

NSW Tariff Structure Statements

Submission to the Australian Energy Regulator



Energy
Consumers
Australia



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Summary

Energy Consumers Australia (ECA) welcomes the opportunity to make a submission to the Australian Energy Regulator (AER) in response to the Issues Paper on Ausgrid, Endeavour Energy and Essential Energy's Tariff Structure Statement (TSS) proposals.

ECA does not believe that the proposed tariffs give effect to the intent of the amended National Electricity Rules (NER) governing the development of network tariffs. Accordingly, ECA does not believe that the proposed tariffs are sustainable or in the long term interests of consumers. However, the proposed tariffs will only apply for two years, instead of the five for which future TSSs will be in place. ECA accepts, therefore, that the proposals should not be completely redone, provided there are significant improvements in a variety of areas in the next round of TSS development.

Background

In December 2014, the Australian Energy Market Commission (AEMC) made amendments to the NER governing how distribution network service providers (DNSPs) develop their tariffs. The central intent of the amendments was to make tariffs better reflect the costs of providing network services. In particular, by sending consumers a price signal about the future cost of their consumption, consumers could modify their behavior in ways that reduce the total cost of the network over time and ultimately, the amount passed through in their bills. The NER seeks to achieve this by requiring tariffs to be based on the long-run marginal cost (LRMC) of delivering a particular energy service to a particular class of customers.

DNSPs across the National Electricity Market (NEM) are currently developing their first tariff structure proposals under the amended NER. The new tariff structures will take effect in NSW from 1 July 2017. However, in introducing the new rules, the AEMC stated that any transition need not be immediate and could take place over multiple regulatory periods, to give consumers time to adjust to the change.

It is also important to note that the tariffs that commence on 1 July 2017 in NSW will only be in place until 30 June 2019. This two-year transition will then allow the TSS process to be aligned with the AER's five-year revenue determinations for the three networks, as intended by the AEMC.

The long term interests of consumers

The National Electricity Objective (NEO) of the NEL is ‘to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers with respect to price, quality reliability, safety and security of supply.’¹

Promoting the long term interests of consumers (LTIC) is the principle objective of the Australian Energy Markets Agreement (AEMA) and is the objective specified for ECA.¹

In assessing the LTIC, ECA is conscious of the position outlined in the explanatory statement accompanying changes to the Limited Merits Review arrangements for network revenue and price determinations. That stated that the LTIC is given best effect when ‘consumers do not pay more than necessary for the quality, safety, reliability and security of supply of electricity’.²

ECA believes that over the long term (defined by economists as the period over which all inputs of production are variable) cost-reflective network tariffs should help ensure consumers do not pay more than is necessary for network services. Such tariffs are, therefore, in principle in the LTIC. ECA takes this position for two reasons.

Firstly, more cost reflective tariffs allow consumers to receive price signals about the cost of their usage and the potential rewards of changing behavior or making investments such as more efficient appliances, distributed generation and storage assets, smart meters or energy management services.

Secondly, current tariff structures create cross subsidies between customers with certain characteristics. For example, customers with high peak demand or a high ratio of peak demand to total use (load factor) receive a cross subsidy from other consumers. These cross-subsidies are significant; modelling conducted for the AEMC suggests that customers without air conditioners pay an extra \$683 per year in network charges to cover the cost of the network required to serve customers with air conditioners.

Providing price signals and unwinding cross subsidies inherent in existing tariff structures will necessarily mean that some consumers pay more and some less than under current arrangements. It is therefore critical that the new tariff structures are developed in a way that is

¹ See ECA Constitution, Section 4.1(a) “To promote the long term interests of Consumers of Energy with respect to the price, quality, safety, reliability and security of supply of Energy services by providing and enabling strong, coordinated, collegiate evidence based consumer advocacy on National Energy Market matters of strategic importance or material consequence for Energy Consumers, in particular for Residential Customers and Small Business Customers.”

² The Hon JA Rau, *Second reading speech explanation to the Statutes Amendment (National Electricity and Gas Laws – Limited Merits Review) Bill*, South Australian House of Assembly, 26 September 2013.

consistent with the intent of the amended NER and is sensitive to the impact of sudden price movements.

Foremost here is that the tariffs are actually reflective of long-term costs, that they have been developed in conjunction with consumers and that consumers are provided with the requisite tools to be able to manage their energy expenditure.

Accordingly, in assessing TSS submissions, ECA does not seek to re-litigate the new rules and the intent behind them. However, there are a number of aspects to the transition to cost-reflective network tariffs that must come together for the best results for consumers to be achieved. These factors are discussed further below.

Ausgrid, Endeavour Energy and Essential Energy's proposals

The proposals from the three NSW electricity distributors represent a continuation of a 'tariff reform program' that started coming into effect from 1 July 2015 and will continue in 2016-17. The program has shifted tariffs from inclining block pricing to declining block pricing, through the annual pricing proposals approved by the AER.

ECA does not believe that the declining block tariffs that the three businesses propose to apply from 1 July 2017 reflect the LRMC of providing network services, on which the NER requires networks to base their tariffs. ECA also understands, from the extensive face-to-face consultations that took place between the three networks and consumer advocates, that calculations of the LRMC of each network used a time horizon of only four years. This is not the period over which all network inputs are variable and will, therefore, hinder the intent of the NER – that customers are given price signals about the avoidable cost of future consumption.

This approach is a particular issue for consumers in NSW where, as a consequence of changed reliability requirements and response to inaccurate forecasts, there was over-investment in the last regulatory period. Consumers would be entitled to question for example, whether the increases in electricity prices over the past ten years (Figure 1) have delivered the level of reliability improvements one might expect (Figure 2).³

³ Figure 1 is sourced from page 135 State of the Energy Market 2015, AER, <https://www.aer.gov.au/publications/state-of-the-energy-market-reports/state-of-the-energy-market-2015>. Figure 2 shows system average frequency index (SAIFI), and has been constructed using data from the 2007 AER State of the Energy Market (1999-2000 to 2005-06) and data supplied to ECA on request by AER. Prior to 2005/6, data for the ACT was included in the NSW category.

Figure 1: Retail price index (inflation adjusted) – Australian capital cities

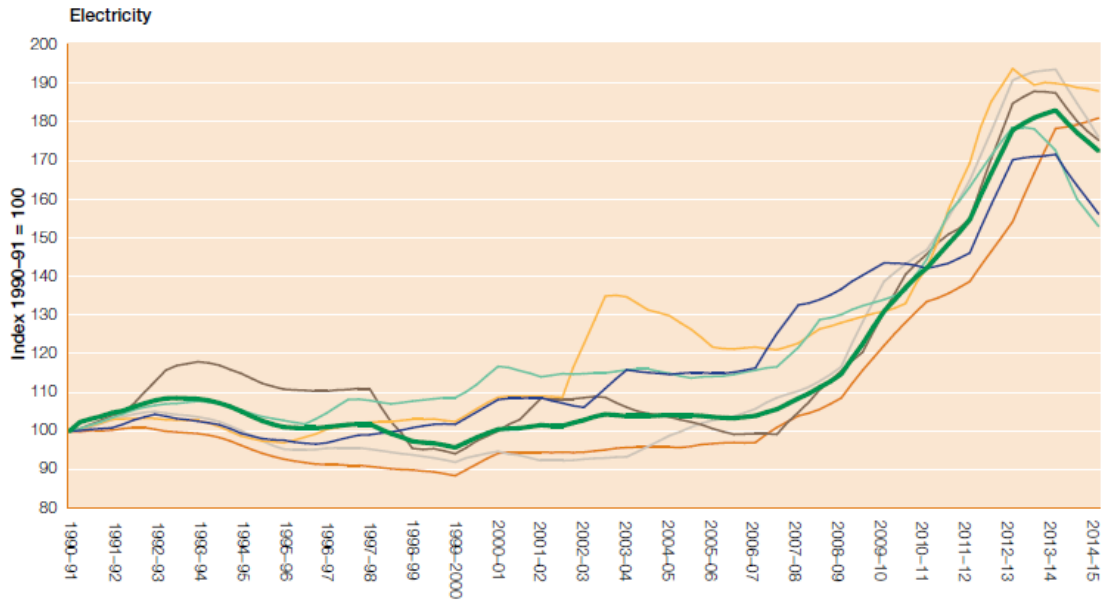
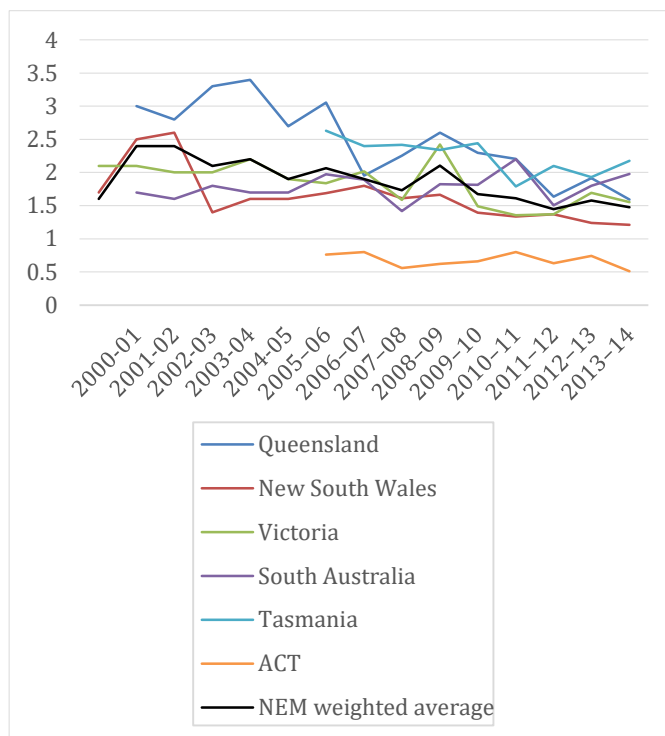


Figure 2: Unplanned SAIFI00



Had the LRMC been assessed by networks at the start of that regulatory period, LRMC would have been significantly higher. When applied correctly it is axiomatic that the LRMC cannot vary markedly from period to period.

The TSS development process

ECA has been disappointed with the process followed by the three businesses in developing their tariff proposals. While all three businesses were prepared to spend significant time engaging with consumer advocates, ECA can see no evidence of that engagement having informed or influenced the proposals that have been made to the AER. Instead, it appears to ECA that the NSW businesses developed tariff proposals and then sought to justify and defend these in consultations with consumers. We explore this further in the Appendix to this submission.

ECA is similarly disappointed that the three businesses have chosen not to begin trials of cost reflective tariffs (in particular, tariffs with a demand-based component), with a view to gathering information for the next round of TSS development.

However, ECA recognises that this is a time of significant uncertainty and transition for the NSW businesses. Changes within the organisations and the finalisation of matters relating to ownership will remove some impediments that these networks have experienced in their approach to tariffs. The impact of the Limited Merits and Judicial Reviews of the AER's revenue determinations for the three businesses should also not be underestimated.

Therefore, ECA believes it is not reasonable to call for the AER to reject the TSSs in question or request a complete review including effective consultation, even though there are potential reasons for doing so.

However, ECA is convinced that declining block tariffs are not cost reflective. Further there is evidence that neither inclining nor declining block tariffs provide an effective price signal to consumers. Ito (2014) found that consumers respond to average rather than marginal cost prices.⁴ Consequently, the impact of a declining block is simply to cross-subsidise high energy users by low energy users.

ECA looks forward to being involved in consumer engagement processes by the three NSW businesses to develop their TSSs to apply from 1 July 2019. Given the same advocates will be seeking to engage in the revenue determinations to apply from the same date, consultation by

⁴ Koichiro Ito, Do Consumers Respond to Marginal or Average Price? Evidence from Nonlinear Electricity Pricing *American Economic Review* 2014, 104(2): 537–563 http://home.uchicago.edu/ito/Ito_Marginal_Average_AER.pdf

the networks should commence immediately. A commitment by the networks to a framework for this consultation should be considered favourably in decision making on the current proposals.

Role of retailers and enabling technologies

The transition to cost reflective pricing poses challenges for energy businesses in communicating to consumers the new tariffs and the opportunities and challenges they provide.

As the primary point of contact for consumers, energy retailers have a crucial role to play. How retailers revise their tariffs as a consequence of the changes to their input costs will determine how effective the tariffs are in rewarding consumers whose consumption pattern increases network efficiency. This depends on both the structure of the tariffs, the way they are communicated to consumers and the tools available to consumers to monitor and manage their use.

ECA believes retailers need to do much more to engage with their customers on the transition to the new tariff structures. ECA strongly encourages retailers across the NEM to work with consumers to develop products and materials that allow consumers to make informed decisions about whether the early adoption of cost-reflective pricing is right for them.

It is also important to note that even where offered by networks, cost reflective tariffs will only be available to consumers who have enabling advanced meters. Networks and retailers should, therefore, be working to support the roll out of advanced meters to consumers seeking to obtain them, including through third-party metering service providers.

Conclusion

ECA does not support the tariffs proposed by Ausgrid, Endeavour Energy and Essential Energy. However, for a number of practical reasons, we do not believe that the businesses should be required to completely remake their proposals at this time. Rather, the businesses must significantly improve the standard of the proposals – and the process to develop those proposals - that will come into effect on 1 July 2019. ECA looks forward to engaging with the three NSW distributors as part of that process.

Thank you for the opportunity to make this submission. If you would like to discuss this submission further, please do not hesitate to contact Oliver Derum, Associate Director Advocacy and Communications, on 02 9220 5514 or by email at oliver.derum@energyconsumersaustralia.com.au.

Appendix – Engagement by NSW networks

Introduction

In engaging in the TSS processes for Ausgrid, Endeavour Energy and Essential Energy, ECA has endeavoured to take a facilitative rather than participative role. Consumer advocates who were involved in the processes will be making their own submissions.

A consistent theme in the recently completed Review of Governance Arrangements for Australian Energy Markets was the need for better engagement by the regulatory institutions, including the Energy Council, the AEMC and the AER. This included consumer engagement.

ECA shares this concern. However, regulator engagement with consumers is a poor proxy for market participant engagement with consumers. In the best of all possible worlds market participants and consumers would be approaching regulators with proposals supported by both.

The development of Tariff Structure Statements as standalone propositions under the transitional arrangements for the National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014 provided an opportunity for such engagement. The requirement for network providers to describe how they had engaged as part of their proposal should only have acted as an encouragement of this approach.

This has not been the case in New South Wales.

Accordingly, ECA's comments are offered as hopefully constructive suggestions that will contribute to improved outcomes in the next round of TSS development in NSW.

The AEMC rule change

On 27 November 2014 the Australian Energy Markets Commission (the AEMC) made the National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014 Rule Change Determination. The determination set out new rules that will require distribution network businesses to develop prices that better reflect the costs of providing services to individual consumers so that they can make more informed decisions about how they use electricity.

The amended rule transitional arrangements required that the New South Wales Distribution Network Service Providers (the NSW DNSPs – individually Ausgrid, Essential Energy and Endeavour Energy and collectively Networks NSW) submit to the Australian Energy Regulator (the AER) a Tariff Structure Statement (TSS) by 27 November 2015. The transitional

arrangements also included amendments to rule 6.8 to apply those rules to the submission of a TSS rather than a full Regulatory Proposal. A critical element of that is that the TSS be accompanied by an overview paper that describes how the DNSP has engaged with retail customers and retailers in developing the proposed tariff structure statements and has sought to address any relevant concerns identified as a result of the engagement.

In a covering letter to the NSW DNSP's submission to the AEMC consultation paper on the rule change dated 19 December 2013, Networks NSW wrote⁵:

The NSW DNSPs broadly support the amendments that seek to result in greater consultation in network tariffs and to bring forward the timing of the annual price-setting process to provide Retailers with earlier notification of the AER's approval of network prices. The NSW DNSPs also agreed with the AEMC that there is scope to improve the distribution pricing arrangements by providing DNSPs with stronger incentives to set network prices more efficiently.

Despite welcoming the idea of better consultation, the NSW DNSPs did not support the proposed requirement that DNSPs set prices on the basis of Long Run Marginal Cost. The letter stated:

This is a fundamental change to the distribution pricing framework and is unlikely to be effective in delivering more certain pricing outcomes for stakeholders, particularly in the case of DNSPs under a revenue cap where volume risks are borne by customers in the form of price volatility over time. The absence of positive incentives in the proposed framework will undermine the incentives of DNSPs to continue to pursue innovative tariff strategies, particularly in respect to the equitable recovery of residual network costs.

In their submission to the AEMC's draft rule determination the NSW DNSPs reiterated their concern about the implications of Long Run Marginal Cost pricing and their concern that prescriptive rules might "impede or discourage DNSPs from researching innovative tariff structures." More particularly in the covering letter dated 16 October 2014 Networks NSW wrote⁶:

We note that transitional arrangements have been proposed for most DNSPs, requiring submission of the initial TSS to the AER by 1 July 2015. There are compelling and pragmatic reasons why this date is problematic for the NSW DNSPs

⁵ See <http://aemc.gov.au/getattachment/2ea6f88d-ee11-4693-99c9-c9f4b09fa655/Networks-NSW.aspx>

⁶ See <http://aemc.gov.au/getattachment/581e2731-69c8-4cc2-9406-ddac1a715342/Networks-NSW.aspx>

and we submit that there would be scope for more effective customer consultation if the first TSS was not required until at least December 2015.

That request by the NSW DNSPs was agreed to in the Rule Determination.

NSW DNSPs' consultation

As identified in their submissions to the AEMC rule change, NSW DNSPs had concerns about the application of LRMC pricing (even though they acknowledge it was already a principle to which regard had to be given under the previous rules). The NSW DNSPs also expressed a desire to explore innovative pricing approaches.

Given these concerns, their expressed welcoming of "greater consultation in network tariffs" and the extension of time for submission to provide "scope for more effective customer consultation" it would be expected that the NSW DNSPs would have used the available time for a very effective consultation process.

That expectation has not been fulfilled.

In September 2015 the NSW DNSPs published Electricity tariff reform in NSW: An invitation to comment (the Discussion Paper). This document opens with an overview that states (Page 3):

The opinions and views of our customers and stakeholders are extremely important to us as we deliver our services and work to meet the needs of the communities that we serve.

In our conversations with customers and stakeholders over the past two to three years we know that our customers' priorities are for affordable, reliable and safe electricity. We also know our customers value stable electricity bills.

The paper continues (Page 9):

Consulting and engaging our customers and the community is integral to how we run our businesses.

We encourage customers and stakeholders to respond to this issues paper by 30 October 2015 and tell us what you think of our proposals for future tariffs.

We're asking for feedback on this discussion paper by using the site we have created on the NSW Government's Have Your Say online feedback website....

In particular, we are seeking to capture and understand your answers to these questions:

- a) *How well do you understand tariffs and how they apply to you?*

- b) *Do you have enough information about different kinds of tariffs and how they relate to your electricity bill?*
- c) *What kinds of tariffs would most suit your household/small business?*
- d) *What should we take into account that has not been discussed in this document?*

The paper then indicates that discussion of tariff reform has been running since 2013/14 in a “phase 1” which were “triggered through a range of workshops, roundtables and other consultations.” Phase 2 was initiated by the publication of the Discussion Paper, which occurred less than three months before the TSS submission was due.

On 24 September ECA participated in an ENA and Networks NSW roundtable Supporting Vulnerable Energy Customers and Network Tariff Strategy. ECA also participated in two further roundtables on 15 October (the Scenario Roundtable) and on 30 October (the Wrap-Up Roundtable).

Despite the invitation in the Discussion Paper for submissions that asked what kind of tariff would most suit consumers, it otherwise assumes that a declining block tariff is the appropriate structure for NSW DNSPs. The Discussion Paper does consider a variety of optional tariffs, including the existing time of use tariff, a social tariff, a demand tariff and a food and fibre tariff. However, at the Scenarios Roundtable the NSW DNSPs stated “Our initial thinking is that the above matters have not been sufficiently tested or supported by the wider community to include in our 2017-19 TSSs”

The NSW DNSPs stated that aspects of their approach which some consumer advocates found challenging were specifically framed by the rule determination. In considering this submission, the rule determination has also been considered.

ECA expects that the consumer advocates involved in the consultation will make their own submissions. From the consultation it appeared that consumer advocates were disinclined to accept that a declining block tariff is cost reflective and were unsatisfied by the reasons that were given as to why a demand tariff wasn’t included as an option.

Conclusion




ECA has been disappointed with the quality of the consultation by the NSW networks for the current round of TSSs. In bringing these concerns to the attention of the AER and the businesses in question, ECA's is keen to contribute to the development of significantly improved processes for the next round of TSS development. We encourage the NSW networks to approach the task of engaging with consumers to improve outcomes for all participants, including networks.



Energy Consumers Australia

ABN: 96 603 931 326

Suite 2, Level 14, 1 Castlereagh Street
Sydney NSW 2000

 02 9220 5500
 @eca_advocacy
 energyconsumersaustralia.com.au