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18 December 2013

John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Submission on distribution network pricing arrangements

Please find attached our submission regarding the Australian Energy Market Commission's consultation paper on National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014.

We would be pleased to provide further assistance to the Commission on this important area of reform. If you would like to discuss any aspect of our submission please contact Craig Madden, Director, Network Regulation, on (03) 9290 1443.

Yours sincerely

Andrew Reeves
Chairman
Australian Energy Regulator

Rule changes – Distribution network pricing arrangements

AER Submission to AEMC Consultation Paper

December 2013

AUSTRALIAN ENERGY REGULATOR

Contents

1 Summary

Our main recommendations and positions in response to the proposed rule changes and to the AEMC's consultation paper are set out below.

Pricing principles	▪ Support requiring tariffs to be economically efficient and cost reflective (targeting time and location of use). ▪ Basing tariffs on Long Run Marginal Cost (LRMC) can improve on the status quo. There is no need for prescription on exactly how it should be estimated and applied, so as to not restrict tariff evolution—providing network cost drivers are targeted. ▪ Further, guidance should be provided on its interpretation to account for time and location factors—this could preferably be covered in an AER guideline ▪ The preferred approach to recover fixed costs (residual to LRMC-based pricing) appears to be via fixed charges, and cost reflectively apportioning these (if possible). ▪ Support a requirement to consider customer impacts of tariffs. The principle's intent needs exploring but should be broad to cover the appropriateness of tariffs and matters of managing tariff transition / volatility.
Tariff classes	▪ Support amendment making it mandatory for tariff classes to be defined on an economically efficient basis taking account of transaction costs—providing consistency in the pricing rules on the need for cost reflectivity. ▪ Recommend need for clarity on interpreting criteria for assignment and reassignment of customers between tariff classes. Examine criteria referring to the 'nature and extent of a customer's usage' and how customers with micro-generation should be treated as compared to customers without such facilities.
New framework with Price Structures Statement (PSS)	▪ Support requiring distributors to prepare, consult on, and be bound to (in regard to tariff structure) a PSS, as a focal point for their consultation with stakeholders. ▪ Recommend that the PSS be broad and cover tariff strategy as well as information SCER suggests. PSS requirements should be set flexibly via an AER guideline. ▪ Require consultation on a PSS prior to submission to the AER for review. ▪ Allow mid–regulatory period amendments to the PSS, where significant changes are proposed and/or AER requires amendments to ensure a PSS better complies with the NER.
Timing of reviews	▪ Broadly support bringing forward the timing of pricing proposals to achieve timelier tariff notifications. Practicalities of pricing and input data availability can likely be overcome, keeping in mind achieving an appropriate balance between timeliness and precision.
Tariff transition / volatility	▪ Recommend broader and more direct consideration of approaches intended to manage tariff transitions and volatility: ▪ Suggest that a rationale for managing these issues can be designed consistent with the National Electricity Objective (NEO). ▪ Suggest the proposed new pricing framework with a binding PSS and requiring consideration of customer impacts, provides a platform for distributors to manage these issues in consultation with stakeholders. This appears preferable to prescriptive approaches, like numerical limits on prices (explicit side constraints in the rules).
AER guidelines	▪ Various pricing rules might require further clarification—pricing principles, PSS requirements, tariff classes and assignment criteria. A separate pricing guideline can cover these. Should also consider whether more specific/customised guidance on distributor consultation is needed, than currently provided in AER Consumer Engagement Guideline.
Timing of reforms	▪ Further consideration required on how/when to introduce the pricing reforms, given potential constraints for upcoming revenue determinations for NSW/ACT and SA/QLD.

2 Introduction

The AER welcomes the opportunity to respond to the AEMC's consultation paper on proposed changes to the distribution network pricing arrangements in the National Electricity Rules (NER). This consolidates proposals from the Independent Pricing and Regulatory Tribunal (IPART) of New South Wales and the Standing Council on Energy and Resources (SCER). This is a significant package of reforms that raises a number of issues around the rationale for, and management of, a transition to more cost reflective distribution pricing.

Improving the efficiency of price signals by greater reflectivity of network cost drivers is important for efficient use of and investment in electricity networks. We therefore support requiring more specific regard to economic efficiency and cost reflectivity in the rules guiding how tariffs are set. However, we recommend there be further consideration to how the NER can reflect this. In particular:

- We support tightened pricing principles for tariffs to target underlying network cost drivers, but the drafting of the rules should enable targeting both short and long run cost drivers, flexibility for innovation, and be specific enough for compliance assessment.
- We consider that an enhanced focus on Long Run Marginal Cost (LRMC) could improve on the status quo. However, any requirement to focus on LRMC should not be implemented in a way that limits a move to more dynamic pricing approaches over time. LRMC of itself, might be insufficiently informative without further explanations and guidance.

A shift away from the time and geographically averaged, consumption volume based network tariffs that most consumers currently face will be significant. Tariffs will potentially evolve in sophistication and variability with time and location of energy use. Information and volatility challenges will need managing in a transparent and preferably in a nationally consistent way. These issues need broader consideration in this rule change and clarity is needed on measures that might temper change—that is, the speed and extent to which Distribution Network Service Providers (DNSPs) can introduce more cost reflectivity. On these issues we consider:

- Managing potential stakeholder concerns around tariff volatility or transition, can be considered relevant to achieving the National Electricity Objective (NEO). Addressing such concerns, by attempting to provide sufficient notice, information or certainty with respect to significant tariff changes, can be consistent with the economic efficiency and the long term interest of consumers.
- Aspects of SCER's new pricing framework can help manage these issues. A binding Pricing Structures Statement (PSS) with requirements to consider tariff impacts on customers can provide an effective focal point for stakeholder consultation and certainty on tariff structures.
- Managing tariff transition or volatility via this framework, placing onus upon a DNSP-stakeholder dialogue (with our oversight) also allows for adaptation and customisation. This is relevant as efficient tariffs are used to address specific network challenges of demand on different assets. They are also part of a suite of potential solutions—along with network augmentation or demand management. Therefore, we recommend that the PSS' scope be broader than the rule change intends and set out a DNSP's tariff strategy—setting out network challenges, why various tariffs are the best solutions, impacts that might need managing, and evolutions expected at least over the regulatory period.

Our submission also responds to more specific issues raised in the AEMC's paper, including:

- The process by which the PSS is reviewed and how it is consulted on.
- The need for AER guidelines to provide explanations on various aspects of the pricing rules.
- Options to achieve more timely outcomes of price reviews.
- Options for the timing of implementation of the reforms to upcoming revenue determinations.

3 Pricing principles

The NER distribution pricing principles[1] are the main means to influence the design of network price signals that are to be passed, via retailers, to consumers in some form. Improving the efficiency of price signals is a key area of national energy reform. Pricing principle reforms should be designed with clear and defined objectives, suitable to the present and future. They should be relevant in dealing with current network challenges (mostly peak demand, network underutilisation), as well as possible future challenges from different technologies, or changes/declines in demand patterns. In particular, while the principles need to be mindful of current constraints (e.g. metering, consumer understanding) in setting tariff objectives, they should not be bound to these constraints and allow for market evolution.

Our responses to SCER's proposals are framed with these considerations in mind. We support:

- A tightened requirement in the pricing principles for tariffs to reflect underlying short and long run drivers of costs. However, this needs to allow sufficient flexibility for DNSP innovation on the tariff options that they consider best address this cost reflectivity objective. The LRMC concept might be a useful anchor toward this end, but requires additional explanation or guidance so that the objective is clear. We also note there are variants to the use of the LRMC concept as the key requirement that could be explored.
- A customer impact principle—if interpreted broadly it can provide for DNSP tariff consultation to include transition strategy and thereby address matters of volatility. The ideal/intended scope and status of this principle among the others needs exploring.

3.1 Targeting network cost drivers

SCER proposes specific reforms to the pricing principles to address tariff efficiency. These include a key principle to set tariffs for services 'on the basis of' LRMC rather than just 'take it into account' (as is currently the case), and two sub-clauses requiring regard to the ability to reflect time and locational network cost drivers, as far as possible. In considering the appropriate wording of the pricing principles, we think these should achieve a number of objectives, including providing:

- A key requirement—for economically efficient tariffs. The goal is targeting network cost drivers (both short and long run) which for electricity vary by location and time of use.
- Guidance—to DNSPs on the overall cost reflectivity objective of tariffs, when constructing tariffs and framing tariff proposals for our assessment.
- Enforceability—there needs to be some structured way by which we can assess whether a DNSP's proposed tariff structures comply with the objectives of the pricing principles.
- Flexibility—for DNSPs to design tariffs suited to their network and customer needs, and to evolve their approach as technologies like advanced metering become prevalent, or demand conditions change. Pricing approaches might vary from when there is significant peak demand and latent capacity, to a situation where peak demand is decreasing. The wording shouldn't constrain greater tariff dynamism, thereby leaving tariff design to DNSPs.
- Certainty/stability—some consumer assurance as to rates of change – as a change in tariff structures can potentially have a large impact on customer bills. There should be a clear approach to managing these issues.

[1] Clause 6.18.5 of the NER.

Efficient pricing of distribution networks

There are various options that should be explored to provide a cost reflectivity objective in the NER. This includes tariffs needing to be 'economically efficient', 'cost reflective', or 'reflective of underlying drivers of network costs'. These could be flexible enough to allow innovation, but would require further explanation, given their potentially broad interpretation. This could occur through an AER guideline. We would consider these requirements to set efficient prices as mandatory, but the means of achieving this as flexible. SCER's proposal prefers explicit reference to an economic concept in LRMC, as the basis on which to set tariffs. LRMC based pricing, strictly interpreted might not be the theoretical optimum for addressing all aspects (short and long term) of efficient pricing. However, referring to LRMC can be useful to forward the cost reflectivity objective as long as its application allows for efficient tariff structures to evolve over time.

With respect to the short and long run aspects of efficient pricing, the theoretical optimum is to set prices on the basis of Short Run Marginal Cost (SRMC), which could:

- Address short-run decisions on the efficient use of existing network and consumption assets by pricing network congestion, given a fixed network base—this would provide efficient signals to consumers on whether to draw additional power from the network, reduce local consumption, or increase local production.[2]

- Provide signals for efficient long-run investments in generation, consumption and network assets[3]—over the long term, if tariffs at locations reflect the SRMC of network use, these should on average reflect the LRMC of network augmentation to that location.[4]

It is becoming increasingly important that prices reflect some degree of dynamism to address these short and long term effects. This is due to the emergence of new technologies consuming energy in different ways or allowing consumers to better manage their demand or even export energy. Full dynamic approaches, such as those based on SRMC are currently unattainable—subject of little or no practical experience at a distribution network level, here and abroad.[5] Until these are attainable, basing prices on LRMC might be a sufficient second best alternative—that is, basing prices on calculations of long-run network augmentation costs. Using LRMC estimates in this way, to target short and long-run issues, will not precisely reflect network conditions at given time points. This is because LRMC estimates need to be made in advance of network conditions materialising and the need for network augmentation. However, if DNSPs can reasonably predict locational constraints or times in which network peaks are more likely than others, they might be able to use LRMC to provide price signals which would still be superior to existing approaches.[6] Over time, these approaches should evolve with more advanced metering technologies[7]:

- Without advanced metering network augmentation costs could be apportioned in some broad manner, such as one peak/off-peak price for consumers across the whole year.

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2 For example, it's increasingly important for consumers to know when to: use technologies that might export energy to the grid—photo-voltaic units, battery storage; use demand-side options—direct load control or other similar automated demand management systems; or, when to use peaky technologies—recharging electric vehicles, using air conditioners.

3 For consumers this refers to decisions on which appliances to invest in, with respect to their energy use.

4 Marsden Jacob Associates, *Estimation of Long Run Marginal Cost (LRMC),* November 2004, p.36

5 It would possibly involve some form of centralised system of constraint equations and optimisation algorithms. It could also result in significant instability in prices or in revenues for DNSPs–although there might be a role for various hedging instruments in managing this instability, and an extension of the retailer's role which is already to manage volatility on behalf of consumers.

6 Currently, the vast majority of residential consumers in the NEM face flat tariffs that depend on consumption volumes and do not vary by time of day or location.

7 While advanced metering would facilitate more dynamic/efficient tariff options, it's also possible that SCER's proposal to require distribution tariffs to be efficient and cost reflective could provide for more rapid deployment of advanced meters.

- With advanced metering the options are potentially extensive. Costs could be apportioned to more accurately target times or locations of greatest use, charges could have peak/off-peak components that vary by season or each hour of the year, or they could be set to recover all augmentation costs on certain few peak periods in any given year. However, as the ability to price in a more granular way (to reflect network cost conditions) becomes possible, there will inevitably be other considerations, such as transaction, billing, marketing and other costs that would mitigate overly complex tariff schedules .

Given the potentially varied options for applying LRMC estimates to target network cost drivers, and with these options evolving over time as metering and customer understanding improves, any prescription on LRMC application could constrain innovation. The key objective is that DNSPs increasingly target cost drivers. To this end, we accept that SCER's proposed sub-clauses for the pricing principles could be informative. They provide that when applying LRMC, time and location should be reflected, as far as possible.

Assessing compliance

It is uncertain how to determine that tariffs set on the basis of LRMC would comply with the pricing principles. This uncertainty arises due to both the varied ways of applying LRMC, and various ways of estimating it. We do not think the NER should be specific on estimation methods. While this rule change should consider whether any method is superior, or derives sufficiently different results, at this stage it is not apparent to us that any particular method should be preferred.

There are numerous theoretical and practical approaches in estimating LRMC. The most common methods are the Average Incremental Cost (AIC), Marginal Incremental Cost (MIC) and Turvey approaches. Most DNSPs use the AIC approach. Their choice of approach will probably depend on data availability and how the approaches fit with their overall planning models. For example the:

- AIC approach[8]—for a given time period, takes the sum of forecast capex and incremental opex (discounted by the cost of capital) and divides it by incremental demand (discounted by the time preference rate of consumption) that the expenditure plan would cater for. This method is simple and cost estimates and time periods could be aligned with a regulatory control period.

- Turvey approach[9]—determines the present value of an optimised investment schedule meeting forecast capacity. Further optimised investment schedules are then calculated for small/permanent increases (or decreases) in the previous capacity forecast. The difference in present value between the initial investment schedule and the one that would be required for an increase in forecast capacity (plus the incremental operating costs), divided by the hypothesised demand increase, is the marginal cost. This approach is information intensive, requiring explicit network planning and cost estimation, for numerous different demand scenarios in different network areas.

A possible reason why the NER might need to prescribe methods is if some costs were allowed to be calculated contrary to efficient pricing, thereby inducing artificially low LRMC estimates.[10] Of the methods mentioned, MIC appears the most sensitive to subjectivity, particularly in regard to claims over the expected timing of expansion projects. For instance:

8 Mann, Saunders & Warford, *A note on capital indivisibility and the definition of marginal cost,* Water Resources Research, Vol.16 no.3, June 1980, pp.602-604.

9 Turvey, *What are marginal costs and how to estimate them?,* Technical Paper 13, Centre for the study of regulated industries/University of Bath School of Management, March 2000, pp.7-9.

10 This might be relevant where a DNSP is under a form of control that might allow it to gain (maintain or increase revenues) by not reducing demand—an issue that might be lessened if revenue caps are applied, as proposed for NSW/ACT networks. In such a case, declines in demand will not lower revenues.

- The MIC approach[11]—looks at the next significant investment in capacity only. It is the difference between the present value of the next large capex increment and the present value of such an investment deferred by a year, divided by the incremental demand that would require this investment to be undertaken, plus the marginal operating costs. Any slight change in a parameter, such that it moves a project's timing forward or back, resulting in a different project becoming the 'next significant investment' could significantly alter cost estimates.

Residual costs

A subsequent issue to consider is how to allocate costs unrecovered by LRMC. This issue of residual costs arises from the cost structure of natural monopolies. With declining costs as scale rises, LRMC pricing may not yield sufficient revenue to cover the total costs of providing services.[12] SCER queries how these residual costs might be recouped, citing options like Ramsey pricing or 'postage stamping'. Exploring the likely quantitative magnitude of residual costs is required before deciding on an approach. However, it appears to us that the approach that would least distort efficient pricing and demand is to recoup residual costs as fixed components in tariffs, and to attempt to cost reflectively apportion some of these costs. This approach could address what appears to be the ultimate goal of Ramsey pricing, to target inelastic demand, without leading to what we see as potential problems of strict interpretation of that approach. Concerns with Ramsey pricing could relate to its data intensiveness, or if it is used in recouping costs in an unexpected/ex-post way.

Economic theory suggests that one way for consumers to face correct price signals at the margin, while still recovering revenues overall, is to use a two-part (or multi-part) tariff.[13] There could be a variable charge to provide an efficient usage signal, and another to recover residual costs. Consistent with this approach, residual costs could be applied evenly across the entire customer base via a 'postage stamp'. In our view, the objective that Ramsey pricing attempts to achieve (non-distortion of demand by targeting inelasticity) could suggest that residual costs be applied to inelastic components of tariffs, not just consumers. Residual costs could be recouped via fixed charges which do not vary with demand. This is preferable because:

- it can be applied easily, without the need to determine elasticity's of (different) consumers or classes under a Ramsey pricing approach.
- it would provide a stable approach to residual costs, providing certainty to consumers with respect to the investments that they have made or intend to make.

Further, if possible, these fixed costs should be cost reflectively apportioned. This is consistent with the principle that revenue from any group of services/customers should exceed the incremental or attributable costs of providing those services and serving those customers.[14] While residual costs might be shared and do not vary with demand (hence their exclusion from the efficient usage charge), they might include costs that could be cost reflectively apportioned to consumers. It is difficult to comment precisely on how this might be achieved. An example would be where some of these fixed costs relate to specific network elements and could therefore be apportioned to customer/tariff classes that use those elements. For example, apportioning the fixed costs of high voltage assets to high voltage customer tariff classes but not others.

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11 Marsden Jacob Associates, *Estimation of Long Run Marginal Cost (LRMC),* November 2004, pp.11-13.

12 All DNSPs that currently attempt to quantify LRMC in tariff proposals set revenues to recover from tariff classes above that which would be recovered from pricing at LRMC. See for example, Powercor, *2014 Pricing Proposal*, October 2013, pp. 51-52; SA Power Networks, *Annual Pricing Proposal 2013-14*, May 2013, pp. 60-62; Essential Energy, *Annual network prices report*, May 2013, pp. 37-42.

13 Braeutigam, *Optimal policies for natural monopolies,* Chapter 23 of Handbook of Industrial Organisation, Vol II, p.1312.

14 This is also reflected in the current pricing principle (6.18.5(a)) requiring the revenue to recover from a tariff class should be above the avoidable cost of not serving those customers, but below the stand alone cost of serving those customers.

We recognise that a concern with recouping residual costs via fixed costs could be that if these costs are significant they could overpower the efficient usage signal, or encourage some consumers to disconnect from the network. To understand the significance of this, it is worth exploring the quantitative scale of residual costs in this rule change. We anticipate these could vary with network capacity. That is, if the costs of adding extra network capacity are increasing with network capacity (e.g. due to space/area constraints, or limitations in obtaining easements in urban areas) then in principle the residual costs could be small. Alternatively, if the costs of adding network capacity are decreasing with network capacity (due to economies of scale) then the residual costs could be large.

An alternative, suggested by economic theory, where a two-part tariff is unfeasible, is using Ramsey pricing.[15] This apportions costs to those with least elastic demand. That is customers for which an increase in charges will not reduce demand. Aside from the information intensity of determining customer elasticity's, a further concern with Ramsey pricing could arise if it is used to allocate residual costs to customers in an unforseen and ex-post manner—after they have made sunk investments.[16]

3.2 Customer impacts

We agree with SCER that the current principle requiring regard to whether a consumer is able or likely to respond to price signals when determining tariffs, could encourage DNSPs to shift costs to consumer classes considered least likely to change their behaviour. Amending this requirement such that in determining tariffs, DNSPs need to have regard to a broader consideration of customer impacts, provides potential for those setting tariffs to consider various matters important to stakeholders. This could include the appropriateness of tariffs and also the DNSP's transition strategy, providing a means of addressing issues of tariff certainty/volatility (discussed in Section 7). That said, the principle requires further exploration in this rule change on its intended scope and status among other pricing principles. These are matters that might warrant further explanation by way of an AER guideline.

Moving to greater efficiency and flexibility in network tariffs will present challenges for consumers and retailers. There will be new types of sophisticated and innovative tariffs and stakeholders will need to understand how these operate to know how to respond. There could also be greater price volatility, not only in shifting to new tariffs but also in how prices vary over the course of a day, season or year. To manage these matters, the customer impacts principle could operate together with DNSP requirements to consult in developing or seeking to amend the PSS. We expect this consultation would need to cover the following:

- Whether or how a particular tariff is appropriate to particular customers. This could be interpreted in various ways, including whether the consumer was adequately informed on how the tariff operates, or has any other impediments to responding to the price signal. We consider there might also be value in requiring DNSPs to identify and quantify any customers that they expect to be worse off from a proposed change in tariff structures.

- How a DNSP proposes managing a transition to more efficient tariff options. This principle could provide a means of managing price volatility by introducing a form of 'speed-hump' to tariff transition. The onus should be on DNSPs in consultation with stakeholders, with the possibility of our oversight by way of PSS reviews. While potentially significant in providing meaningful engagement, matters of transitioning to new more efficient tariffs will be difficult to

[15] See for example, Church and Ware, *Industrial Organisation: A strategic approach*, Irwin McGraw-Hill 2000, p. 789.

[16] Similar concerns are raised in economic literature. For example, Laffont and Tirole argue that Ramsey pricing implies expropriation of sunk investments and would likely be rejected in practice. Laffont and Tirole, *Competition in Telecommunications*, The MIT Press, 2000, pp. 74-75

determine. There is a trade-off between the speed of introducing efficient prices and price shocks on stakeholders.

While supporting the customer impact principle, its scope and status among other pricing principles should be clarified, that is, which considerations should take primacy? For example, how might customer impacts interact with requirements to consider jurisdictional instruments, or to base prices on LRMC? Possible approaches include:

- The appropriateness of tariffs for particular consumers could in practice be linked to how DNSPs determine their tariff classes and assigned particular types of customers to one class or another (discussed in Section 4). As such, if in consulting with consumers on impacts, it is determined that there are reasons why some should be grouped on a different basis, this would influence tariff assignment, but may still be reflective of relative costs of supplying different customer types.
- A DNSP as part of its PSS could propose, in consultation with stakeholders on customer impacts, to smooth the price effects of a transition to new tariffs over the course of the regulatory period, such that prices would be fully compliant with LRMC over a given period.

4 Tariff classes

Network pricing efficiency objectives should feature not only in the pricing principles, but flow to other pricing rules that might influence efficiency. The latter include criteria DNSPs are to consider in determining tariff classes[17], and then assigning customers to classes.[18] How tariff classes are defined determines the tariffs that customers are then allocated. Given this role, we support SCER's proposal to tighten the current criteria, making it mandatory for tariff classes to be defined on an economically efficient basis and avoid unnecessary transaction costs, rather than just have regard to these matters. This should provide consistency through the pricing rules, for tariffs to target network cost drivers.

Economic efficiency is a broad concept so we would interpret this as expecting tariff classes to be designed on the basis of some relationship to network cost drivers. There might be various ways of reasonably designing tariff classes consistent with this requirement, including by reference to:

- Voltage levels—costs of serving customers might vary on the basis of large differences in voltage levels, depending on asset types required to serve these different voltages.
- Location—reflecting network length or density required to serve customers in particular locations over others.
- Customer usage profiles—reflecting impacts of energy use at peak times vs non-peak times.
- Distributed generation—given different use patterns of such customers, and impacts these units might have on network voltage levels from their ability to export energy back to the grid.

DNSPs have to date adopted various approaches, generally by means of the consumption volume size of customers or connection voltage. It is possible that the approaches sought by DNSPs on tariff classes will alter with the reforms to the pricing principles. This is particularly with regard to where tariff classes might currently reflect consumption volumes rather than contribution to peak demand.

We consider that these matters should be addressed in the PSS. In so doing, we recognise that further broad guidance might be needed on how tariff classes should be set. The tariff class requirement would be mandatory and would increase the prominence of this aspect of our reviews. Clear justifications would assist our reviews, and stakeholders in engaging on a PSS.

Assignment & reassignment procedures

SCER's proposed amendments to tariff class provisions are related with NER provisions for customer assignments/re-assignments between tariff classes. These provide DNSPs with criteria on how to assign customers, including by: the nature and extent of their usage, the nature of their network connection, or whether they have remotely-read interval metering. It appears SCER's proposal to make it mandatory to set tariff classes on an economically efficient basis would be supported by these provisions. The examples described earlier of some possible ways of reflecting cost drivers in tariff classes would ultimately relate to matters such as usage or connection types.

While SCER's proposal here is limited to the composition of tariff classes, we are aware of issues that have over time been raised to us by stakeholders. These might be worth exploring directly in this rule change, or in an AER pricing guideline. For example:

[17] Clause 6.18.3 of the NER.
[18] Clause 6.18.4 of the NER.

- Need for interpretation on the meaning of 'nature and extent of a customer's usage'. There are various references to 'usage' in these provisions[19] and it is unclear if this is to be interpreted on the basis of the time of demand rather than consumption volumes.
- Some tariff assignment provisions are also unclear, including how to interpret the provision that retail customers with micro-generation facilities should be treated no less favourably than customers without such facilities but with a similar load profile. It is unclear what this clause implies, and if it applies to re-assignments within the same tariff class.

More significantly, complaints received by us often concern a lack of customer understanding of the reasons why they might be re-assigned to different tariffs within a tariff class. These re-assignments sometimes result in significant increases in network charges not associated with changes in consumption and demand patterns.

As worded, the provisions relating to the economic basis of tariff class design and customer assignment only relate to the tariff class level. The rule change should explore, with particular regard to PSS consultation, if there is need for greater transparency on customer re-assignments within tariff classes. Any change to these provisions, applying them to a more detailed level would probably need to be considered together with other provisions that are set on tariff class level, such as the side constraints.

[19] This includes: clauses 6.18.4(a)(1)(i), 6.18.4(a)(2), 6.18.4(b) of the NER.

5 New framework for tariff setting

SCER's proposal requiring DNSPs to prepare a PSS can improve the process by which they design, apply and modify tariffs. All stakeholders would benefit by way of greater engagement, visibility and certainty. We support the proposal but make the following recommendations on its implementation:

- DNSPs should be required to consult with a broad range of stakeholders on a PSS before submitting it to us for review.
- If the PSS is to provide certainty at least in tariff structures, it should be binding on DNSPs for the regulatory control period. DNSPs should be allowed to propose mid-period amendments, via a suitable threshold allowing only significant changes resulting in a more compliant PSS.
- In addition to SCER's suggested coverage, the PSS should provide an overall tariff strategy, setting out expected network challenges, why tariff options are the best solutions, expected stakeholder impacts and tariff evolutions. This strategy should be forward looking and cover at least the regulatory period. Also, specific additions to the PSS should be considered—such as customer assignment procedures and other matters raised in section 3.
- The required coverage of the PSS should be flexible over time, and there should be discretion for us to adapt its requirements—best dealt with as part of an AER guideline.

5.1 Consultation on the PSS

The introduction of more efficient tariffs could raise various uncertainties for stakeholders, on how new tariffs operate, how to respond, and possible volatilities—all of which need to be managed. The new tariff setting framework proposed by SCER[20] has the potential to improve stakeholder engagement and information. In particular, the PSS should provide a focal point for guiding these discussions, but regard is needed on how this might practically occur.

Parties to consultation

There is differing language throughout SCER's rule change proposal as to which parties DNSPs need to consult with on tariffs. Our view is that consultation should cover the following:

- Retailers—as the key in the process of packaging network tariffs for consumers. Discussions on network tariffs lack meaning without some engagement on what retailers might do with these. Retailers are also the consumer interaction point and currently perform the role of managing risks from volatility in wholesale market prices for consumers. Over time this role could extent to the management of network price volatility from more dynamic distribution tariffs. Further, retailers could also become a focal point for various demand-side participation and management services that could help consumers manage their responses to price signals. We expect that retailers might be interested in the intended design and likely magnitude of network tariffs, and the strategy with respect to any transition to these tariffs.
- Consumers—discussions on tariff design and implementation strategy will be important. Consumers and their representatives will have interest in whether tariffs are designed appropriately for their circumstances. This includes understanding tariff assignment or reassignment and certainty on changes to tariff structures or levels over time. Consumer difficulties will arise given that it is the retailer who ultimately decides how to pass on network

[20] SCER's proposes DNSPs to consult on, and propose a PSS when submitting a revenue proposal. A PSS would also be submitted with annual pricing proposals. Mid-period PSS amendments would be proposed to us (after consultation) prior to annual tariff proposals. Tariff proposals would need to comply with revenue determinations and the PSS.

tariffs. Further, as not all consumers are homogenous, this rule change will need to consider how DNSPs might practically engage with consumers.

- Other parties—these could include organisations providing demand-side management services to the market, such as demand aggregation or direct load control, which might either be alternatives to, or interact with, tariff based options.

Timing of consultation

We are keen to explore stakeholder views on how to streamline consultation, given the potential for consultative burden and practical limits on interaction points in the tariff setting process. We consider that a key aspect of the PSS' operation is placing the consultative onus on DNSPs. This recognises that stakeholder interactions in tariff setting should be a more central part of business practices. Such interactions are now, following recent network regulation rule changes, expected of DNSPs in preparing revenue proposals before submission to us[21] and in interacting with others via their Demand-Side Engagement Strategies and stakeholder registers.[22] As such, we consider that:

- DNSPs should be required to consult in developing an initial PSS prior to submission to us at the revenue proposal stage. Proposals to amend the PSS mid-period should also be made only after consultation. This better embeds consultation in DNSP business practices and provides us greater assurance of appropriate testing of tariff strategies.
- In reviewing an initial PSS in the revenue determination process, we would assess (in some way) whether and how DNSPs consulted and resolved concerns. This exercise will not be trivial, given the potential scope of the customer impacts principle that the PSS needs to address. During the revenue assessments we would likely seek further stakeholder input. We envisage this as a means of addressing matters unresolved during the PSS consultation.
- Requiring consultation prior to submitting a PSS to us, and requiring its submission with the revenue proposal, means that consultation will not add to the existing timing concerns around the conclusion of tariff reviews (discussed in Section 6).
- An issue needing consideration is how to provide consultation/visibility on tariff levels. Engagement on tariff structure might not substitute for knowing the likely trajectory and magnitude of tariff levels. This should not be undertaken during the annual pricing approval process. Rather, DNSPs should consult on pricing structure and levels prior to submitting proposals. An approach might be for DNSPs to use their revenue proposal figures in setting price trend levels in the initial PSS, to be later replaced with our draft revenue decision, and published together with revised proposals.

5.2 Scope of PSS

The SCER proposes that the PSS' scope be set out in the NER. It suggested specific matters to be addressed, including: listing of tariff classes and structures, elements of charging parameters, expected price trends and explanations of how the PSS addresses the pricing principles. We consider that the scope of the PSS should be adaptable over time as circumstances change. This is best achieved by allowing AER discretion to determine PSS requirements by way of a guideline. While supporting the specific information SCER proposes to require in a PSS we consider that the PSS

[21] AEMC, *Rule Determination: National Electricity Amendments (Economic Regulation of Network Service Providers) Rule 2012*, 29 November 2012, p.x.

[22] AEMC, *Rule Determination: National Electricity Amendment (Distribution Network Planning and Expansion Framework) Rule 2012*, 11 October 2012, p.ii.

should also comprehensively explain the intended tariff strategy, which should also be forward looking, covering at least the regulatory period. Matters of strategy would include the following:

- Network challenges—envisaged challenges of demand on the network. DNSPs should be able to predict these. They form the basis upon which revenue proposals are established and the basis upon which DNSPs comply with annual planning reporting requirements.[23]
- Solutions—explanations why proposed tariff structures can overcome specific problems. This would help us assess a PSS against the pricing principles, and provide stakeholders with a clearer picture on why certain tariffs are to be introduced.
- Impacts— issues DNSPs anticipate needing to manage. Particularly relevant with regard to its consideration of the customer impacts principle.
- Evolutions—intended tariff rebalancing. For example, whether DNSPs intend to gradually recover higher revenue proportions from certain charging parameters, tariff classes, or customer types or to gradually phase out certain tariffs over the regulatory period. It should also include (non-binding) information on expected trends in actual tariff levels.

Further, more specific information not featured in SCER's proposal concern procedures for customer assignments and reassignments. These are important areas where greater stakeholder clarity is required. The NER currently provide principles for our consideration in formulating provisions for assignments and reassignments between tariff classes, as part of our distribution determinations.[24] They should be included in a PSS, with a guideline elaborating on necessary information.

5.3 PSS & tariff proposal assessments

To provide some certainty on the tariff structures DNSPs intend to offer over a regulatory control period, it is important that structures do not differ to those set out in a PSS. We consider SCER's proposal for the PSS to be binding on the DNSP of key importance. Binding DNSPs in this way would mean that in preparing initial tariff proposals (after our revenue determinations) and annual tariff proposals, they would need to offer tariffs complying structurally to those in the PSS.

DNSPs should be able to predict the nature of tariffs they intend to implement for a regulatory period, with respect to network challenges they foresee. However, we recognise that exceptional circumstances could arise, like significant unexpected demand changes. It is appropriate that DNSPs can propose amendments to structures set out in their PSS to cover these contingencies, providing there is a threshold. On this matter, we believe the drafting of SCER's rule change needs examining, given some sections suggest a PSS would be approved if it is consistent with the pricing principles, and in other sections, that PSS amendments only be approved if they better reflect these principles. In our view, proposals need to demonstrate why amendments would result in a more compliant PSS.

SCER also proposes that if we reject a proposed PSS, the PSS in force for a regulatory period should be that which was in force in the last year of the earlier period. This could be unworkable where:

- We refuse to approve an inaugural PSS—there would be no PSS in place as a default.
- An existing approved PSS becomes no longer adequate. This could relate to changes in demand, network use, or emergence of new technologies, which might suggest that existing tariff options are not addressing these matters in a cost reflective way.

[23] DNSPs must carry out an annual planning review covering a minimum forward period of 5 years, and report on anticipated network challenges such as system limitations, capacity forecasting etc. AEMC, *Rule Determination: National Electricity Amendment (Distribution Network Planning and Expansion Framework) Rule 2012*, 11 October 2012, p.ii.

[24] Clause 6.18.4(a) of the current NER.

We recommend that the NER be amended to allow us the discretion to set a compliant PSS, noting:

- A similar arrangement is already reflected in the current NER, allowing us to make necessary amendments to a pricing proposal or a Negotiating Framework, to rectify any deficiencies.[25]
- For the initial PSS, we would have time to set out amendments necessary for a proposed PSS to be NER compliant. There might not be an ideal solution to a situation (possibly rare) where we find during the regulatory period that the PSS is no longer appropriate.

[25] Clauses 6.18.8(c) and 6.12.3(h)(2) of the current NER, respectively

6 Timing of price reviews

The current timeframes of when network prices take effect each year often create difficulties for stakeholders, including retailers, consumers and jurisdictional regulators (where price regulation exists). Many groups have sought earlier notification of changes in the level (quantum) of network tariffs to facilitate their own processes. These include the setting of retail offers, financial year budgeting, or setting regulated retail prices. IPART's rule change proposal sought to address this concern by bringing forward the timing of when Transmission Network Service Providers (TNSPs) and DNSPs need to submit pricing proposals, and for there to be a fixed timeframe for our annual price reviews.

Our submission to the AEMC's earlier consultation paper (IPART's proposal), supported bringing forward the timing of network price proposals, subject to resolution of various data input issues.[26] While IPART's proposals are now consolidated with SCER's, the AEMC is yet to advance recommendations on achieving more timely outcomes. To provide certainty and streamlined reviews, resolving the timing concern needs to ensure as practical that information submitted in pricing proposals is based on actual data, not forecasts. There are inevitable trade-offs between precision on inputs to pricing and timely tariff outcomes.

From submissions to the AEMC's earlier paper[27], it appears that concerns on the impacts on transmission pricing might be alleviated by still bringing forward timeframes but not by as much as IPART intends. This option needs careful exploration. If this can be achieved, bringing forward timing appears the only potential solution, as we do not consider that the new pricing framework with a PSS will provide for earlier resolution of tariff reviews.

6.1 Timing effect of new framework

SCER's new pricing framework would shift to the revenue determination, tariff structure reviews against the pricing principles. Further, as SCER intends, any proposed annual PSS amendments would be made, six months prior to tariffs needing to take effect. The AEMC has now queried whether this framework will actually help address the timeliness concern. We consider this won't of itself address the concern, but will ensure that tariff reviews do not become longer. This is given that SCER's proposal would require more detailed reviews of compliance against pricing principles (LRMC, customer impacts etc.), the PSS and demonstration of effective consultative processes.

Reviewing tariff structures against pricing principles and other related matters (tariff class and assignment provisions) are only part of current tariff reviews. Other core aspects, not directly subject of SCER's proposal, concern quantitative assessments of the reasonableness of any data input to pricing (so called reasonable estimates) and compliance with caps set in our revenue determinations and side constraints. As set out in our earlier submission to the AEMC, circumstances often lead to our reviews being delayed, mostly due to aspects of these quantitative control and estimation matters.[28] These aspects could become more significant as pricing structures become more complex. As such, should the AEMC seek to fix the timeframes for our annual reviews, this should consider including 'stop the clock' provisions. These should allow timeframe extensions, if certain circumstances arise. To date, these circumstances have related to:

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[26] AER, *Submission to AEMC consultation paper – Rule changes: annual network pricing arrangements*. Accessible on http://www.aemc.gov.au/Electricity/Rule-changes/Open/annual-network-pricing-arrangements.html.

[27] See Grid Australia, *Submission to Annual Network Pricing Arrangements Rule 2013*, 5 July 2013, p.2.

[28] AER, *Submission to AEMC consultation paper – Rule changes: annual network pricing arrangements*, p.4. Accessible on http://www.aemc.gov.au/Electricity/Rule-changes/Open/annual-network-pricing-arrangements.html.

- Non-compliance of pricing proposals with the NER, such as late submissions.
- Changes in circumstances following the initial pricing proposal submission, such as decisions by the Australian Competition Tribunal or jurisdictional Government directives.[29]
- Insufficiently substantiated reasonable estimates associated with the introduction of flexible time of use tariffs in Victoria.

6.2 Bringing forward price reviews

Consistent with our earlier submission, we support attempting to bring forward the date of DNSP pricing proposals but consider that various data input issues need to be effectively addressed to the extent practicable.[30] As far as possible, network businesses should use actual data, not forecasts of relevant variables, when submitting pricing proposals. Otherwise the risk of inaccurate prices being set increases. The significance of these risks need examining and evaluation against the benefits of more timely outcomes of tariff reviews—noting there will inevitably be trade-offs here. Data input issues include:

- Changing the CPI used in AER regulatory determinations from March-to-March to December-to-December. This is preferable to using CPI estimates in pricing, then needing reconciliation.
- The extent of revenue or cash flow risks resulting from requiring distributors to rely, in their pricing proposals, on forecasts made earlier in the year
- The impact on TNSPs of requiring prices to be finalised earlier, which may require:
    - Relying on forecasts of intra-regional settlement residues and inter-regional TUOS charges. We note from Grid Australia's submission to the AEMC's earlier consultation paper, that this concern might be alleviated to some extent if transmission prices were brought forward by one month (that is, submitted on 15 April) rather than two (submitted on 15 March)—as proposed by IPART.[31]
    - Bringing forward AER S-factor approvals. This might be a lesser concern than other matters here. As set out in our earlier submission we have been looking at ways of streamlining our assessments. However, our ability to conclude S-factor assessments can often be delayed for reasons similar to those for DNSP tariff reviews.

These factors could influence the stability of prices over time. Generally, for network businesses under a revenue cap, relying on forecasts further out than otherwise necessary can increase risks of over or under-recovery of revenues in a single year, leading to more year-to-year pricing volatility. For businesses under a weighted average price cap, relying on forecasts made further out than otherwise necessary places greater risk of under-recovery onto them, while customers would risk over-recovery of network business revenues.

[29] A recent example is APA GasNet transmission tariffs in Victoria. These were to be submitted on 18 October 2013, however due to a decision of the Australian Competition Tribunal, we needed to amend revenue requirements, advise APA GasNet of same, and seek their resubmission - provided on 22 November. This added 3 weeks to the process.

[30] AER, *Submission to annual network pricing arrangements*, July 2013, pp. 2-4.

[31] Grid Australia, *Submission to Annual Network Pricing Arrangements Rule 2013*, 5 July 2013, p.2.

7 Tariff transition / volatility

While supporting network tariffs increasingly reflecting network cost drivers, the shift from largely flat consumption volume based tariffs to more time or location varying efficient tariffs will likely have various impacts. There might be price level movements purely in shifting to new tariffs, and over time as these vary in different ways. SCER's rule change is somewhat unclear on the intention with regard to the management of these issues, and whether these are to be directly considered in this rule change. In our view, broader consideration is needed, and approaches to managing tariff transition and volatility should be conceived in terms of the NEO and applied in a nationally consistent way:

- Having regard to possible stakeholder concerns about tariff volatility is relevant to the NEO considerations of economic efficiency and long term interests of consumers.
- SCER's new pricing framework might be put to managing tariff transition and volatility. These options also need broad consideration as to whether they substitute, complement or are preferable to other options like numerical side-constraint limits. The latter would allow less flexibility for adaptation over time and depending on their design, could constrain innovation toward more efficient pricing.

7.1 Framework for managing transition / volatility

Issues of tariff volatility and transition have historically been viewed in terms of social equity and approaches to their management have applied to particular jurisdictions via the NER/NEL, which operate under the NEO's economic framework.[32] These issues can be addressed more directly as consistent with the NEO and in a nationally consistent way. As we see it, tariff volatility and transition can probably be understood in various ways:

- Notice and expectations. SCER's reforms intend providing efficient signals for stakeholders to respond to. Implementing fundamentally different ways of pricing via significant changes to structure or levels without adequate information and notice might allow insufficient preparation time for stakeholder responses. This might involve more information for consumers on tariff design, expected level trajectory, and perhaps smoothing tariffs over time.
- Protecting sunk investments. A shift to fundamentally different tariff structures overnight could cause economic harm to consumers who have made investments (appliances or choice of business location) on the basis of earlier expectations of tariff structures.[33] This issue might be overcome by smoothing the introduction of new tariff structures.

Implementing new tariffs in a way that neglects these above-mentioned issues might not lead to more efficient outcomes and also not be in the long term interest of consumers. We acknowledge that approaching these issues on a per customer basis will be impossible. DNSPs cannot gauge whether every stakeholder sufficiently understands the tariffs it proposes, hence the importance of the PSS.

7.2 Management options

The rule change should explore the intended role of SCER's proposed new framework with respect to managing tariff transition and volatility issues. We consider that it might be put to this role, by requiring DNSPs to do the following:

[32] This point was also made by the Productivity Commission's (PC) report on network regulation frameworks. The PC cited various examples of jurisdictional governments intervening explicitly or implicitly to modify charging regimes for equity reasons, including for example, South Australian legislation setting out derogations from the Rules for the 2010 distribution determination, and requiring that fixed supply charges not increase by more than $10 per year. PC, *Electricity Network Regulation Frameworks*, P.C Inquiry Report Vol.2.No.62, 9 April 2013, p.444.

[33] There are common examples of this, including situations where consumers who have invested in PV units have been shifted onto demand based tariffs from consumption-volume tariffs—which operate in very different ways.

- Prepare and consult on a PSS—providing clear expectations and information so retailers and consumers understand any new tariffs or strategy intended over the regulatory control period.
- Be bound to structures in the PSS for the regulatory period (unless proposed modifications are more efficient)—providing greater certainty with regard to stakeholder investments.
- Consider consumer impacts in designing tariffs—providing a means of requiring consideration of how to approach volatility, and a stakeholder dialogue framework.

This framework would place the onus of managing tariff transition and volatility upon a DNSP–stakeholder dialogue (with our oversight). In doing so, it could provide for management approaches that are more adaptable and customised to particular network circumstances. As noted earlier, efficient tariffs represent an option to address specific network challenges. Therefore, decisions on the speed by which greater cost reflectivity in tariffs is introduced would depend somewhat on the nature and timing of expected network challenges.

We recognise that approaching transition issues via the customer impacts principle, might cause tension between compliance with mandatory requirements like pricing on the basis of LRMC. One approach is where a DNSP, after consulting with stakeholders, determines a suitable transition path to implement more cost reflective tariff structures—this could be seen as an objective to achieve over the course of a regulatory period. The current wording of the pricing principles might suggest that DNSPs are to implement new tariffs immediately, which could result in concerns as set out above.

Numerical limits

Managing tariff transition and volatility issues via SCER's framework as set out above, might negate the need for other alternatives. An alternative that currently exists in the NER is applying numerical side-constraints. These limit the expected weighted average revenue to be raised from a tariff class from a particular year to another by no more than CPI-X plus 2 per cent.[34] These options that 'hard-wire' one set numerical approach in the NER to manage transition and volatility, would be less flexible than using SCER's DNSP/stakeholder dialogue based framework. Further, determining a numerical limit would need to allow sufficient flexibility for DNSPs to progress toward greater cost reflectivity in tariffs.

While the NER side-constraints appear designed to target price volatility, in practice they provide little constraint on individual tariff movements because they only apply to tariff classes. Individual tariff components within tariff classes can (and do) vary by large amounts year-on-year, as long as the revenue collected from that class remains within the overall constraint. We note that a large part of recent price volatility has been due to DNSPs shifting the weight of variable charges relative to fixed charges within tariffs. There are no restrictions on changes to individual tariff components.

Should the aspects of SCER's proposed PSS and engagement framework not be adequate to address tariff volatility, there may be a need to tighten the side constraint, by applying it to tariffs rather than tariff classes. The challenge would then be to still provide sufficient flexibility so as to not constrain the ability of DNSPs to innovate and introduce more cost reflective network tariffs.

Side constraints are only one option for addressing volatility, and they might interact with others. As such, they should be subject to broader review. This should consider their objective, ongoing relevance, composition and interaction with other rules. It is unfortunate that the AEMC considers that a broad review of side constraints, outside of SCER's minor proposed amendments is out of scope. With respect to these minor amendments, we accept:

[34] Clause 6.18.6 of the current NER.

- Applying them across regulatory control periods, not just within—providing continuous smoothing of impacts. However, while SCER suggests this might address the consumer expectation for tariff classes prevailing at the end of a regulatory period to form the basis of those at the beginning of the next, in practice side constraints provide little constraint on structures.
- Removing the clause suggesting that side constraints do not limit the extent to which a tariff for customers with remote interval metering may vary according to time or other circumstances of their usage. We agree this clause appears redundant and would lack clarity on whether consumers with interval meters were exempt from the side constraint.

Other options

There might be quite different alternatives to managing volatility and transition. The AEMC's Power of Choice review recommended a gradual phasing-in approach to more efficient tariffs and advanced metering. That is, by segmenting consumers, and determining opt-in / opt-out arrangements, and situations where smart meter installation would be required. SCER opted for jurisdictional governments determining how to implement any such reforms in their areas. Not knowing how jurisdictions might respond to these matters could make it difficult for DNSPs to anticipate what might be expected. It also makes it difficult for us to comment on required NER reforms to manage volatility and transition.

8 AER guidelines

SCER proposes to require us to publish a guideline on stakeholder consultation, and leaves to our discretion whether to publish a guideline dealing with the economic aspects of pricing. We will need to observe how various components of this rule change such as the exact wording of the pricing principles progress before definitively identifying the scope of any AER guidelines. In doing so, we are keen to avoid excessive burden or prescription where this is unjustified. This submission identifies areas where there might be need for further explanation as to the interpretations of rules or procedural or justification expectations. These cover issues of an economic, procedural or consultative nature, including:

- Interpretations:
    - any reference to LRMC, and how it might be viewed in light of an overall objective for tariffs to reflect underlying drivers of network costs which vary by time and location.
    - the scope of matters to consider with respect to customer impacts.
    - the various matters that DNSPs are to consider in defining tariff classes and in assigning and reassigning customers.
    - the approach to be used to recover costs residual to LRMC.
- Expectations :
    - on justifications that should be made to show how DNSPs have approached the pricing principles, including the need to explain matters concerning LRMC qualitatively and quantitatively.
    - on how DNSP's are to indicate how they have consulted with stakeholders and dealt with any issues raised therein, as part of the development of their PSS.
    - Role and scope of PSS and how this may need to evolve/change over time

With respect to consultation we are unclear on the need to set out expectations that are more specific or customised for pricing than the broad principles based approach used in our current Consumer Engagement Guideline (CEG) for NSPs.[35] We note though that this guideline implemented under our Better Regulation program only targets consumers, and other parties like retailers will also have a core interest in distribution pricing. If there is need for more extensive guidance here, this could be achieved by way of a revision to the CEG rather than a separate pricing consultation guideline.

[35] AER, *Better Regulation – Consumer Engagement Guideline for Network Service Providers,* November 2013. Accessible on http://www.aer.gov.au.

9 Timing of reforms

As identified in the AEMC's consultation paper the expected conclusion date for this rule change (November 2014) creates difficulties for upcoming distribution revenue determinations. Given the staggered timeframes for these reviews, decisions are required on the speed by which the reforms in the rule change package should be introduced. These are substantial reforms and it is important that they be introduced carefully and appropriately.

Other than potential improvements to the timing of tariff reviews (pending resolution of the matters proposed by IPART), most aspects of these reforms are probably matters for which the benefits might be gradual. In light of the questions set out in the AEMC's consultation paper concerning when the reforms should be introduced, we would prefer that matters such as developing a PSS be undertaken when an AER guideline is in place:

- While we are uncertain as to the complete scope of a pricing guideline, we have identified a number of important aspects in the pricing principles, tariff class and assignment provisions that will require further explanation. Furthermore, we have suggested that the full scope of a PSS should be something that we would set out in a guideline.
- The first PSS will likely be the most difficult to implement given its novelty. It is therefore important that there be a strong consultative process in developing and reviewing this PSS.

We are keen to hear stakeholder views on this issue as part of the rule change process, and whether there might be a better process by way of any transitional rule provisions:

- For NSW/ACT DNSPs, this rule change's completion will be well after they have submitted revenue proposals (31 May 2014 for the full determination). Even with transitional rules allowing PSS submission after the revenue proposal stage, it would appear difficult for us to develop a new pricing guideline by the time we are required to publish our final determination (30 April 2015) and to require consultation on the PSS after completion of a guideline.
- Similarly, for SA/QLD DNSPs, the completion of this rule change will be after they have submitted revenue proposals to us (31 October 2014). With our draft decisions due on 30 April 2015 and final decisions on 31 October 2015, there could be some scope to develop a guideline by the time our final decisions are due, but the consultation problems would still remain as per the NSW/ACT case.
- For VIC DNSPs, the completion of this rule change will be before they submit revenue proposals to us (30 April 2015) and before we release our draft decisions (31 October 2015). It might be difficult for a guideline to be finalised by the time these DNSPs submit revenue proposals but they might be able to be guided say by a draft guideline.

As an alternative, particularly for NSW/ACT/SA/QLD DNSPs, this rule change could explore the option of allowing DNSPs to submit a higher level document for their inaugural PSS which could later be made firmer upon completion of an AER guideline. This higher level document could be guided by the AEMC's draft or final rule change determinations:

- For NSW/ACT DNSPs this option would still mean that they would be submitting their inaugural PSS after the first year of the regulatory period.