

# Annual Pricing Process Review

Final position paper  
– second stage

December 2022

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## About Us

We, the Australian Energy Regulator (AER), work to make all Australian energy consumers better off, now and in the future. We are the independent regulator of energy network service providers (NSPs) in all jurisdictions in Australia except for Western Australia. We set the revenue requirements these NSPs can recover from customers using their networks.

The National Electricity Law and Rules (NEL and NER) and the National Gas Law and Rules (NGL and NGR) provide the regulatory framework which govern the NSPs. Our role is guided by the National Electricity and Gas Objectives (NEO and NGO).

NEO:<sup>1</sup>

...to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

NGO:<sup>2</sup>

...to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.

The decisions we make and the actions we take affect a wide range of individuals, businesses and organisations. Effective and meaningful engagement with stakeholders across all our functions is essential to fulfilling our role, and it provides stakeholders with an opportunity to inform and influence what we do. Engaging with those affected by our work helps us make better decisions, provides greater transparency and predictability, and builds trust and confidence in the regulatory regime. This is reflected in our *Stakeholder engagement framework* and in the consultation process we are following.<sup>3</sup>

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<sup>1</sup> NEL, s. 7.

<sup>2</sup> NGL, s. 23.

<sup>3</sup> AER, *Revised stakeholder engagement framework*, September 2017.

# 1 Overview

This paper sets out our final position on the second stage of our review into improving our annual pricing process for electricity distribution network providers (distributors).

Each year, the distributors submit pricing proposals to us for approval which contain the electricity network prices they will charge consumers to recover their allowed annual revenues. In April 2021, we initiated a review with the aim of developing a process to facilitate more timely and accurate annual pricing approvals as well as improve the presentation of pricing outcomes for stakeholders.

In the first stage of the review, we engaged with distributors to develop a better process for our assessment of annual pricing proposals for years 2 to 5 of the regulatory control period (second half of 2021). The key outcomes were the development of a formal pre-lodgement engagement process and standardised pricing models.<sup>4</sup>

The second stage (second half of 2022) built on the first stage outcomes. In this stage, we engaged with stakeholders more broadly to improve the presentation and transparency of annual pricing outcomes to assist stakeholders for their own processes.

For the upcoming round of regulatory determinations,<sup>5</sup> the second stage also included:

- consideration of improvements to the initial pricing process for the first year of a regulatory period, and
- a standardised approach to the application of the side constraint mechanism in regulatory determinations.

After engaging stakeholders, we have developed outcomes that will be implemented for the 2023–24 annual pricing process and beyond. This is further discussed in section 3. These developments follow our commitment in the [AER Strategic Plan 2020–2025](#) to design our systems to work in ways that deliver efficient regulation of monopoly infrastructure.<sup>6</sup>

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<sup>4</sup> AER, [Annual pricing process review – final position paper](#), December 2021.

<sup>5</sup> [Ausgrid – Determination 2024–29](#); [Endeavour Energy – Determination 2024–29](#); [Essential Energy – Determination 2024–29](#); [Evoenergy – Determination 2024–29](#); [Power and Water Corporation – Determination 2024–29](#); [TasNetworks – Determination 2024–29](#).

<sup>6</sup> AER, [AER strategic plan 2020–2025](#), December 2020, p.9

## 2 Background

Each year, distributors submit to us for approval their electricity network prices they propose to charge for the upcoming regulatory year. We approve a pricing proposal if:

- it is compliant with the requirements of the NER, the applicable distribution determination and tariff structure statement, and
- all forecasts associated with the proposal are reasonable.

We must approve pricing proposals within constrained legislative timelines:

- as soon as practicable for pricing proposals in the first year of a regulatory control period
- within 30 business days from the date of receipt of annual pricing proposals in all other years of a regulatory control period.

We have historically required several resubmissions from each distributor to achieve a pricing proposal that is compliant and capable of approval. This has resulted in a resource-intensive process in a constrained timeline.

Adding to these pressures is the importance of timely approvals for stakeholders:

- Distributors – to implement prices in billing systems and communicate prices to retailers and consumers
- AER – to meet our obligations under the NER (approve pricing proposals within 30 business days of receipt) and to develop Default Market Offers
- Retailers – to input into retail prices and meet their obligations under the Prohibiting Energy Market Misconduct (PEMM) Act
- State regulators – as part of jurisdictional regulation or other process, or, in the case of the Essential Services Commission, to develop Victorian Default Offers
- Consumers – Default Market Offers and retail offerings that accurately reflect approved network prices, rather than indicative prices.

### 2.1 Outcomes of the first stage

In December 2021, we published a final position paper to complete the first stage of the annual pricing process review. The outcome of the first stage included development of:

- A formalised pre-lodgement engagement process; and
- Standardised pricing model templates.

This pre-lodgement engagement process and standardised pricing models are intended to streamline the annual pricing process, automate analysis, and present more relevant outputs for all stakeholders. These factors would increase the likelihood of distributors submitting proposals that are compliant and capable of being approved in the first instance.

Further detail on the outcomes of the first stage is available on our website, [here](#).

The 2022–23 annual pricing process was the first to apply the pre-lodgement engagement process and standardised pricing model templates.

### 3 Outcomes of the second stage

In the second stage of this review, we sought stakeholder feedback on our preliminary positions put forward in the preliminary position paper.<sup>7</sup>

Stakeholders provided feedback through written submissions, during online stakeholder workshops, and directly with us (such as emails or phone calls). We received feedback from a range of stakeholders, including distributors, retailers, and consumer representatives.

After engaging stakeholders we are set to deliver the following outcomes:

- Improved presentation of annual pricing data for stakeholders. Namely the presentation of data in models and the outcomes of our review of annual pricing proposals.
- A standardised ‘statement of compliance’ and a clear expectation of the content required to be submitted in a pricing proposal. We will explore implementing standardised pricing proposal documents following the 2023–24 pricing process.
- Revised standardised models that correct errors encountered in the 2022–23 pricing process, as well as improving presentation of outcomes and automating analysis.
- A proposed process for year 1 pricing. We expect to refine and implement this in time for the 2024–25 pricing process with relevant distributors.
- A [revised side constraint mechanism](#) (published November 2022 and therefore is not discussed in this paper).<sup>8</sup> It will be implemented in upcoming regulatory determinations.

Stakeholders also provided the following feedback that was outside the scope of this phase of the review:

- Standardisation of tariffs to create consistency across the networks, including consistent charging components and units of measurements (E.g., \$ per year vs cents/day)
- Rule changes to move the timelines (or simply the approvals) earlier to ensure prices are approved more quickly and flow into relevant processes – stakeholders noted that AER is the most logical proponent for such a rule change
- The role of the AER to house relevant pricing documents for stakeholders’ ease of access due to difficulty and inconsistency of accessing through distributors.

#### 3.1 Stakeholder usage of outputs

We understand many stakeholders use the data in our standardised pricing models to assist in their own functions, such as preparing default offers, reporting on network performance, retail price notifications, and for their own compliance purposes. We also saw an opportunity to develop the pricing models further to allow for stakeholders to interact directly with the models and reduce the reliance on guidance from AER staff.

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<sup>7</sup> AER, [Annual pricing process review – stage 2 – position paper](#), August 2022.

<sup>8</sup> AER, [Annual pricing process review – side constraint mechanism – final position paper](#), November 2022.

We therefore sought an understanding of stakeholders' usage of data and outputs from the pricing proposals and requested feedback and comments on:

- data or output stakeholders currently use or would like to be able to obtain from pricing proposals and/or models;
- current presentation of relevant data and outputs;
- additional functionality for the model;
- data input for default cost movement outputs charts in AER communications; and
- other output charts to be made available in the model

We received limited feedback on stakeholders' usage of outputs in the model. Stakeholders noted the model is complex, and that the core purpose of compliance should be prioritised. Feedback provided was generally related to presentational elements of the model.

We have considered the feedback provided from this process and reflected as appropriate in revisions to the standardised pricing models. Further revisions are made as flagged in the following sections.

### **3.2 Pricing proposal content and presentation**

We considered developing standardised templates for the pricing proposal documents to streamline compliance reviews.

We sought stakeholder feedback on our suggestion to develop standardised pricing proposal document templates. This includes:

- data or outputs currently used by stakeholders that is not present in the pricing proposal model;
- stakeholder preference for whether proposed tariffs should be wholly located within the pricing model (and not included in pricing proposal documents, for example);
- stakeholder preference for whether customer-facing pricing proposal documents and tariff tables are to be produced and published by distributors without AER review; and
- whether customer-facing pricing proposal documents should be published only by the distributor or as part of annual pricing proposals by the AER.

There was general support for standardising the pricing proposal documents, and for this to be developed collaboratively in time for the 2024–25 pricing proposals where possible. There was feedback about the presentation of new or changed tariffs, as well as other elements that will be considered in preparing those standardised templates.

Further, distributors generally considered they are best placed to prepare customer/stakeholder-facing documents, and that these need not be reviewed and published by the AER.

In response to stakeholder feedback, and as a transition to standardised templates in subsequent years, we have developed additional resources and positions to assist with improving the content and presentation of annual pricing proposals. This includes developing



a standardised ‘statement of compliance’ and setting expectations on the content required to be submitted in annual pricing proposals.

Some stakeholders provided feedback on standardising tariff offerings and charging structures across distribution networks. We note that stakeholders should engage with distributors and the AER through the tariff structure statement (TSS) development and assessment processes in relation to this.

### **3.2.1 Statement of compliance**

A standardised ‘statement of compliance’ provides a list of compliance requirements that distributors must meet under the NER and/or applicable distribution determinations. This report ensures that all compliance measures have been met and provides a quick snapshot of the compliance of the pricing proposal. We consider this report will improve the likeliness of pricing proposals being compliant in the first instance, allow us to make more efficient decisions regarding compliance, and provide improved accessibility to stakeholders.

The statement of compliance is generally related to more qualitative aspects of compliance, including those related to tariffs. Compliance related to quantitative aspects are generally reflected in the standardised pricing models and summarised on ‘Output report’ worksheets.

The statement of compliance template is provided as an attachment to this final position paper.

### **3.2.2 Pricing proposal content**

We have developed a list of content we expect distributors to provide in pricing proposal submissions. We expect that providing this guidance will result in more consistent pricing proposals across distributors. This will make pricing proposals more accessible to stakeholders, and more likely to be compliant in the first instance.

The content we expect distributors to provide in an annual pricing proposal includes:

- Main pricing proposal document
  - Both public and confidential versions where applicable
- Standardised pricing model
  - Both public and confidential versions where applicable
- Standardised ACS pricing model
  - Both public and confidential versions where applicable
- Supporting documentation for transmission expenditure forecasts
- Supporting documentation for jurisdictional scheme amounts
- Forecasting methodology and any supporting documents/models

We have not produced a standardised pricing proposal document template at this stage of the review. We do consider this would be of value and expect to look at this in future years. However, we consider the content of the main pricing proposal document should focus on compliance, and should include:

- Demonstrations of compliance that are not addressed elsewhere (i.e., in the pricing models or statement of compliance)
- Any additional information required in relation to demonstrations of compliance
- Replication of key data outputs from the pricing models only if necessary (noting the model is sufficient to demonstrate compliance)
- Additional information to benefit other stakeholders as necessary.

### 3.3 Model Revisions

We have revised the standardised pricing models to correct for errors encountered in the 2022–23 pricing process, as well as to further develop functionality of certain components of the model. We sought stakeholder feedback on our suggested revisions to the standardised pricing models as outlined in the Stage 2 preliminary position paper.

Stakeholder responses supported revisions to the models, noting correction of errors should be prioritised, and no additional complexity or administrative burden should be introduced. Suggestions were made for the AER to develop a central model with analysis and outputs for publication. We will consider this further for the 2023–24 pricing process, as we have been unable to dedicate resourcing to this task within this review.

We have incorporated the feedback and further revised the standardised pricing models.

#### 3.3.1 Revised standardised pricing model

Our revisions are focussed on:

- Improving the cost movement analysis
  - Appropriately treat tariffs with a controlled load component
  - Include tariffs with demand components
- Improving automation in the model
  - Automated trend analysis
  - Validations on inputs and the integrity of the model
- Making outputs more accessible
  - Output reports summarising compliance and key data
  - Improving layout of unders/overs accounts
  - Macro to create optional summary file (with tariffs, output reports, and cost movement analysis)
- Improving functionality
  - Price control sheet (for distributors or AER to set proposed prices based on constant movements from previous prices)
  - Breakdown of jurisdictional schemes presented throughout model
  - Treatment of unpaid network charges relating to retailer of last resort events
- Revisions to action issues raised in the 2022–23 pricing process.

We have also updated the handbook that accompanies the standardised pricing models to reflect these revisions.

We do not expect to revise the model annually moving forward. We note the model is more efficient by its rolling nature, and annual revisions interrupt this efficiency. We plan to make future revisions through our regulatory determination process, where revisions can address changes imposed by the regulatory determination (E.g., the changes to the side constraint mechanism), or any revisions to address other issues.

### 3.4 Year 1 pricing

In our position paper, we sought stakeholder feedback on our proposal to develop a better process for assessing and earlier approval of pricing proposals for the first year of a regulatory control period.<sup>9</sup>

We consider there is an opportunity for us to approve first year proposals earlier, assisting regulators with the timeliness of finalising default offers and retailers setting prices for the forthcoming year. The position we put forward for consideration was pre-lodgement engagement with the distributors in March, distributors submit formal proposals upon publication of our final determination, and the AER review and approve these by mid-May.

We then sought feedback on our suggested process for first-year pricing. This included feedback and comments on:

- any issues present in applying the established pre-lodgement engagement process;
- proposed timelines for submission and approval;
- the availability of data at relevant points in the timeline;
- whether this timeline produces unreasonable burden or resourcing constraints; and
- other suggestions that could improve this process.

We received strong stakeholder support to approve year 1 pricing proposals earlier, particularly prior to the finalisation of default offers. Distributors noted if pursuing this objective, then the process needs to add value and not extra burden. The distributors noted that the timing of their submissions would be contingent on them receiving timely final determination outcomes (embargoed prior to public release) to enable them to set their prices. The distributors also noted risks that would be involved in providing a pricing proposal submission prior to, or alongside, a regulatory determination being made/published. This includes the risk of their decision-makers being required to support their submission based on embargoed data.

Stakeholders also raised the opportunity to make rule changes to move the regulatory determination timelines forward 1–2 months, which was outside the scope of this phase of the review. This would not be a simple task as there are numerous interconnected components of the regulatory framework that would need to be considered, and 9 out of 14 regulatory determination processes are already afoot. However, we have noted stakeholder feedback for future considerations on timing.

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<sup>9</sup> In the first year of a regulatory control, distributors are required to submit initial pricing proposals within 15 business days of the AER making a final regulatory determination (by end of April). The AER is required to approve these proposals as soon as possible. This generally leads to submissions by mid to late May, and approval by mid to late June.

Based on stakeholder feedback, our final position is to adopt a more flexible approach to the first year pricing process by providing a guiding timeline but working with each distributor based on their individual circumstances. The guiding timeline is as follows:

- AER to provide embargoed data and models relating to the final determination in March
  - This will include pre-filled pricing models
- Distributors to engage with AER on quantity forecasts in March/April
- Distributors to flag any concerns with pre-filled data in April
- Distributors to engage with AER on expected submission timeline in April.

Our goal is for distributors to submit their pricing proposals in the first week following the AER's final determination (usually made April 30) and for us to approve them (if appropriate) by mid to late May, 1 month earlier than current timelines.

We will engage directly with the relevant distributors in the lead up to the first instance of this process in 2024–25. Depending on the progress of their respective determinations, we may trial this approach, or variations of this approach, with select distributors, rather than all.