13 February 2014

Mr Warwick Anderson
General Manager, Network Regulation
Australian Energy Regulator
GPO Box 3131
Canberra ACR 2601

[by email to QLDelectricity2015@aer.gov.au]

Dear Mr Anderson

RE: FRAMEWORK AND APPROACH FOR ENERGEX AND ERGON FOR PERIOD COMMENCING 1 JULY 2015

Origin appreciates the opportunity to comment on the Australian Energy Regulator's (AER) *Preliminary positions paper* covering the Framework and Approach for the Queensland distribution network service providers (DNSPs), Energex and Ergon, for the period commencing 1 July 2015.

As a leading electricity retailer in Queensland Origin has a strong interest in effective regulation of distribution services in that state.

Origin's primary interests with respect to the Framework and Approach relate to:

- The classification of large customer connection services;
- The classification of metering services;
- The choice of control mechanism and the approach to tariff reform.

1. <u>The classification of large customer connection services</u>

Origin supports the re-classification of large customer connection services as alternative control services, on the basis that new providers of large customer connections have entered the market and are performing some large customer connections in competition with distributors. The new classification will help to encourage greater transparency in pricing for these services and thereby, greater competition. We also agree that moving to a negotiated service arrangement is not desirable as long as Queensland DNSPs maintain sole responsibility for authorising prospective competitors to perform these connections.

2. <u>Classification of metering services</u>

Origin strongly supports the AER to re-classify metering services for type 5 and 6 meters as alternative direct control services. As outlined by the AER, this classification:

- Encourages greater competition in the provision of metering services by ensuring customers do not continue to pay for a type 5 or 6 meter they no longer use;
- Improves transparency in the cost of metering services, which also supports greater competition;

- Ensures customers with multiple meters are charged in a cost-reflective manner; and
- Support the recommendations of the Power of Choice review with respect to encouraging more competition in the provision in metering services and the move towards interval meters.

3. <u>Choice of control mechanism</u>

Origin acknowledges the AER's preference for revenue caps for electricity distribution services in the NEM. We have in the past outlined our concerns that revenue caps:

- provide little incentive for a DNSP to restrain its spending programme when growth in cost drivers such as peak demand and customer numbers fall short of forecast levels, and
- can lead to successive price hikes, because DNSP revenue is currently recovered primarily via volumetric tariff components (even though their costs are largely fixed) and volumes are falling.

For these reasons Origin has advocated for a weighted average price cap (WAPC), with separate amendments to the pricing principles to limit the scope for DNSPs to propose non-cost reflective pricing under the tariff basket framework. Origin acknowledges that the WAPC has not led DNSPs to increase the fixed component of their charges significantly. As an alternative, Origin's concerns with the revenue cap could be addressed through the following reforms:

- including a hybrid component, as examined by the AER in its *Preliminary positions paper*, whereby the revenue cap could be adjusted within the period in line with changes to key cost drivers such as customer numbers and peak demand when these fall below forecast levels;
- increasing the fixed component in network prices relative to volumetric components.

Taken together these reforms would help to limit the extent to which network prices must rise in order to allow distributors to recover fixed revenues as volumes fall.

4. <u>Approach to tariff reform</u>

Network tariffs in the NEM are typically heavily weighted towards volume-based components, even though generally at least 50 percent of DNSPs' costs are fixed independently of volume. While this was less of a concern in an environment of rising average household consumption, a number of factors including generous subsidies for solar and a drop-off in manufacturing load have put downward pressure on volumes, highlighting the inefficiency of current tariff structures.

As a result of these tariff inefficiencies customers with peakier demand but falling volumes are being cross-subsidised by customers with flatter loads in terms of network costs. (This intensifies the cross-subsidy that already occurs in relation to wholesale energy as a result of all customers on Type 6 metering paying based on the net system load profile.) Under-recovery from customers with peakier profiles requires further increase in network prices, which in turn builds the incentive for other customers to undertake measures to reduce their exposure to volumetric charges, perpetuating the cross-subsidy.

For these reasons Origin supports the AER's view, outlined in its *Preliminary positions paper* covering the Framework and Approach for SA Power Networks,[1] that a national reform to network tariff reform is required, in a coordinated manner. In Origin's view the most feasible way to address the problem in the near term is for DNSPs to increase the fixed component of their tariffs so they are more closely aligned with costs. Another benefit of decreasing the reliance on the variable component, as outlined under point 2 above, is that adjustments to prices required under a revenue cap would be more modest even in the event volumes continue to fall.

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[1] AER, Preliminary positions paper, Framework and Approach – SA Power Networks, December 2013, p.14

There are a number of mechanisms that could be applied to manage any disproportionate impact on smaller customers, including:

- Introducing a volume threshold below which the increase in the fixed component is more limited;
- Direct and transparent support measures for low income customers.

Origin acknowledges that, unlike in South Australia, there is nothing in the current Framework and Approach that precludes DNSPs from rebalancing further towards the fixed component in a measured fashion. In practice, however, and in light of the AER's shift in preference towards revenue caps, there may need to be further changes to the rules framework to increase the incentives for DNSPs to adopt more efficient tariffs. This work will fall to policy-makers and the Australian Energy Market's Commission (AEMC).

Dramatic rebalancing can create complications for retailers,[2] but this is largely because retailers currently get inadequate notice of finalised changes in distribution prices. Origin supports a rule change proposal put forward by the Independent Pricing and Regulatory Tribunal of New South Wales (IPART) which seeks to provide retailers earlier notice of changes.

Origin also supports the application of the Capital Expenditure Sharing Scheme and Service Target Performance Incentive Scheme, in the interest of improving service outcomes and value for money.

If you have any questions regarding this submission please contact Steven Macmillan in the first instance on (02) 9503 5005.

Yours sincerely,

Keith Robertson
Manager, Retail Regulatory Policy

[2] Envestra has in the past increased its fixed charge for residential gas distribution by more than 52 percent in one year