



## **Ausgrid Submission**

AER Position Paper: Default Market Offer 2020-21

October 2019

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Lodged online

Dear Mark,

Ausgrid welcomes the opportunity to comment on the Australian Energy Regulator's (AER) position paper for establishing a methodology to set default market offer (DMO) prices for 2020/21. We are supportive of the policy intent of the DMO to protect consumers who are not engaged in the market from paying unreasonably high prices.

In our submission we outline that our network prices decreased significantly between 2018/19 and 2019/20 and the effect of this may not be properly captured in the AER's methodology for setting the DMO going forward. We agree in principle with the proposed methodology for setting the new DMO, but for the Ausgrid distribution area slight amendments could result in better outcomes for customers.

Our submission also offers feedback on several other matters raised in the position paper, in particular, the decision not to set a separate DMO for time of use (TOU) customers. This could result in retailers being incentivised not to pass on the TOU signals in our network prices.

Please refer to our submission below for further details. If you have any queries in respect of this submission, please contact Fiona McAnally (02 9160 3730 or [fiona.mcanally@ausgrid.com.au](mailto:fiona.mcanally@ausgrid.com.au)).

Yours sincerely

A handwritten signature in black ink, appearing to read "Iftekhar Omar", written in a cursive style.

Iftekhar Omar  
Head of Regulation

# Submission

## General observations

As noted in our submission to the DMO draft determination for 2019/20, we are supportive of the policy intent of the DMO to protect consumers who are not engaged in the market from paying unreasonably high prices. Consultation with consumers repeatedly tells us that energy affordability is their number one concern, and Ausgrid has worked hard to reduce costs and the network element of electricity prices over the last few years.

While our submission regarding the reduction in network prices between 2018/19 and 2019/20 was noted by the AER, it decided not to pass those (or other) savings through in the 2019/20 DMO. While we support the AER's preferred position regarding the methodology to adjust the DMO for 2020/21, we are concerned that using the 2019/20 DMO as a base may mean that some consumers in Ausgrid's area of operation could miss out on the network savings accrued in 2019/20 on an ongoing basis.

Our submission also offers feedback on several other matters raised in the position paper.

## Approach to setting DMO annual price

Ausgrid agrees that the most reasonable approach for setting DMO prices in the future is to use the 2019/20 DMO prices and adjust them based on forecast changes to the underlying costs of supply. However, using the DMO set for Ausgrid's area in 2019/20 as a base, risks not passing through the reductions in network input costs that occurred for Ausgrid in 2019/20, which may be possible to do without dis-incentivising innovation, competition and market participation.

In its first DMO decision, the AER made three observations in support of the decision not to pass through forecast network savings in Ausgrid's area:

- The unique circumstances of the remittal process
- Applying the whole of the transmission revenues reductions to Ausgrid customers only
- The outcome would be DMO prices at levels consistent with market prices.<sup>1</sup>

The outcome of the remittal process did result in a unique circumstance of returning approximately \$310m customers, smoothed over the five year regulatory period. Now that the remittal process has concluded with certainty, this has flowed through into actual network prices for 2019/20.

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<sup>1</sup> AER, Final Determination – Default Market Offer Prices 2019-20, April 2019, p58.

The application of Ausgrid's reduction in transmission revenues across NSW is relevant to the estimate of movement in network use of system (NUOS) prices. However, not to the extent that it would have materially changed the impact to NUOS prices – the actual reduction for a 3,900 kWh customer on EA010 was approximately 14% compared to the estimate of approximately 16% in the final determination. In future, we would be happy to assist the AER in calculating transmission price changes in the Ausgrid area.

The final observation in support of not adjusting the network component of input costs for 2019/20 was that it would lead to DMO prices in 2019/20 at levels consistent with observable market offers at the time of the first DMO decision (i.e. in 2018/19). The AER considered that this would risk disincentivising competition and market participation.<sup>2</sup> Clearly this would not be a good outcome. However, as significant network price reductions were put into effect through the AER's 2019-24 final determination for Ausgrid, the commensurate reductions in retailers input costs may mean that there is an opportunity to maintain the incentives for competition and market participation while still reflecting Ausgrid's network price reductions in the DMO.

The AER's analysis of market offers in July 2019 showed the lowest residential market offer increased by 6% for tier 1 retailers, and reduced by 2% for tier 2 retailers<sup>3</sup>. The ACCC has found that the cheapest residential market offer was relatively unchanged, and the median market offer was slightly higher between June 1 and July 12, 2019<sup>4</sup>. IPART has found that the lowest residential market offer in Ausgrid's area increased by 3.1% after 1 July<sup>5</sup>. The approach the AER takes to setting the DMO has an effect on retail pricing.

The effect of not passing through the network savings in the 2019/20 DMO price has a flow on effect under the AER's preferred methodology to adjust the percentage cost change between 2019/20 and 2020/21. Figure 1 shows this effect.

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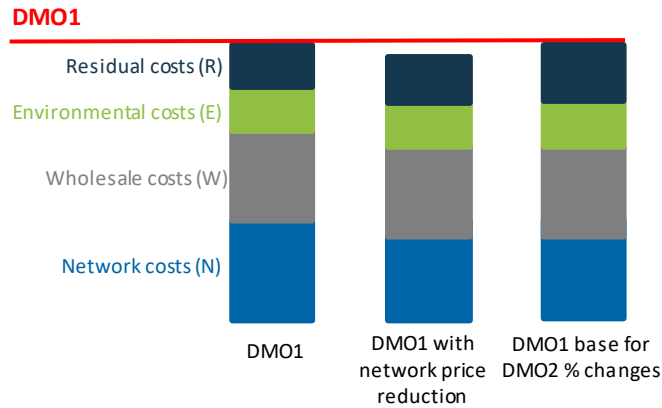
<sup>2</sup> AER, Final Determination – Default Market Offer Prices 2019-20, April 2019, p58.

<sup>3</sup> AER, Affordability in retail energy markets 2018-19, September 2019, p 42.

<sup>4</sup> ACCC, Inquiry into the National Electricity Market – August 2019 Report, p 53.

<sup>5</sup> IPART, Performance and competitiveness of the NSW retail electricity market, Draft report, October 2019, p 10.

**Figure 1: Example cost stacks**



Based on the methodology put forward by the AER, the residual component of the cost stack will be increased by CPI. This is expected to be higher than the price change for Ausgrid’s residential network tariff in 2020/21 (subject to revenue adjustments prescribed under the control mechanism).

**Forecasting changes in the cost of supply – network costs**

The proposed flat and controlled load network tariffs proposed by the AER for Ausgrid’s distribution area are appropriate for setting a DMO for flat tariffs.

The AER has suggested that X-factors from revenue determinations may be used in the absence of approved pricing proposals. In NSW, pricing proposals are generally not approved until 30 April each year which means they will not be available for use for the DMO which must be published on 1 May. We do not agree that using the approved X-factors will provide an accurate reflection of the movement in prices for these reasons:

- An updated X-factor to reflect the annual update to return on debt and WACC may not be available, depending on the timing of each business’ averaging period
- Movement in overall revenue may not reflect movement in the tariffs used in the DMO, particularly if tariff rebalancing is being undertaken
- As noted in the position paper, using X-factors only would exclude the effect of over and under recoveries which can sometimes be substantial.

We suggest that the AER use draft pricing proposals, even if they are not yet approved, for the calculation of movement in network prices. Ausgrid is happy to work with the AER to provide the most accurate outcome in the absence of approved prices.

With respect to metering costs, it is not clear that using the movement in ACS metering costs for DNSPs is the most appropriate proxy for metering price changes. The revenue being recovered on a legacy basis for type 5 and 6 meters is affected by operating costs that are increasing due to the loss of economies of scale at the same time that economies of scale and associated efficiencies are increasing for contestable meter providers. Further, the capital cost is reducing as there is no investment in new meters, a situation which is not representative of the overall meter market.

The number of meters replaced with advanced meters since implementation of Power of Choice is not immaterial. Over time, the balance between customers with type 5 and 6 meters and advanced meters will tip towards advanced meters and it will be less appropriate to link movements in prices to distributors' ACS revenue determinations. We suggest that:

- Metering costs are removed from the network component and presented as a separate component. Even if the AER does decide to use the X-factor in ACS metering prices as the basis for updating the 2020/21 DMO, keeping metering separate would reflect the changes that have occurred in the market that reduce networks' involvement in metering each year
- The AER consider other ways to estimate changes to metering costs.

#### Model annual usage determination

The AER's position is to use the same model usage and TOU period usage allocations that were used in 2019/20. Ausgrid agrees that the model usage remain unchanged for the Ausgrid distribution area for flat and controlled load tariffs as there has not been a material change to consumption levels for the relevant tariffs. In the absence of a compelling reason to change, consistency from year to year will assist customers to better understand prices in the market.

However, we do not agree with the time of TOU period usage allocations for Ausgrid's distribution area. This is because the peak allocation is materially higher than the actual average peak usage as shown in Table 1 below.

**Table 1: AER v Ausgrid 3 period<sup>6</sup> TOU allocations**

	AER <sup>7</sup>	Ausgrid actual
Peak %	31.9	14.5
Shoulder %	39.5	55.4
Off-peak %	28.6	30.1

<sup>6</sup> We are unable to comment on the 2-period and 4-period usage allocations as we do not have corresponding tariffs.

<sup>7</sup> AER, Final Determination – Default Market Offer Prices 2019-20, April 2019, p79.

The difference is likely due to the introduction of seasonal TOU in 2018/19 where there is no peak period for four months of the year. The AER allocations refer to data provided by ACIL Allen in its 2017 electricity benchmarks report, which was published prior to the introduction of seasonality in Ausgrid's TOU prices. There is a significant differential between the peak network price and the shoulder and off-peak network prices, which means that a DMO bill calculated using the proposed allocations would be much higher than a typical bill. This could result in retail prices that dilute network price signals as retailers might rebalance pricing in order to meet the DMO price, or to create a higher discount from the DMO reference bill.

### **Time of use and solar tariffs**

The Position Paper notes that the Commonwealth Government intends to extend the DMO price to residential customers with solar and TOU tariffs<sup>8</sup>. The AER's position is that the DMO prices for flat consumption are suitable for solar and TOU customers. Ausgrid makes two observations regarding this position:

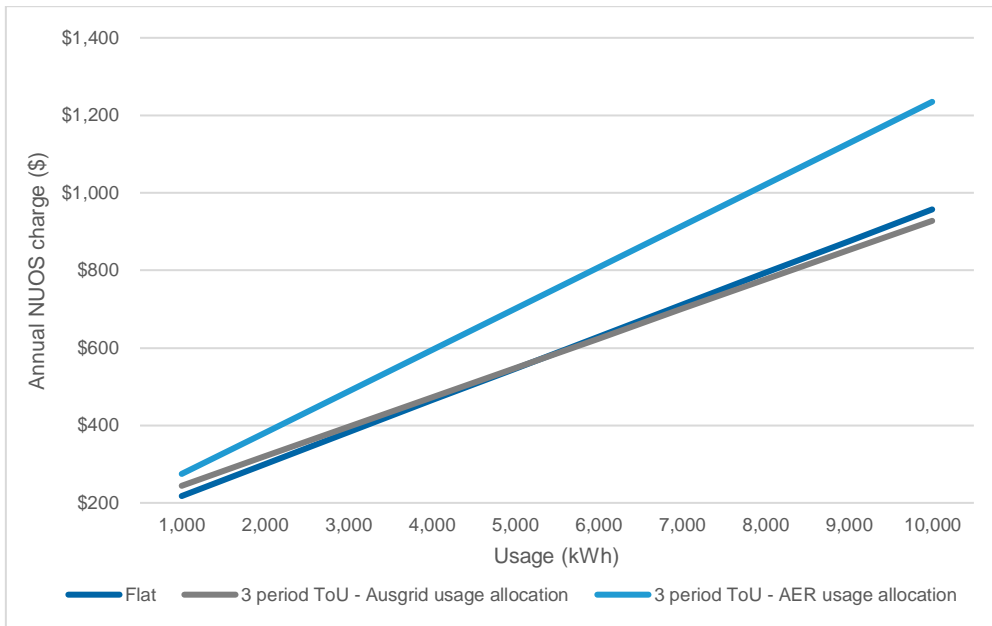
- The average annual consumption for customers on Ausgrid's TOU tariff EA025 in 2018/19 was c. 6,600 kWh (excluding controlled load consumption)
- The annual metering charge for customers on residential TOU tariffs in 2019/20 was approximately \$19 more than the metering charge for flat tariffs and the annual fixed network charge for customers on TOU tariffs in 2019/20 was approximately \$33 more than the fixed network charge for the flat residential tariff.

TOU tariffs are generally beneficial to larger users of electricity. The chart below shows the consumption level at which a customer is better off being on Ausgrid's TOU network tariff given the average Ausgrid TOU profile.

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<sup>8</sup> AER, Position Paper – Default Market Offer 2020-21, September 2019, p47.

**Figure 2: TOU NUOS bills at various consumption levels**



As the chart shows, the point at which a customer would be better off from a network point of view is over 5,000 kWh which is higher than the model annual usage of 3,900 kWh or 4,800 kWh when in conjunction with controlled load. This will make it difficult for retailers to produce standing offer TOU retail prices that both meet the DMO and continue to offer market prices lower than the DMO, while maintaining cost reflectivity to the underlying network tariff. We understand that retailers are not obliged to maintain cost reflectivity to the network tariff, but we don't believe regulation should preclude them from doing so. Note also that the current AER usage allocation produces network bills significantly higher at all levels of consumptions.

Ausgrid's view is that the characteristics of TOU customers are materially different enough to flat users to warrant a separate DMO. At the minimum, we recommend setting an alternative model usage (in addition to changing the usage allocations as discussed in the previous section). Ausgrid is willing to assist the AER with alternative usage levels for its TOU network tariff for the Ausgrid area.



A scenic landscape at sunset. A paved road curves through a wooded area. Large trees are silhouetted against the bright orange and yellow sky. A utility pole with power lines stands on the right side of the road. The overall mood is peaceful and serene.

**Thank you**

