AGL Energy Limited
ABN: 74 115 061 375

Level 22, 120 Spencer Street
Melbourne VIC 3000

Locked Bag 14120 MCMC
Melbourne VIC 8001

T: 03 8633 6000
F: 03 8633 6002
www.agl.com.au

A few words.

2 May 2012

Mr Warwick Anderson
General Manager – Network Regulation
Australian Energy Regulator
GPO Box 3131
CANBERRA ACT 2601

Submitted via email to NSWACTelectricity@aer.gov.au.

Dear Mr Anderson,

AGL Energy welcomes the opportunity to comment on the Discussion Paper on "Matters relevant to the framework and approach, ACT and NSW DNSPs 2014 – 2019", issued by AER on April 2012 (Paper).

AGL Energy (AGL) is one of Australia's largest energy company that operates across the supply chain including investments in electricity generation and energy retailing. AGL has over 3 million retail customers and operational control of some 3,000MW of generation capacity in the National Electricity Market (NEM).

AGL has three areas of concerns in relation to the framework and approach for a control mechanism of the 2014 - 2019 price determination:

- The relative impact of control mechanisms on the efficacy of retail pricing;
- The significance of control process on AGL's ability to manage pricing changes and consumers' management of energy cost; and
- The emerging issues of smart meters rollout.

Flow-on effects of control mechanism to retail pricing designs and cost management for consumers

AGL believes that while the control mechanism is the primary instrument for distributors to recover its allowable revenue, its formulation and implementation must take into account the flow-on effects to retail pricing and consumers' ability to manage their cost of energy supply. Given that network cost contributes half of the total cost of energy supply, it has a significant impact on consumer's increasing concern on energy cost management and the retailers' ability to respond appropriately to consumers' changing needs. AGL supports distributors in gaining an acceptable return on and of their investment in network services; however, it should be supported by an enforcement of robust network pricing principles and practices that promote cost transparency and predictability that facilitate choices for the retailers and consumers.

From AGL's perspective, it is highly desirable to have a tariff control that results in a price path with a reasonable degree of certainty and predictability. This is important for AGL in considering medium and long term contracts for consumers and our ability to manage the cost of providing such energy services. In AGL's view, a strong regime in tariff re-balancing is critical as it bears a strong relationship to our supply contracts and hence the end user's potential exposure to the fluctuations of network costs. There should be a strong emphasis in the control framework that ensure any significant changes in network cost are gradual and incremental.

Our analysis shows that the total average network cost in NSW has increased by 113% from 2006 to 2011. During this period, the annual average cost increase was 6.5% (2006), 6.2% (2007), 9% (2008), followed by a spike of 25% in 2009 and an annual increase of around 18% (2010) and 16.5% (2011). AGL believes it is important for AER to consider if such a steep rate of change in network cost could be managed effectively through the framework and approach of control mechanism. It seems reasonable to expect that such control mechanism could be formulated to maintain a reasonable rate of cost change both between and within the regulatory periods of price reviews. As a retailer, an important objective for AGL is to ensure consumers are not subject to an unreasonable steep cost fluctuation in energy supply. Our ability to do so effectively and equitably across all consumer groups relies in large part on a predictable nework cost. Effective management of the change of network cost will encourage the development of longer term offers and creates opportunity for better financial planning and management.

Increasing need for a more consumer-focused framework and approach

While having a predictable price path is essential, it is also critical for the control mechanism to recognise the changing consumer demand on energy supply. Consumers are becoming more aware and sensitive to energy supply issues as energy cost escalates. AGL believes that consumers are increasingly seeking more information and alternatives to control their energy consumptions and cost. Hence, the network control mechanism should be formulated from the consumers' perspective as the efficacy of any pricing signals ultimately depends on the consumers' willingness to respond.

To this end, it is imperative that the control framework provides flexibility in formulating network tariffs that can respond to consumer demands. To achieve this, AER may consider a framework and approach that includes distributors working with retailers and consumers when proposing a change to network tariffs. AGL believes that this approach could greatly improve the prospect of retailers and consumers embracing new pricings and provide more choices to manage different risk requirements. AGL would encourage the AER to consider a tariff control framework that promotes greater linkages between network tariffs and consumer demands.

Rollout of smart meters would encourage greater consumer participations

A related issue for greater consumer engagement is the increasing importance of smart meters and smart grid policy developments in the NEM. The introduction of smart meters and smart grids provide consumer opportunities to interact more closely with the energy supply system. While the level of consumer participation has been increasing with the larger consumers, the significant increase in investment in smart meters would markedly change the participation rate of smaller consumers. Such a change means that smart meters and other technologies could become a key competitive element for the provision of innovative energy management services.

In AGL's view, the bundling of metering services as part of the network services will need to be re-considered as it presents a potential barrier for the development of a competitive market for metering and data provision services. For accumulation meters, there is a potential for the consumers to pay twice for its metering cost if retailers decide to install a smart meter, which is clearly not acceptable. This becomes more critical as smart meters in New South Wales and Queensland are rollout as Type 5 meters, which could suggest that unregulated metering services are funded from regulated revenue. AGL understands that AER has indicated in the past that "it would be unlawful for distributors to use regulated revenue to fund unregulated activities". Again, this is not acceptable under the National Competition Policy that requires monopoly business to be structurally separated from contestable business. AGL urges AER to consider the need to segregate the cost, pricing and revenue requirements of metering provision and services from the "poles and wires" network services, as is in the case in Victoria and South Australia. AGL believes it is important to have a consistent framework and approach across all jurisdictions as many retailers and consumers operate nationally.

Weighted Average Price Cap versus Revenue control

In terms of achieving an appropriate level of predictability and flexibility, AGL is of the view that Weighted Average Price Control (WAPC) is far more preferable to revenue cap or yield control. WAPC provides a more reasonable level of control over the setting of tariff coupled with side constraints that restrict the movement of annual tariff categories. However, AGL believes that side constraints should be applied to each tariff. It becomes ineffective when applied to broadly defined tariff categories and is not sufficient to limit the opportunity for gaming nor provides price predictability.

Revenue cap or yield control tends to produce more unpredicted tariff changes due the over and under adjustments. Again, this is undesirable for retailers and consumers in terms of cost management risk. AGL believes WAPC is a more effective control mechanism through the control of tariffs. While there is the prospect for gaming, it is more desirable to to achieve tariff predictability and flexibility, the two properties that better support pricing strategies for a dynamic market environment.

Implementation of Control

AGL is concerned about the implementation of these tariff controls. The current process is for the annual network tariff reset to be approved too close to the retail price change date of 1 July. There should be sufficient notice for retailers to prepare new retail prices and meet the requirements to notify consumers of the proposed changes. In particular, there should be sufficient time for incorporating complex tariff proposals to achieve the intended pricing outcome for the consumers. AGL urges AER to review the timing and process for the annual re-set of network tariffs, as distributors, retailers and consumers are facing more challenges in managing energy cost.

Please contact Kong Min Yep on 03 8633 6988 for further information regarding this submission.

Yours sincerely,

Alex Cruickshank
Head of Energy Regulation