

Reform of the distribution network pricing arrangements under the National Electricity Rules to provide better guidance for setting, and consulting on, cost-reflective distribution network pricing structures and charges

Rule change request

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1. Name and address of rule change request proponent

Standing Council on Energy and Resources (SCER)
SCER Senior Committee of Officials
Standing Council on Energy and Resources Secretariat
GPO box 1564
Canberra ACT 2601

2. Description of the proposed rule change

This rule change request seeks to:

- (a) improve the clarity of, and strengthen existing pricing principles in the National Electricity Rules (NER) for distribution network service providers (DNSPs) to ensure they develop and set prices based on Long Run Marginal Cost (LRMC).
- (b) enable the Australian Energy Regulator (AER) to have sufficient time and opportunity to review DNSP's pricing proposals and requested variations in pricing structures to ensure the DNSP pricing arrangements are consistent with the amended pricing principles; and
- (c) improve the existing consultation requirements for DNSPs so that retailers and consumer groups have a greater opportunity to consider and influence network charges and the structure of those charges.¹

Under the proposed changes, the DNSPs will continue to be responsible for designing their pricing arrangements, in accordance with their circumstances. SCER considers these changes will help in the effective transition to more efficient and flexible pricing options and reflects a balance between prescription and flexibility in the rules (i.e. ability for DNSPs to structure their network tariffs in innovative ways). Moreover, it provides for deliberation, consultation and accounting for the consumer impacts of this shift.

The rule change proposal promotes the National Electricity Objective (NEO) by encouraging development of more efficient network charges that better allow consumers to respond effectively in ways that minimise network costs over time while smoothing the transition for consumers.

The proposed rule specifically seeks to amend Chapter 6 of the NER including to:

- Amend the existing distribution network pricing principles so that DNSPs set cost reflective network charges, and structure those charges, in a manner that reflects the LRMC of providing network services.
- Require DNSPs to take into account the impacts on consumers of more efficient and flexible network structures and charges.
- Require DNSPs to provide a statement of the way they propose to structure their network charges (in the form of a network pricing structures statement) as part of their network regulatory proposals. The statement of proposed pricing structures would also be included in their annual pricing proposals, and published on their websites.
- Require DNSPs to consult formally with stakeholders when developing their network prices and charging structures during the regulatory proposal stage. DNSPs would also be required

¹ Pricing structures for example can include flat prices (this is a price structure which has no time element incorporated but could include a block structure), time of use or variations of time of use, for example seasonal time of use, critical peak pricing, or demand based pricing options (\$ per kWh or kVA per day).

to consult with stakeholders regarding any significant amendments they make to their pricing structures and charges over the course of the regulatory control period.

- Require the AER to develop a consultation guideline that sets out how DNSPs should consult with retailers and consumer groups with respect to network pricing structures in its pricing proposal, the timing of such consultation, and any relevant information that DNSPs should provide as part of the consultation.
- Include a provision which enables the AER to consider any proposed variations to pricing structures as approved in the regulatory determination. The DNSPs would need to provide the AER the requested variations six months prior to the relevant pricing year. A time limit should be provided for the AER to confirm the variations.

The proposed rule would affect specifically the following clauses of Chapter 6 of the NER - clauses 6.1.3, 6.2.8, 6.8.2, 6.9.1 6.9.2, 6.9.3, 6.10.1, 6.10.2, 6.10.3, 6.10.4, 6.11.1, 6.12.1, 6.12.3, 6.13, 6.18.1, 6.18.2, 6.18.5, 6.18.6, 6.18.8, 6.18.9, 6.22.2.

3. Context to the rule change request

In December 2012, the Council of Australian Governments and SCER agreed to a broad energy reform package to support investment and market outcomes in the long term interests of consumers. This included consideration of demand side participation (DSP) in the electricity market.

In delivering this reform package, SCER has considered the evidence that there are significant costs and foregone opportunities arising from the absence of clear price signals to end use consumers for network infrastructure (particularly at peak times).

This rule change seeks to address this issue, in part, by strengthening the pricing principles so that network prices and tariff structures become more cost reflective.

This rule change is also part of a broader package and should be viewed in this light. SCER is also pursuing a wide range of reforms aimed at ensuring that network infrastructure is planned, built, priced and utilised effectively. This includes improved demand forecasting, improved benchmarking and information collection and reforms to limited merits review. It also responds to other recommendations of the Power of Choice (PoC) review which promote better price signals to end users, opportunities for end users to participate in the market, and enabling technologies like smart meters.

The changes implied by this reform package point to a significant shift in the way customers use, purchase, interact with and are charged for, electricity. Electricity, however, is an essential service, and major changes to its provision are not to be taken lightly. SCER is cognisant that changes to network pricing through this rule change – when combined with enabling technologies – may result in significant changes in the distribution of network charges between customers and classes of customers. Sharper, more cost reflective prices will positively affect most users of electricity, but some will be impacted negatively.

In recognition of the distributional impacts of such a shift, it is important that changes in network tariff structures are subject to appropriate regulatory scrutiny. In particular, it is important that there are clear plans and pathways to more cost reflective pricing, which are based on all the available information, consulted on wherever possible, and signalled as far in advance as possible. In so doing, customers (and retailers) will be better able to adapt and respond to these new prices in ways that maximises their economic welfare.

Therefore, as part of the implementation of reforms, SCER agreed to progress this rule change proposal as recommended by the AEMC in its final report for the PoC review.²

AEMC Power of choice review

In November 2012, AEMC published its final report for the PoC review.³ The purpose of the review was to investigate and identify the market and regulatory arrangements needed across the supply chain to facilitate efficient investment in, operation and use of DSP in the National Electricity Market (NEM).

The PoC review identified the opportunities (information, education, and technology, and flexible pricing options) for consumers to make more informed choices about the way they use electricity. The review also addressed the market conditions and incentives required for network operators, retailers and other parties to maximise the potential of efficient DSP and respond to consumers' choices. The overall objective of the review was to ensure that the community's demand for electricity services is met by the lowest cost combination of demand and supply side options.

The PoC final report recommended that there were opportunities to improve the efficiency of the electricity market by facilitating more active participation of the demand side.

The AEMC proposed changes to the electricity market rules and jurisdictional regulations, and proposed action for SCER and jurisdictions to progress. The recommendations covered the following priority areas for reform:

1. Building consumer awareness, education and engagement.
2. Engaging with consumers – provision of energy management services to residential and small business consumers.
3. Consumer information – access to electricity consumption data.
4. Enabling technology (i.e. metering and metering services).
5. DSP in wholesale electricity and ancillary services markets.
6. Efficient and flexible pricing options for consumers.
7. Distribution network incentives.
8. Distributed generation.
9. Energy efficiency measures and policies that impact or seek to integrate with the NEM.

Efficient operation of price signals in the NEM

In the final report for the PoC review, the AEMC recommended a gradual phase-in of efficient and flexible⁴ retail energy pricing options for residential and small business consumers, in part through the introduction of cost-reflective distribution network pricing structures.

This was based on the AEMC's assessment of the existing efficiency of price signals in the NEM in accordance with the Terms of Reference of the review. The AEMC investigated among other things the existing price setting processes (and incentives for efficient operating and capital

² <http://www.scer.gov.au/workstreams/energy-market-reform/>

³ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November 2012

⁴ The AEMC identified efficient and flexible pricing options as those that provide a more efficient signal for consumers to better value consumption and energy services than is currently the case.

expenditure) by distribution network businesses and how price signals may influence consumers' decisions on how and when to consume.⁵

The AEMC found that, currently, consumers are not always faced with retail electricity tariffs that accurately reflect the variability of costs of supplying and delivering electricity to consumers. These costs vary with the level of demand.

Consumers are generally provided with flat or inclining block pricing structures which do not necessarily signal the time-varying costs associated with their consumption on network and electricity supply costs. Therefore, most consumers are currently unable to capture the value of changing their electricity consumption patterns.

The AEMC identified a number of reasons why more efficient and flexible pricing options at the retailer level are not currently provided more widely. This included weak incentives in the existing regulatory arrangements for retailers and network businesses to introduce flexible pricing options; a lack of the appropriate metering technology; and a lack of consumer understanding of and engagement with flexible pricing.

This rule change request specifically addresses the current incentives and level of guidance within the NER for network businesses to set cost-reflective network pricing structures and charges for consumers. The issues regarding metering technology and consumer engagement are being progressed through separate requests to the AEMC.

SCER is currently considering the amendments required to give effect to the AEMC's recommendation for a phased approach at the jurisdictional level.⁶ Any consequential changes required to the NER in light of these considerations will be made through that process.

4. Nature and scope of issues the rule change request will address

The PoC final report found that there were opportunities to strengthen the current regulatory arrangements for distribution network businesses to set network charges that better reflect the efficient costs of providing network services.⁷ The AEMC also found there should be greater consideration and consultation by DNSPs with regard to the potential impacts on consumers of the network pricing structures and charges they develop and set.⁸

The AEMC PoC review final report contained a set of draft specifications. These outline the specific changes to Chapter 6 of the NER required to implement the AEMC's recommendations.⁹

4.1. Amendment of the distribution network pricing principles

Ability and incentive to set cost-reflective pricing structures and charges

⁵ It is important to recognise that while prices are important, prices on their own will not bring about efficient outcomes in terms of consumer decision making – consumers need other conditions to help inform their choices, such as capability to respond, information about cost impacts of consumption, technology platforms and the flexibility to choose based on preferences/circumstance.

⁶ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November 2012, p.170-176.

⁷ That is, signal the costs of supplying electricity at different times, and the costs of meeting peak demand in different parts of the network.

⁸ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November, p.181.

⁹ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report – draft specifications, AEMC, 30 November 2012.

Having network tariffs that reflect the structure of costs is important because this provides efficient signals for consumers to capture the value of their DSP actions, such as reducing consumption at peak times. This will in turn reduce network and other system costs over time.¹⁰

Currently, energy and network costs are averaged across the vast majority of residential and small business consumers, resulting in each consumer paying a proportion of total costs that depends on their absolute consumption level, rather than when they consume or their location.¹¹ As noted, there are a number of reasons for this, including the incentives on network businesses.

The extent to which distribution network businesses adopt cost-reflective network pricing structures will depend on their commercial exposure to changes in both revenue and costs, their judgement about how retailers will incorporate network pricing structures into consumer tariffs, and how consumers then respond to those tariffs. A network business' commercial exposure depends on the overall effect of the regulatory regime (e.g. whether they can secure any financial rewards for reducing network costs under the NER, the degree to which costs can be rolled into the asset base and the regulated rate of return on those assets). The role of the regulator to consider and review network businesses' pricing is also an important factor.

The NER provides the framework and guiding principles for how network businesses should set and structure their network charges. The key principles are currently as follows:

- Principle 1: the revenue of each price class should lie on or between avoidable and standalone cost (6.18.5 (a));
- Principle 2: the distribution network business must "take into account" the LRMC for a network service in setting network prices and pricing parameters (6.18.5 (b) (1));
- Principle 3: network prices must be determined having regard to transaction costs (6.18.5 (b) (2) (i));
- Principle 4: network prices must be determined having regard to the ability of consumers to respond to the price signals (6.18.5 (b) (2) (ii)); and
- Principle 5: where prices that are based on the above principles do not recover expected revenue for the distribution business, the distribution business must adjust its prices in a way that recovers the outstanding amount in a way that minimises distortion to efficient patterns of consumption (6.18.5 (e)).¹²

The AEMC in the PoC review considered network charges should signal the efficient costs of providing the network (i.e. the LRMC of expanding the network to meet peak demand). The AEMC considered that it is these costs that should be signalled to consumers, as these can be most influenced by consumers' behaviour, such as in their choice of technology (i.e. types of appliances) they might purchase and use.¹³

While forward-looking efficient prices provide the appropriate price signal, the costs of historical investment decisions by networks also need to be recovered from consumers. This should be in a manner that minimises the distortions to decision-making.

While pricing taking into account LRMC is a requirement in the rules (principle 2 above), in practice network businesses have been reluctant to set network prices that reflect marginal cost in

¹⁰ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November, p.148-149.

¹¹ The network recovers its average cost by a combination of a fixed charge and variable charge.

¹² Clause 6.18.5 of the NER.

¹³ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November, p.184.

this way and there is significant discretion about how network pricing structures and charges may be set under the existing pricing principles.

The AEMC highlighted a number of reasons for this. Firstly, the AEMC considered that the existing provision in the Rules provides network businesses with insufficient guidance on how to interpret the LRMC principle or how this should be reflected in network tariffs.¹⁴ The AEMC highlighted in its supplementary paper, “DSP and profit incentives for DNSPs”¹⁵, that the minimal guidance provided in the current provision (clause 6.18.5 (b) (1)) was based on the assumption that price capped network businesses would have a commercial incentive to price at efficient costs. This may not be the case in practice however, as in the context of DSP, profits for price capped network businesses are linked to volumes, and network businesses will likely price in a manner that maximises profits/volumes. The AEMC noted that this may not necessarily be the same as setting prices in a way that minimises costs. Secondly, principle 2 only requires network businesses to ‘take into account’ the LRMC in price setting (i.e. there is no explicit obligation).¹⁶

The AEMC considered that as result, DNSPs have tended to use more stable pricing approaches (i.e. flat or inclining block) that reflect a compromise of a range of factors, including jurisdictional limitations on geographic price variation for specific customer classes; the transaction costs of developing or designing flexible tariffs; and perceptions on whether consumers are capable of responding to any tariffs developed.¹⁷

How the rule change request addresses the issues

SCER has agreed that the pricing principles should be amended to encourage more efficient network pricing. Consequently, it is proposed that the pricing principles¹⁸ are amended to include:

- a requirement for network tariffs developed by DNSPs to be based on the LRMC of providing network services, rather than just being required to take LRMC ‘into account’
- requirements to ensure that network charges are to be based on the drivers of network costs to the maximum extent possible
- a provision which allows network charges to reflect, as appropriate, any geographic variations in costs caused by current and forecast constraints within the distribution network.
- recognition that distributors may be limited in the extent to which they can base prices on LRMC, locational, or temporal factors by jurisdictional policies and practical constraints such as the need to limit transaction costs, lack of suitable metering, or have price structures that are not overly complex. Distributors should be required to identify in the Pricing Structures Statement where such constraints have limited the application of the pricing principles. The AER should have the ability to reject a PSS if they are not satisfied with the approach taken by distributors on this matter.

¹⁴ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November, p.184.

¹⁵ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, Supplementary paper – DSP and Profit Incentives for DNSPs.

¹⁶ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November, p.184.

¹⁷ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November, p.185.

¹⁸ Clause (6.18.5 (b) (1) of the NER.

SCER notes that the AER can develop guidelines, where it considers this necessary for informing interpretation of the NER. Development of a supporting guideline could improve the clarity for businesses with regard to how they should interpret the requirement to base network prices on LRMC. For example, a guideline could contain information relating to;

- How the rules provision requiring network charges to be based on LRMC may be interpreted, and the types of methodologies and approaches that may be used; and
- Relevant factors the AER may take into account in determining whether network prices and pricing structures developed by the DNSPs are consistent with LRMC.

It would be at the AER's discretion to determine whether development of a guideline would be of benefit to DNSPs in interpreting the pricing principles.

The proposed changes seek to reflect that network costs are largely driven by meeting peak demand requirements. This varies temporally and spatially across the network. Where network tariffs reflect the costs of meeting peak demand over time, consumers will be able to value network use more accurately, and thereby respond efficiently in ways to help minimise costs over time. This in turn will ensure energy expenditure is as low as efficiently possible for all consumers in the long run.

Managing the introduction and evolution of cost reflective tariffs

DNSPs are able to exercise wide discretion over the structure and application of network tariffs. This is appropriate as DNSPs hold the information required to price their own services efficiently. Therefore this proposal continues to place responsibility for proposing annual network tariffs in the hands of the DNSP.

However, there are stakeholders – particularly end use consumers and retailers – who are particularly affected by the choices that DNSPs make over their tariff structures. As DNSPs are monopolies, they may not always be appropriately incentivised to take the impacts on these customers fully into account in deciding on tariff structures.

Furthermore, these customers may need to plan some time ahead to adapt to the cost impacts of shifting tariff structures efficiently. At present, the information available to DNSPs' customers on future expected pricing changes is limited, and the annual tariff publication process is not obliged to align with past projections.

Therefore, this proposal requires DNSPs to develop and submit to the Regulator a “pricing structure statement” accompanying a DNSP's regulatory proposal. The intent of this statement is to provide information to:

- Assist customers and other stakeholders to respond effectively to changing prices and structures over the coming determination period by providing information on tariff classes, tariff structures and charging parameters
- Support the development of flexible network tariffs that can be passed through to customers in retail tariffs
- Provide transparency and allow scrutiny (in particular by AER) that pricing principles have been followed; and
- Inform the subsequent annual tariff publication processes.

Information that distributors might set out in their pricing structure statement which would be consistent with this intent could include, for example:

- how DNSPs have met the pricing principles;
- a breakdown of the tariff structures that the DNSP proposes to apply;

- expected take up of tariffs and allocation of revenue across tariffs (which may be based on historical usage);
- changes in tariff structures over the course of the regulatory control period including:
 - the introduction of new tariffs, retirement of old tariffs, changes from voluntary to mandatory status
 - an indication as to whether each individual tariff component would increase by more, less, or about the same as the average change over the regulatory control period;
- expected changes in network charges over the course of the determination period;
- expected customer impacts by class;
- how customer consultation, jurisdictional policies and practical constraints (or other relevant provisions in the Rules) have shaped proposed network structures;
- how residual costs will be recovered; and
- expected risks and volatility.

A DNSPs pricing structures statement must inform its pricing proposals during a regulatory control period. Pricing proposals must in turn be consistent with the pricing structures statement.

In developing the pricing structure statement, it is expected that a distributor would consult with its customers to ascertain the impact of pricing structures it is contemplating, and the Regulator would give regard to the pricing principles for direct control services.

In addition to information on pricing structures, the Pricing Structures Statement will also include information on expected changes in network charges and changes in individual tariff components relative to the average change. In light of this, the AEMC is asked to consider during the consultation on this rule change:

- If the proposed consultation timings are compatible with when DNSPs can reasonably be expected to have information which informs their expected changes in network charges and their strategy for changing tariff components relative to the average change; and
- In order to avoid an excessive consultation burden, if there may be circumstances when DNSPs would not need to consult on expected changes in network charges and changes to tariff components (for example due to smoothing, overs and unders, or changes in consumption).

The ultimate outcome should be a more transparent, predictable and useful process which will help DNSPs and customers adopt and adapt to more cost reflective tariffs over the regulatory control period.

Taking into account consumer impacts in designing cost-reflective network charges

The introduction of flexible pricing options may expose many consumers to a range of new and different tariff structures, even though some consumers already have flexible pricing options (i.e. peak, off -peak, shoulder). As part of the AEMC PoC review, it was highlighted that consumer engagement and participation will be critical if the benefits of flexible pricing options are to be realised.

Clause 6.18.5 (b) (2) (ii) of the existing pricing principles sets out that DNSPs are to have regard to whether a consumer is able or likely to respond to price signals. This principle could be interpreted to mean that network charges should be set in a way that matched the price responsiveness of consumers, rather than how such structures and charges may impact particular

types of consumers (i.e., those with limited capacity to respond to proposed pricing options).¹⁹ As a result there may be a risk that costs may be shifted onto consumers with flat retail tariffs as these consumers are less likely to respond and adjust their behaviour.²⁰

To address this issue, it is proposed that Clause 6.18.5 (b) (2) (ii) be removed and replaced with a requirement that DNSPs appropriately consider and set out how their proposed pricing structures and charges may impact particular classes of consumers.

An important way for DNSPs to meet this principle is to engage in appropriate consultation on the structure of network prices. The proposal for consultation requirements in developing network pricing structures and charges is provided in section 2.

In addition, in order to provide greater clarity and certainty on the setting of tariff classes, it is proposed that clause 6.18.3(d) be amended so that the two sub-clauses are requirements rather than just matters to be taken into account.

Recovering residual costs

Network charges which are set to recover LRMC could lead to under recovery of total network cost (LRMC sits below average costs for natural monopoly network businesses). However, any remaining costs would also need to be recovered by the DNSP.

The rules set out that where prices based on efficient pricing principles do not recover full costs, the remaining costs should be recovered in a non-distortionary manner. Generally, there are two approaches that could be considered to achieve this. First, through Ramsey pricing, which suggests that recovery of such costs are most efficiently allocated to consumers with the lowest price responsiveness, or at times when demand responsiveness is lowest. A second approach, also consistent with efficiency, is to recover remaining costs in the form of a postage stamp (where the unit charge does not vary with consumption or location) that is applied as widely as possible so as not to affect existing utilisation of the network.

It is proposed that the AEMC consider as part of the rule-change process which mechanism for recovering residual costs is most appropriate (postage stamp, Ramsey or something else).

In making their decision on the preferred approach the AEMC is asked to consider:

- allowing for recovery of residual costs in a way that does not distort or undermine flexible pricing, where flexible pricing is available;
- potential impacts on particular classes of consumers; and
- the appropriate balance between potential impacts on particular classes of consumers and efficient pricing.

Should the AEMC feel that a single approach is not appropriate for all jurisdictions or distribution network areas, the AEMC could also consider whether the AER should be given the discretion to determine the best approach at the time of making a regulatory determination.

Side constraints

In the PoC the AEMC considered that existing side constraint provision (6.18.6 (e)) appears to be redundant and lacks clarity on whether consumers with interval meters would be deemed exempt from application of the pricing side constraint, and considered that this should be removed.²¹

¹⁹ Australian Energy Market Commission, Power of choice review – giving consumers options in the way they use electricity, final report, AEMC, 30 November, p.187

²⁰ AEMC, op.cit, p.187

²¹ AEMC, op.cit, p.189.

This proposal specifically seeks to remove clause 6.18.6 (e) of the NER. This is to clarify that regardless of whether consumers have interval meters or accumulation meters, the side constraint provisions apply to their tariff.

The distributor pricing structure statement will be an important guiding document for changes in tariff structures through the regulatory period, with the direction proposed by the distributor and agreed by the regulator. Consumers will expect that the tariff structures prevailing at the end of a regulatory period will form the basis of those at the beginning of the next, and that further substantial change will be proposed and evaluated through a subsequent pricing structure statement. Therefore, this proposal proposes that the side constraints under clause 6.18.6 apply between as well as within regulatory control periods.

4.2. Consultation on network pricing structures and charges

It is important that, in developing new pricing structures and charges, consumers are appropriately engaged and have an understanding of any changes so that they can make informed choices and decisions.

The AEMC proposed that there should be a greater role for consumers and retailers to review flexible pricing options set by network businesses. This has also been raised by IPART in its rule change request to the AEMC.²²

There are two existing processes under the NER into which greater consultation on the development of network charges could be incorporated: the regulatory determination process and the annual price setting process.

First, network businesses are required to submit a 'regulatory proposal' to the AER which forms the basis for a network determination on allowable revenues. Two important consultation requirements with respect to submission of the regulatory proposal are:

- for a network business to show how it has engaged with electricity consumers and has sought to address any relevant concerns identified as a result of that engagement;²³ and
- provision for stakeholders to provide submissions to the AER on the regulatory proposal.²⁴

Network businesses are not however currently required to indicate how they intend to structure their network prices in their regulatory proposals, thus consultation on pricing structures is not required at this stage.

Second, DNSPs are also required to submit a pricing proposal every year for review by the AER. That proposal sets out the proposed tariffs and tariff structure, the classes of consumers to which the tariffs apply for each year, and sets out any variation and the nature of such variation that could occur for network tariffs during the year. DNSPs are not required to consult on either the level or structure of network tariffs under this process.

How SCER proposes to address these issues

SCER considers providing a greater opportunity for retailers and consumer groups to review and influence pricing structures will facilitate the transition to and development of more efficient network charges which better allow consumers to respond effectively in ways that minimise network costs over time.

²²AEMC, op.cit, p.190-192.

²³Clause 6.8.2 (c) (2) is a new clause recently implemented as a result of the AEMC rule determination on network regulation rule change.

²⁴ Clause 6.9.3 and clause 6.8.2 of the NER.

It is therefore proposed that the following amendments are made to Chapter 6 of the NER:

- Require DNSPs to provide a statement of network prices and pricing structures at the same time as their regulatory proposals, which would outline how they meet the pricing principles. The development of network pricing structures would be subject to the broader consultation requirements during the regulatory proposal stage.
- Require DNSPs to update where necessary the statement of price trends for network prices and pricing structures statement each year alongside their annual pricing proposals. Where DNSPs seek to vary pricing structures significantly during the regulatory period, this would need to be consulted on, with any proposed variations submitted as part of the annual pricing proposal for consideration and approval by the AER. DNSPs should explain how the proposed variations better meet the pricing principles than the existing structure, and how consumer impacts have been taken into account in developing them.
- Require the AER, when considering whether to approve a proposed pricing structure statement to take into account the extent to which the proposed pricing structure statement addresses issues raised by consumers. (SCER considers that this could be achieved using a similar provision to that developed under Rule 6.5.6(e)(5A))
- Require annual prices submitted by the DNSP to the AER to comply with the most recently approved pricing structures statement.
- Require DNSPs to publish the pricing structures statement alongside other relevant tariff information they are required to publish on their websites, to support greater transparency and information provision to the wider market.²⁵
- Require the AER to develop a consultation guideline that sets out how DNSPs should consult with retailers and consumer groups with respect to varying pricing structures in their pricing proposals, how DNSPs may consider impacts on different types of consumers, the timing of such consultation and any relevant information that DNSPs should provide as part of the consultation.
- Include a provision which enables the AER to consider any requested variations to the pricing structures that were approved initially in the regulatory determination. The DNSPs would need to provide the requested variations to the AER six months prior to the relevant pricing year. AER should have a time limit to confirm the DNSP pricing variations. Where the AER does not approve a variation the most recently approved pricing structure would continue to apply.
- Changes to the timing of the pricing proposal process may also be required as a result of these changes.

In considering the requirement to submit a statement of network prices and pricing structures at the same time as their regulatory proposals, the AEMC is requested to consider during its consultation process whether the appropriate balance has been struck between allowing sufficient time for consumers and retailers to provide meaningful input and the ability of the DNSPs to have reliable information on network charges.

The AEMC is also requested to consider if there may be circumstances when DNSPs would not need to consult on changes to charges (for example due to smoothing, overs and unders, or changes in consumption).

²⁵ Clause 6.18.9 of the NER

5. How the proposed rule will or is likely to contribute to the achievement of the National Electricity Objective.

The National Electricity Objective is set out in section 7 of the National Electricity Law. The NEO 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”.*²⁶

The proposed rule would contribute to the achievement of the NEO as it is likely to promote efficient investment in, and the efficient operation of, electricity services, in particular distribution network services.

Recent rises in retail electricity prices have primarily been driven by increases in network charges. A large share of network costs is attributable to peak demand. As noted, in most cases existing network charges do not necessarily reflect the costs of supplying and delivering electricity at peak times.

The proposed rule seeks to improve the efficiency of price signals to consumers and to encourage the take-up of efficient DSP. This will be achieved through strengthening the incentives on distribution network businesses to set pricing structures and charges that accurately reflect the efficient costs of the network. Flexible pricing options that accurately reflect network costs assimilate information about the value of reducing or shifting consumption at different times so as to reduce the impacts on network and electricity supply infrastructure. More efficient network pricing and hence uptake of efficient DSP can help to avoid investment in supply side infrastructure and so lower system costs. It may also encourage better investment decisions by networks because it provides better signals of when investment is required.

The proposed rule is in the long term interests of consumers as it requires DNSPs to accurately reflect the cost of providing network services. This in turn provides consumers with better opportunities to actively participate in the market, capture the value of changing their consumption (i.e. compare the value of electricity services with the costs incurred through the electricity supply chain), and hence manage and reduce their energy costs. Over the longer term, more efficient pricing of networks should have significant flow-on impacts to overall electricity expenditure faced by consumers due to better utilisation of the network and deferral of peak demand driven network investment.

The AEMC as part of the PoC review provided a high level estimate of the potential benefits that could be realised with more efficient and flexible pricing options. These are provided in Chapter 11 of the PoC final report.

6. AEMO’s declared network functions

The proposed rule will not affect the Australian Energy Market Operator’s declared network functions.

7. Expected costs, benefits and impacts of the proposed rule

Benefits

²⁶ Section 7 of the National

The proposed rule is likely to result in significant benefits across the electricity supply chain. Benefits are likely to include:

- improved price signals to consumers;
- incentives and stronger obligations on DNSPs to reflect efficient costs of providing network services;
- efficient investment in networks to meet peak demand;
- potential lower network charges for end use consumers than otherwise would have been due to more efficient investment in and use of electricity services;
- better opportunities for retailers and consumers to input to distribution network pricing structures and charges; and
- transparency of information on impacts of proposed network prices to consumers.

Costs

The proposed rule largely places requirements on DNSPs and the AER. While there may be some implementation and administration costs, these are not likely to be excessive given the requirements can be undertaken as part of (or in conjunction with) existing processes and practices. Further they place requirements on DNSPs which should be part of their existing business practices and roles.

It is noted that there would be some costs with moving to flexible pricing options, however these are expected not to outweigh the benefits of the proposed changes and the take-up of efficient DSP in the long run.

The expected costs, benefits and impacts for each party are outlined below.

End use consumers

The proposed rule is expected to impact consumers to the extent that they will have greater choice of pricing options, and have a better understanding of the network charges they may face. This information will help consumers manage costs. Further, there will be more opportunities for consumers to make informed choices based on the benefits that the end use services provide. As noted, in the longer term, it is expected that more efficient pricing will reduce upward pressure on electricity prices and hence lead to lower electricity costs for all consumers.

DNSPs

The proposed rule improves the incentives and provides greater guidance to network businesses on how to apply the pricing principles under the rules to set efficient and flexible network prices. This should allow for greater innovation and flexibility for network businesses to set more flexible pricing options that accurately reflect the costs of meeting peak demand on the network. This would promote efficiency in the use of and investment in networks and reduce the costs of providing electricity services to consumers.

The proposed rule also requires network businesses to consider impacts on consumers of their pricing structures and charges, and ensure that retailers and consumers have been engaged in their regulatory and annual pricing proposals. This will allow network businesses to consider the impacts of their pricing structures and charges and whether consumers will be able to respond effectively. It is not expected that such arrangements will impose a substantial regulatory burden on DNSPs, given DNSPs may consolidate consultation on pricing with consultation on regulatory determinations under the November 2012 economic regulation rules.

Retailers

The proposed changes require DNSPs to consult with retailers in developing pricing structures and charges. This should increase opportunities for retailers to consider network pricing structures consistent with the preferences of customers. This is likely to further support product innovation in the retail market.

The AER

The proposed rule would provide greater clarity to the AER on how distribution network businesses are to apply the pricing principles under the rules, and thus set efficient network prices. This should provide transparency and reduce any uncertainty for the AER when assessing distribution network pricing structures and charges as part of the regulatory determinations and annual pricing proposals.

The proposed rule requires the AER to have a greater role to monitor and verify DNSP pricing proposals. Further, the reforms place requirements on the AER to develop information guidelines to support the distribution businesses. It is considered that the requirements will not have a significant administrative burden on the AER because this can be undertaken as part of existing processes.

8. Summary of consultation

Stakeholder consultation on the issues associated with the distribution pricing arrangements that govern how DNSPs set charges was undertaken through the various stages of the AEMC PoC review.

Submissions were received from a large number of stakeholders during each stage of the review. Overall there was broad consensus on the need to improve and strengthen the existing pricing arrangements for distribution network businesses.

A summary of stakeholder positions can be found in the AEMC PoC final report.