



6 March 2009

Mr Chris Pattas
Network Regulation South
GPO Box 520
Melbourne Vic 3001

Dear Mr Pattas

**AER PRELIMINARY FRAMEWORK AND APPROACH PAPER FOR VICTORIAN
DISTRIBUTION BUSINESSES IN REGULATORY PERIOD 2011**

This submission refers to the Framework and Approach paper released by the Australian Energy Regulator (AER) in December 2008 in relation to Victoria, in accordance with clause 6.8.1 of the *National Electricity Rules* (NER). The Framework and Approach paper relates to Victorian Distribution Network Service Providers (DNSPs) in the regulatory control period commencing 1 January 2011.

Origin is a leading retailer of electricity in Victoria, providing services to retail customers throughout the state. As a result, the regulation of Victorian distribution networks will have a direct impact on Origin and its customers.

Origin is pleased to respond to the AER's preliminary Framework and Approach paper, recognising that it represents only the first stage in shaping the regulatory framework for Victorian DNSPs for the next regulatory period, and is limited to preliminary proposals in the areas of classification, control mechanisms and the application of various schemes.

The key points in Origin's submission are as follows:

- Origin generally accepts the proposed classification of services, provided that jurisdictional requirements to tender for new connections and augmentation remain in place (or equivalent requirements introducing contestability). The alternative control classification for most excluded services should promote transparency in the attribution of costs.
- Weighted average price caps are the appropriate control mechanism for standard network services performed by Victorian DNSPs.



- In light of the fact that the AER has now completed comparable Framework and Approach decisions in Queensland and South Australia¹, Origin contends that the process of deliberation in Victoria would benefit from putting the discussion and analysis more within the context of the AER's approach across these other jurisdictions.
- Origin supports the application of the relevant schemes to the extent they support superior and more effective outcomes for customers.

Classification

Origin notes that the effect of the AER's approach in Victoria is that:

- prescribed network services should be classified as standard direct control, and
- excluded services should generally be classified as direct control, and further, as alternative direct control, in cases where the cost of the service is attributable to an individual party.

This approach is supportable in Origin's view given the AER's desire to emphasise consistency with the current approach and the existing Victorian framework. The alternative direct control classification for most excluded services should promote transparency in the attribution of costs.

Origin notes that the AER's proposed approach in Victoria leads to only two sets of services being classified as negotiable. In both cases, jurisdictional arrangements require tendering. All remaining services will be subject to a form of direct control. Origin supports this classification of negotiable services, provided that where contestability for new connections and augmentations remains limited, requirements to tender for these services remain in place.

Origin looks forward to more clarity, as a result of consultation under the Determination, on what will constitute a "standard" level of service in specific cases.

Control mechanisms

Origin supports a weighted average price cap (WAPC) for standard direct control services.

Section 6.2.5 (c) of the NER provides the criteria for the AER to resolve the control mechanism applicable to regulated services. The criteria consider:

1. the need for efficient tariff structures;

¹ Note that the NSW approach occurred under transitional rules in the NER.



2. the possible effects of the control mechanism on administrative costs for the AER, DNSP and users or potential users;
3. the regulatory arrangements (if any) applicable to the relevant service immediately before the commencement of the distribution determination;
4. the desirability of consistency between regulatory arrangements for similar services (both within and beyond the relevant jurisdiction); and
5. any other relevant factor.

After consideration of the criteria, Origin submits that weighted average price caps (WAPC) are the most appropriate form of regulation for standard network services.

Revenue caps may not allow for deviations from forecast volumes and demands, whereas price cap regulation is more likely to provide a more efficient tariff structure. A WAPC control mechanism provides tariff flexibility for dealing with unexpected volume variation. A revenue cap would be consistent with the prior classification in Victoria, as well as with the approach in New South Wales and South Australia.

Origin is concerned that there is little consistent discussion of what the requirement for efficient tariffs means for customers. To be efficient, a pricing structure must be clear, so customers can react to incentives. Time of use tariffs are a pertinent example. Efficient time of use tariffs should allow for a closer alignment of interests between the DNSPs and the customer in relation to optimal network loads. However, this cannot happen if DNSP tariff structures do not take into account the energy supply chain end to end.

The different approaches currently adopted by the DNSPs to link demand type to network pricing for small customers - including time of use pricing, capacity pricing and seasonal peak pricing - are of great concern to retailers, due to:

- the cost to retailers of system changes required to integrate new tariff structures for small groups of customers;
- customer confusion, when a markedly different retail tariff applies to the same retail product in different DNSP zones, and
- a lack of clarity on the intended impact of a given tariff structure on customer behaviour (where tariff structures are reflected in retail prices).

These concerns are compounded for retailers when a DNSP adopts a tariff structure that differs from those offered by other distributors, which covers only a small subset of customers, and which cannot be expressed in billing - either at all, or without significant delay or expenditure. In this way, some tariff structures do not allow for alignment along the supply chain. If price signals are not passed on, they do not influence customer behaviour, they merely increase



overall cost. Under these circumstances, such tariff structures could not be considered efficient.

Origin would encourage further examination of the requirement for efficiency in tariffs, not only in the context of network constraints and cost recovery, but also in the context of the end customer. Principles could be developed to guide the formulation of tariff structure, in light of the need for alignment across the energy supply chain.

Analysis in the context of multiple jurisdictions

Given that the AER has now finalised the Framework and Approach in South Australia and Queensland, Origin contends that there would be value in the AER placing its deliberation on classification in Victoria within the broader context of the AER's approach in these other jurisdictions.

Origin understands that the AER's initial emphasis in all three states has been on maintaining approaches consistent with prior regulatory periods, with uniformity across jurisdictions a goal for the medium term.

Where uniformity across jurisdictions is not achievable in the short term, Origin sees clear comparisons across states to be one benefit of a national regulator.

A systematic overview could note the categories of services provided by DNPs in each state, where these overlap and differ, and which differences at a jurisdictional level have led the AER to differing classifications. Using the same name for the same service in each jurisdiction (and different names only to the extent that services differ) would also facilitate comparison.

For example, in the case of energisation, the proposed classification in Victoria is alternative direct control, on the basis that this is a monopoly service whose cost can be attributed. In Queensland, the service is recognised slightly differently, as "de-energisation and re-energisation" and falls in the fee based services group, but the classification will be as in Victoria, with a similar rationale. Lastly, in South Australia, energisation sits in standard connection services, and will be classified as standard direct control service, on the basis it is a core service (Table 1).



Table 1. Energisation classification across Victoria, Queensland and South Australia

State	Service recognised as	Classification	Service grouping
VIC	Energisation	Alternative direct control	Connection services
QLD	De-energisation and re-energisation	Alternative direct control	Fee based services
SA	Standard connection services (to include energisation)	Standard direct control	Connection services

In the above example, comparison of the approaches is complicated because the same service is recognised under different names, included in different groupings and classified according to slightly different rationales. As noted by the AER, some inconsistency is unavoidable, either as a result of the application of the NER, or because service names have specific meanings under existing jurisdictional determinations. Furthermore, in all likelihood, many of the differences will be of minimal practical significance. However, the significance or otherwise is difficult to assess in the circumstances.

While it may not be feasible (or desirable) to identify every service in the total set of services provided by DNSPs across all states, an analysis of service groupings could highlight where service groupings align and where alignment has not been possible. This could form the basis for a very helpful core resource when assessing future distribution regulatory reviews and looking for regulatory benchmarks.

The benefit of such an analysis would be greater transparency and more valuable feedback on classification from parties other than DNSPs.

The AER’s study a *Review of Services provided by Distribution Network Service Providers*, released in 2006, provided some helpful information in this vein. However, as the study pre-dated much of the AER’s recent deliberation over classification, it does not reflect the painstaking process of review under the NER that has occurred since then.

Schemes

Service Target Performance Incentive Scheme (STPIS)

Origin notes that key elements of the STPIS were concluded as a result of a separate consultation process, which concluded in June 2008. Origin also notes that the STPIS is currently the subject of a separate process of consultation.



Schemes to improve service levels for customers are desirable to the extent that benefits and costs available to the DNSPs reflect the value of service improvements to the customer.

Origin notes that based on the AER's Final Decision on the STPIS, telephone answering is the key customer service parameter. This parameter is easily quantifiable and reliable answering services are recognised as valuable. However, the AER has noted that it may determine (or a DNSP may propose) that other customer service parameters should be included in the customer service component, if other aspects of service are of concern to stakeholders.²

In this context, Origin would note that there may be a need for a broader range of customer service parameters under the STPIS. Metering data quality is one example, where there is currently no means to create incentives for a higher number of actual reads compared to estimated reads or substitutions of data. Accurate meter reads will be more important for both customers and retailers in light of the smart meter roll out, given that accurate reads of interval data will be central to determining customer's bills as well as to wholesale market settlement.³

Origin looks forward to contributing to the current consultation on proposed revisions to the STPIS.

Efficiency Benefit Sharing scheme (EBSS)

Origin notes that key elements of the EBSS were concluded as a result of a separate consultation process with concluded in June 2008.

Origin supports transparent schemes which deliver savings to customers through greater efficiencies.

Demand Management Incentive Scheme (DMIS)

Origin is a strong proponent of schemes that promote efficient use of energy and allow customers to become more informed about the impacts of their energy use and their opportunity to influence this.

Origin supports the DMIS in principle, on the condition that as proposed, allocations are approved ex post, on the basis of demonstrated expenditure that was effective in achieving benefits in demand management. It is also essential

² AER, *Electricity distribution network service providers Service target performance incentive scheme*, June 2008, p.15

³ While minimum levels for accuracy in meter reads could also sit in the Guaranteed Service Level (GSL) component of the STPIS, the existing STPIS does not allow for new parameters to be introduced into the GSL, whereas this is available under the customer service component. This could, however, be the subject of amendments to the STPIS.



that where DMIS schemes are funded (outside the pilot and trial framework), the benefits of DM in terms of capital and operating expenditure reductions are captured in the subsequent years, and that this is achieved in a transparent way that enables critical evaluation of the projects.

Should you have any questions, or wish to discuss this response further, please contact Steven Macmillan (Regulatory Analyst) on (03) 8665 7155 in the first instance.

Yours sincerely

A handwritten signature in black ink, appearing to read "Bev Hughson". The signature is written in a cursive, flowing style.

Bev Hughson
National Regulatory Manager - Retail