

5 July 2013

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

National Electricity Amendment Annual Network Pricing Arrangements Rule 2013 (ERC0149)

Dear Mr Pierce

The Energy Networks Association (ENA) appreciates the opportunity to contribute to the assessment of the proposed National Electricity Amendment Annual Network Pricing Arrangements Rule 2013 (the Rule change) put forward by the Independent Pricing and Regulatory Tribunal (IPART) of New South Wales.

ENA is the peak national body representing electricity transmission and distribution businesses throughout Australia. Our members are responsible for the annual calculation of transmission and distribution price components of the electricity bill for the more than 9.7 million electricity customers across the National Electricity Market (NEM).

In addition to ENA's response, a number of our network members have made individual submissions to the Rule change proposal. Grid Australia has made a submission on behalf of transmission businesses.

ENA considers that the assessment framework described by the Australian Energy Market Commission (AEMC) in its Consultation Paper on the Rule change is appropriate.

It is ENA's view that the IPART proposals should be considered in the context of the Standing Council on Energy and Resources (SCER) in-principle support for changes to the distribution pricing principles to support more cost reflective distribution network charges. The forward looking network tariff reviews being undertaken by a number of businesses themselves should also be taken into account. We understand that the SCER reform will be considered through a rule change process in 2013.

ENA understands that IPART is seeking to improve the allocative efficiency of the process for setting retail electricity prices. This is in two parts: by improving the capacity of retailers to set prices after considering network prices, and by requiring greater input from retailers and consumers in the annual price setting process so that consumers are better able to understand and respond to price changes.

For retailers, the benefit of earlier notification of network prices is to be able to manage the variance in the coming year's network price or tariff structure, as compared to the current year. However, ENA members consider that the IPART proposal has the real potential to increase, rather than reduce, such variance by requiring greater reliance on estimates and forecast assumptions. The potential benefit to retailers from having more time available between notification and commencement of the pricing changes may come at the cost of greater year-to-year volatility in transmission and distribution network prices.

ENA considers that there is a balance to be struck between transmission and distribution businesses providing information on changes in pricing and tariff structures earlier and ensuring that the information provided is sufficiently accurate.

IPART also proposes to introduce greater certainty over how network prices will change over the regulatory period through a new guideline on expected price trends to be imposed by the AER and an amendment to the National Electricity Rules (NER). ENA does not support changes in the NER to constrain annual price or tariff structure changes which in effect amount to a change in the price control mechanism. This rule change proposal does not demonstrate net benefits to consumers as it will either increase regulatory risk by imposing unmanageable risks on distribution businesses or increase the volatility of price adjustments required between regulatory periods.

While ENA members support greater certainty which can be achieved through improving stakeholder engagement on future price trends, ENA does not support new prescriptive requirements for the consultation process. ENA considers that this customer engagement should be guided by the framework to be developed under the AER's Better Regulation guideline on consumer engagement.

ENA has provided more detailed information in the attached submission on the three areas of early notification, consultation on distribution network prices and tariff changes, and constraining annual distribution network price changes.

Should you wish to further discuss this submission please contact Lynne Gallagher on 02 6272 1515

Yours sincerely



John Bradley
Chief Executive Officer

Submission on the AEMC Consultation Paper, National Electricity Amendment Annual Network Pricing Arrangements Rule 2013 (ERC0149), June 2013

Earlier notification of annual network price changes

The Rule change would bring forward the finalisation of network prices to 15 March each year for transmission businesses and, in states other than Victoria, to 30 April each year for distribution network businesses. In Victoria, the effect would be to bring forward the finalisation of network prices to 31 October each year for distribution network businesses.

The ENA understands that the Rule change would apply to the notification of network pricing for the first year of the regulatory control period as well as the subsequent years. In ENA's view it is impractical to require earlier notification of price changes in the initial year. As the AEMC has stated the effect of this would be to require the AER to begin the revenue determination process earlier (now approximately 16 months before the start of the regulatory control period) or to shorten the time taken to finalise the process. Therefore, were the AEMC to approve changes to timing in subsequent years, the ENA does not consider that it is necessary to keep timings in the first year and subsequent years the same.

The ENA has assumed in this response to the Rule change proposal that the AER will agree to approve prices within 20 business days of receiving annual pricing proposals from distribution businesses, should this Rule change be successful. Otherwise there is no benefit to retailers in bringing forward the notification of transmission and distribution prices.

For retailers, the benefit of earlier notification is to be able to manage the variance in the coming year's network price or tariff structure, as compared to the current year. However, ENA members considers the IPART proposal has the real potential to increase, rather than reduce, such variance by requiring greater reliance on estimates and forecast assumptions. The potential benefit to retailers from having more time available between notification and commencement of the pricing changes may come at the cost of greater year-to-year volatility in transmission and distribution network prices.

The setting of transmission prices by 15 May already requires forecasting of key inputs both to the end of the current financial year and for the next financial year. Bringing this forward by two months would significantly increase the reliance on forecast inputs to transmission pricing. This would in turn increase the potential volatility in the setting of retail prices and prices for customers directly connected to the transmission network. Grid Australia in its submission to the Rule change proposal has illustrated the significance of the use of forecasts for settlement residues when it points out the difference between forecast settlement residues and year-end actuals varied from - 45 per cent to + 81 per cent between 2007-08 and 2012-13.

There is interdependence in the Rule change proposal to bring forward the finalisation of transmission and distribution prices. As a result of this interdependence it will be difficult for distribution businesses which have prices commencing from 1 July each year to finalise their prices by 30 April unless transmission prices are finalised by 15 March. This is because under the proposal, distribution businesses would be required to submit their price proposals to the AER by 31 March. Further, if as a result of consultation, the Rule change proposal is modified to require distribution businesses to finalise their prices on the basis of draft transmission prices (which are currently available in mid-April), then the risk of under-recovery or over-recovery of revenue is transferred from the transmission network businesses to distribution businesses.

The potential effect of bringing forward the finalisation of network prices on retail price volatility in subsequent years remains however.

Note that in Victoria, distribution businesses apply the final transmission prices available on 15 May in their pricing proposals submitted to the AER in October. Therefore there is no benefit to Victorian retailers of bringing forward the finalisation of transmission prices, and a cost from a greater reliance on forecast data necessitating corrections to prices in the subsequent year.

There is a further constraint on any bring forward of distribution pricing proposals. The relevant control mechanism for each distribution business (whether a revenue cap or weighted average price cap) will specify which annual inflation measure to use in their annual pricing proposal. For example distribution businesses with prices commencing on 1 July may be required to use a March to March quarter CPI (released end April) in their annual pricing proposals. Businesses with prices commencing on 1 January may be required to use September quarter CPI (released end October). This suggests that the bringing forward of network price notification, were it desirable, could only be implemented in a staggered manner, jurisdiction by jurisdiction, at the beginning of the next regulatory control period. Additionally, network businesses in Victoria note that the use of a June quarter CPI figure would be problematic in the roll-forward of the Regulated Asset Base (RAB) under their regulatory framework.

Network businesses acknowledge it is desirable for all stakeholders that retail businesses have an appropriate opportunity to respond to network prices in developing their tariffs and services. It is also recognised retail price regulators require appropriate time where they continue to have a role (noting network businesses support retail price deregulation in competitive markets).

ENA considers that there is a balance to be struck between transmission and distribution businesses providing information on changes in pricing and tariff structures earlier and ensuring that the information provided is sufficiently accurate. The AEMC may wish to assess, through worked examples, the potential for future price variability due to a change in timeframes and the ENA would be prepared to assist in this process.

Consultation on proposed annual network price changes

In its Consultation Paper, the AEMC has questioned what form of consultation would be useful to consumers or consumer groups, whether there would be benefit in such consultation and what scope is there for consultation on proposed network prices.

Network businesses support effective engagement with stakeholders as being likely to assist retailers to better structure their prices and to enable consumers to understand and respond to price changes and changes in tariff structures.

Naturally, distribution network businesses are already engaging with stakeholders, including in the regulatory determination process and remain committed to continuous improvement. As part of their regulatory proposal distribution businesses are also required to provide an indication of future prices for review by the AER.

The NER currently requires that the statement of expected price trends includes an indication of how prices will change over the regulatory period and the reasons for the expected changes. While it is true that distribution businesses are not required to include information on possible changes to network tariffs per

se, it is common for businesses to go beyond these requirements and make information available to assist retailers and their customers to understand price changes.

In addition to the NER requirements, distributors are also already subject to jurisdictional regulatory requirements relating to notification periods. For instance, the Victorian Use of System agreement requires that:

- Distribution businesses are to provide retailers with structural changes by September;
- Distribution businesses are to provide retailers with copies of their pricing submission within 2 days of giving it to the AER; and
- Distribution businesses are to provide retailers with approved tariffs within 2 days of AER approval.

Similar requirements apply in some other jurisdictions.

ENA considers that it is appropriate that the views of retailers, consumer groups, and other stakeholders be taken into account in developing the proposed network pricing structures to apply for the regulatory period. Similarly, key stakeholders could be consulted on variations in network pricing structures in later years. ENA's views are consistent with the AEMC recommendations in the Final Report of the Power of Choice Review (the Final Report), that are designed to strengthen the requirements for consultation with key stakeholders on network tariffs and to allow for more regulatory verification that network tariffs comply with the rules.

In this context we note that the AEMC has proposed that:

“AER develops and publishes a guideline for network tariff arrangements that covers two purposes. Firstly, to provide more detailed interpretation of how the pricing principles can be applied. Secondly to set out consultation and information requirements with respect to development of network pricing structures statement and its annual updating in the pricing proposals of distribution businesses.”¹

As recognised in the AER's draft consumer engagement guideline, we agree that businesses should be explicit about what they can influence in the engagement process and what realistically could be difficult to change. It is difficult to identify a benefit in *consulting* consumers or consumer groups on annual pricing proposals unless there are changes to the structure of network tariffs. This is because no stakeholder is in a position to influence price outcomes from year to year within a regulatory control period, under constant tariff structures. These outcomes are influenced by a number of factors that are also beyond the control of distribution businesses, including changes in transmission pricing, cost pass throughs, and under and overs adjustment to the annual revenue requirement for businesses under a revenue cap. It is noted that current annual price setting process by the AER within a regulatory control period does not involve external consultation and in most cases results in confirmation of the distributor's implementation of the price control, rather than an exercise of regulatory discretion.

ENA proposes that it is more appropriate for network business consultation frameworks to be informed by the AER Better Regulation Guideline on engagement, rather than the current Rule change proposal. It would be better to progress this under AER Guideline, not only because that reform process is already underway but because a Guideline provides the correct light-handed environment to foster innovation, rather than prescriptive compliance. If the AER were to provide additional guidance, it should be focussed

¹ AEMC Power of Choice Review, Final Report, November 2012, page 181

on consultation with key stakeholders in the development of network tariff structures over a regulatory period and not - as proposed under the Rule change - on consultation on annual price changes.

Statement of expected price trends

The Rule change has proposed that the AER would only approve a pricing proposal from a distribution business if it was satisfied that the proposal meets existing regulatory requirements and “is consistent with a DNSPs statement of expected price trends”.

We agree with the AEMC’s statement in the Consultation Paper that “there appears to be potential risks in making the approval of annual network prices dependent, in part on the accuracy of forecasts made in the statement of expected price trends”.

Linking the approval of annual pricing proposals to the statement of expected price trends is effectively a change in the price control mechanism for distribution businesses.

Distribution businesses must have the ability to respond to unanticipated changes in demand by pursuing tariff reforms, subject to side constraints and the X-factor constraint under the control mechanism. To add another layer of control over the setting of prices is not in the long term interests of electricity consumers whose interests will be advanced through longer term tariff reform.

The Rule change as proposed would not promote the National Electricity Objective (NEO), as it would undermine the integrity of the regulatory determination process and expose distribution businesses to an uncompensated risk of under-recovery, thereby increasing regulatory risk. Such a process would also be inconsistent with the revenue and pricing principles contained in the National Electricity and Gas Law, in particular, the requirement to ensure that distribution businesses have a reasonable opportunity to recover at least the efficient costs of providing the regulated service. Were this risk to be sought to be mitigated through subsequent ‘true up’ mechanisms, it is noted that this would represent an additional source of inter-period volatility in the network charges of consumers.

Therefore network businesses urge the AEMC to reject the proposal to amend the NER to constrain annual price or tariff structure changes, as in effect it amounts to a change in the regulatory control mechanism, that would be to the detriment of the long term interests of consumers.