

30 May 2007

By email: MCEMarketReform@industry.gov.au

Manager, MCE Secretariat
Department of Industry, Tourism and Resources
GPO Box 9839
CANBERRA ACT 2601

Dear MCE Secretariat

Economic Regulatory Package – National Electricity Rules distribution revenue and pricing rules

The Consumer Action Law Centre, the Consumer Utilities Advocacy Centre and the Society of St Vincent de Paul Victoria welcome the opportunity to comment on the exposure draft of the *National Electricity (Economic Regulation of Distribution Services) Amendment Rule 2007* (the **Draft Rule**), the related explanatory memorandum and the two NERA Economic Consulting publications, *Distribution Pricing Rule Framework* and *Distribution Rules Review – Network Incentives of Demand Side Response and Distributed Generation*, released by the Ministerial Council on Energy (MCE) Standing Committee of Officials (SCO) on 13 April 2007.

1 Executive summary

We note that the effective regulation of distribution network service providers (DNSPs) plays an important public interest role. Up to 50 per cent of the final electricity bill for residential consumers is derived from the revenue of regulated distribution services, and the prices and tariffs set by DNSPs significantly impact consumers. Considering that continued access to affordable electricity is fundamental to health and wellbeing, we are concerned to ensure that regulatory determination processes deliver monopoly DNSPs sufficient revenue for the efficient provision of services only, as well as ensuring that that revenue is recovered equitably across the customer base.

In light of these concerns, we have reservations about the content of the draft rules, and particularly that the draft rules appear to limit the ability of the Australian Energy Regulator (AER) to deliver efficient and equitable outcomes for the market and for consumers. We are concerned that by being overly prescriptive, the rules may lock in the AER to processes and

practices that are either unworkable, cumbersome to change and/or not in the interest of the market and consumers. Accordingly, we would recommend the rules focus on detailing high level principles that ensure the AER has the flexibility to evolve regulation as required by market conditions and is guided by representative consultative processes that ensure all market participants have the ability to engage with regulation.

2 Draft Rule

2.1 Classification of distribution services

The Draft Rule proposes that the AER classify distribution services as direct control services or negotiated distribution services (and, if neither of those apply, as unregulated services by default), using a principles-based approach. While we recognise that the Expert Panel on Energy Access Pricing recommended a principles-based approach to the form of regulation on the basis of the relationship between efficient outcomes and market power, we are not convinced that the approach of the Draft Rule will bring about efficient outcomes.

We agree that direct price or revenue controls should apply to services under conditions of natural monopoly and substantial market power, and that the form of regulation factors in section 2E of the draft NEL are appropriate to determine whether such services should be subject to direct control regulation. We further note that clause 6.2.1(b) of the Draft Rule states that in classifying a distribution service, the AER must have regard to the form of regulation factors in the NEL, the form of regulation already applicable, the need for consistency in the form of regulation for similar services and any other factor the AER considers relevant.

We are concerned, however, that this approach serves to create, rather than reduce, uncertainty, particularly between price determinations. This uncertainty may lead to poor planning and investment decisions by DNSPs, and impinge upon efficiency. It also creates confusion for consumers, who may be uncertain about how services are to be regulated.

The notion (outlined in 6.2.2.(b)) that the regulator is required to assess the potential competitiveness of each service for each price review strikes us as unworkable in practice, as well as providing unnecessary incentives for businesses to argue the issue on the off chance they may win. Our experience – particularly in rural and regional areas – has been that the potential competitiveness of most services provided by a DNSP is limited. Even where customers are able to seek tenders, the DNSP remains a vital element in the equation, providing information and access to its network. It is not uncommon for consumers to be told that for jobs under \$30,000, local contractors simply won't bother to tender, as they cannot compete on an equal footing.

Similar issues occur where there is inconsistency between jurisdictions on what has previously been defined as a regulated service. While we agree that it is impractical to list excluded services in the initial Rules, we remain unconvinced that the proposed approach will elicit the intended outcome.

As such, we cannot support the Draft Rule requiring the AER to undertake such a cumbersome process – potentially for each price determination – and would recommend that a more effective and efficient methodology be identified. It would seem far more appropriate

for the AER (or AEMC) to determine distribution service classification up-front, for all DNSPs, rather than it being part of a revenue and pricing determination. We note that the services typically provided by DNSPs are fairly uniform.¹ We would also recommend that the AER (or AEMC) consult closely with stakeholders in this exercise.

Exacerbating the impact of this uncertainty is the fact that any amendment to the Rules, which would be required so that regulation adapts to an evolving market, must be subject to the cumbersome rule-change process. This will ultimately impact negatively on all customers and potentially the DNSP's themselves. It would be in the interest of market efficiency if the Rules contained high level principles only from which the regulator could develop the appropriate controls and regulations as required. Restricting the AER to the classification of services as part of the distribution determination only is overly prescriptive and potentially counter-productive.

We note that clause 6.2.8 of the Draft Rule allows the AER to issue public guidelines as to the classification of distribution services. In our view, it makes sense for such guidelines to be mandatory and binding as to the classification of distributions services. This should improve certainty, and therefore efficiency, in the new distribution framework.

We have similar concerns about the division between standard control services (building block method) and alternative control services, once a decision has been made to classify services as direct control services.

2.2 Control mechanism for standard control services

The Draft Rule provides the AER with discretion as to the form of price control, having regard to the factors listed in clause 6.2.5(c). We do not have a fixed opinion about whether price caps or revenue caps are the most appropriate control mechanism for the regulation of distribution use of system (**DUOS**) services. We note that the type of control mechanism is related to the pricing rules discussed further below, and should not be looked at in isolation. Despite this, it is our view that the AER should have the specific role in assessing which is the appropriate form of control mechanism, and that this should not be left to the discretion of the DNSPs.

2.3 Weighted average cost of capital (**WACC**)

We understand the need to balance the benefits from certainty in codification of WACC parameters, the need for regulatory discretion, and the need for transitional arrangements. Overall, we think the Draft Rule has achieved this balance by giving discretion to the AER in setting WACC parameters until such time as a review can be undertaken, at which time the AER may adopt values, methods or credit rating levels for DNSPs generally (the Draft Rule states this should be by 1 July 2009). We agree that undertaking a review that will apply such values across DNSPs generally should reduce costly reviews and debate at each distribution determination. However, we are concerned about a timing implication related to this approach.

¹ Australian Energy Regulator, *Review of Services provided by Distribution Network Service Providers*, November 2006.

Fixing WACC parameters over a long period of time may hinder the ability of the WACC to reflect market dynamics and realities, which could lead to DNSPs over-recovering to the detriment of consumers. It is our view that, considering distribution costs make up 40-50 per cent of a consumer's final bill, the economic regulation of distribution should be able to respond to short term and mild cyclic fluctuations in business conditions, interest rates and economic activity. Recognising the cost (and hassle) savings that might be gained in setting the WACC generally to apply over 5 year periods, we are concerned that WACC parameters set in 2009 might apply to a DNSP whose revenue reset is to apply from 2013 – 2018. Values that may have been appropriate for a five-year period from 2009 may not be appropriate in 2018. The problem may be exacerbated if the regulator estimates conservative WACC parameters to compensate for future uncertainty. We do not believe that change to the date of the proposed AER review of WACC parameters will address this problem, and request that the SCO reconsider this matter.

2.4 Treatment of expenditure forecasts

We note that the Draft Rule has adopted the same decision rule in relation to expenditure forecasts that the Australian Energy Market Commission (AEMC) adopted in relation to its recent review of transmission revenue regulation. We support this reformulated rule, noting the significant debate surrounding previous versions of the rule. The Draft Rule should not unduly limit the AER's discretion and we will be closely watching how this decision rule operates in practice, especially in relation to the AER's current reviews of transmission revenue of Victorian transmission businesses SPI AusNet and VenCorp.

2.5 Reopening provision

We strongly support the exclusion of a general reopening provision from the Draft Rule. It is our view that DNSPs should be required to maintain their costs within any revenue determination over the length of the regulatory period. Exclusion of a re-opening provision should encourage DNSPs to improve long-term planning and investment decisions, as well as promote certainty in price outcomes for consumers.

2.6 Service target performance incentive scheme

The impact of reliability and quality problems is very different between transmission and distribution, and therefore requires more stringent regulation of electricity distribution to protect consumers, recognising the detriment to consumers and communities from poor reliability and quality. Apart from the inconvenience caused to households and individual businesses by blackouts and damaged appliances, outages and voltage variation impose very real restrictions on a community's economic growth, by limiting their capacity to attract new investment into regional areas, and reduce their competitiveness. These problems are particularly acute for rural and regional communities.

An important and welcome development in the Victorian regulatory framework has been an increased emphasis on developing the right service incentives to drive improved performance, as well as setting service standards that enable the regulator to monitor service levels across the state, including to the worst-served areas. We have strongly supported such schemes which operate in the Victorian framework, including the S-factor

scheme which provides rewards and penalties for any improvements or shortfalls in service performance outcomes through changes to the distributor's allowed revenue.

We are concerned that the Draft Rules conflates those two objectives into one, and that the AER is not provided with sufficient guidance to identify what are the objectives and intended outcomes for this regulatory function.

We are particularly concerned that clause 6.6.2.(f), outlining the procedures for amending service targets/standards, in fact will disadvantage poorly served consumers and communities further, by reducing the capacity of the regulator to respond in a timely fashion to areas of poor service. While we acknowledge that processes must be followed, we fail to see what possible benefits such a cumbersome and drawn-out process offers, to customers in particular, but also to the regulator and the DNSPs.

We also strongly believe that an effective incentive scheme must include a system of guaranteed service level payments to help bring about improvements in those areas that are currently worst served, and to provide some redress to consumers for the inconvenience caused to them. We note that clause 6.6.2 of the Draft Rule talks about 'an incentive scheme' (the singular); we hope that this would not prevent the AER from establishing a GSL scheme in addition to a general service incentive scheme.

In summary, we believe that the framework outlined in the Draft Rules mean that Victorian consumers, particularly those outside metropolitan areas, will in effect be worse off using this approach. As such, we cannot support the approach outlined in clause 6.6.2, and would strongly recommend that this section of the Draft Rules be revisited, to produce a service incentive scheme that is practicable, and produces real service improvements to consumers.

2.7 Distribution consultation procedures

We support the need for the AER to consult with stakeholders in making its decisions. We are concerned, however, that the level of prescription laid out in the Draft Rules may have the unintended effect of restricting consultation, including to those stakeholders who should be most closely consulted. While we acknowledge the need for a timely and efficient decision-making process, we would remind the SCO that consumer stakeholders, particularly in rural and regional areas, often find it difficult to participate in regulatory decisions. The timelines outlined in clause 6.16 are so rigid they will, inevitably, exclude consumer groups, and the benefit of such a level of prescription (outside of the distribution businesses) is difficult to perceive.

It should be noted that requiring one consultation process for all issues unwittingly locks in the AER to consultation that may not be appropriate. Depending on the scope and scale of an issue, it would be in the interest of the AER to use its discretion and engage in the appropriate consultation process. While we do not doubt the ability of the AER to consult effectively, our concern is that overly prescriptive rules, over time, may have the effect of restricting the AER and undermining its ability to function.

We would recommend the adoption of high-level principles that encourage the AER to consult effectively with stakeholders, but can take the time the process demands. The current text in the Draft Rules encourages the AER to use that as the minimum process for

stakeholder consultation, rather than facilitating the right forms of consultation for the processes, and ensuring that the AER is required to consult actively and widely. The Victorian experience in recent years, where much more attention was paid to contacting rural and regional consumers, produced a much higher level of participation in the last Electricity Distribution Price Review.

We believe that the AER should be doing more in establishing consumer consultation procedures as a matter of course. For example, it is our view that the AER should establish as a priority a consumer consultative committee. Although the AER's current activities are limited to upstream aspects of energy regulation, with the enacting of the amendments to the NEL and the Draft Rule, the AER is now obtaining responsibility for activities much closer to consumers. These will be expanded with the further amendment package currently being prepared in relation to retail and non-economic distribution related functions of the national energy market. We note that the AER has been visiting the consultative committees of the jurisdictional regulators, as well as using the National Consumers Roundtable on Energy. While we support this, we think it is incumbent on AER to establish its own standing consultative mechanisms. Effective consumer consultation will ensure that the decisions of the AER will be more robust and more likely to be accepted by stakeholders.

2.8 Distribution pricing rules

(a) Pricing principles

Another significant concern with the Draft Rule relates to the pricing rules in clause 6.18. The Draft Rule follows the transmission pricing rule developed by the AEMC which adopted a principle-based approach to the pricing rules. This approach eliminates the need for the rules to contain prescriptive cost allocation methodologies. We are concerned that this approach significantly weakens the regulatory protections for end-users.

At the outset, we note that there is no definition of 'tariff' in the Draft Rules. It is our view that tariff should be clearly defined to include all parameters of a network charge, including fixed and variable charges.

The structure of network tariffs plays an extremely important role in how consumers across the network are charged. While the pricing rules do not constrain overall revenues and profits earned by a DNSP, they do constrain the shares of those revenues to be recovered from different customers or groups of customers.² We are principally concerned about the lack of principles ensuring equity in the rule and the consequent ability of network businesses to have significant discretion in how they set charges. In our view, prices should reflect no more or less than the totality of costs incurred on behalf of customers, there should be an ability to maintain government policies around geographic averaging of distribution tariffs, and there should be a defined and tangible role for the AER to assess whether proposed tariffs are efficient and equitable.

² While we note that the decision as to whether or not customers are actually presented with the prices charged by DNSPs is made by retailers, with the current push for deregulated retail pricing, we are concerned that consumers will increasingly feel changes in prices charged by DNSPs.

According to the NERA Economic Consulting paper, *Distribution Pricing Rule Framework*, the pricing rule responds to three objectives:

- to ensure that revenues earned from each customer or group of customers are set by reference to the efficient costs incurred in serving that customer or group of customers (objective 1);
- ensure that the structure of individual tariff elements is consistent with economic efficiency (objective 2); and
- provide a regulatory rule and compliance framework that involves incentives and compliance costs that are commensurate with the benefits (costs) of achieving (not achieving) objectives 1 and 2 (objective 3).

While we are generally supportive of these objectives, we are concerned with the ability of tariffs to impact specific customer classes inequitably while achieving these objectives. While we acknowledge NERA Economic Consulting's statement that these principles can accommodate geographic tariff averaging (with some derogations), we see a need to ensure that tariff differentiation won't mean that electricity prices become unaffordable for consumers living in particular areas. We note that many consumers (both households and businesses, particularly rural) make decisions about where to live based on existing cost structures. It is our view that Governments should still have a role to play in ensuring pricing principles relating to economic efficiency do not prevent other measures to ensure affordability across networks.

We are also concerned about the ability of the Draft Rule to satisfy the objective in relation to compliance. We note that in the Essential Services Commission's (ESC) electricity price determination for 2006 – 2011, it required DNSPs to issue a tariff strategy report in addition to annual tariff reports. The tariff strategy reports were to set out DNSPs' overarching tariff strategy, specifying the underlying methodology used to formulate that strategy. Further, annual tariff reports should be consistent with DNSPs' tariff strategies. The ESC argued that this approach should improve transparency and accountability, by enabling consumers to understand what changes DNSPs proposed to make to tariffs and tariff structures and why they were intending to make those changes. Despite this, the tariff strategy reports that were submitted by the DNSPs were insufficient to help distributors and retailers comprehend the DNSPs' intentions for tariff movement.³ The ESC particularly criticised the poor information on the costs that were underpinning tariff decisions. The ESC required DNSPs to resubmit their tariff reports, but even in the revised reports:

there was still insufficient information provided for stakeholders to understand why current tariff structures were or were not providing efficient pricing signals and the changes to tariffs required to ensure these price signals were provided.⁴

We find this troublesome, and indicative of an ineffective regulatory system. Considering the important public interest in ensuring efficient pricing signals and for customers not to be charged more than the costs incurred on their behalf, we believe there should be greater regulatory control over pricing. While we are not against the tariff strategy reports per se (indeed, poor tariff strategy reports enabled consumer representatives to further understand

³ Essential Services Commission, *Comparative Report on the Distributors' Reporting Requirements, Tariff Strategy Reports 2006-2010, Annual Network Tariff Reports 2006* (September 2006).

⁴ Essential Services Commission, *Comparative Report on the Distributors' Tariff Strategy Reports 2006-2010* (March 2007).

why the tariff information provided was insufficient), the lack of transparency and accountability in the current regime needs to be addressed for consumers to have confidence in the regulation of distribution pricing and ultimately confidence in their consumption choices.

The significant information asymmetries that exist between DNSP's and the regulator mean that the AER is unlikely to be able to accurately measure and enforce the costs and benefits of objective 1 and 2 as stated above. The impact of cost/benefit ambiguity and the relative simplicity of cost reflective tariffs and economic efficiency mean the latter objective is likely to be systematically de-prioritised.

In the Victorian context, rural customers in particular, already disadvantaged by a lack of transparency in determining network connection costs, are likely to suffer from network tariffs that aim to recoup the value of specific assets off the customers served by that asset alone. For example, given the lack of customer density in rural settings, many commercial decisions are highly sensitive to the cost of securing reliable power. Framing the value of a network asset by its ability to generate its own revenue ignores the downstream value of that asset and how the value of the network asset may change over time, subsequent to its implementation. In essence, prioritising network investment according to the immediate value that asset will be able to recoup, limits economic growth of dependant assets around 'efficient' network investment so that the network is served by customers as opposed to customers being served by the network.

We do note that clause 6.18.7 of the Draft Rule proposes requirements around regulatory compliance with pricing principles that are similar to the transmission pricing rule. Under the Draft Rule, DNSPs must submit a pricing proposal and if it does not conform to the Draft Rule, the AER can require it to be re-submitted. We strongly support this approach. The transmission pricing rule, in addition to this, however, requires the regulator to publish pricing methodology guidelines and allows for public submissions to be made in response to a pricing proposal. These requirements do not appear to be replicated in the Draft Rule. NERA Economic Consulting's paper argues that the characteristics of the distribution network make cost allocations a difficult and cumbersome task for a regulator. While this may be true, DNSPs will still have to undertake internal cost allocations so as to comply with the pricing principles. It is our view that the regulator should have a more active role in overseeing the adequacy of these cost allocations, and for the relevant information to be made public. Indeed, such transparent and accountable processes are essential to ensure the integrity of the regulatory system.

(b) Side constraints

We strongly support the proposed clause 6.18.6 of the Draft Rule in relation to side constraints on tariffs. It is our view that such a constraint on price variation can limit rapid rises applying to particular tariffs and particular customer classes of customers. Rapid price increases can significantly disadvantage many consumers, who are often juggling increasing prices for a range of household goods and services.

We are concerned, however, that the side constraints will only operate to reduce price shock between years within a regulatory period. Clause 6.18.6(b) is framed so as the limit of CPI-X+2% is not to apply in the years between the final year of a regulatory period, and the first

year of the ensuing regulatory period. We note the current Victorian regime applies side-constraints in these years. It is our view that limiting side-constraints in this fashion is nonsensical, effectively allowing potentially significant price shocks at the beginning of a regulatory period. The policy principle underlying side constraints is to mitigate short-term price shocks for consumers and to encourage DNSPs to plan their tariff strategies effectively. Without the side constraints applying between regulatory periods, consumers will be subject to potentially high price rises in the first year of a regulatory period.

We also note that the proposed additional side constraint of 3.5% to apply to parameters within a tariff class has been abolished in the Draft Rule. The reason for this exclusion is not made explicit in the consultation documents and we believe the additional side constraint can ensure that DNSPs do not unfairly modify parameters within a tariff class over the regulatory period. Recent research commissioned by the Consumer Utilities Advocacy Centre highlights the inequities that can occur within tariff classes when parameters (ie, fixed versus usage components) are varied significantly.⁵ We would welcome this exclusion being revisited.

We do note, additionally, that the proposed side constraint rules do not take account for current cost allocations and whether current tariffs are equitable or efficient. The rule presupposes that tariffs are balanced to begin with. In particular, we are concerned that tariffs that currently have high fixed charges will be perpetuated, even where this is inefficient or inequitable. In our view, the AER should be given some role in determining whether current tariffs are efficient and equitable.

We are also concerned about the imposition of new tariffs and the role of side constraints, particularly in relation to the roll out of interval meters. We are concerned that reassignment of customers to new tariffs is effectively a way to evade the imposition of side constraints. For example, in AGL's tariff strategy report, it proposed phasing out a number of tariffs with current customer being reassigned to a time-of-use tariff. As noted by St Vincent de Paul in their submission to AGL, placing dual fuel customers on a time-of-use tariff would require these households to shift current electricity consumption into the off-peak rate, if they were to maintain the same or similar overall electricity costs. Such load shifting is extremely difficult for dual fuel households, who do not have capacity to shift load (as they already use gas for space and water heating), and will result in increased overall prices for them.⁶ It is even arguable that such a time of use tariff promotes the installation of electric storage space and water heating, which is contrary to other policy drivers around carbon emissions.

We note that the NERA Economic Consulting report suggests that new tariffs should be assigned an existing 'parent' or 'origin' tariff for the purposes of side-constraints. This suggestion does not appear to have been adopted in the Draft Rule. We would strongly support such a rule being included so as to

Finally, we note that clause 6.18.6(c)(3) of the Draft Rule states that the side-constraint does not prevent price differentials resulting from the installation of remotely read interval metering or of other similar metering technology. We are not entirely sure what is the meaning or intention of this clause. It is not clear what is meant by 'price differentials' (undefined) in a

⁵ firstprinciples Pty Ltd, *Consumer Welfare Implications of the Gas Distribution Tariff Structures in Victoria*, prepared for the Consumer Utilities Advocacy Centre (March 2007).

⁶ Society of St Vincent de Paul Victoria, *Comment on the AGL Strategy Report 2006-2010*.

clause that applies to 'tariff classes' (defined). It is also unclear what is meant by 'installation'. We note that 'innovative' tariffs which may be used in conjunction with interval metering technology don't arise merely because of 'installation' of the technology. It is the use of such technology that can bring about innovative tariff structures, not merely the installation. If the clause is intended to allow the side-constraint rule to be evaded where such technology is installed, we would not support its inclusion. We believe that the side-constraint rules should apply equitably across all tariff classes, and consumers should not be discriminated against merely because a particular type of technology has been installed.

2.9 Schedule 6.2 – Regulatory Asset Base

We have concerns over Schedule 6.2 of the Draft Rule regarding ways in which the value of a regulated asset base can be amended. Specifically, it appears that the Draft Rule opens the door for assets not previously accounted for to be revisited and included in a revised asset valuation. Paragraph (e)(8)(ii) states summarily that the value of the asset base may be increased by the inclusion of past capital expenditure that has not been included in that value, but only to the extent that such past capital expenditure:

- relates to a standard control service;
- is considered to be reasonably required by the AER to achieve capex objectives;
- is allocated to the standard control services in accordance with principles and policies set out; and
- *has not otherwise been recovered.*

We do not see that assets not previously recovered should be included as part of any adjustment process. It can be assumed that any asset not previously recovered was either unaccounted for by the DNSP, unknown by the DNSP, not considered significant enough to be recovered and/or subsequently, not relevant to the operation of the DNSPs business. Accordingly, the Draft Rule appears to open the door for gaming on behalf of the DNSPs with subsequent inflated asset price risk and flow on price impacts to consumers.

3 Demand Side Response (DSR) and Distributed Generation (DG)

The following is an outline of concerns about NERA Economic Consulting's review of network incentives for DG and DSR. We have used the recommendations arising out of the NERA paper to guide our discussion. Our comments follow each italicised recommendation.

- *The rules should require that, once appropriate form of regulation is determined for domestic distribution use of system charges, DNSPs should be required to allow such customers to install and use PV on the basis of the same usage and capacity tariff elements applying to equivalent sized load.*

Firstly, the rules should refer to DG, not just PV. Secondly, it is not clear if this recommendation means customers will be charged for using DG as though it were a load or if it means customers can recoup the value of their generation equal to the cost of supplying an equivalent load. We would support DG installations to be able to recoup value for generation, at least equal to the cost of operating an equivalent load, but not limited to the cost of operating an equivalent load.

- *Revenue rule approach to WACC determination should avoid creating systematic upward or downward bias. Potentially:*
 - *allowing the AER to include a capital expenditure efficiency mechanism in the building blocks control setting method; and*
 - *requiring the AER to consult on the potential DSR and DG incentive implications of any proposed operating or capital expenditure efficiency mechanism.*

We would support consultation on potential DSR and DG incentive implications and would recommend such consultation be with stakeholders representative of all market participants.

- *The distribution revenue rule should require the opex and capex assessment that require the AER to be satisfied the forecast expenditure reasonably reflects efficient non-network alternatives available to DNSP.*

We support any requirements that forecast expenditure reasonably reflect efficient non-network alternatives available to DNSPs. However given the difficulty of assessing the efficiency of the DNSP's forecast expenditure, it is necessary that proponents of DG and DSR have the opportunity to put forward the business case for non network alternatives where appropriate. To facilitate this, DNSP network plans forecasting future investments and/or capacity shortfalls need to be transparent, comprehensive and made publicly available in time for DG and DSR proponents to develop alternatives to network augmentation.

- *Potential DSR and DG incentive impacts of service incentive schemes should be considered by the AER when specifying the operational detail, service targets and applicable penalties and rewards for such schemes. This may be achieved by including this as a principle under the initial distribution rule.*

We agree with the recommendation in principle. In consulting on the DG and DSR impacts from service schemes, stakeholders should be representative of all market stakeholders.

- *Price caps should be preferred over revenue controls for the purpose of facilitating the utilisation of DSR and DG, particularly once advanced meters and the easing of side constraints improve the potential for more efficient pricing.*

The discussion paper suggests that price caps ensure the DNSPs shift costs from being capacity based to usage based (currently, usage costs are very low – reflective of distribution losses only). It is stated that in the absence of advanced meters, this allows DSR and DG proponents to better recover value – as they offset the now inflated usage charge as opposed to capacity charge (which cannot be measured without AMI). If this is the rationale for price caps over revenue controls, the recommendation should read 'particularly **until** advanced meters and the easing...'.

- *The initial rules should not prevent DNSP's from offering prudent discounts.*

The discussion explicitly raises the potential for DNSPs to discount network costs where they risk losing revenue as a result of more efficient DSR and DG measures being implemented. Therefore 'prudent discounts' could be used by DNSPs to lock out DG and

DSR proponents from the market by shifting costs across the DNSP asset base. This rule would further entrench the inherent market advantage DNSPs have over DSR and DG proponents and undermine efficient competition. We do not support a rule which allows 'prudent discounts' by DNSPs.

- *Where tariff reassignment restrictions are to be included in the Rules, these should be limited to principles that ensure tariff assignment and reassignment is based on:*
 - *customers usage and connection characteristics, i.e. the drivers of network costs; and*
 - *providing equal treatment to customers with similar usage and connection characteristics.*

Tariff reassignment restrictions should also be subject to affordability criteria. That is, no customer should be reassigned to an unaffordable tariff.

- *DNSPs should be required to reassign customers to a time of use tariff following installation of advanced metering infrastructure at a customer's connection. Reassignment should be accompanied by customer education regarding demand management and how this affects their bill.*

There is no guarantee that by installing an interval meter and implementing a time of use tariff that the customer and/or the market will be better off, therefore a time of use tariff should not accompany installation of interval meters on a mandatory basis. Further, neither retailers or DNSPs have incentive to educate the customer on minimising their cost – therefore both options represent 'risk'. It should be noted that customer confusion and disadvantage will result in increased market costs in the long run. Therefore we do not support the default reassignment of customers to time of use tariffs following the installation of advanced metering infrastructure, and are surprised that this level of market interference is even contemplated.

- *Voluntary payments from DGs to DNSP's should be permitted where a DG agrees to pay for upstream network augmentations in order to increase energy transfer capability, in the same way that a transmission connected generator can pay for upstream augmentations of the transmission system.*

In principle, we agree with the recommendation. However if DGs pay for upstream network augmentations, these costs should be recoverable in the same way that network operators can recover cost from network augmentations. This would reflect the value of the DG investment to the market and DNSPs.

- *Initial rules should retain a requirement for DNSPs to submit proposed negotiating framework for DG connection charges to the regulator for approval and publication. Rules should require the AER to be satisfied that this:*
 - *provides robust procedure for negotiation of connection agreements including information exchange;*
 - *requires DGs only to fund shallow connection costs, where shallow is defined as the nearest point of the existing distribution network; and*
 - *provides for DG proponents to be made aware of options for the funding of deep connection costs or the connection constraint consequences of these*

not being funded (either by DG or customers), including measures to ensure the provision of sufficient information to apply the regulatory test so as to determine the extent of any appropriate user funded network augmentation.

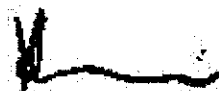
In principle, we agree with the recommendation. However the wording should outline a transparent and accessible procedure as opposed to a robust procedure.

- *The rules should remove the requirement for DNSP's to make avoided TUOS charges payments to DG's as the requirement may motivate obstruction by DNSP's.*

Avoided TUOS charges are critical to reflecting the value of DG and should be recoverable by DG proponents. There are more effective ways to reduce obstruction by DNSP's.

Should you have any questions about this submission, please contact us.

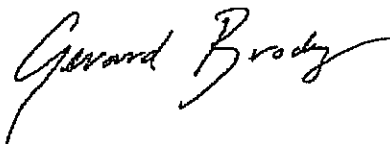
Yours sincerely



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