

4 July 2013

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John

Dear Mr ~~Pierce~~,

SUBMISSION TO AEMC'S CONSULTATION PAPER - PROPOSED RULE CHANGE - ANNUAL NETWORK PRICING ARRANGEMENTS

We welcome the AEMC's initiation of the proposed changes to the National Electricity Rules (Annual Network Pricing Arrangements). In our view, these changes would improve the process for setting annual network prices by promoting a more efficient allocation of risk and reducing the administrative costs on stakeholders including the Distribution Network Service Providers (DNSPs), energy retailers, and the Australian Energy Regulator. The proposed changes would also improve the competitive retail market by providing retailers with additional time to consider network pricing in developing retail prices, to make changes to billing systems where necessary, and to notify customers.

This submission responds to the issues summarised in the AEMC's Consultation Paper and highlights some important developments that have occurred since the original Rule change proposal was submitted.

Providing a more efficient allocation of risks

The Consultation Paper highlights the importance of allocating risk to those parties who are best placed to manage them.

In our view, the current arrangements place significant risk on retailers, such that they may not be able to pass through network tariffs or reflect the structure of the network tariffs. Retailers currently have little scope to manage this risk. For example, unlike network businesses they do not have access to an 'unders and overs' account to manage revenue risk.

This risk is magnified by obligations on retailers under the National Energy Consumer Framework. Since we submitted our proposal, the NSW Government has commenced the National Energy Consumer Framework in NSW which requires retailers to provide 10 business days' notice of changes to Standing Offer Prices and Regulated Offer prices. Retailers now have firm timing obligations under the National Electricity Law, making it more likely that without changes to the timing of annual network price changes, they will be

required to bear further risk by continuing to estimate network prices, or to delay changes to retail prices. Given the dynamic nature of the energy market, the likelihood of more frequent changes to the structure and level of individual network tariffs will only increase this risk to retailers. This is unlikely to be an efficient allocation of risk, nor in the long term interest of customers.

It is important to highlight that the chain of interdependent pricing steps that the AEMC summarises in its Consultation Paper, should culminate in final **retail** prices that are paid by customers. While network prices are an important element of final retail prices, in our view, the Consultation Paper does not provide sufficient consideration of the implications of the current arrangements and the proposed changes for retailers, end-use customers and the operation of the competitive retail market.

Reducing the administrative costs of changes to annual network prices

Frequently, DNSPs are required to resubmit their annual price proposals to accommodate final transmission price changes. This duplicates the administrative costs incurred by the DNSPs and the AER. In our view, the proposed Rule changes which brings forward the date for transmission pricing by 2 months, reduces the likelihood of DNSPs needing to resubmit their pricing proposals, and the AER being required to assess compliance with multiple proposals. This should also reduce the time required for the AER to assess the proposals.

Balancing the need for flexibility and predictability in changes to annual network prices

We welcome the Consultation Paper's focus on the importance of consumers having a degree of certainty and predictability in relation to annual changes in prices and broader confidence in the market and supporting regulatory arrangements. However we also consider it important that network and retail prices are able to respond to changing market conditions. The Rule change proposal is not intended to reduce this flexibility.

Notwithstanding the AEMC's recommendation to consult on the structure of prices as part of its *Power of Choice* review, we consider it important to consult on both the level of individual tariff components and the structure of the network prices. While retailers and customers require notice of a change in the structure of prices, significant changes in the levels of individual tariff components are also critical. For example, not only would retailers, customers and embedded generators (such as solar PV owners) want to know about changes to the structure of prices (eg, the introduction of a capacity charge or inclining block tariff), but they would also want to know if tariffs within the current structure are going to change significantly (eg, significant increase in the fixed tariff component of prices). Our proposed changes leave sufficient flexibility for network prices to change in response to developments in the market. This is likely to promote efficient investment in, and use of, electricity services. However, changes should be made in consultation with retailers and customers and with sufficient notice.

Please contact Anna Brakey on 9290 8438 or Alexis van der Weyden on 9290 8460 if you have any queries in relation to the submission.

Yours sincerely

James Cox

James Cox,
CEO and Full Time Member



Independent Pricing and Regulatory Tribunal

Annual network pricing arrangements – Rule change proposal

**Submission on AEMC's Consultation Paper
July 2013**

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The Tribunal members for this review are:

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Mr James Cox PSM, Chief Executive Officer and Full Time Member

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1 Introduction

For customers to receive efficient pricing signals and to best respond to these signals, they should be consulted on the level and structure of prices and have advance notice of price changes. This principle is central to the National Energy Consumer Framework (NECF).¹

In our view the current National Electricity Rules (NER) does not sufficiently promote this principle. While the NER focus on facilitating efficient investment in the network by ensuring that cost reflective network tariffs are developed and assessed by the Australian Energy Regulator, they place little encouragement on network businesses to consult with retailers and end customers on changes to the structure and level of tariff from year-to-year changes. Given that they place no firm date for finalising network prices, they also do not adequately consider how network prices are reflected in the retail prices paid by customers and as a result transfer a significant amount of risk to retailers. To meet their obligations under NECF retailers may need to delay changes to retail prices, or set their retail prices without sufficient consideration and consultation in relation to the underlying network tariffs. There is therefore a tension between the objectives underpinning the NER and the National Energy Retail Law.

To better manage this tension we proposed changes to the NER to improve the timing of annual network price setting and to improve retailer and customer engagement in network price setting. Specifically, we proposed that network prices be set:

- ▼ with greater consultation to allow customers to better understand any proposed changes and to provide retailers with greater opportunity to understand the impact of any network changes on their pricing strategies and to develop their retail prices, and
- ▼ earlier to allow greater consultation on retail price changes and for customers to receive earlier notification of the change to their prices.

In June 2013 the AEMC initiated our Rule change proposal and released a Consultation Paper. We welcome the AEMC's consideration of the proposed changes.

In our view the Consultation Paper:

- ▼ broadly set out risks that we consider to be relevant in considering the proposed rule change;

¹ The implementation of the National Energy Customer Framework (NECF) involves the transfer of current State and Territory responsibilities to a single set of national Laws, regulations and Rules. Under NECF retailers are required to provide 10 business days' notice of a price change to Standing Offer Prices and Regulated Offer Prices by publishing the prices on their website and publishing a notice in a newspaper circulating in the State.

- ▼ adequately captures the network pricing process timeline and the implications of the proposal for network businesses
- ▼ highlights the importance of consultation and stakeholder engagement in providing the opportunity for network business and retailers to understand consumer's preferences and for consumers to make informed choices about the prices they pay for electricity and make appropriate consumption decisions.

However we encourage the AEMC to consider:

- ▼ The implications of the current arrangements and the proposed changes for retailers, end-use customers and the operation of the competitive retail market
- ▼ The potential that the additional benefits from including more up to date information in the setting of cost reflective network prices is lost as a result of retailers being unable to reflect these tariff levels and structures in setting retail prices
- ▼ That retailers have firm obligations rather than requirements for 'best endeavours' in setting retail prices. In practice, under the current arrangements retailers will have significantly less time than 20 business days to develop and consult on their retail prices
- ▼ Our experience suggests that with sufficient resourcing and planning, the AER should be able to assess and approve the proposed prices network prices within 20 business days
- ▼ The unnecessary administrative costs incurred by the DNSPs and the AER resulting from the submission and assessment of multiple pricing proposals due to the uncertainty surrounding final transmission prices
- ▼ The need to balance flexibility and predictability in terms of annual changes to the level **and** structure of the network prices.

We are willing to work with the AEMC and other stakeholders to ensure a package is put in place that balances the objectives underpinning the NER and the National Energy Retail Law and is in the long term interest of customers.

2 Proposed Rule changes

We remain supportive of the Rule change proposal for the reasons set out below. Additionally, since we made the proposal, the National Energy Customer Framework has commenced in NSW, increasing the impetus for the network pricing arrangements in the Rules to be improved.

2.1 The current Rules should be improved

As set out in the AEMC consultation paper, we consider that the current National Electricity Rules do not include appropriate arrangements for the annual setting of network prices. Specifically, we consider that:

- ▼ Retailers and customers do not get notification of annual network price changes in a reasonable timeframe prior to them taking effect;
- ▼ The timing of finalising network prices causes difficulty in setting retail prices in sufficient time to meet the requirements to notify customers under the National Energy Retail Rules, particularly for Standing Offer Prices and Regulated Offer Prices
- ▼ Retailers and customers are not consulted on the development of annual network prices
- ▼ There should be some earlier indication of how network prices will change over time.

2.2 The proposed Rule changes will benefit retailers and customers

The proposed changes to the Rules include requiring:

- ▼ Transmission network service providers (TNSPs) to publish their prices by 15 March each year (2 months earlier than current provisions)
- ▼ Distribution network service providers (DNSPs) to submit their proposed prices to the AER 3 months before they take effect (1 month earlier than current provisions)
- ▼ The Australian Energy Regulator (AER) to publish approved prices within 20 business days from the date of submission
- ▼ DNSPs to publish approved prices on their websites within 5 days of approval
- ▼ The AER to develop a guideline setting out both the consultation to be undertaken in developing and updating the statement of expected price trends and the information that is to be included in the statement. The DNSPs would need to set prices in accordance with this statement.

In our view, these changes would improve the process for setting annual network prices by promoting a more efficient allocation of risk and reducing the administrative costs on stakeholders including the Distribution Network Service Providers (DNSPs), energy retailers, and the Australian Energy Regulator. The proposed changes would also improve the competitive retail market by providing retailers with additional time to consider network pricing in developing retail prices, to make changes to billing systems where necessary, and to notify customers. In particular, we consider that this package of amendments will provide significant benefits, including:

- ▼ Providing for greater input from retailers and customers in developing network prices.
- ▼ Providing a clear price path over the regulatory period to ensure that all stakeholders have access to information on how network prices may move. This can benefit retailers, customers and policy makers.
- ▼ Reduce administrative costs by allowing distribution companies to include final transmission prices in the distribution pricing proposals that they submit to the AER, eliminating the need to submit based on draft transmission prices and then make adjustments to reflect final transmission prices
- ▼ Providing the AER with discretion to determine the most appropriate information to be included in the statement of expected price changes and the consultation that should take place in developing and changing that document. It is more appropriate that this level of detail is included in a guideline rather than the NER so that it can evolve through time according to stakeholder needs and best practice.
- ▼ Providing more certainty that final network prices will be notified in the prescribed timetable by imposing a requirement on the AER to approve final network prices within 20 business days of receiving the proposal from the distribution businesses.
- ▼ Reducing the risks on retailers by providing retailers with additional time to consider network pricing in developing retail prices (for Standing Offer Prices, Regulated Offer Prices where applicable, and Market Retail Contracts) to make changes to billing systems where necessary, and to notify customers of changes to retail prices
- ▼ Providing a more reasonable timeframe for retail price regulators to approve Regulated Offer Prices, where relevant, and for Standing Offer Prices to be set by retailers in Victoria and South Australia
- ▼ Improving the functioning of the competitive retail markets in the NEM by allowing retailers to set their market offers in response to Standing Offer Prices, and for customers to have time to assess these offers prior to new prices taking effect

2.3 Additional impetus for the changes arising from the National Energy Consumer Framework

Since we submitted the proposed changes, the National Energy Consumer Framework has commenced in NSW.² Retailers are now required to comply with the National Energy Retail Law, requiring them to provide 10 business days' notice of a price change to Standing Offer Prices and Regulated Offer Prices by publishing the prices on their website and publishing a notice in a newspaper

² The *National Energy Retail Law (Adoption) Act 2012* (NSW) commenced on 1 July 2013.

circulating in the State.³ Under the National Energy Retail Rules, retailers need to provide notice of changes to a tariff under a Market Retail Contract as soon as practicable and in event no later than the customer's next bill, providing the retailer with more flexibility.⁴

However, because there is currently no firm date for finalising network prices, retailers may need to estimate the network prices when setting their Standing Offer Prices in order to comply with the Law. Not only can this distort the price signals, but retailers may need to take on the risk that approved network prices differ from what they expect. This could lead to higher than necessary prices faced by customers if the retailer passes this risk through to customers. In our view, retailers are not best placed to manage this risk leading to a sub-optimal allocation of risk.

Because we pass through actual network costs, the Regulated Offer Prices cannot be set in NSW until the network prices are approved. Therefore, while we work closely with the Standard Retailers to get Regulated Offer Prices approved as soon as possible, it is possible that the prices might not be finalised in time for a 1 July price change. There is a more probable risk that the Regulated Offer Prices are not set in time for the retailers to meet their notification obligations under the National Energy Retail Law.

3 Response to Consultation Paper

We continue to support the Rule change proposal. This section comments on the relevant Rule changes and reviews undertaken by the AEMC and responds to specific questions raised in the paper.

3.1 Relevant Rule changes and reviews

In its Consultation Paper the AEMC sets out relevant Rule changes and reviews that it has undertaken.

It lists a 2009 proposal by EnergyAustralia (now Ausgrid) to move the transmission network prices publication date from the 15 May to 15 March each year, which is one element of the proposal currently being considered. The AEMC decided not to make the Rule change proposal because it considered that the change was not proportionate to the problem identified (which related to

³ Section 23 of the National Energy Retail Law (as applied in New South Wales by the *National Energy Retail Law (Adoption) Act 2012* (NSW)); clause 8.2 ('Changes to tariffs and charges') of model terms and conditions for standard retail contracts as set out in Schedule 1 of the National Energy Retail Rules.

⁴ Rule 46(4) of the National Energy Retail Rules made under Section 34 of the National Energy Retail Law (as applied in New South Wales by the *National Energy Retail Law (Adoption) Act 2012* (NSW)).

distribution network pricing). The proposal currently being considered differs because it will also facilitate distribution prices being set earlier and with greater consultation. This will have positive implications for retailers, customers and the competitive retail markets across the NEM, increasing the overall benefits arising from making the change.

The AEMC also lists its Power of Choice Review and sets out its relevant recommendations. Notwithstanding the AEMC's recommendation to consult on the structure of prices as part of its *Power of Choice* review, we also consider it important to consult on the level of the network prices. While retailers and customers require notice of a change in the structure of prices, significant changes in the levels of individual tariff components are also critical. For example, not only would retailers, customers and embedded generators (such as solar PV owners) want to know about changes to the structure of prices (eg, the introduction of a capacity charge or changes to an inclining block tariff), but they would also want to know if tariffs within the current structure are going to change significantly (eg, significant increase in the fixed tariff component of prices).

While restricting changes to the structure of tariffs (say every 5 years as the AEMC proposes) may allow for more extensive consultation, it is likely to come at the expense of providing flexibility in the structure of tariffs through time. Given the dynamic nature of the energy market, we consider it important that network businesses have the flexibility to alter the structure of their tariffs within the determination period, subject to consultation with retailers and customers. Our proposed changes leave sufficient flexibility for network prices to change in response to developments in the market while recognising that changes should be made in consultation with retailers and customers and with sufficient notice.

3.2 Response to specific questions and issues raised in consultation paper

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

The AEMC set out risks that it considers relevant to considering the proposed rule. We generally agree with the risks identified, however we note that the risks that network tariffs do not recover the allowed revenues of TNSPs and DNSPs is closely associated with the form of regulation. The AER has recently announced that it will change its form of regulation for the NSW DNSPs to a revenue cap, removing the revenue risk for the NSW DNSPs.

Further, we consider that there are two additional risks that were not listed that the AEMC should consider:

- ▼ The risk that the retailers will not be able to comply with the requirements of the National Energy Retail Law, and the resulting tension between the objectives underpinning the NER and the National Energy Retail Law.
- ▼ The risk that customers pay more than necessary for electricity, reflecting the risk passed from the retailer to the customer relating to not knowing final network prices when setting their Standing Offers.

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

While it is desirable for network prices to reflect input costs, unless there is sufficient time for network prices to be included in retail prices, then the benefits of the additional accuracy in network prices will be lost by their estimation in setting retail prices.

The AEMC has listed a number of inputs required to finalise transmission and network pricing. We recognise that setting network prices earlier will require consequential timing changes for required inputs, as highlighted in our original proposal. One important change would be the AER using an earlier measure of CPI in its determinations. We recommend that the AEMC consider what the optimal provisions are and, if they are inconsistent with the current determinations, put in place transitional provisions so that the CPI definition can be altered in the upcoming round of price determinations. Where it is not appropriate to change the dates of the required inputs, then the AEMC should consider whether that input will be captured through the regulatory framework, including the ‘unders and overs’ account where there is revenue cap regulation.

We note that the AEMC has listed the published loss factors as a required input in setting network prices. While loss factors are required to set retail prices, they are not required to set network prices and are therefore not relevant inputs.

Questions 5 & 6 – Should the AER have a set timeframe in which to assess all DNSP annual pricing proposals? Is there 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

As discussed above, under NECF the retailers must provide 10 business days’ notification of changes to Standing Offer Prices and Regulated Offer Prices. Because the retailers have a set timeframe, it is important for the AER to have a set timeframe to allow the retailers to meet their obligations.

Retailers have firm obligations rather than requirements for ‘best endeavours’ in setting retail prices. In practice, under the current arrangements retailers will have significantly less time than 20 business days to develop and consult on their retail prices.

We do, however, recognise that the AER needs adequate time to undertake its compliance and approval process. Our proposal included 20 business days for the AER to assess and approve the prices. Our experience suggests that with sufficient resourcing and planning, the AER should be able to assess and approve the proposed prices network prices within 20 business days.

While the timeframes included in Rules needs to be conservative to account for a variety of circumstances, we encourage the AER to undertake best endeavours to approve and notify the network prices as soon as practical.

Questions 7 & 8 – How much time do retailers and jurisdictional regulators require for notification of network prices before finalising retail tariffs and notifying customers? Is the proposed notification of two months sufficient?

It is important to highlight that the chain of interdependent pricing steps that the AEMC summarises in its Consultation Paper, culminates in final **retail** prices that are paid by customers. While network prices are an important element of final retail prices, in our view, the Consultation Paper does not provide sufficient consideration of the implications of the current arrangements and the proposed changes for retailers, end-use customers and the operation of the competitive retail market.

Just as networks require a number of inputs in setting their prices, retailers (and regulators in jurisdictions that have retained price regulation) requires a range of inputs in setting the retail prices, including the network costs and where relevant, the retail price determination (which itself requires a large amount of information).

We encourage the AEMC to consult with retailers and consider the key dates and inputs in the pricing process for retailers in setting their Standing Offers and market prices.

To assist the AEMC in appreciating the interaction between network prices, retail determinations, and regulated retail prices, the Table below sets the annual price setting process included in our retail price determination.

Timetable for annual price compliance, 1 July 2015 and 1 July 2016

Action	Timeframe	Days allowed for this task
IPART releases final annual review report	June	
AER approves network prices	May-June	
Standard Retailers have both R and N values	T	
Standard Retailers submit regulated price proposal	T+8	8 business days
IPART notifies Standard Retailers whether satisfied/not satisfied with proposal	T+18	10 business days
Final date for Standard Retailers to propose alternative Annual Pricing proposal	As notified by IPART (T2)	
Final date for IPART to notify Standard Retailers whether satisfied/not satisfied with alternative Annual Pricing Proposal	T2+10	10 business days

While these are the requirements set down in the determination, both the Standard Retailers and IPART typically undertake these tasks in less than the allowed time in order to facilitate a 1 July price change.

This year, the AER approved network prices by 7 June. We did not release our final report until 17 June. We approved the prices and placed the regulated price list on our website by 21 June. We do not consider that this is an adequate timeframe, but it demonstrates how the retailers and regulator can work together to facilitate a streamlined price approval process.

We consider that the two months that we have proposed is sufficient to set regulated retail prices. It will allow the Standard Retailers to consider and consult on how to pass through the network prices into regulated retail prices. Nevertheless, we recognise that regulation of retail prices is a transitional issue – in our view greater benefits from this Rule change proposal will arise from the competitive markets across the NEM.

[Questions 9 & 10 – What type of consultation on level and structure of network prices would be useful to consumers/consumer groups and what benefit should there be? How much scope would there be for consultation on proposed annual network prices?](#)

We consider that consultation on the level and structure of network prices would be useful to retailers, consumers, consumer groups and policy makers.

We consider that it is useful to consult on both the level and structure of network prices. The AEMC raises the possibility of consulting on the structure of network prices only and doing it as part of the revenue setting process. However, we consider that:

- ▼ The level of prices should be consulted on in addition to the structure. The DNSPs currently have a high degree of discretion in setting the level of individual tariff components. It would be useful for both retailers and customers to know, for example, if the level of fixed charges was going to increase significantly over the coming years.⁵
- ▼ It is appropriate that DNSPs have the flexibility to amend both the structure and level of prices during the regulatory period. Locking a DNSP into a particular price structure for the regulatory period will prohibit it from responding to developments in the market and from innovating its prices throughout time (rather than at fixed intervals). We consider that a DNSP should have flexibility to change its pricing strategy, but that changes during the regulatory period should be done in consultation with retailers and customers, and with sufficient notification. We have recommended that the AER develop the guidelines for the statement of expected price trends, which would deal with both the level and structure of the prices, consultation and the timing of any changes.

Questions 11, 12 & 13 – How useful is the current statement of expected price trends to retailer and consumers? What influences the statement of expected price trends? Should a DNSP’s approval of its annual prices be linked to how accurately it can track the statement?

For our regulated retail price setting purposes, we find the current statements of expected trends to be of limited use.

Our proposed Rule change involved the AER developing a guideline on the content for the statements, providing for flexibility throughout time so that the information is useful to customers and retailers and remains relevant over time.

Unless the statement is in some way linked to the price approval process, it is at risk of being an administrative burden on DNSPs that offers limited benefits to retailers and customers.

⁵ For example, it is likely that the structure of current network prices does not reflect the highly fixed cost nature of network costs. DNSPs, such as Ausgrid, have indicated that they are likely to re-balance their tariffs towards fixed component tariffs over time. Ausgrid Network Pricing Proposal: For the Financial Year Ending June 2014, May 2013