AUSTRALIAN ENERGY REGULATOR

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Open letter

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Dear stakeholder

Electricity network charges in the ACT and NSW from 1 July 2018

This letter explains the interim arrangements that we are in the process of formalising to govern the setting of electricity network tariffs (and non-price terms and conditions) for the 12-month period commencing on 1 July 2018.

These are interim arrangements, in the sense that, after the final level of allowed revenue is determined through the remittal process, an adjustment to future network tariffs will be needed if there is any difference between that final allowed level of revenue and the level of revenue already recovered under these interim arrangements.

The remittal process is to determine the revenue that the ACT and NSW electricity distributors are allowed to earn from customers for the provision of electricity network services over the 2014–19 period. Given the timing of the remittal processes, any necessary adjustments arising from this final allowed level of revenue would flow through to tariffs in the 2019–24 period. The Australian Energy Market Commission (AEMC) introduced participant derogations that allow the NSW/ACT electricity distributors to smooth out this adjustment into the 2019–24 period, if an adjustment is necessary, following the conclusion of the remittal process.

Background

On 26 February 2016, the Australian Competition Tribunal (the Tribunal) handed down its decisions on the limited merits review of the AER's electricity distribution determinations made in April 2015.

The Tribunal set aside and remitted to the AER for further consideration its determinations for the following ACT and NSW electricity distributors:

- the ACT electricity distributor, Evoenergy (formerly named ActewAGL)
- the NSW electricity distributors Ausgrid, Endeavour Energy and Essential Energy

On 24 March 2016, the AER applied to the Full Federal Court for judicial review of the Tribunal's decisions. The Court upheld the AER's appeal regarding gamma, but dismissed other aspects including the AER's decisions on return on debt and operating expenditure.

Resolution of the remittal process is likely to take some time. In the interim, it was not clear what network charges should apply. Neither the Tribunal's or Court's decisions, nor the electricity rules, provided an unambiguous way forward.

Current 2017–18 interim arrangements

In 2017, we entered into enforceable undertakings with the ACT and NSW electricity distributors to establish network tariffs for the 12-month period commencing on 1 July 2017. In addition, the 2017–18 enforceable undertakings enabled the ACT and NSW electricity distributors' to apply their Tariff Structure Statements (TSS), which came into effect on 1 July 2017. The TSS are part of a process of network tariff reform affecting all electricity distributors in the National Electricity Market.

The 2017–18 undertakings sought to facilitate network tariff reform and promote the objectives of revenue/price stability, predictability and transparency by:

- adjusting the distribution component of Evoenergy's, Essential Energy's and Endeavour Energy's network revenues approximately in line with inflation.[1] The 2017–18 undertakings adjusted the transmission and jurisdictional scheme components of their network charges in a manner consistent with the control mechanism in our 2015 final decisions.
- adjusting the components of Ausgrid's network revenue (distribution, transmission and jurisdictional schemes, respectively) in line with inflation.
- providing for all non-price components of the distribution determinations (e.g. connections policies, classification of services, and negotiated services framework) to be maintained.

Essential Energy entered into a two (2) year undertaking from 1 July 2017 to 30 June 2019. Hence, we do not need to formalise a new undertaking for Essential Energy. The method for calculating their 2018–19 network charges is largely similar to that used in 2017–18.

For the other electricity distributors, the current enforceable undertakings are set to expire on 30 June 2018. As the remittal process is on-going, we are in the process of establishing new interim arrangements through entering into new enforceable undertakings with the electricity distributors to govern the setting of network tariffs to be applied from 1 July 2018.

2018–19 interim arrangements for electricity

As with 2017–18, our approach for the 2018–19 undertakings seek to facilitate network tariff reform and promote the objectives of revenue/price stability, predictability and transparency by:

- establishing a framework in the undertakings that caps the overall allowed revenue that the electricity distributors may recover from their customers, during this interim period
- providing for the submission of annual pricing proposals from each distributor that proposes tariffs for the 12-month period from 1 July 2018, which is consistent with the allowed level of revenues or prices, specified in the undertaking. The undertakings will also ensure the annual

[1] The base revenue for escalation differed between the respective electricity distributors.

pricing proposals are consistent with the TSS, with the partial exception of Endeavour Energy as we explain below.

- Provide for all non-price components of the 2015 distribution determinations (e.g. connections policies, classification of services, and negotiated services framework) to be maintained.

Attachment A to this letter provides more detail on the approach we expect will be reflected in each of the new undertakings.

In addition to these revenue/price considerations, Endeavour Energy recently proposed to include provisions in their 2018–19 enforceable undertaking that would amend the tariff assignment policy for residential and small business customers in their TSS. We agree with Endeavour Energy that this would enable the smoother introduction of cost reflective tariffs in the upcoming regulatory control period. We discuss this in more detail in attachment B to this letter.

We are in discussions with the ACT and NSW electricity distributors regarding the terms of the undertakings that will give effect to the above, but have not yet accepted undertakings from any of the electricity distributors. When undertakings are accepted by the AER, we will make them publicly available on our website. We expect this to happen by late March or early April 2018.

Yours sincerely

Chris Pattas
General Manager
AER Network Pricing, Policy and Compliance

Attachment A—Details on approach in individual undertakings

For electricity distributors, network charges include three separate components:

- Distribution charges—these charges would normally reflect the allowed revenue cap that is set by the AER's distribution determination to recover the efficient cost of providing network services to convey electricity across the distribution network.
- Transmission charges—these charges reflect the pass through of transmission network costs to consumers via the distributor. Distributors normally recover these costs on an actual cost recovery basis, with any under or over-recovery of actual costs in any year passed through or back to consumers in future years.
- Jurisdictional scheme amounts—these charges often recover the cost of state/territory government based environmental programs, the costs of which are passed through to consumers. Distributors normally recover these on an actual cost recovery basis, with any under or over-recovery of actual costs in any year passed through or back to consumers in future years.

There are some differences in the approach we are working towards with each electricity distributor, which take into account their different circumstances. In considering the approach for each electricity distributor, we have had regard to the following guiding principles:

- minimising price volatility
- predictability
- simplicity
- transparency
- the impact on the distribution determination for the 2019–24 regulatory control period
- facilitating undisputed aspects of a determination to the greatest extent possible (particularly TSS)

We have also had regard to each of the electricity distributors' remittal processes where they inform our consideration of these guiding principles for the 2018–19 undertakings.

The table below summarises the approaches to the electricity distributors' network tariffs.

Table: Approach to new enforceable undertakings

	Ausgrid	Endeavour Energy	Evoenergy
Length of undertaking	1 year (1 July 2018 to 30 June 2019)	1 year (1 July 2018 to 30 June 2019)	1 year (1 July 2018 to 30 June 2019)
Distribution charges	Undertaking sets distribution revenue allowance Revenue allowance equal to the 2017–18 revenue allowance in nominal terms (as specified in the 2017–18 undertaking) Prices determined through annual pricing approval process TSS continues to apply	Undertaking sets distribution revenue allowance Revenue allowance based on the 2017–18 revenue allowance (as specified in the 2017–18 undertaking) escalated by one year of actual inflation Prices determined through annual pricing approval process TSS continues to apply, with an amendment to the tariff assignment policy (see attachment B)	Undertaking sets average revenue cap, in line with Evoenergy's control mechanism in the 2015 distribution determination Average revenue cap based on the 2017–18 average revenue (as specified in the 2017–18 undertaking) escalated by one year of actual inflation Prices determined through annual pricing approval process TSS continues to apply
Transmission charges	Transmission charges equal to 2017–18 transmission revenue in nominal terms (as specified in the 2017–18 undertaking)	Transmission charges based on 2018–19 estimated costs (with unders/overs account to adjust for difference between estimates and actuals from previous years)	Transmission charges based on 2018–19 estimated costs (with unders/overs account to adjust for difference between estimates and actuals from previous years)
Jurisdictional scheme charges	Jurisdictional Scheme charges based on 2018–19 estimated costs (with unders/overs account to adjust for difference between estimates and actuals from previous years)	Jurisdictional Scheme charges based on 2018–19 estimated costs (with unders/overs account to adjust for difference between estimates and actuals from previous years)	Jurisdictional Scheme charges based on 2018–19 estimated costs (with unders/overs account to adjust for difference between estimates and actuals from previous years). Jurisdictional scheme charges for large feed-in tariffs to reflect new ACT government arrangements, which spread out over/under-recovery adjustments over time.

Attachment B—Amendment to Endeavour Energy's TSS

We understand Endeavour Energy is considering including provisions in their 2018–19 enforceable undertaking that would amend the tariff assignment policy for residential and small business customers in their TSS.[2] We support this amendment to the current TSS. As we discuss below, it would enable a smoother transition to cost-reflective tariff structures in the 2019–24 regulatory control period that incorporates feedback from stakeholders.

Endeavour Energy's current TSS includes a block tariff and a time-of-use tariff for residential and small business customers.[3] The current TSS provides that, from 1 July 2018:

- new customers will be assigned to the default TOU tariff with the option to opt-out to the block tariff (through their retailer).
- existing customers who chose to modify or upgrade their existing network connection from single to three phase will be assigned to the default TOU tariff (if their metrology allows) with the option to opt-out to the block tariff (through their retailer).

Endeavour Energy is currently consulting on its 2019–24 regulatory proposal with stakeholders. As part of that consultation, it initially proposed to introduce a demand charge to the time-of-use tariffs in their TSS for the 2019–24 regulatory control period (2019–24 TSS proposal).

Endeavour Energy is reflecting on stakeholder feedback that a demand tariff with time-of-use energy charges is overly complex. Stakeholders suggested replacing the time-of-use charging component with a flat usage charge (but retaining a fixed component and a demand component). Endeavour Energy is considering amending its 2019–24 TSS proposal to reflect this feedback.

However, Endeavour Energy considers there could be complications if the 2018–19 enforceable undertaking gives effect to the assignment policy in the current TSS that would apply from 1 July 2018. For example, customers assigned to time-of-use tariffs from 1 July 2018 might face this tariff structure for one year at most before facing a new tariff structure from 1 July 2019 under the 2019–24 TSS proposal. This could cause confusion among Endeavour Energy's customers and increase transaction costs.

Endeavour Energy therefore proposes to include a provision in the 2018–19 undertaking that removes the TSS assignment policy that applies from 1 July 2018. This would maintain the current policy of assigning new customers (and existing customers modifying or upgrading their network connection) to the block tariff, with the ability to opt in to the time of use tariff.

2 Specifically, customers in Endeavour Energy's "low voltage energy" tariff class.

3 There are also controlled load tariff options for these customers.