

Annual Pricing Process Review

Final position paper
– first stage

December 2021

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AER reference: AER213041

Amendment record

Version	Date	Pages

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About us

We, the Australian Energy Regulator (AER), work to make all Australian energy consumers better off, now and in the future. We are the independent regulator of energy network service providers (NSPs) in all jurisdictions in Australia except for Western Australia. We set the revenue requirements these NSPs can recover from customers using their networks.

The National Electricity Law and Rules (NEL and NER) and the National Gas Law and Rules (NGL and NGR) provide the regulatory framework which govern the NSPs. Our role is guided by the National Electricity and Gas Objectives (NEO and NGO).

NEO:¹

...to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

NGO:²

...to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.

The decisions we make and the actions we take affect a wide range of individuals, businesses and organisations. Effective and meaningful engagement with stakeholders across all our functions is essential to fulfilling our role, and it provides stakeholders with an opportunity to inform and influence what we do. Engaging with those affected by our work helps us make better decisions, provides greater transparency and predictability, and builds trust and confidence in the regulatory regime. This is reflected in our *Stakeholder engagement framework* and in the consultation process we are following.³

¹ NEL, s. 7.

² NGL, s. 23.

³ AER, *Revised stakeholder engagement framework*, September 2017.

1 Introduction

In August 2021, we initiated a review into improving our annual pricing approval process for electricity distribution network service providers (distributors). The aim of the review is to develop a process for more timely and accurate annual pricing approvals as well as improve the presentation of pricing outcomes for stakeholders.

The initial phase of the review is made up of two stages:

- First, engagement between the AER and distributors to develop a better process for the AER's assessment of annual pricing approvals for years 2 to 5 of the regulatory control period
- Second, standardisation of pricing proposal documents and engagement with other stakeholders to ensure the pricing model can provide the required data for their own processes, such as setting retail prices or developing default offers.

Following consultation with the distributors, we have completed the first stage of this initial phase. The outcome of this first stage includes development of:

- A formalised pre-lodgement process between us and distributors to better utilise resources to engage on pricing proposals outside of the constrained timelines of the formal approval process. It will also increase the likelihood of receiving pricing proposals that are compliant and capable of being approved in the first instance.
- A standardised pricing model template that will streamline the resources and engagement required by us and distributors to review and engage on pricing proposals. It will also minimise risk of input and modelling errors and allow for reporting outputs that are beneficial to the AER, distributors and stakeholders.

This paper sets out our final position on these issues which will be implemented for the 2022/23 annual pricing process and beyond.

The development of these aspects for the annual pricing approval process follows our commitment in the [AER Strategic Plan 2020–2025](#) to design our systems to work in ways that deliver efficient regulation of monopoly infrastructure.⁴

We will progress the second stage of the initial phase in the second half of 2022.

In 2022, we also intend to progress the next phase of the review which will include a review into the timing of pricing proposal approvals for the first year of a regulatory control period.

⁴ AER, *AER strategic plan 2020–2025*, December 2020, p.9

2 What's wrong with the annual pricing process

Each year, the electricity distributors submit to us for approval the electricity network and alternative control service prices they propose to charge consumers for the upcoming regulatory year. We approve a pricing proposal if:

- it is compliant with the requirements of the NER, the applicable distribution determination and tariff structure statement, and
- all forecasts associated with the proposal are reasonable.

However, each year we encounter a number of recurrent issues which impact our ability to approve pricing proposals within the legislative timelines. For example, in our compliance assessments, we regularly encounter issues that require distributors to resubmit their pricing proposals, or part thereof.

We note that in 2020 and 2021, only 2 of the 28 pricing proposals initially submitted were considered compliant and capable of being approved. For the remaining 26 pricing proposals, we required the distributors to resubmit them before they could be approved. Some key points from the pricing proposals received in 2020 and 2021:

- 64% of proposals included input errors
- 64% of proposals included model errors
- 61% of proposals included compliance issues
- 54% of proposals included typographical and/or transcription errors that required correcting to be capable of approval.

The resubmission of pricing proposals creates additional administrative burden. In most instances, the issue is minor and requires the distributor to resubmit a document or a model to address the issue. However, at times the issue is substantive which requires engaging with distributors, and at times other stakeholders, for resolution.

For each resubmission, we must perform a compliance check. If further issues are uncovered then more resubmissions and compliance checks are required. The back-and-forth and/or further engagement processes are time consuming and puts at risk our ability to approve pricing proposals within the regulatory requirement.

The timely approval of pricing proposals is important for a number of stakeholders:

- Distributors – to implement prices in billing systems and communicate prices to retailers and consumers
- AER – to meet our obligations under the NER (approval pricing proposals within 30 business days of receipt) and for the development of Default Market Offers

- Retailers – to establish their retail offerings and meet their obligations under the Prohibiting Energy Market Misconduct (PEMM) Act
- State regulators – as part of jurisdictional regulation or other process, or, in the case of the Essential Service Commission, for the development of Victorian Default Offers
- Consumers – Default Market Offers and retail offerings that accurately reflect approved network prices, rather than indicative prices.

The regulated timelines for the annual pricing process were established prior to the introduction of the Default Market Offer and PEMM Act. The current timing for approving pricing proposals, (generally around mid-May), does not reflect the needs of these key stakeholders. For example, the Default Market Offers are required to be published before 1 May, and therefore are unable to reflect approved network prices. Any delays in the process (as were experienced at the height of the COVID-19 pandemic) can create constraints on retailers in developing and communicating retail offerings prior to 1 July and maintain compliance with the PEMM Act.

In this initial phase of the review, we targeted two key areas to assist the distributors in submitting more compliant pricing proposals and the AER achieving more timely pricing approvals. These areas are the timing and presentation of pricing proposals.

2.1 Timing

We have to approve pricing proposals within constrained legislative timelines:

- as soon as practicable for pricing proposals in the first year of a regulatory control period
- within 30 business days from the date of receipt of annual pricing proposals in all other years of a regulatory control period.

This timing can restrict our ability to engage on key areas of the proposals in detail, particularly when considering the other tasks to be undertaken within that time.

As a result, there have been instances where we needed more time than specified in the NER to be satisfied a pricing proposal is compliant. In other instances, time pressures resulted in errors not being identified, which required corrections after publishing approved proposals. These outcomes are not desirable given the importance of timely (and accurate) approvals for stakeholders who rely on the outcomes of this process.

In our recent processes we have found that engagement with the distributors before they formally submit their pricing proposals has resulted in efficiencies in the pricing approval process. Through this engagement distributors provided us with preliminary information relating to the more substantive aspects of their pricing proposals. This

pre-lodgement engagement has resulted in less engagement being required on these elements during the constrained timelines of the formal approval process.

Through the first stage of this review, we worked with the distributors to develop a more formalised pre-engagement process to allow better engagement on these more substantial elements of the pricing proposal prior to formal submission. The formalised pre-engagement process is expected to increase the likelihood that a pricing proposal submitted is compliant and capable of approval..

2.2 Presentation

In addition to the timing constraints, our assessment of pricing proposals is further complicated by the wide range of documents and models distributors submit to support their proposals and to demonstrate compliance. The range of documents and models vary across distributors, each presents similar information in different ways and can include a variety of supporting information.

As a result, we can spend a significant amount of time in the initial phases of an approval process familiarising ourselves with the distributors' models and documents. This reduces the time available to do a compliance assessment. The time consuming 'discovery' phase is sub-optimal given the time constraints of the approval process.

The distributors are also impacted by the presentation of differing pricing proposals. Often we issue information requests to the distributors because we are unable to locate information or have misunderstood how a pricing model works. Responding to the information requests increases the administration burden for distributors.

To address these issues, we worked with the distributors to develop a standardised pricing model template to be used to submit their annual pricing proposals.

We consider there is further scope to improve the presentation of pricing proposals for approval which will reduce the administrative burden for distributors and the AER. This may include standardised pricing proposal documents. We will engage more with this opportunity in the next stage of our review in the second half of 2022.

3 Pre-lodgement engagement

We have developed a formal pre-lodgement engagement process between us and electricity distributors to develop a better process for our assessment of annual pricing approvals for years 2 to 5 of the regulatory control period.

This formal pre-lodgement engagement will assist in streamlining the formal pricing approval process as it allows early engagement on key elements of pricing proposals that are known with some certainty in advance. These are likely to include forecast demand, alternative control service prices, components of unders/overs accounts, and any significant cost drivers. The process also provides opportunity for distributors to engage with us on material issues they are aware of in the upcoming submission.

This early engagement will reduce the impost on our and distributor resources within the formal timelines, by reducing the time we require to review proposals and the amount of engagement with distributors on these issues once formally submitted. In our experience, we observe benefits for the distributors in receiving less information requests from us and fewer resubmissions of proposals.

Additionally, we introduced a role for us to initiate the pre-lodgement engagement process by providing the distributors with the standardised model template with pre-filled inputs. This approach provides us with an opportunity to further test the standardised model template for the 2022-23 pricing approval process, and allows the distributor to undertake a quality assurance of the inputs.

We consider the pre-lodgement engagement process will increase the likelihood of distributors submitting pricing proposals in the first instance that are compliant and capable of being approved. This may provide opportunity for earlier publication of approved pricing proposals for the benefit of all stakeholders. In particular, earlier publication will benefit stakeholders that rely on approved network prices, such as the Default Market Offer and Victorian Default Offer, as well as retailers.

In future phases of this review, we will consider how a pre-lodgement process might be incorporated into the pricing approval process in the first year of a regulatory control period, or what other opportunities may be available.

Attachment A sets out the pre-lodgement engagement process we developed with the distributors, including a timeline of the process.

4 Standardised model template

In addition to the pre-lodgement engagement process, we have developed standardised pricing model templates to create efficiencies in our approval process, assist distributors with their submissions, and improve stakeholder understanding of our pricing approval outcomes.

We consider standardised pricing model templates allow:

- us to pre-fill known information into the model to reduce the amount of data entry required by the distributors
- development of automated calculations and compliance checks in the model to highlight and reduce data input errors as well as streamlining our assessment process
- greater familiarity with the models to increase our understanding of submitted proposals which will result in less engagement with distributors during the constrained timing of the approval process.

We developed the model templates in consultation with the distributors to develop an agreed set expectations on the information we require and how the model can demonstrate compliance. This reduces the disparity that exists at times between what is submitted by distributors and what we require for determining compliance.

The standardised model templates will reduce the risk of input, model, and compliance issues that currently occupy a large component of our engagement with distributors after submission. In turn, the use of the standardised model templates will increase the likelihood of proposals being submitted by 1 April that are compliant and capable of being approved.

A substantial benefit for us will be the ability to develop a universal guideline for our review of pricing proposals, creating time efficiencies in our review.

The standardised model templates will be first used by the distributors for their 2022/23 pricing proposals. While we and the distributors have collectively tested the model templates, we expect the 2022/23 pre-lodgement engagement process to be an opportunity to further test the functionality of the model.

Additionally, we developed template models that produce outputs that are of greater use to us, the distributors and other stakeholders. As discussed below, one of these outputs is cost movement analysis. We intend to progress further development of pricing proposal outputs through our engagement with stakeholders in stage two of the review, following the 2022/23 pricing process.

We consider the standardised model template benefits consumers and other stakeholders by producing consistent and transparent submissions with a lower

likelihood of errors being present. We have incorporated some more consumer-friendly outputs into the model template to make it more accessible to more stakeholders. As with the cost movements outputs, we intend to progress these outputs further in further stages of the review.

4.1 Cost movement analysis

In terms of outputs from our pricing approvals, we report estimated network cost movements to be experienced by customers as a result of approving prices for the upcoming regulatory year. Distributors generally also report on movements.

However, it is common for our estimated cost movements to differ to that of the distributors as a result of differing methodologies, consumption profiles, or even the inclusion of metering charges.

In creating standardised model templates, we have included cost movement functionality into the model template. The model uses our current approach. Based on feedback from distributors, the template includes the ability for the distributors to override some inputs to allow particular consumption profiles to be input (e.g. to reflect those used for the calculation of default offer). We consider the inclusion of cost movement calculations will provide more consistent reporting which will create greater transparency for stakeholders.

We will progress our considerations of the reporting of cost movement analysis in our engagement with stakeholders following the 2022/23 pricing process.