



5 November 2015

Mr Vince Graham
CEO
Ausgrid, Endeavour Energy and Essential Energy

By email: haveyoursay@endeavourenergy.com.au

Dear Mr Graham

PIAC comments on proposed Tariff Structure Statements

The Public Interest Advocacy Centre (PIAC) thanks Ausgrid, Endeavour Energy and Essential Energy (the NSW DNSPs) for the opportunity to respond to their consultation document *Electricity tariff reform in NSW: An invitation to comment* (the consultation document). The consultation document forms part of the NSW DNSPs process to develop Tariff Structure Statements (TSS), which will be submitted to the Australian Energy Regulator (AER) for approval. PIAC notes that as part of the introduction of new rules, the TSS in question will apply for only two years from 1 July 2017, instead of the standard five years. A five-year TSS will come into effect in NSW from 1 July 2019.

PIAC believes that efficient, fair and sensible network tariffs are essential to the realisation of the National Electricity Objective (NEO). With this in mind, this submission addresses four issues:

1. the proposed declining block tariffs;
2. whether an opt-in demand-based tariff should be offered by the NSW DNSPs;
3. the use of a three-year time horizon in calculating long run marginal costs (LRMC); and,
4. the NSW DNSPs consumer engagement in the TSS process.

In the context of recent DNSPs consultations in NSW, the consumer engagement process has been extensive, including six extensive roundtable discussions. All of the issues below have been discussed at length in those meetings and this submission is a formal record of the positions that PIAC has expressed throughout its participation.

Declining block tariffs

Until recently, NSW DNSP tariffs have been inclining blocks, meaning the marginal price of consumption increases across three blocks. The NSW DNSPs have begun transitioning to a declining block tariff structure, and propose to continue to do as part of the 2017-19 TSS. When the transition is complete, the decline across the three blocks will vary across networks, ranging from about 15% in the case of Ausgrid¹ to around 60% in the case of Endeavour Energy.²

PIAC has two concerns with declining block tariffs. Firstly, rather than sending a signal about the cost of avoidable network investment (a key aim of cost reflective tariffs),

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¹ Ausgrid, *Tariff Structure Statement*, presentation to roundtable, 30/10/15, Sydney, slide 60
² Endeavour Energy, *TSS discussion*, presentation to roundtable, 30/10/15, Sydney, slide 7.

such tariffs signal that marginal cost reduces as consumption increases. PIAC accepts that for households who only have accumulation meters, it is not possible to price based on peak demand (the growth of which drives the need for further expansion of the network). Nonetheless, PIAC believes that it is reasonable to assume that if a declining block structure sends a signal to customers that they should consume more (because at higher levels consumption is cheaper, rather than more expensive), that increased consumption is likely to contribute to a growth in peak demand. This would occur if the increase in consumption does not change the load profile, meaning peak times remain peak times. Given household load profiles are largely driven by lifestyle (especially when people are home) PIAC expects that this would be the case.

Secondly, PIAC does not believe that NSW DNSPs should 'go it alone' in encouraging consumers to increase consumption, at a time when the general thrust of policy initiatives is seeking to improve energy efficiency and reduce consumption (for a variety of reasons). While changing consumer behaviour in relation to energy consumption is not easy, some progress has been made in recent years. In this context, PIAC considers that network tariffs should not be structured in a way that once again encourages consumption.

Accordingly, PIAC does not support the proposed introduction of a declining block tariffs for the NSW DNSPs. PIAC believes that ultimately cost reflective-tariffs will be made up of a fixed charge and a variable charge based on peak demand or demand at peak times. However, in the absence of the required meters in all homes, PIAC believes that inclining block tariffs send a clearer signal about avoidable future network investment.

Recommendation 1

PIAC recommends the NSW DNSPs return to inclining block tariffs, rather than continuing to transition to a declining block structure.

Introduction of opt-in demand tariff

At present, smart meters (which offer many benefits to many consumer market segments) are being rolled out in NSW by 'the market'. That is, there is no mandated process, but rather smart meters will be installed when consumers want and pay for them to. Networks NSW has indicated repeatedly that as a result of this policy, the NSW DNSPs have no part to play in the deployment of smart meters. However, PIAC argues that this should not extend to not having an (opt-in) demand-based tariff offering. The availability of such an offering would meet the needs of those highly-informed consumers who wish to move to cost reflective tariffs ASAP, and also, by its very existence, promote increasing awareness of the transition consumers face in electricity pricing in the long term.

PIAC understands from discussions with relevant staff that the NSW DNSPs have concerns about making the necessary calculations to introduce such a tariff in the allowed time frame. PIAC believes this risk of error could be mitigated by using conservative pricing assumptions. In developing a highly novel product that is offered, potentially on a trial basis, to highly informed consumers this would be reasonable. In addition, it is likely that uptake would be slow at first, meaning only a small percentage of revenue will be collected from customers on such tariffs. This would be consistent with the undertaking in the consultation documents, that the NSW DNSPs are 'committed to providing customers with a choice of tariffs'.³

Nonetheless, the fact the next NSW TSSs will last for two years means that the next opportunity to introduce such a tariff offering is relatively close. Accordingly, PIAC recommends that if the NSW DNSPs do not introduce an opt-in demand based tariff

³ NSW DNSPs, 2015, *Electricity tariff reform in NSW: An invitation to comment*, 18.

(including in trial form) as part of the 2017-19 TSSs, then it should commit to having such a tariff under the following TSS.

Recommendation 2

PIAC recommends that the NSW DNSPs offer an opt-in demand based tariff to small customers, potentially on only a trial basis, as part of the 2017-19 TSSs.

Recommendation 3

PIAC recommends that if the NSW DNSPs do not introduce a demand-based tariff in 2017-19 TSSs, they commit to doing so for the following five-year TSS period.

Period used to calculate long-run marginal cost

The National Electricity Rules (NER) contains pricing principles that must guide the development of network tariffs. These include a requirement that ‘each tariff must be based on the *long run marginal cost* of providing the service to which it relates’ [emphasis in original].⁴ This provision is intended to reduce (or eliminate) cross subsidies between tariff classes and send price signals to consumers about the cost of their consumption. The provision was strengthened by the AEMC, as part of its *Distribution network pricing arrangements* rule change process, finalised in November 2014.⁵

However, the move to more cost-reflective tariffs will take some time, potentially spread over multiple five-year network revenue determination periods. This is due to the presence of a consumer impact principle that means any transition must be undertaken gradually.⁶ In addition, PIAC notes that under the NER, LRMC is specifically defined as ‘the cost of an incremental change in demand...over a period of time in which all factors of production...can be varied’.⁷

PIAC submits that such a period is much longer than the three years that PIAC understands (from consultations with the NSW DNSPs) was used to calculate LRMC for the development of the TSS to which this submission relates. PIAC considers that this short time period will distort any cost-reflective signals that are contained in final tariffs. Accordingly, PIAC recommends that a more appropriate period be calculated. PIAC notes that networks have detailed information about asset lives, as these form part of AER network revenue determinations.⁸

Recommendation 3

PIAC recommends that the NSW DNSPs calculate LRMC using a period over which all their assets are variable.

Consumer engagement in the TSS process

Finally, PIAC wishes to express its gratitude to all participants in the consultation that has taken place as part of this process. The NSW DNSPs have made a number of staff repeatedly available to discuss the issues in great detail (including where this involved travel). The process has also been driven by representatives from the Alternative Technology Association and Energy Consumers Australia, who have not participated in other major processes involving the NSW DNSPs, such as the recent revenue determinations.

⁴ NER, cl 6.18.5(f).

⁵ For more information see www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements

⁶ NER, cl 6.18.6.

⁷ NER, ch 10 – Glossary (at page 1174 in version 74).

⁸ See for example, AER, 2015, *Attachment 5 – Regulatory depreciation, Ausgrid final decision 2015-19*, 10.

PIAC has found the process to be a vast improvement on previous engagement efforts involving the NSW DNSPs and would like to see the model that has been developed be carried forward into future processes.

PIAC also wishes to note that consumer engagement is a core requirement for energy network businesses. Consumer engagement should, therefore, be the responsibility of a senior staff member who's workload allows the task to be given sufficient focus. PIAC, therefore, recommends that the NSW DNSPs resource the task accordingly. This is not meant as a criticism of the performance of any staff of the NSW DNSPs.

Recommendation 4

PIAC recommends that the three NSW DNSPs give responsibility for consumer engagement activities to an appropriately senior staff member, with sufficient time and resources to carry out the task.

PIAC looks forward to continuing to work with the NSW DNSPs in the development of network tariffs. Once again, PIAC thanks the NSW DNSPs for the opportunity to provide comment on the consultation document. If you require any further information, please do not hesitate to contact Oliver.

Yours sincerely



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