Australian Energy Market Commission

CONSULTATION PAPER

National Electricity Amendment (Annual Network Pricing Arrangements) Rule 2013

Rule Proponent

Independent Pricing and Regulatory Tribunal of New South Wales

6 June 2013

RULE CHANGE

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About the AEMC

The Council of Australian Governments (COAG), through its then Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. In June 2011, COAG established the Standing Council on Energy and Resources (SCER) to replace the MCE. The AEMC has two main functions. We make and amend the national electricity, gas and energy retail rules, and we conduct independent reviews of the energy markets for the SCER.

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1 Introduction

On 12 September 2012, the Independent Pricing and Regulatory Tribunal of New South Wales (IPART) (the proponent) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission). The rule change request seeks to modify the annual network pricing arrangements for electricity network service providers. Specifically, IPART is proposing changes to:

- require annual network prices to be approved and notified two months prior to taking effect;
- require consultation on the development of annual network prices supported by requiring the Australian Energy Regulator (AER) to establish guidelines for Distribution Network Service Providers (DNSPs) on developing and updating their statement of expected price trends; and
- amend the AER's assessment criteria for approving DNSPs' annual network prices to include consistency of the proposed prices with their statement of expected price trends.

This consultation paper has been prepared to facilitate public consultation on the rule change request, and to seek stakeholder submissions on the rule change request.

This paper:

- sets out a summary of the Annual Network Pricing Arrangements rule change request proposed by the proponent;
- provides a summary of past rule change determinations and reviews relevant to this rule change request;
- sets out the assessment framework for this rule change request;
- identifies a number of questions and issues to facilitate the consultation on this rule change request; and
- outlines the process for making submissions.

Appendix A provides background information on the rule change request.

2 Details of the rule change request

The proponent submits that:

- retailers and customers do not get notification of annual network price changes in a reasonable timeframe prior to taking effect;
- timing of finalisation of network prices causes difficulties in setting regulated retail prices for jurisdictions where retail price regulation still exists and changes to retail market offers which are generally linked to regulated retail prices;
- retailers and customers are not consulted on the development of annual network prices; and
- there should be some certainty in how network prices will change over the regulatory control period.

The proponent has put forward a range of changes to address the identified problems. These are discussed in more detail below.

2.1 Notification of annual network price changes

2.1.1 Problem identified

The proponent states that under the current pricing arrangements, retailers and customers do not get adequate notification of annual network price changes. It notes that this extends to situations where network prices are significantly increased, and also where the tariff structures are changed from the previous year's.

The proponent submits that there is insufficient time available to determine retail prices due to the time taken in the finalisation of network prices. It states that often retailers have to rely on estimated network prices for the retail price change as network prices are not finalised in time.

The proponent states that since retailers rely on network tariff structures to set their retail tariff structures, the limited time available between notification and commencement of the price change causes difficulty in incorporating the network tariff structure in the retail tariffs. These issues also cause retailers difficulty in making changes to their billing systems to properly reflect the new network tariff structures. The proponent argues that if retailers have little time to accommodate network price changes, then they:

- cannot pass through network price signals and set competitive and well-structured retail tariff;
- provide a range of offers;
- explain price changes to customers; and

- arrange implementing hardship policies to assist customers.

The proponent states that lack of notification time is not only an issue for retailers in developing retail tariffs for their market offers, but also for jurisdictional regulators determining regulated retail prices. This is because jurisdictional regulators factor in network tariffs in setting regulated retail prices. Regulated retail prices cannot be finalised for the upcoming tariff year until the annual network prices have been approved and published.

The proponent also states that notification of annual network prices are further delayed by the fact that the National Electricity Rules (NER) does not provide a time limit to the AER to assess DNSP's pricing proposals.

2.1.2 Solution proposed

The proponent has proposed the following changes to the NER in relation to the rules that establish the annual network price setting timeframe:

- Transmission Network Service Providers (TNSPs) must publish their prices by 15 March each year;
- DNSPs' network prices are required to be finalised and published two months prior to taking effect;
- the AER must publish the approved network prices within 20 business days of receiving pricing proposals from DNSPs; and
- DNSPs must publish the annual network prices within five business days of the publication of the approved pricing proposal by the AER.

The proposed changes would mean that transmission prices would be finalised by TNSPs two months earlier than currently required. It would also mean that DNSPs would need to submit their annual pricing proposals to the AER for approval one month earlier currently required. Under the proposed changes, the AER will also need to approve and publish the pricing proposals within the specified timeframe to allow notification of the annual network prices within two months prior to taking effect.

2.2 Consultation on proposed network prices

2.2.1 Problem identified

The proponent states that, while the NER requires consultation during the revenue determination process, this requirement does not extend to the annual setting of network prices. In particular, the proponent states that despite having a significant degree of discretion in the development and setting of network prices, the DNSPs are not required to engage or consult with retailers and customers in this process. Similarly, there are no requirements on the AER to consult during its approval of annual network prices.

The proponent states that retailers and customer representatives should be involved the development of network prices. In its view, involvement of customers would provide the greatest benefit as they can provide better information on how they are likely to respond to different prices.

2.2.2 Solution proposed

The proponent has proposed to require the AER to issue guidelines on what DNSPs should include in their statement of expected price trends. As part of developing the guidelines, the AER would be required to establish the consultation that DNSPs would need to undertake in developing and changing this statement and the timing of the statement.

2.3 Statement of expected price trends

2.3.1 Problem identified

The proponent states that DNSPs currently have considerable discretion in setting network prices which has resulted very little certainty in how network prices will change over the regulatory control period. The proponent notes network tariffs can change dramatically from year to year and some of these changes have been substantial.

2.3.2 Solution proposed

The proponent has proposed to amend the approval criteria of network prices to include consistency with the DNSP's statement of expected price trends. The proponent believes that this will provide greater certainty and information to stakeholders on the price path of price changes in the future. The AER would therefore approve the pricing proposal if it is satisfied that it meets the existing regulatory requirements and is consistent with a DNSP’s statement of expected price trends.

2.4 Consultation undertaken by proponent

In developing its rule change request, the proponent undertook its own consultation with a range of stakeholders. The rule change request included copies of submissions that it received in its consultation process.

3 Relevant rule changes and reviews

3.1 Rule change on the publication of transmission network prices

The AEMC considered a rule change in 2009 on changing the timing of publication of transmission prices.[1] This rule change was submitted by EnergyAustralia (now Ausgrid) that proposed to move the transmission network prices publication date from the 15 May to the 15 March each year.

The main arguments proposed in support of the proposed rule were that it would:

- reduce the administrative burden associated with the price approval process;
- induce more efficient and accurate pricing signals for customers; and
- enable DNSPs to avoid financial exposure.

The AEMC assessed rule change proposal and found that the proposed rule did not meet the statutory rule making test. At that time, the AEMC based its decision on the basis that the proposed rule would not be a proportionate response to the problem identified and thus would be inconsistent with good regulatory practice. The AEMC also found that the problem identified was not material and was specific to New South Wales.

The AEMC instead made a more preferable rule, based on an alternative rule proposed by Grid Australia that allowed the draft Maximum Allowed Revenue (MAR) to be used in calculating transmission prices in the first year of a regulatory control period if the final MAR was not available. The more preferable rule also provided for an "unders and overs" mechanism to allow for the recovery of differences between the draft and final MAR.

3.2 Rule change on inter-regional transmission charging

The AEMC made a rule in February 2013 introducing new inter-regional transmission charging arrangements for TNSPs in response to a rule change request from the former Ministerial Council on Energy.[2] This rule determination introduces a requirement for TNSPs to publish an annual modified load export charge (MLEC) amounts by 15 March each year on the basis that the NER currently requires TNSPs to publish their prices by 15 May each year. The AEMC considered a two month period between the publication of MLEC and final transmission prices to be sufficient.

The MLEC will not affect the total revenues earned by each TNSP. However, it will impact on how those revenues are recovered from customers. Therefore, the MLECs will need to be factored into the annual transmission prices TNSPs must determine and

1 AEMC, *Transmission Network Prices Publication Date*, Rule Determination, 26 March 2009.

2 AEMC, *Inter-regional transmission charging*, Rule Determination, 28 February 2013.

publish. The commencement date for the inter-regional transmission charging arrangements is 1 July 2015. This would require the first publication of the MLEC by 15 March 2015.

3.3 Power of choice review

In November 2012 the AEMC provided its final report on the Power of Choice review to the Standing Council on Energy and Resources (SCER).[3] The review made a number of recommendations to SCER to amend the NER to improve the current annual tariff setting process. In particular, the AEMC recommended:

- changes to the distribution pricing principles to provide better guidance for setting efficient and flexible network pricing structures;
- more robust consultation and verification applied to the annual network tariff setting process, including consulting on requested changes to the approved statement of network pricing structures;
- a new requirement for DNSPs to develop and consult with retailers and consumer groups on a statement of proposed network pricing structures as part of their regulatory proposals;
- possible changes to the network pricing side constraints which prohibits price changes of greater than two per cent from one year to the next; and
- a requirement for the AER to publish a guideline for network tariff arrangements.[4]

The AEMC noted that there are some potential areas of overlaps and differences between its recommendations to SCER and those proposed by IPART in its rule change request.[5]

SCER has agreed to a number of AEMC's recommendations at its 14 December 2012 meeting and is currently progressing their implementation.[6]

The AEMC will consider any overlaps from this rule change request and the Power of Choice review recommendations if and when SCER submits the rule change request.

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3 AEMC, *Power of Choice Review - giving consumers options in the way they use electricity*, Final Report, 30 November 2012.

4 Id., pp. 181-191.

5 Id., pp. 191-192.

6 SCER, Meeting Communique, 14 December 2012.

4 Assessment framework

The Commission may only make the proposed rule if it is satisfied that the proposed rule will or is likely to contribute to the achievement of the National Electricity Objective (NEO) as set out under section 7 of the National Electricity Law (NEL).

Section 7 of the NEL states:

> "The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to -
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system."

In assessing whether the rule change request will or is likely to contribute to the achievement of the NEO, the AEMC is proposing to consider how the proposed rule will promote the long term interest of consumers with respect to pricing. The AEMC will take into account how different components of efficiency such as allocative efficiency, productive efficiency and dynamic efficiency are affected by the proposed rule.[7] In particular, the AEMC will consider whether the benefits of the proposed rule with respect to earlier notification of annual network price changes, consultation on the development of network prices and pricing certainty in future network price changes, outweigh the potential costs.

In determining how the benefits of the proposed rule measures against any costs, the AEMC will consider whether the proposed rule:

- promotes efficient allocation of risks;
- provides appropriate stakeholder engagement;
- minimises undue regulatory burden; and
- provides predictability and stability in the regulatory framework and outcomes.

Theses aspects of the proposed assessment framework are briefly discussed below.

4.1 Efficient allocation of risks

Changes to the rules can affect existing obligations for market participants or create new ones. This in turn will have the effect of increasing risks for some participants

7 Allocative efficiency requires that energy services are provided, and consumption decisions are made, on the basis of prices that reflect the opportunity (or marginal) costs of goods and services. Productive efficiency occurs when business produce the goods and services they offer to consumers at least cost. Dynamic efficiency occurs when productive and allocative efficiencies are achieved over time, taking account of technological change and innovation.

while reducing risks to others. Risks have costs and these costs will ultimately be passed on to consumers in the form of prices. Some of the types of risks that may be a relevant consideration for the proposed rule include:

- risk that network tariffs do not recover the allowed revenues of TNSPs and DNSPs;
- risk that retail tariff structures do not reflect the network tariff structures and therefore do not send efficient pricing signal to consumers;
- risks from retailers not being able to pass through network tariffs in time for retail price changes;
- risks to consumers from changing network tariffs and uncertainty in the level of future price changes; and
- risks from the AER having to approve network prices within a limited timeframe.

Allocating risks to those participants who are best placed to manage them helps to achieve productive efficiency because it is the lowest cost way of managing those risks. Appropriate allocation of risk therefore contributes to minimising the costs of providing electricity to consumers. The AEMC will consider whether the proposed rule promotes efficient allocation of risks between TNSPs, DNSP, the AER, retailers and consumers.

4.2 Stakeholder engagement

Stakeholder engagement is an important aspect of the regulatory process because it can allow for views of different stakeholders to be taken into account in determining pricing outcomes. Allocative efficiency is achieved when retailers provide only those goods and services that are demanded by consumers. This can only be achieved when retailers or jurisdictional regulators are basing decisions on accurate information. Stakeholder engagement should help to achieve this by more closely identifying what consumers are, and are not, willing to pay for, and setting prices accordingly. It should also help regulators gain better information about retailers' businesses and costs and set more efficient prices based on that information.

Consultation also provides the opportunity to convey information that can assist consumers to make informed choices about the prices they face for their electricity supply and make appropriate consumption decisions.

Better pricing outcomes can therefore be achieved when stakeholders have greater involvement in the regulatory process. The AEMC intends to consider whether the proposed rule on consultation on development of network prices will result in better pricing outcomes for stakeholders.

4.3 Regulatory burden

Complying with the NER carries a certain level of regulatory burden for various participants in the form of administrative costs. Rules that create additional regulatory burden or increase administrative costs should be minimised where possible and be proportionate to the expected benefits. The AEMC intends to consider whether the implementation and administrative costs arising from the proposed rule is proportionate to the benefits. If the proposed rules are complex to administer or difficult to understand by stakeholders, then they are less likely to achieve their intended end, or will do so at higher cost, reducing productive efficiency.

4.4 Predictability and stability

Changes to rules should not create undue uncertainty for market participants. Lack of stability in regulatory arrangements can affect confidence of stakeholders to invest and participate in the markets. This can reduce productive efficiency, as it increases the total cost of providing energy services. It can also affect dynamic efficiency, as it may prevent businesses from making long term investments which reduce costs, or improve service quality, over time.

To minimise uncertainty, changes to the rules should be transparent, proportional and objective. While rules evolve and need to change from time to time to ensure that they remain fit for purpose and do not act as barriers to efficient investment outcomes, this should be done in a transparent and predictable way that provides market participants sufficient warning and opportunities for engagement.

The same principles should apply to the determination of efficient prices for consumers. While cost reflectivity is important, it will only produce allocatively efficient outcomes if consumers have a reasonable opportunity to respond to and manage their costs. Large step changes in prices, particularly where they are unanticipated, are likely to undermine consumer confidence in market and the supporting regulatory arrangements.

The AEMC will therefore assess the degree to which the proposed rule supports predictable and stable outcomes for stakeholders.

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

5 Issues for consultation

A number of issues appear to be relevant for consideration in this rule change request. In this chapter, we discuss the following aspects:

- notification of annual network price changes;
- consultation on the development of network prices;
- the role of statement of expected price trends;
- interactions between the components of the proposed rule; and
- issues around the notification of network prices for the first year of the regulatory control period.

The issues discussed below are provided for guidance. Stakeholders are encouraged to comment on these issues as well as any other aspect of the rule change request or this paper including the proposed framework.

5.1 Notification of annual network price changes

The proponent has raised an issue concerning the extent to which notification is provided of changes in annual network prices.[8] This section considers what notification different groups of stakeholders may require concerning changes to annual network prices, and how the proponent's proposal could impact those stakeholders.

This section only relates to the annual pricing process that applies for years in a regulatory control period *after* the initial pricing proposal. Separate considerations apply for the pricing process for the first year of a regulatory control period. The initial year notification issue is discussed in section 5.5.

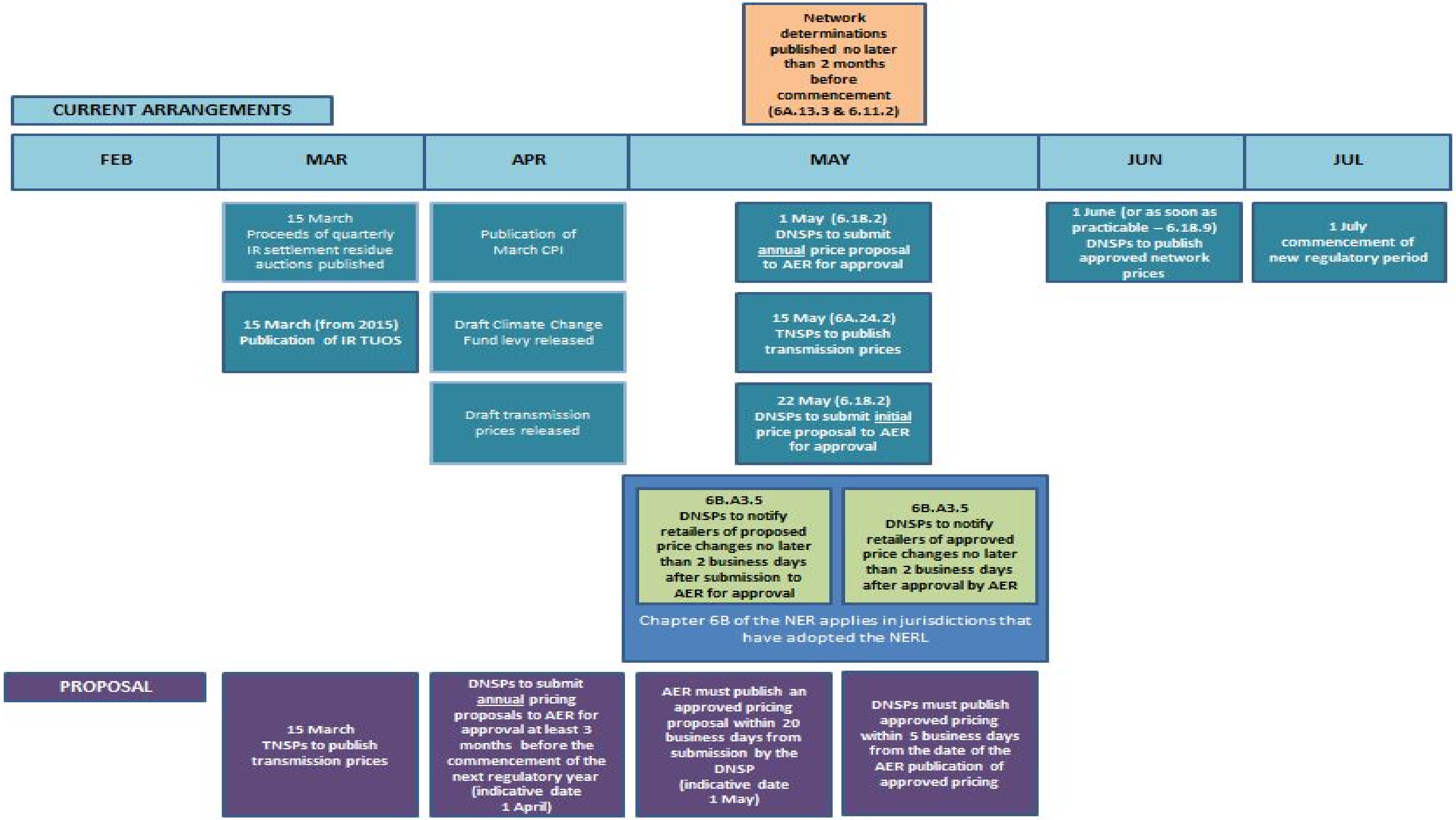
5.1.1 Impact on network service providers

To better gauge the significance of the problem identified by the proponent, we propose to consider a more detailed evaluation of the pricing process that is followed by TNSPs and DNSPs. This includes consideration of the different types and timings of inputs required by the network businesses to develop their respective prices.

Figure 5.1 schematically shows the simplified timeline of the annual network pricing process under the current NER. It also shows how the process would work under the proponent's proposed rule.

8 Network prices refer to prices charged by DNSPs through their network tariffs. DNSPs also include transmission charges in their network prices. See section A.1 in Appendix A for more information.

Figure 5.1 Network pricing process timeline



In Victoria, the new regulatory period commences on 1 January, as opposed to 1 July in the remaining National Electricity Market (NEM) jurisdictions. This means that DNSPs submit their annual pricing proposals by 1 November for approval. However, TNSP prices must still be published by 15 May for each financial year with the Australian Energy Market Operator (AEMO) having the responsibility to do so.

While there are differences in the regulatory arrangements in Victoria that go beyond timing, such as AEMO's role in setting prices, these do not appear to affect the considerations for the purposes of this rule change request. To the extent that AEMO publishes the Transmission Use of System (TUOS) prices by 15 May for each financial year as required under Chapter 6A, Victorian DNSPs would need to used estimated calendar year TUOS in their pricing proposals.

As indicated in Figure 5.1, there are a number of external inputs that feed into the development of TNSP and DNSP pricing. Some of these inputs are estimated due to the timing of their availability and subsequently adjusted in the pricing proposals once final numbers are known.

We understand that, in general, TNSPs rely on the following inputs to finalise their transmission network prices:

- the Maximum Allowed Revenue (MAR) adjusted for any unders or overs;[9]
- cost pass throughs and contingency projects mechanism adjustments to MAR approved by the AER;
- Consumer Price Index (CPI) determined by the AER as part of the revenue determination to adjust MAR (usually March quarter published by the Australian Bureau of Statistics in late April);
- proceeds of quarterly inter-regional settlement residue auctions published on 15 March annually; and
- inter-regional TUOS charges will be published on 15 march annually from 2015-16.

For DNSPs, the following inputs appear to be needed before they can submit their annual pricing proposal to the AER:

- transmission prices;
- if under a revenue cap, any adjustments to the DNSP's annual revenue requirement for any unders and overs, approved by the AER;

9 The unders and overs refers to the reconciliation process undertaken to adjust for any differences between the allowed revenue for a particular year and the actual revenue collected in that year for revenue cap businesses. This reconciliation process occurs to adjust future revenues for any under or over-recovery of revenue from the most recently completed regulatory control year. The unders and overs account is maintained by the TNSPs and DNSPs and adjustments are approved by the AER each year prior to pricing finalisation.

- cost pass throughs and contingency projects mechanism adjustments to the annual revenue requirement approved by the AER;
- CPI determined by the AER as part of the revenue determination;
- loss factors advised by AEMO;
- jurisdictional scheme costs. Many jurisdictions have established feed-in schemes, the costs of which are generally recovered through the network prices; and
- other adjustments advised by the AER in accordance with the application of the control mechanism, such as D factor, S factor, F factor and efficiency benefit sharing scheme adjustments.

In addition, all data used by a DNSP as part of a pricing proposal must be audited prior to the AER's assessment.

The proponent has proposed moving the timings of finalising network prices forward in order to establish a more reasonable timeframe for retailers and jurisdictional regulators to develop retail prices. This would effectively mean that network pricing would be finalised two months prior to the commencement of the new regulatory year, that is, 1 November in Victoria and 1 May in the other NEM jurisdictions.

There is an inherent tension in trying to balance the timing aspect of the annual pricing approval process. The process involves a chain of interdependent pricing steps culminating in final published network prices. Each party therefore needs sufficient time to get the relevant information before determining their own prices.

The revenue determinations necessarily reflect the assumptions relating to market conditions, forecasts and requirements relevant at the time they are made. However these underlying input assumptions are subject to a number of uncertainties that may result in actual network price trends differing from that expected at the time of the revenue determinations which make it difficult to forecast the extent to which network prices will change.

One of the key factors in the variability in network pricing is changes in demand and the control mechanism the network is subject to. For example, network prices proposed by a network business under a revenue cap in each year of the regulatory control period take into account any revenue under or over-recovery from the previous year to account for any difference between the expected and actual revenue of previous year. If the actual consumption volumes fall, then the business will increase the prices to maintain its revenue at the allowed level.

For businesses regulated under a weighted average price cap, changes in consumption will also lead to changes in revenue, subject to the businesses' ability to re-balance their tariffs to recover its allowed revenues.

Generally, TNSPs and DNSPs use the most up to date data in order to reduce the risk of not recovering their allowed revenues. This means that information on latest demand forecast and revenue adjustments are important inputs into the pricing process. For those DNSPs under a weighted average price cap, they also require up-to-date information on demand for pricing as they bear the risk of actual demand being greater or less than forecast demand. Any change to the timeframes in setting network pricing will influence the information that these businesses have in setting their prices and therefore influence their ability to mitigate revenue risks.

Another significant factor that is contributing to variability in network pricing is the impact of the rapid uptake of rooftop solar generation experienced in some NEM jurisdictions in recent years, encouraged by a combination of high feed-in tariffs offered, the impact of the Solar Credits Multiplier under the Small scale Renewable Energy Scheme and the availability of various government grants. This has led to applications by DNSPs to the AER for the approval of the recovery of higher than expected costs associated with these schemes. These have often been relatively substantial, for example the approval of applications for the recovery of costs incurred in 2011-12 made by ActewAGL (Australian Capital Territory) for the amount of $0.7 million, and Ergon Energy and Energex (Queensland) for $27.8 million and $78.6 million respectively. Once approved, these amounts are generally factored into the network prices to be recovered from customers.

While many jurisdictional governments are seeking to wind back these schemes, the current impact of these schemes is, in some jurisdictions, still substantial. For example, the Queensland Competition Authority has estimated that the cost of direct feed-in tariff payments under the Queensland scheme will total $2.9 billion ($2013-14) by the end of the Scheme in 2028. It notes that when the cost impacts of the scheme peak during 2015-16, feed-in tariff payments are expected to account for around $276 to the average residential customer's annual electricity bill, or around 17 per cent of the total bill.[10]

The proponent suggests that although setting prices earlier in the year will mean greater reliance on estimated values rather than actual, network businesses are better placed to manage any revenue risk arising from this due to the use of 'unders-and-overs' accounts in their pricing processes. This is a reference to the mechanism utilised by network businesses to reduce the uncertainty inherent in using forecasts, and allows for adjustments to be made revenues for revenue cap businesses to account of under and over recoveries of costs made in the previous year.

If TNSPs and DNSPs are required to set network prices with less actual information, then the revenue risks associated with a greater reliance on estimations could increase. Any change to the timeframes in setting network pricing will influence the information that these businesses have in setting their prices and therefore influence their ability to mitigate revenue risks. While the use of unders and overs is attractive, it can also increase the risk of price volatility to customers in subsequent years if the adjustments are sizable.

10 Queensland Competition Authority, *Estimating a Fair and Reasonable Solar Feed-in Tariff for Queensland*, Final Report, March 2013.

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

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

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

5.1.2 Role of and impact on the AER

While the AER is not required to review the annual pricing of TNSPs, it has the role of approving annual network prices of DNSPs. With the exception of the Victorian DNSPs, the 1 July network regulatory year commencement date means that the AER must approve annual pricing proposals of eight DNSPs concurrently.[11]

Under the NER, the AER must assess the pricing proposals for compliance with the pricing principles, the regulatory determination, as well as other requirements in the NER. Undertaking this process includes a detailed review of the inputs and the mathematical checking of methodologies and formulas used by the DNSPs in their calculations. The AER is also required to check that the forecasts used by DNSPs in developing their proposals are reasonable.

Where the AER considers the proposal to be non-compliant in some way, the process becomes more iterative between the AER and the DNSP, requiring more time. The AER can require the DNSP to resubmit an amended proposal to correct the identified deficiencies. This must be submitted by the DNSP within 10 days of receiving the notice from the AER.

In circumstances where the AER is satisfied that all requirements are satisfactorily met, then the AER must approve the proposal. This requires the recommendation to approve going through the AER's own internal process to gain formal approval before it can take effect.

11 This is in addition to a number of annual gas pricing proposals that are submitted for approval around the same time.

The AER can also choose to make the necessary amendments itself to correct the deficiencies in a proposal and approve an amended network pricing schedule. However, while this might speed the approval process up, in practice it is may not be a desirable outcome, particularly in terms of regulatory transparency and accountability.

The AER therefore requires adequate time to assess each proposal individually and follow up issues with relevant DNSPs on an ongoing basis where this is necessary. There is no date set for the final approvals to be made by the AER, with the NER simply providing that the approved pricing proposal takes effect at the commencement of the regulatory year to which it relates.

In this way, the AER undertakes the assessment of pricing proposals on a 'best endeavours' basis, with the flexibility provided under the NER allowing the AER to allocate adequate time for the detailed assessments to be made, as necessitated by the circumstances of each individual proposal.

The proponent's proposal to give the AER 20 business days to assess pricing proposals of DNSPs would mean that the AER no longer has the flexibility to undertake detailed examination of those proposals that warrant further assessment for compliance. This would particularly limit the AER's ability to request further information from the DNSP on their modelling or data, unless the process had commenced much earlier.

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

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

5.1.3 Impacts on jurisdictional regulators and retailers

The proponent states that a lack of a definitive date for the finalisation of annual network prices means that timing for the development and finalisation of retail prices can easily be subject to delays.

Network prices is the largest component of retail prices, accounting up to 50 per cent of a typical electricity bill.[12] Retailers require time to develop their own tariffs. Consequently, the later the network prices are notified, the less time would be available for retailers to understand any changes made to the structure and level of network tariffs and develop their own retail offers.

Further, if retailers are not notified about the level of network prices in time for the retail price change, they may potentially include an uncertainty premium in their retail prices to protect themselves against under-recovering network charges from their

12 See Table A.1 in Appendix A.

customers. Lateness in the notification of network prices also affects retailers' ability to notify and explain the price changes to their customers.

This problem may be exacerbated where a DNSP has introduced changes to the network tariff structure rather than just the price levels of tariffs. Where the structure of network tariffs have changed, it may necessitate the retailer developing retail pricing structure that appropriately reflects the changed network tariff structure. It may also require the retailer to implement adjustments to its billing systems to accommodate new pricing structure and explain the changes to its customers.

Late notification of network prices can also impact on the development of regulated retail prices. The later the notification, the less time would be available for jurisdictional regulators to approve final regulated retail prices in those jurisdictions that retain retail price regulation.[13] Those regulators have different approaches to setting retail prices but in each case some time would be required once the network prices are known in order to produce the final regulated retail prices.

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

Question 8	**Is the proposed notification of two months sufficient?**

5.2 Consultation on development of network prices

Currently, there is no consultation on proposed network prices. DNSPs have the ability to change their network prices annually. This not only includes changing the level of their network prices, but also the structure of existing tariffs or introducing new tariffs. The proponent submits that lack of consultation means that interested stakeholders such as retailers and consumers are unable to provide valuable information on the likely impact and effectiveness of the proposed network prices.

Consultation on the development of network prices may assist DNSPs to gain a better understanding of how their network prices will likely affect consumers. It may also give DNSPs an opportunity to learn about the potential impact of its network pricing structures on retailers.

Consultation could take a number of different forms. First, consultation could be undertaken by the DNSP as the proponent proposes, or, it could be undertaken by the AER. As a public body the AER has certain requirements to take into account submissions provided in consultation. A DNSP would not have similar obligations, unless these were provided for in the NER.

13 The jurisdictions which retain retail price regulation are New South Wales, Queensland, Australian Capital Territory and Tasmania.

There are also different possibilities for the frequency of consultation. Consultation, could occur annually. Alternatively it may be more appropriate to hold consultation less frequently, such as once every regulatory control period.

In considering what consultation is appropriate, it is important to bear in mind the number of DNSPs for whom the AER must approve network prices, and the regulatory burden consultation would impose on the AER and stakeholders.

Another important consideration in assessing the proposed rule will be to determine what type of consultation would be important and appropriate for stakeholders. Consultation could occur at the level of prices, or the structure of proposed network prices, or both. This is important because each of these issues could involve different levels of consultation. In addition, stakeholder expectations may also differ. Retailers may be more interested in understanding whether DNSPs are proposing to change the structure of their network prices, while consumers may be more focussed on overall changes in pricing from one year to the next.

The proponent has proposed addressing lack of consultation by requiring the AER to issue guidelines on how DNSPs should develop and consult on their statement of expected price trends which the DNSPs are currently required to publish annually. Under the proposed rule, the AER's guidelines would determine what type of consultation should occur and how the DNSP should change the statement. The role of the statement of expected price trends is discussed in section 5.3.

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

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

5.2.1 Power of choice review recommendation

We note that in the Power of Choice review, the AEMC has recommended that DNSPs be required to include a statement of proposed network pricing structures as part of their regulatory proposal. It is envisaged that such a statement would be developed with the input of retailers and consumer groups. Subsequent revisions to the statement would be consulted on with stakeholders and approved by the AER.[14]

The AEMC's recommendation is different from IPART's proposal in two respects. First, the AEMC has recommended that the statement should only be on the pricing structure as distinct from information on levels of prices. This type of information on the structure of tariffs could potentially be useful to retailers in having certainty on the

14 AEMC, *Power of choice review - giving consumers options in the way they use electricity*, Final Report, 30 November 2012, p.187.

types of network tariffs that the DNSP will offer over the regulatory control period. Secondly, the AEMC proposed for the consultation on the statement to occur concurrently with the regulatory determination process. A key advantage of consulting through the regulatory determination process is that is provides for a consolidated consultation with all relevant stakeholders in one process, thereby minimising the regulatory burden on the AER and stakeholders.

The alternative proposal may be to incorporate consultation on network tariff structures in the regulatory determination process as proposed in the Power of Choice review. We will consider any overlap between this proposal and this rule change if and when SCER submits the rule change.

5.3 Statement of expected price trends

The proponent has proposed two changes to the statement of expected price trends as follows:

- to require the AER to issue consultation guidelines on what DNSPs should include in their statement of expected price trends to address lack of consultation in the development of network prices; and
- to amend the criteria in the NER for the AER to apply in approving the annual pricing proposal to include the requirement that the proposed prices are consistent with the DNSP’s statement of expected price trends.

In considering whether the scope of the statement of expected price trends should be changed, it is necessary to first determine the current role of this document and what stakeholders use this document for.

The current NER requires the statement of expected price trends to include:

- an indication of how the DNSP expects prices to change over the regulatory control period; and
- the reasons for the expected changes.

The NER does not require this statement to include any information on possible changes to network tariff structures which could be useful to retailers in anticipating future changes. The requirement to include reasons for the expected changes would be useful to retailers and as well as consumers. Retailers could find this information useful in explaining price changes to their customers.

In practice, the current level of information in the statement of expected price trends varies from DNSP to DNSP. For instance, some DNSP's provide more detailed information on categories of network tariffs, while some only provide average changes in prices across broad tariff categories. Some of this information may be too technical some customers such as residential and small business customers.

Complying with the statement of expected price trends may be an issue for DNSPs given that the actual annual network prices are influenced by a number of factors beyond the control of the DNSP. Some of the factors include:

- changes in recovery of TUOS pricing;
- any unders and overs adjustment to the annual revenue requirement of DNSPs under revenue caps;
- cost pass throughs and contingency projects mechanism adjustments to the annual revenue requirement approved by the AER;
- the accuracy of forecast demand;
- the accuracy of forecast customer numbers; and
- subject to distribution pricing principles and side constraints, the need to re-balance or restructure network tariffs.

Given these factors, it could be difficult for a DNSP to forecast with sufficient certainty the price path of average network prices, and even more difficult to forecast the expected price trend at any meaningful individual customer class tariff level. While the proponent has not suggested how "consistency" of the DNSP's proposed prices with the statement should be interpreted and applied, 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.

As with the consultation issue, it is important to understand what information stakeholders value most and ensuring that such information is available in timely manner and updated to reflect changing circumstances.

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

Question 12	**What influences the statement of expected price trends?**

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

5.4 Interaction between various components of the proposed rule

5.4.1 Notification and consultation

We have dealt separately above with the three components of this rule change request. In fact, there are strong interrelationships between the three components that should be borne in mind.

In particular, there is a strong relationship between notification and consultation. While the proponent's proposal seeks to provide for greater notification of annual network prices as well as introduce consultation on the development of network prices, we note that there is potential trade-off between these two objectives. This is because the pricing process cannot be moved forward indefinitely. The greater the additional time allowed for notification, the less available for a consultation process.

Intuitively, consultation would occur earlier than notification in the pricing process. However a requirement for earlier notification of final network prices means that DNSPs may not have a reasonable timeframe to undertake consultation where there are material changes to their network prices. Conversely, later finalisation of network prices provides greater scope for DNSPs to consult on their proposed network prices.

5.4.2 Consultation and statement of expected price trends

The proponent has proposed changes to the statement of expected pricing trends which, among other things, would increase the level of consultation in the pricing process. The proposed consultation would occur when the statement of expected prices is developed or adjusted.

There are a number of different ways in which the level of consultation in the pricing proposal process could be expanded. Use of the statement of expected price trends is just one way consultation could be expanded. If this is the method chosen, however, the ability to use the statement of expected price trends as a means of consultation will depend on whether this document has other functions. For example, the statement of expected price trends may be used as a means of providing certainty to retailers and consumers on the structure of network prices.

Processes for consultation may also be implemented separately to the statement of expected pricing trends. If this is the case there would be less interaction with the decision on the role of the statement of expected pricing trends.

5.5 Initial year network pricing

The NER makes a distinction between the timing of a pricing proposal made in the first year following a distribution network regulatory determination (initial pricing proposal), and a pricing proposal made in a subsequent year in a regulatory period (annual pricing proposal). This is because the initial pricing proposal must be approved between the finalisation of the AER's revenue determination (which sets the revenues for the regulatory control period) and the start of the regulatory control period. On the other hand for the subsequent annual pricing proposals the revenue is already set and the timing for the annual pricing proposal is less dependent on other processes.

While the proponent has raised the issue of notification of network pricing for the first year of the regulatory control period, it has not proposed any solution.

Due to the dependency on the AER's revenue determination process, it is a more challenging task to increase the level of notification in respect of the initial pricing proposal. Since this would require more time between the completion of the AER's revenue determination process and the start of the regulatory control period, the AER's revenue determination process would need to be either shortened in length or shifted so that it commenced earlier.

In the AEMC's rule determination on the Economic Regulation of Network Service Providers rule change in 2012, it decided that the revenue determination process should be extended in order to allow further opportunities for engagement between the AER, consumers and network businesses. If this process was now shortened to better accommodate network pricing process for the initial pricing year, it would not produce an optimal outcome for these parties.

However, if the revenue determination process was to commence earlier to allow the initial year pricing process to commence sooner, there is the increased risk that forecasts provided as part of the regulatory proposals would be out of date by the time the regulatory control period commences. This is because the process already commences approximately 16 months before the start of the regulatory control period.

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

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

6 Lodging submissions

The Commission has published a notice under section 95 of the NEL for this rule change proposal inviting written submission. Submissions are to be lodged online or by mail by 4 July 2013 in accordance with the following requirements.

Where practicable, submissions should be prepared in accordance with the Commission's Guidelines for making written submissions on Rule change proposals.[15] The Commission publishes all submissions on its website subject to a claim of confidentiality.

All enquiries on this project should be addressed to Zaeen Khan on (02) 8296 7800.

6.1 Lodging a submission electronically

Electronic submissions must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code ERC0149. The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

Upon receipt of the electronic submission, the Commission will issue a confirmation email. If this confirmation email is not received within 3 business days, it is the submitter's responsibility to ensure the submission has been delivered successfully.

6.2 Lodging a submission by mail

The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated. The submission should be sent by mail to:

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Or by Fax to (02) 8296 7899.

The envelope must be clearly marked with the project reference code: ERC0149.

Except in circumstances where the submission has been received electronically, upon receipt of the hardcopy submission the Commission will issue a confirmation letter.

If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

15 This guideline is available on the Commission's website.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	See AEMC
CPI	Consumer Price Index
DNSPs	Distribution Network Service Providers
IPART	Independent Pricing and Regulatory Tribunal of New South Wales
MAR	Maximum Allowed Revenue
MLEC	Modified load export charge
NECF	National Energy Customer Framework
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NERL	National Energy Retail Law
NERR	National Energy Retail Rules
SCER	Standing Council on Energy and Resource
TNSPs	Transmission Network Service Providers
TUOS	Transmission Use of System

A Background

This appendix provides background information on the rule change request and is structured as follows:

- section A.1 explains the relationship between network prices and retail prices;
- section A.2 describes the current annual transmission pricing requirements for TNSPs;
- section A.3 describes the current annual network pricing requirements for DNSPs;
- section A.4 describes the current consultation and information requirements in the network pricing process; and
- section A.5 describes obligations on retailers under the National Energy Customer Framework relating to the how often they can vary standing offer prices.

A.1 Relationship between network and retail prices

Network prices are a key cost component of the retail prices offered to customers. Network prices are made up of transmission and distribution use of system charges. These are usually combined by DNSPs into a single network price to retailers. This price is then passed through to customers as part of the retail electricity price. The network component of a typical residential customer's electricity bill is shown in Table A.1 below

Table A.1 Network cost component of residential retail prices in 2012-13

Jurisdiction	Percentage of network cost (combined transmission and distribution charges)
Australian Capital Territory	43%
New South Wales	55%
Victoria	34%
Tasmania	57%
South Australia	51%
Queensland	50%

Source: AEMC, *Possible future retail electricity price movements: 1 July 2012 to 30 June 2015, Electricity price trends report*, 22 March 2013.

The AER is the economic regulator of both TNSPs and DNSPs operating in the NEM. Chapters 6A and 6 of the NER set out the timelines, regulatory processes and principles governing the setting of network prices for transmission and distribution respectively. The processes and timetables are similar, although not identical.

TNSPs and DNSPs must periodically apply to the AER to determine their revenue allowances for a defined regulatory control period, typically five years. For TNSPs, the AER determines a cap on the maximum revenue that the network can earn over the regulatory control period. For DNSPs, the AER determines either a cap on the revenues or prices that can be earned over the period.

Once the allowed revenues are determined by the AER, prices are then set on an annual basis in each year of the regulatory control period. This annual network pricing process is set out in the NER. While not a necessary step for TNSPs, DNSPs are required to have their proposed network prices approved by the AER prior to being passed on to customers via retailers.

The network prices DNSPs charge has two elements. The first is the structure of the network tariffs they assign to various customer classes. The structure refers to the charging components of the tariff such as the fixed and variable components that a particular network tariff may have.[16] The second element is how the pricing level of each network tariff, or the charging component of each network tariff, varies from year to year.

Retail tariff structures are generally based on network tariff structures determined by the DNSPs. In jurisdictions where retail price regulation exists, the regulator with the responsibility for retail pricing sets annual regulated retail prices in reference to network tariffs which are generally passed directly through to customers.[17] In respect of market offers, retailers also pass on the network prices through their retail tariffs. The development and implementation of retail pricing is therefore dependent on notification of network prices for the relevant year.

Network prices change each year on 1 July in all NEM jurisdictions except for in Victoria where the price change occurs on 1 January. Regulated retail prices also change on the same date as the network prices. As retail market prices are often linked to regulated retail prices, market prices also generally change in line with the regulated retail prices.

A.2 Current transmission pricing requirements

The requirements in relation to transmission pricing are set out in Part J of Chapter 6A of the NER. It also includes a number of pricing principles for transmission prices.[18]

16 Tariff structure or variables also means consumption blocks or time bands for time-of-use charging.

17 NEM jurisdictions that have retained retail electricity price regulation are Queensland, New South Wales, the Australian Capital Territory and Tasmania.

18 NER clause 6A.23

In addition, the AER is required to make and publish pricing methodology guidelines relating to the preparation by a TNSP of a proposed pricing methodology.[19]

TNSPs submit their proposed pricing methodology to the AER alongside their revenue proposal as part of the periodic regulatory determination process.[20] The AER is required to either approve or refuse to approve the proposed pricing methodology, and to provide the reasons for its decision.[21] The AER must approve the TNSP's proposed pricing methodology if it is consistent with the pricing principles set out in the NER, and complies with the requirements of the pricing methodology guidelines.[22]

Once approved, a TNSP must publish its current pricing methodology on its website. It must also publish the prices for each of the categories of prescribed transmission services to apply for the following financial year, by 15 May each year for the purposes of determining distribution service prices.[23] The NER provides an exception for the first year pricing where the AER does not make a final decision at least three months prior to the financial year commencing. In this case, the NER specifies that the TNSP must set its prices either in accordance with AER's draft decision, or pricing methodology most recently approved by the AER, or previous method used by the TNSP.[24]

In Victoria, AEMO has the responsibility of publishing annual TUOS prices. AEMO publishes TUOS prices in accordance with the requirements under Chapter 6A.

DNSPs incorporate TUOS prices into their network prices which they charge retailers and some large customers.

A.3 Current distribution pricing requirements

The requirements in relation to distribution pricing are set out in Part I of Chapter 6 and Part A of Chapter 6B the NER.

A.3.1 Chapter 6

Under Chapter 6, each DNSP's annual network prices must be submitted to the AER as a pricing proposal and approved before it can take effect. DNSPs' pricing proposals set out the proposed tariff classes for the upcoming regulatory year and the proposed tariffs and charging parameters that correspond to each of these tariff classes. They also include information, including demand forecasts, which supports assessment of the

19 NER clause 6A.25.

20 NER clause 6A.10.1(a).

21 NER clause 6A.14.1(8).

22 NER clause 6A.14.3(g).

23 NER clause 6A.24.2. The term "financial year" is defined in Chapter 10 of the NER as "a period commencing on 1 July in one calendar year and terminating on 30 June in the following calendar year".

24 NER clause 6A.24.3(b).

compliance of the DNSP's proposed tariffs with the applicable control mechanism under their regulatory determination.[25]

Pricing proposals must be submitted within fifteen business days of the publication of the distribution determination for the first regulatory year of a regulatory control period and at least two months before the commencement of subsequent regulatory years during the regulatory control period.[26] The AER is responsible for assessing and approving proposed network prices before they take effect.

The proposed network tariffs and their charging parameters must comply with the distribution pricing principles set out in clause 6.18.5 of the NER. These principles can be summarised as follows:

- the revenue of each price class must be greater than the incremental cost and less than the standalone cost of the service;
- DNSPs must take into account the long run marginal cost for a network service in setting network prices;
- DNSPs must have regard to the transaction costs associated with the tariff and whether retail customers of the relevant tariff class are likely to respond to price signals in setting network prices; and
- where the above principles do not result in prices which recover expected revenue, the DNSP must adjust prices in a way that minimises distortion to efficient patterns of consumption.

In addition, the distribution prices must also comply with the side constraints provisions set out in clause 6.18.6 of the NER.

The AER must approve a pricing proposal if it is satisfied that:

- it complies with clause 6.18 of the NER including the distribution pricing principles; and
- all forecasts associated with the proposal are reasonable.[27]

If the AER is not satisfied with a proposal on this basis, it may require the relevant DNSP to amend and resubmit the proposal within ten business days of the AER's notice, or make the necessary amendments itself.[28] If the DNSP fails to submit an amended proposal, or the amended proposal is unsatisfactory, the AER may also make the necessary amendments.[29]

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25 NER clause 6.18.2.

26 NER clause 6.18.2.

27 NER clause 6.18.8(a).

28 NER clause 6.18.8(b).

29 NER clause 6.18.8(c).

A.3.2 Chapter 6B

Chapter 6B was introduced into the NER as part of the implementation of the National Energy Customer Framework (NECF) under the National Energy Retail Law (NERL) and commenced operation on 1 July 2012.

Clause 6B.A3.5 of the NER sets out the obligation of DNSPs to notify retailers of any changes to the network prices. DNSPs have an obligation to notify retailers of any proposed changes to the network prices no later than two business days after the date on which the changes are notified to the AER.[30] This information is required to be treated as confidential preliminary information by the retailers.[31]

Once the AER approves the network prices, the DNSPs are required to notify retailers of the price changes no later than two business days after receiving approval.[32] Further, DNSP are required to notify retailers of any change in the level of a network charge (other than a network tariff) as soon as reasonably practicable after the DNSP becomes aware of that change and, if the change requires the approval of the AER , no later than two business days after the AER advises the DNSP that the change (or the resulting charge) is approved by the AER.[33]

Chapter 6B also states that DNSPs have no liability if the proposed changes in the preliminary pricing information provided to retailers are not subsequently approved or are modified by the AER.[34]

Chapter 6B provisions currently only apply to DNSPs in those jurisdictions that have adopted the NECF. The jurisdictions that have adopted the NECF to date include South Australia, Tasmania and the Australian Capital Territory.[35]

A.4 Current consultation and information requirements

The current annual network pricing process in distribution does not require DNSPs or the AER to consult with stakeholders. DNSPs do not have any obligation to consult with retailers or consumers on the development of the structure of their network tariffs or the level of prices. The NER also does not require the AER to consult with stakeholders on its decision on whether or not to approve the DNSP's pricing proposals. The AER provides documentation only if it chooses to reject a DNSP’s initial

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30 NER clause 6B.A3.5.

31 NER clause 6B.A3.5(b).

32 NER clause 6B.A3.5(2)

33 NER clause 6B.A3.5(a)(3).

34 NER clause 6B.A3.5(c).

35 The New South Wales Government has expressed an intention that the NECF under the NERL will commence in New South Wales on 1 July 2013.

pricing proposal, in which case it issues a short determination outlining its reasons for rejection.[36]

The NER does however impose certain pricing publication requirements on a DNSP once its annual pricing proposal is approved by the AER. The DNSP must publish:

- a statement of the DNSP's tariff classes and the tariffs applicable to each class;
- for each tariff – the charging parameters and the elements of the service to which each charging parameter relates; and
- a statement of expected price trends (to be updated for each regulatory year) giving an indication of how the DNSP expects prices to change over the regulatory control period and the reasons for the expected changes.[37]

The NER requires this information to be published on the DNSP's website 20 business days before commencement "if practicable", or "as soon as practicable" thereafter.[38] Since the regulatory year for network price changes is 1 July in all NEM jurisdictions except Victoria, the effective date for publication of this information is in June. In Victoria the regulatory year commences on 1 January and the date for publication of the network pricing information would occur in December.

A.5 Frequency of retail price changes under NECF

As part of the implementation of the NECF package, the National Energy Retail Rules (NERR) was introduced under the NERL. The NERR introduce new obligations on retailers relating to the frequency that standing offer prices may be varied. Standing offer prices refers to tariffs and charges that are charged to customers for or in connection with the sale and supply of energy.

Under the NERR, retailers are not able to vary standing offer prices more than once every six months.[39] If a retailer varies its standing offer prices, it is required to publish the variation in a newspaper and on its website at least 10 business days before the variation comes into effect.[40]

This means that in jurisdictions that have implemented the NECF package, if retailers to do not receive timely notification of annual network prices, this will affect their ability to pass through network charges to their customers on standing offers for a minimum of six months.

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36 Examples of rejected pricing proposals include *Powercor – Annual pricing proposal 2013* and *United Energy – Annual pricing proposal 2013*.

37 NER clause 6.18.9(a).

38 NER clause 6.18.9(b).

39 NERR, schedule 1 clause 8.2(b).

40 NERR schedule 1 clause 8.2(a).