13 February 2014

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

[by email to SAelectricity2015@aer.gov.au]

Dear Mr Anderson

RE: FRAMEWORK AND APPROACH FOR SA POWER NETWORKS 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 SA Power Networks (SAPN) for the period commencing 1 July 2015.

As a leading electricity retailer in South Australia 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 metering services;
- The choice of control mechanism;
- The approach to tariff reform.

1. Classification of metering services

Origin strongly supports the AER continuing to classify metering services for type 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 who switch to a smart meter do not continue to pay for a type 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.

Origin also supports the provision of metering services being broken down in to a meter installation service and meter provision service, in the interests of transparent pricing.

Origin has some concerns that the AER is proposing to maintain Type 5 metering services as negotiated services. To our knowledge SAPN's charges for smart meters are among the highest in the NEM. While in principle the price of Type 4 meters should exercise some downward pressure on the price for Type 5 metering services this may not be effective in practice. In this context Origin notes the proposed policy of the South Australian Department for Manufacturing, Innovation, Trade, Resources and Energy (DMITRE) that Type 5 meters be installed as new and replacement meters. This would mean customers would need access to a ready market of Type 4 meters in order to avoid incurring this cost. This market is likely to develop but may not yet be sufficiently robust to deal with a change in policy such as that proposed by DMITRE. In the interests of consistency across jurisdictions and in light of the fact that Type 5 metering services can only be provided by distributors, Origin would propose that this service be re-classified as an alternative control service.

2. Choice of control mechanism

Origin acknowledges the AER's preference for moving towards 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 distribution network service provider (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 distributor revenue is currently recovered primarily via volumetric tariff components – even though their costs are largely fixed – and volumes are falling, so prices must increase significantly to ensure the approved revenue is recovered (the volume risk is carried by the customer).

For these reasons Origin has advocated for a weighted average price cap (WAPC), with separate amendments to limit the scope for DNSPs to propose non-cost reflective pricing under the tariff basket framework. However, 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 order to 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.

3. Approach to tariff reform

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. This was less of a concern in an environment of rising average household consumption. However, 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. (This intensifies the cross-subsidy that already occurs 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 reduce their exposure to volumetric charges, exacerbating the cross-subsidy.

For these reasons Origin supports the AER's view that a national reform to network tariff reform is required. In Origin's view the most feasible way to achieve this in the near term is to increase the fixed component so it is more closely aligned with the costs of DNSPs. Another benefit of decreasing the reliance on the variable component is that adjustments to prices required under the proposed revenue cap would be more modest even in the event volumes continue to fall.

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.

In light of Origin's support for increasing the fixed component of network charges, we strongly support the AER no longer applying the $10 cap on increases in fixed charges[1]. This limit appears arbitrary in terms of its quantum. Furthermore, while the apparent purpose of the $10 limit is to protect lower income customers, the current cross-subsidy to customers with peakier profiles is likely to be harmful to smaller customers, since many larger households with larger PV systems and more air conditioning capacity are currently underfunding network infrastructure compared to smaller users. The $10 limit is likely to constrain networks moving towards more efficient pricing structures and addressing this cross-subsidy. Rebalancing constraints that are proportionate to overall bill size are preferable and can help to reduce bill shock and maintain momentum towards tariff reform.

Origin also concurs with the finding of the Productivity Commission, as cited by the AER, that "support for low-income or disadvantaged consumers should be provided through targeted and transparent instruments".[2] An arbitrary annual limit on rebalancing towards more efficient tariff structures is unlikely to be the best way to provide targeted support for customers that have difficulty meeting their payment obligations.

Dramatic rebalancing can create complications for retailers,[3] but this largely because retailers currently get inadequate notice of 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. Lastly, if the AER has concerns with instability in prices due to rebalancing this is better addressed through percentage constraints on rebalancing than an arbitrary dollar figure.

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

[1] Clause 9.29.5(d) of the National Electricity Rules

[2] Productivity Commission, Electricity Network Regulatory Frameworks No. 62, 9 April 2013, as cited in AER, Preliminary position paper, Framework and Approach for SA Power Networks for the period commencing 1 July 2015, p.68

[3] Envestra at one point increased its fixed charge for residential gas distribution by more than 52 percent in one year