Overview of our TSS Update

Purpose

The following information explains the rationale for changing our tariff strategy and provides a summary of updates to our Tariff Structure Statements (TSSs) being provided to the Australian Energy Regulator (AER) on 1 May 2019.

Our commitment to our customers

We collect regulated revenues, allowed by the AER, through our network tariffs. These revenues cover all operating and capital expenditure for the two companies. Energex and Ergon Energy are committed to doing this in a way that meets the expectations of customers and requirements of stakeholders, which includes government and regulators. Through ongoing consultation with our customers and stakeholders, we understand our tariffs need to:

- Be fair and equitable.
- Be simple and easy to understand.
- Be cost-reflective.
- Signal what the network businesses need to signal in order to keep future costs down.
- Take into account the attributes of various customer segments.
- Take into account the rapid growth of new technologies like solar, batteries and EVs.
- Pass on reductions arising from lower approved revenue amounts.
- Leave no-one behind.
- Meet regulatory rules.

Rationale for changing our tariff strategy

The energy market is rapidly changing. Energex and Ergon Energy are operating with significant challenges – high and increasing penetrations of solar PV, the emergence of battery energy storage systems and electrification of transport, changing customer preferences, declining energy consumption and reducing daytime peak demands.

Tariff reform is a critical element in addressing these challenges while continuing to deliver affordability and choice to customers.

The proposed tariffs aim to reduce cross-subsidies between customer classes, minimise uneconomic investment in solar PV and emerging technologies, contribute to an increase in network utilisation, and delay or defer network investment in augmentation, power quality and voltage management.

Tariff Strategy Principles

In response to these challenges, and in line with feedback from our customers, the following network tariff strategy principles underpin the development of our network tariffs:

- Effectively signal to customers the cost of providing network services.

- Signal an efficient adoption of Distributed Energy Resource (DER) [1] technologies, and encourage appropriate optimised use of that technology.
- Are as simple as possible in their structure, and resources and information are provided to improve understanding for customers and retailers.
- Are underpinned by data-driven decision making.
- Are underpinned by genuine stakeholder engagement.
- Have consideration for customer impacts in the pace and magnitude of change.
- Are flexible, innovative, and cognisant of the decisions made by other DNSPs.

Feedback on the TSSs

During stakeholder engagement in late 2018, we were asked to give further consideration to issues such as:

- The need to develop a default network tariff that is straightforward to assign to our customers and start the transition towards more cost reflective tariffs, especially for our basic meter customers.
- The challenges for retailers and customers in the initial selection of the optimal network access allowance band of the Lifestyle Package and the Small Business Package.
- Accommodating uncertainty around the pace and direction of change in the 2020-25 regulatory control period, including the level of DER adoption, how DER is likely to be utilised and the optimal price signals to be projecting.
- The drivers of network investment during and beyond the 2020-25 regulatory control period given the growth of DER.
- Managing tariff-induced network peak risks (i.e. shifting of the time and magnitude of network usage peaks) and optimising the peak window.

Following our consultations in 2018, and in response to customer and stakeholder feedback, we are considering new network tariff options for Standard Asset Customers (SAC)[2] to assist their transition to cost reflective tariffs.

In the Explanatory Notes accompanying the TSS submissions, these were positioned as 'intermediate' network tariffs and were presented as concepts, reflecting their emergence in the latter stages of the TSS consultation process.

New Default Network Tariff options

We recently explored two new potential default network tariff options (referred to as the intermediate tariff options). These tariffs emerged as 'stepping stones' towards cost reflectivity in response to stakeholder feedback and to better support and prepare our customers for a fast-changing environment.

In light of stakeholder feedback and our customer impact analysis, these initial concepts have evolved into new cost reflective tariff options for residential and small business customers which recognise greater customer access to digital meters. These tariffs are further detailed below.

Proposed Network Tariff for Existing Basic Meter and Existing Digital Meter Customers (Residential and Small Business Basic Tariffs)

Like the Ergon Energy legacy inclining block tariff, this proposed tariff comprises two parts: an access charge per day plus an inclining block volume charge per kWh, with blocks increasing in 10,000kWh per annum increments for our residential and 20,000kWh for our small business customers. It is proposed that the daily rate would be set comparable to the fixed daily charge of the Energex legacy default flat tariff (T8400 for residential and T8500 for small business customers). This approach would ensure that most residential and small business customers would not experience any significant bill impact when moved to this new tariff. It would also ensure that larger residential and small business customers with consumption higher than their respective first block would pay network charges that better reflect their network usage requirements. We believe this tariff structure offers a credible path toward a capacity based future and towards greater cost reflectivity.

[1] DER systems are small-scale power generation or storage technologies used to provide an alternative to or an enhancement of the traditional electric power system.
[2] SAC customers connected at the low voltage network as defined in our Annual Pricing Proposals

Network Tariffs for New Digital Meter Customers (Residential and Small Business Demand and Capacity Tariffs)

Network capacity tariffs are based on the premise that peak demand driving upstream network investment will progressively become a lesser issue and that exploring streamlined network capacity tariff options is a more appropriate approach.

The concept of capacity-based network tariffs is currently used for major customers and we propose to extend it to low voltage customers.

For customers with digital meters, we are proposing two network tariff options, being the residential and small business demand tariffs, and the residential and small business capacity tariffs.

The residential and small business demand tariff includes a fixed charge, two demand charges (measured in kW/month demand) for daytime (10am to 4pm) and for night time (4pm to 9pm) and a volume charge. It is proposed that the night time demand charge would be based on the maximum monthly half-hourly demand recorded within the evening window (4pm to 9pm) and the daytime demand charges would be based on maximum half-hourly monthly demand recorded within the period 10am to 4pm period during the billing month.

The residential and small business capacity tariffs include a fixed charge in $/day, which includes prepayment for a selected capacity level (or minimum demand), two demand charges in $/kW/month for day time and night time which apply to demand in excess of the selected capacity level, and a volume charge in $/kWh. Customers can exceed their capacity level on 3 separate days per month during the evening window (4pm to 9pm) or day time period (10am to 4pm) with no consequence. Customers who exceed their capacity level on more than 3 separate days per month will pay for the highest monthly day time and evening window exceedances of their capacity level at the day time demand rate or night time demand rate respectively. It is anticipated that demand charges for additional capacity use will apply infrequently if the selected capacity level is at least equal to 80% of the customer's maximum annual demand and Energex and Ergon Energy would assist retailers and customers in selecting the appropriate capacity level.

The residential and small business capacity tariffs are designed for simplicity and stability – if the capacity level is appropriate, then the tariff behaves like the familiar 'fixed plus flat' tariff. Controlled load (i.e. on a secondary circuit) is not counted towards the customer capacity.

Over the 2020-25 regulatory control period, we plan to further investigate with our customers and stakeholders various approaches to determine forward looking network capacity tariffs.

Tariff Choice: SAC Small - Residential and Small Business

Under the arrangements set out in the TSSs we submitted on 31 January 2019, existing customers would have had the option to remain on legacy network tariffs or opt-in to the proposed new tariffs.

Based on customer and stakeholder feedback received on 15 April 2019, we now propose the Residential Basic and Small Business Basic network tariffs to be the default for existing customers with basic or digital meters as of 1 July 2020.

We propose the Residential Demand and Small Business Demand tariff to be the default tariff for new residential and small business customers with digital meters after 1 July 2020 and for customers who upgrade – alter or add to – their metering due to a change at the premises, e.g. installation of Solar PV. New customers who are worse off financially on the Residential Demand or Small Business Demand tariff can opt back to the legacy Residential Flat or Small Business Flat (Energex) or Residential Inclining Block or Small Business Inclining Block Tariff (Ergon Energy). Existing customers with digital meters as of 1 July 2020 can opt in to the Residential Demand or Small Business Demand tariff.

The Residential Capacity and Small Business Capacity tariffs are proposed to be opt-in tariffs.

The Lifestyle Package and Small Business Package tariffs will no longer be offered for residential or small business customers.

Tariff Choice: SAC Large and CAC

Energex and Ergon Energy outlined two SAC Large Business Package tariffs and the Commercial Package for Connection Asset Customers (CACs) in their TSSs. These network tariffs required customers to choose a band in the case of SAC Large and nominate a demand based on their demand profile. As a result of customer and stakeholder feedback, we are no longer offering these Package network tariff options for business customers.

Energex and Ergon Energy are proposing to retain most of the remaining legacy tariffs for SAC Large and CAC customers, but are proposing to retire the Ergon Energy SAC Large and CAC Seasonal Time of Use Demand (STOUD) tariffs. The Ergon Energy SAC Large STOUD has been replaced with a Time of Use Demand tariff with an excess demand charging parameter to align with a similar tariff structure already offered by Energex for SAC Large.

The Time of Use Demand tariff will become the default tariff for all new SAC Large customers from 1 July 2020, with existing customers proposed to remain on their existing SAC Large tariffs unless they choose to opt in to the Time of Use Demand tariff.

Finally, Ergon Energy will be introducing transitional network time of use energy tariffs which match the structure of the retail transitional tariffs (there are a number of retail transitional tariffs which will become obsolete as of 1 July 2020). These transitional network tariffs will be offered only to those customers currently on transitional retail tariffs.

Enhanced Control Load Options

Currently, small business customers in both Energex and Ergon Energy can access load control network tariffs as secondary tariffs.

We are also exploring the extension of existing load control tariffs in particular to complement the proposed new default network tariffs. This recognises the value of load control capability in addressing a capacity driven network future. There may be an opportunity to create additional value for customers and an initiative to enable the networks to manage risks and avoid the need for additional network investment.

Based on customer feedback there is significant interest from a number of sectors at the SAC Large level to access an effective load control primary network tariff. Consultation feedback following the release of the TSS has indicated a preference amongst stakeholders that a SAC Large load control network tariff be offered as a broad-based tariff.

Such a tariff would be available to any SAC Large customer in accordance with its associated terms and conditions. This option is the subject of a separate Fact Sheet.

Proposed Changes to Residual Cost Recovery

The pricing principles in the National Electricity Rules provide that where tariffs based solely on Long Run Marginal Cost (LRMC) do not enable us to recover our efficient costs, we may structure our tariffs in order to recover our remaining 'residual' costs, but in a way that doesn't distort LRMC-based signals. To do this, residual costs are usually recovered through parameters that do not vary with network usage:

- Fixed charges, which are unlikely to send distortionary signals leading to inefficient customer response, but can result in adverse financial impacts for lower-consuming customers.

- Off-peak energy, demand or capacity charges, which have favourable distributional effects to the extent that off-peak energy consumption is correlated with customer size and financial resources, but which tend to inefficiently deter off-peak network usage and encourage customers inefficiently invest in DER to bypass the off-peak energy charge.

- Any time energy charges, which minimise distortion only if structured with LRMC signals in other components (i.e. if it is combined with a peak demand charge). With no LRMC signal complementing the any time energy charge, the tariff structure is likely to provide a distortionary price signal encouraging less use of the network with no corresponding reduction in network costs. If an LRMC signal is present, setting an any time energy charge too high may over-signal the LRMC and create distortion in peak period consumption (i.e. customers inefficiently avoid peak period consumption with the combination of the LRMC signal and the high any time energy charge).

In summary, tariff structures do require a fine balancing of charges so that prices can recover revenue allowances in the least distortionary way. Over-balancing recovery in tariff structures through any of the components can create distortionary signals and lead to inefficient customer response, resulting in suboptimal outcomes to some or all customers.

Energex and Ergon Energy are therefore giving consideration to methods for improving the way in which the suite of network tariffs, to be provided in their respective Revised TSS, handle the recovery of residual costs. To this end, we have:

- Proposed default Basic Tariffs with a wide inclining block tariff structure, in place of the current flat rate tariffs offered by Energex. The flat rate tariffs have a fixed charge that is applied uniformly to all customers irrespective of size and which recovers a significant component of residual revenues. This results in larger mass market customers bearing a disproportionately small amount of residual revenues, relative to smaller customers. Our proposed Basic Tariffs have a block size of 10,000 kWh, with block energy rates increasing accordingly in order to better allocate the residual revenue between smaller and larger customers. Customers consuming less than 10,000 kWh per annum will not experience an impact, other than a marginal reduction in the residual revenues allocated to be recovered from them.

- Continued to give consideration to the full or partial allocation of residual costs to Individually Calculated Customers in order to minimise the risk of stranded assets and to avoid higher network charges for other customers as a result of business shut downs or grid defection.

- Broadened the availability of load control tariffs, to soften the peak demand signal sent to customers in their primary tariff whilst appropriately shaping their load profile, to encourage efficient DER adoption and to appropriately allocate residual revenues.