

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601



Att: Mr Warwick Anderson
General Manager, Network Regulation

Submitted electronically to SAelectricity2015@aer.gov.au

18th February 2014

Marjorie Black House
47 King William Road
Unley SA 5061

P. 08 8305 4222
F. 08 8272 9500
E. sacoss@sacoss.org.au
www.sacoss.org.au

ABN 93 197 662 296

**RE: Preliminary Positions Paper, Frameworks and approach
for SA Power Networks Regulatory control period commencing 1 July 2015**

Dear Mr Anderson,

Thank you for the opportunity to comment on the Approach Paper for your 2014 Retail Competition Review program and the workshop hosted by Mr Adam Petersen on January 22nd 2014.

As the peak body for the community services sector in South Australia, SACOSS has a long-standing interest in the delivery of essential services. Our research shows that the cost of basic necessities like electricity impacts greatly and disproportionately on vulnerable and disadvantaged people. Our advocacy is informed by our members; organisations and individuals who witness these impacts in our community.

In its most recent Residential Price Trends report¹, the AEMC projects that distribution charges will grow from 38% of the average bill in 2012-13 to 46% by the end of the current SAPN regulatory period in 2014/15. This element is the single largest component of residential bills and warrants significant attention.

Please find a detailed submission attached that responds to the questions posed in the Preliminary Positions Paper.

We thank you in advance for your consideration of our comments. If you have any questions relating to the above, please contact SACOSS Senior Policy Officer, Jo De Silva on 8305 4211 or via jo@sacoss.org.au.

Yours sincerely,

Ross Womersley
Executive Director

¹ AEMC 2013, Ref EPR0036 2013 Residential Electricity Price Trends, 13DEC2013.

SACOSS Submission to:

Preliminary Positions Paper, Frameworks and Approach for SA Power Networks Regulatory control period commencing 1 July 2015



Background

The AER is currently consulting on the Framework and Approach (F&A) it will take for SA Power Networks' (SAPN) 2015-20 Regulatory Period.

An AER workshop was held in Adelaide on January 22nd, 2014. SACOSS also met with SAPN on January 13th to discuss high level issues relevant to the F&A.

The Preliminary Positions Paper proposes a significant change in the form of regulation: from a Weighted Average Price Cap (WAPC) to a Revenue Cap. Combined with the 'Distribution Network Pricing Arrangements' Rule Change currently being progressed by the AEMC² and the introduction of 'smart meters', this change is expected to contribute to significant changes in the structure of network tariffs for South Australian households and small business.

SACOSS Responses

The SACOSS response to the Preliminary Positions Paper focusses on three main issues:

- The change in the form of control of standard control services to a revenue cap.

SACOSS can only support such a change on the basis that this reallocation of risk is adequately reflected in the Weighted Average Cost of Capital (WACC) set by the AER for the upcoming regulatory period.

- Metering issues.

SACOSS is of the view that the metering-related issue of most immediate importance to the consumers we represent is the issue of monthly billing based on actual meter reads – whether these be manual or remote reads. SACOSS is seeking an assurance from the AER that nothing in the F&A will add to or reinforce any barriers to achieving this.

SACOSS is also of the view that the NEM-wide approach to introducing smart(er) meters for small customers remains a deeply complex issue with persistent challenges for all stakeholders. SACOSS is concerned that the F&A, as one component of a number of interrelated processes, may introduce or reinforce barriers to the efficient introduction of smart(er) meters in South Australia.

- The continuation of a cap on annual changes to the fixed supply charge.

Marjorie Black House
47 King William Road
Unley SA 5061

P. 08 8305 4222
F. 08 8272 9500
E. sacoss@sacoss.org.au
www.sacoss.org.au

ABN 93 197 662 296

² AEMC 2013, <http://www.aemc.gov.au/Electricity/Rule-changes/Open/distribution-network-pricing-arrangements.html>.

The SACOSS position is that this side-constraint derogation should remain in its current form until a compelling case is made for its removal. At this stage there is no evidence that the constraint has interfered with past pricing proposals or is likely to do so in the near future. Further, it is highly unlikely that such a constraint will have any long term impact on the pursuit of efficient prices.

These key points are discussed in more detail in the following sections.

Price Cap vs. Revenue Cap

Consistent with their decision for the NSW Distribution Businesses, the AER is proposing to change the “form of control” applied to SAPN from the current ‘Weighted Average Price Cap’ (WAPC) to a Revenue Cap approach.

The AER’s approach is largely based on the form of control considered most likely to lead to “efficient pricing structures”. However, it is also clear that these somewhat elusive efficient prices (i.e. tariffs) are contingent on the implementation of other reforms such as those proposed in the ‘Distribution Network Pricing Arrangements’ rule change and the availability of the metering technology to support these tariff structures.

The key difference between these two forms of control is in relation to who bears the risk of changes in demand³. Under a WAPC, the business carries this risk – if sales are less than forecast (as has largely been the case in recent years) then they make less money, if sales increase they make more (and can keep it).

Under a Revenue Cap, the revenue received is largely independent of sales volume (with an ‘unders and overs’ account used to correct for year-on-year variations) and so the ‘volumetric risk’ as it is known, is transferred back to customers.

In order to maximise profits under a revenue cap, the business has an incentive to use tariffs to manage its costs – and since SAPN’s costs are largely related to summer peak demand, it makes sense for them to:

- Seek to have a revenue cap based on meeting demand forecasts that are as high as possible, and;
- Set tariffs that discourage the forecasts from being met.

The combined impact of moving to a revenue cap, greater emphasis on marginal cost pricing (the aim of the rule change) and the introduction of “smart meters” is likely to be extremely significant. The SACOSS submission to the AEMC on the rule change emphasised the need for better understanding of distributional impacts and this remains very much the case.

In summary, SACOSS recognises the rationale for pursuing more cost reflective pricing and the importance of a revenue cap in achieving this. However, the change to a revenue cap must also be seen as significantly de-risking the role of SAPN. SACOSS can only support such a change on the basis that this reallocation of risk is adequately reflected in the Weighted Average Cost of Capital (WACC) set by the AER for the upcoming regulatory period.

³ A useful summary is available here: www.oakleygreenwood.com.au/images/OGW_Network-Pricing-Under-a-Revenue-Cap_May13.pdf.

SACOSS notes that the December 2013 Rate of Return Guideline developed as part of the AER's Better Regulation Program contains a point estimate of the Market Risk Premium (MRP) of 6.5%, identical to that applying to SAPN in its current regulatory period.

Metering

SACOSS is of the view that the metering-related issue of most immediate importance to the consumers we represent is the issue of monthly billing based on actual meter reads – whether these be manual or remote reads. SACOSS is developing policy proposals to expand monthly meter reading to vulnerable consumers at little or no direct cost. We are seeking an assurance from the AER that nothing in the F&A will add to or reinforce any barriers to achieving this.

In the Preliminary Positions paper, the AER is proposing some changes to the way that *Type 6* metering is regulated. The changes proposed are relatively minor but draw attention to some broader metering issues for small customers that warrant a more detailed examination.

Type 6 is the standard household accumulation meter⁴. SACOSS notes that since the Preliminary Positions Paper was released, the South Australian Government released a Discussion Paper on a Policy for New and Replacement Meters (Jan 2014)⁵. A remotely read interval meter – the minimal features of a 'smart meter' (or more formally referred to as Advance Metering Infrastructure or AMI) - is classified as *Type 4*. It is SACOSS' understanding that the discussion paper proposes for new and replacement meters to be interval meters but manually read; *Type 5*.

We note that the Preliminary Positions Paper states (s1.3.3 p26) that SA Power Networks is the monopoly provider of *Type 5* and *6* meters (with reference to the National Electricity Rules clause 7.2.3(a)(2)). Further, *Type 5* metering services are currently classified as a negotiated service even though the service itself is not contestable – the rationale being that the service in effect 'competes' with *Type 4* (the provision of which is contestable). The AER is proposing to classify *Type 6* metering services as Alternative Control on the basis that the transparency of prices will "*enhance competition should contestability for these services change*" (s1.3.3 p29).

The Preliminary Positions Paper (s1.3.3 p31) refers to '*Non-standard type 6 import and export meters*' for solar photovoltaic (PV) installations. These meters are classified as a negotiated service however they are not contestable. SAPN has been the monopoly provider of some 150,000⁶ of these meters over recent years. SACOSS and others have observed that the price of meter replacement did not seem to reflect expected economies of scale and has only recently fallen to \$314.60⁷ from \$440 for the majority of these installations.

⁴ Meter Types are defined at Schedule 7.2 of the National Electricity Rules (Chapter 7 Metering) and are discussed in this context in the AEMC Power of Choice Review Supplementary Paper 6 Sep2012 "Principles for metering arrangements in the NEM to promote installations of DSP metering technology" available from <http://www.aemc.gov.au/market-reviews/completed/stage-3-demand-side-participation-review-facilitating-consumer-choices-and-energy-efficiency.html>.

⁵ Available from <http://www.sa.gov.au/topics/water-energy-and-environment/energy/energy-providers-and-bills/advanced-electricity-meters-consultation>.

⁶ Based on data for the number of installations from the Clean Energy Regulator.

⁷ GST incl. from SAPN Network Tariffs and Negotiated Services Manual.

SACOSS is of the view that this is a prima-facie challenge to the idea of ‘negotiated services’ where there is no contestability.

However, SACOSS also understands that the Standing Council on Energy and Resources (SCER) has submitted a rule change proposal to the AEMC in order to expand competition in metering and related services to all customers⁸. Brief discussions with the South Australian Department of Manufacturing, Innovation, Trade, Resources and Energy (DMITRE) indicate that the intent of the rule change would overcome some of the issues raised above. Our understanding is that the AEMC is still considering the request and has not indicated a likely timeline.

In principle, SACOSS is of the view that *Type 4* ‘smart meters’ for small customers offer a range of potential benefits and that such technology is inevitable. However, the costs of implementation should ideally not overwhelm these benefits for the consumers of most interest to SACOSS. In our view and given the overlapping processes and incompatible timing, the treatment of metering in the F&A must contain sufficient flexibility in order to, at the least, not add to or reinforce any barriers to an efficient, workable solution.

To reiterate, SACOSS is of the view that the metering-related issue of most immediate importance to the consumers we represent is the issue of monthly billing based on actual meter reads – whether these be manual or remote reads. SACOSS is seeking an assurance from the AER that nothing in the F&A will add to or reinforce any barriers to achieving this.

A note on Appendix C: Efficient Pricing

This appendix to the Preliminary Position paper considers efficient pricing structures and is used in the rationale for moving from a WAPC to a Revenue Cap – that is, efficient pricing structures have not emerged in SAPN’s pricing under a WAPC approach.

SACOSS considers that the arguments made in this appendix are quite weak and, in essence, constitute a review of the penetration of interval meters. The observations in relation to the availability of “efficient tariff” structures are in fact symptoms of the lack of suitable metering. The conclusion that there is causal relationship to the form of regulation is poorly developed.

The appendix states that (p86) that:

“Recent economic literature has measured losses in allocative efficiency from block tariff structures, finding that losses are often significant” and;

“... the economic literature provides that the equity benefits from block structure tariffs are often minor relative to efficiency detriments and other (non-price based) equity schemes.”

While both statements claim the “*economic literature*”, the footnotes in fact only refer to a single article in the *American Economic Journal: Economic Policy* by Borenstein. It is disingenuous to generalise the findings of this paper – essentially a case study of three Californian tariff structures from 2006 - to the inclining block tariffs developed by SAPN for

⁸ “Introducing a new framework in the National Electricity Rules that provides for increased competition in metering and related services” Rule change request October 2013 available from www.scer.gov.au/workstreams/energy-market-reform/demand-side-participation/smart-meters/

the South Australian context. Borenstein's findings hinge on estimates of marginal costs and price elasticities in California yet the Appendix makes no attempt to contrast these with local estimates.

The underlying driver of costs of the network supplying South Australia's small customers is undoubtedly that of meeting coincident peak demand during summer heat waves. In this respect the pricing approach taken by SAPN of inclining block tariffs is considered a reasonable attempt to provide efficient prices with the available metering.

Side Constraints

The Preliminary Positions Paper refers to the "jurisdictional derogation – side constraint to fixed supply charge for small customers" (s6.1 p67) and the provision in the rules for the AER to amend or remove the derogation.

The constraint is set at a maximum of \$10. The SAPN Supply charge (including metering charges and GST) is set at \$0.399 per day (\$145.80 pa)

The AER's preliminary position is that, "*.. a national approach to pricing structures should be adopted rather than a jurisdictional specific requirement that may inhibit adjustment towards more efficient pricing.*" (s6.1.1 p67)

The AER also provides a quote from the Productivity Commission that suggests that such constraints interfere with efficient pricing.

As outlined in the SACOSS submission to the AEMC on the issues paper for the Distribution Pricing rule change, there is a need for much better understanding of the distributional impacts of major changes to tariff structures. The submission to the Rule Change issues paper by the Energy Networks Association (ENA) refer to side constraints as "*... effectively a brake on annual price changes ...*" and SACOSS would agree but would however consider this to be a good outcome for consumers. The National Electricity Objective (NEO) is framed in terms of the pursuit of the long term interests of consumers. The strongest argument for side constraints is the avoidance of bill shock. In the long term, as required by the NEO, efficient prices will still emerge regardless of the side constraint. Such a constraint will only impact the time taken. In the absence of a clear understanding of the distributional impacts of these changes it will remain critical that these changes only continue at a pace that the community can reasonably absorb. Given the lack of impact on the 'long term' this position appears entirely consistent with the NEO.

Further, as discussed in the Preliminary Positions Paper, SAPN have been trialling capacity based tariffs and SACOSS would consider this to be indicative of the future direction of tariffs for South Australia's small customers. Such an approach should not be impacted by the continuation of the side constraint.

The SACOSS position is that the derogation should remain in its current form until a compelling case is made for its removal. At this stage there is no evidence that the constraint has interfered with past pricing proposals or is likely to do so in the near future. Further, it is highly unlikely that such a constraint will have any long term impact on the pursuit of efficient prices.