution currently offers.

If new metering technology is deployed for all new and replacement meters the revenue from these customers will exceed the 0.5 per cent requirement threshold,[14] even in the absence of a 'street by street' roll out. Accordingly, to take advantage of any new technology ActewAGL Distribution will need to lodge a TSS amendment to the AER in the first three months of 2017/18 for new tariffs to come into effect for the 2018/19 year. This means that either:

1. If there is no change to the metering stock, the TSS will have limited impact as ActewAGL Distribution already has cost reflective tariffs to the extent practically possible. The proposed transition to the TSS process will simply increase costs for consumers, retailers and DNSPs; or
2. If new metering technology is deployed, the TSS will be out of date before it comes into effect and would need to be immediately revised to take advantage of any new deployed technologies. In addition to increasing costs, the binding aspect of the TSS process will *delay* the implementation of cost reflective tariffs by one year (relative to the current rules). Lastly, the revised TSS will be in effect for one year before a new TSS for the next regulatory control period comes into effect.

[14] ActewAGL Distribution currently installs about 8,000 new and replacement meters per year. In 2014/15 revenue from less than 2,200 and 4,400 residential customers would exceed the 0.5% individual and 1% cumulative thresholds.

ActewAGL Distribution notes that industrial and commercial customers already have metering stock which enables more cost reflective tariffs. These customers can already take advantage of time of use, demand and capacity tariffs. In the ACT, 81.5 per cent of the non-residential load (60% of the total load) is now subject to time-of-use or controlled load (off-peak) charges. Of this load, 63% is on demand tariffs and 30% is on capacity tariffs (which includes a demand component).