31 July 2013

Mr Warwick Anderson
General Manager, Network Regulation
Australian Energy Regulator
GPO Box 3131
CANBERRA ACT 2601

Submitted by e-mail: SAelectricity2015@aer.gov.au

Dear Mr Anderson

**RE: QUEENSLAND AND SOUTH AUSTRALIA FRAMEWORK AND APPROACH FOR THE PERIOD 2015-2020**

Origin appreciates the opportunity to provide input to the Australian energy Regulator's (AER) consultation on the framework and approach to apply to Energex, Ergon and SA Power Networks ('the DNSPs') in the period 2015 to 2020.

*Classification of services - Metering services*

In Origin's view the most appropriate classification for metering services under the National Electricity Rules (NER) is alternative direct control rather than standard direct control. Adopting this classification in Queensland would require a change in the Framework and Approach, bringing Queensland into alignment with South Australia, the ACT, NSW and Victoria. Origin also supports a variation to the grouping of metering services in South Australia to align it with the AER's more recent decision in NSW.

Origin has long supported the unbundling of metering services as a means to encourage greater competition in the provision of these services. Spreading the cost of metering across all customers, as currently occurs in Queensland, reduces incentives for competition in metering. This is because customers who opt for a type 4 meter to replace their type 6 meter continue to pay the cost of type 6 meters, even though they are no longer receiving these services. In December 2012 the AER summarised the benefits of re-classifying metering services as alternative direct control, as part of determining the Framework and Approach for NSW distributors.[1]

[1] AER, *Classification of metering services in NSW Matters relevant to the framework and approach for NSW DNSPs 2014-19, Discussion paper*, December 2012, p.28



Origin Energy Limited ABN 30 000 051 696 • Level 45, Australia Square, 264-278 George Street Sydney NSW 2000
GPO Box 5376, Sydney NSW 2001 • Telephone (02) 8345 5000 • Facsimile (02) 9252 9244 • www.originenergy.com.au

Origin contends that on the basis of all the criteria under clause 6.2.2 of the NER, the alternative direct control classification is the most appropriate classification for metering services, with those criteria being:

> *(1) the potential for development of competition in the relevant market and how the classification might influence that potential;*
> *(2) the possible effects of the classification on administrative costs of the AER, the Distribution Network Service Provider and users or potential users;*
> *(3) the regulatory approach (if any) applicable to the relevant service immediately before the commencement of the distribution determination for which the classification is made;*
> *(4) the desirability of a consistent regulatory approach to similar services (both within and beyond the relevant jurisdiction); and*
> *(5) the extent the costs of providing the relevant service are directly attributable to the customer to whom the service is provided.*

With respect to criterion (1) Origin acknowledges that since the AER made its decision to classify metering services as alternative direct control services in South Australia there has been minimal development of competition in those services in that state. However, as acknowledged by the AEMC,[2] this has been in large part due to uncertainty about policies governing the roll out of smart meters. More recently there have been important developments in demand-side participation and policy. Through the launch of its Origin Smart portal in Victoria in August 2012 Origin became the first retailer in Australia to allow customers to monitor their energy use daily. The final recommendations from the Australian Energy Market Commission's (AEMC) *Power of Choice* review determined that future deployments of smart meter technology should occur within a competitive framework. In November 2012, the Australian Government announced it would develop a framework to promote the uptake of smart meters by small customers across the National Electricity Market. As a result, there is greater potential for competition in metering services in both South Australia and Queensland.

To Origin's knowledge the administrative costs of splitting out metering costs have not proven excessive for SA Power Networks or the AER and so are unlikely to be a concern in the case of Energex, which supports criterion (2). The cost to users is reduced by allowing those who opt for a type 4 meter to avoid paying for type 6 services. This improves transparency with respect to the cost of type 6 services, encouraging competition.

With respect to criterion (4), changing the classification of metering services in Queensland will better align arrangements across NEM jurisdictions. Metering charges are split out in South Australia, the ACT and Victoria, and will be split out in New South Wales as of the commencement of the next regulatory period.

[2] AEMC, Power of choice review draft report, Supplementary paper, *Principles for metering arrangements in the NEM to promote installation of DSP metering technology*, 6 September 2012, p. 4.

In South Australia the current classification makes a distinction between 'fixed' meter data services and 'variable' metering services, on the basis that the DNSP would incur the cost of meter data services independently of how many customers remained on the DNSP's meters. In Origin's view this distinction is ambiguous and creates the risk that DNSPs might seek to transfer more metering costs into the fixed category. Origin supports the AER's more recent finding with respect to NSW, whereby metering provision, maintenance, reading and data services are grouped together as alternative direct control services.

With respect to criterion (5), the cost of metering services is directly attributable to individual customers and the alternative direct control classification allows for costs to be attributed more accurately and cost-reflectively.

Origin believes re-classifying metering costs in Queensland as alternative direct control meets the criteria in the NER, and Origin supports a re-grouping of the services in South Australia to align with the approach in NSW.

*Form of control*

Origin supports a weighted average price cap (WAPC) as the most appropriate form of control for electricity DNSPs in the current environment.

Under a WAPC DNSPs carry volume risk, in a similar way to electricity retailers in the competitive market. This means that where volumes fall faster than forecast distributors have an incentive to cut back operational and capital expenditure at the margin to reflect this. Electricity consumption in the National Electricity Market has been falling for a number of years and there has been considerable uncertainty about the pace of this decline. In light of this there is benefit in a control mechanism that requires DNSPs to respond to changing conditions by adapting spending programmes and rebalancing tariffs during the course of the five year regulatory period.

Under a revenue cap revenues must be maintained at approved levels over the five year period even in the event that volumes fall faster than expected. As consumption falls average prices must increase to deliver approved revenues, potentially exacerbating the supply-side response and making it harder for networks to cover fixed costs. In an environment of falling consumption it seems advisable to keep distributor spending strongly linked to changes in end consumption. Under a revenue cap the distribution business has incentives to generate higher estimates of consumption and customer numbers, whereas under a WAPC the incentives are to generate higher forecasts of customer growth, lower forecasts of volume growth, and then to maximise throughput. In this way the balance of incentives under the WAPC are less weighted towards over-

capitalisation of the network, which should result in smaller increases in network prices over time.[3]

Origin recognises that DNSP costs are driven foremost by customer numbers rather than volumes, but in Origin's view changes in these two indicators are strongly aligned over the medium term.

When falls in volumes prove difficult to predict as has been the case in recent years, revenue caps can also lead to volatile prices with an upward bias, which can generate price shock. This is because when volumes fall faster than forecast under a revenue cap prices must increase each year to ensure that the distributor recovers its approved revenue, even if that revenue was linked to capital and operational expenditure programmes that may no longer be justified in light of falling volumes. In Origin's experience customers typically value stable and predictable price paths. Wide swings in prices also create problems for retailers since under current arrangements retailers do not get long enough to review network prices before they must apply them.

Origin understands that the AER recently reconsidered the cost and benefits of price caps relative to revenue caps and its initial findings were that price caps had not consistently delivered efficient pricing to the extent that could have been expected; indeed the AER found some evidence to suggest rebalancing within price caps may have allowed for inefficient pricing outcomes in some cases. In Origin's view the best way to deal with these problems is to address shortcomings in the rules governing pricing.

To the extent that the price cap allows distributors to set tariffs to earn windfall gains we believe this could be better managed through a tightening of the parameters that govern the formulation of tariffs by distribution businesses, specifically sections 6.18.3 to 6.18.6 of the National Electricity Rules (NER). Unlike in the retail market, in a monopoly framework no competitive tension exerts discipline over distributors' rebalancing activities and hence the rules must fulfil this function. Until the shortcomings in the rules can be addressed the AER could undertake to apply greater scrutiny to pricing proposals, particularly where DNSPs move customers from one tariff to another within the period. Origin does not believe that applying revenue caps is the best way to deal with shortcomings in the pricing rules framework.

Moving Energex to a WAPC would align it with approaches in South Australia, Victoria and New South Wales. Origin recommends the WAPC for SA Power Networks be maintained and that the current revenue cap in place for Energex be replaced with a WAPC.

[3] Origin notes that increase in prices under WAPC have been high in the current regulatory period, but this reflects shortcomings in the overall building block framework that the AER is now addressing.

*Application of schemes*

*Service Target Performance Incentive Scheme*

Origin supports schemes that incentivise DNSPs to meet and exceed service targets by linking revenue outcomes to the achievement of these targets. Origin understands that the AEMC anticipates that the Service Target Performance Incentive Scheme (STPIS) will play a larger role under the future National Framework for Network Reliability, which should see the cost of reliability better approximating its value to the end customer. Origin also supports the inclusion of some customer service metrics in the STPIS in addition to measuring time off supply, as distributors' also have customer facing functions. This should strengthen incentives to deliver effective customer service and align distribution businesses with the disciplines of the competitive retail market.

*Demand Management Incentive Scheme*

Origin supports measures that reduce the cost of networks by managing peak demand and understands that the Demand Management Incentive Scheme is likely to be the subject of a rule change flowing from the AEMC's *Power of Choice* review. As recognised in the Final Report of *Power of Choice* these changes will entail improvements to pricing principles to guide network tariff structures, to better reflect drivers of cost associated with demand-side participation.[4]

*Efficiency-benefit sharing scheme*

Origin supports the continued application of Efficiency-benefit sharing schemes to Energex and SA Power Networks, allowing the benefits of efficiency gains to stay with distributors beyond the end of the regulatory period and increasing the incentive to make savings in operating expenditure evenly throughout the period.

Should you have any questions in relation to this submission please contact me on (03) 9652 5555.

Yours sincerely

[SIGNED]

Steven Macmillan
Regulatory Manager

[4] AEMC, Power of choice review – Final Report, 30 November 2012, p.iii