

Annual EUAA Conference 2013 – Empowerment through participation

AEMC Chairman, John Pierce, Speech

Where: Royal on the Park, Cnr Alice and Albert Sts, Brisbane
Date: 16 October 2013

Topic: Strategic priorities for energy market development

Introduction

My thanks to the Energy Users Association of Australia (EUAA) for the invitation to speak today.

I should start by introducing my organisation for those who are not familiar with us.

SLIDE 1

NEM REGULATION AND GOVERNANCE



Law and Policy making



Rule Maker and
advice to SCER



Power System &
Market Operator



Economic Regulation
& Rule Compliance

The Australian Energy Market Commission was established in July 2005 as a national body with two principal functions: we make and amend rules for the National Electricity Market and for elements of natural gas markets. We also provide market development advice to the Standing Council on Energy and Resources. So our work consists of assessing rule changes, which can be initiated by anybody except ourselves, and carrying out reviews, which are commissioned by SCER.

The energy prices and other outcomes that we see as consumers are a combination of what happens in the competitive generation and retail sectors, what happens in the regulated network sectors, and of government policies which impact the energy sector. Think of the carbon price, RET and Feed-in-tariffs, for example.

One of the things we do each year is publish a report on the drivers of expected price movements. This shows that network prices and the combined effect of governments' policies have been major drivers. At the end of 2012 major changes were made to the Rules governing the economic regulation of network businesses. The AER is currently developing guidelines to give effect to these rule changes, and the first regulatory determinations to occur under the new rules will be in NSW and ACT in mid-2014. For Queensland, the first determinations will be in place by mid-2015.

At the beginning of this Rule change process and numerous times since we have said that network price outcomes were a function of the Rules, how the

Rules are applied and the corporate governance of the network businesses. It is also a function of how reliability standards are determined. The Commission has recently published advice on a national framework for determining reliability targets for distribution networks and is close to finalising advice dealing with the transmission sector.

This morning I would like to talk about the AEMC's strategic priorities for energy development, which we have developed in consultation with industry and consumers, and will underpin our advice to SCER and our approach to rule making.

I would then like to focus on two proposed rule changes that have direct relevance for consumers, including large energy users like those represented here today — a proposal to reform distribution price structure arrangements and a proposal to implement a demand response mechanism.

Strategic priorities for energy market development

The topic of your annual conference also resembles one of the AEMC's three strategic priorities for energy market development that we proposed in a discussion paper in April this year. That discussion paper set out a consumer priority, a gas priority and a market priority.

SLIDE 2

PROPOSED STRATEGIC PRIORITIES 2013

Priorities proposed in Discussion Paper, April 2013:

- **Consumer priority:** strengthening consumer participation and continuing to promote competitive retail markets
- **Gas priority:** promoting the development of efficient gas markets
- **Market priority:** market arrangements that encourage efficient investment and flexibility

Discussion paper	Stakeholder workshops	Final report
APRIL 2013	APRIL-MAY 2013	OCTOBER 2013

ENR/C

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We aimed to build as much consensus as possible as to what the key priorities for energy market development should be. This involved a series of well-attended stakeholder workshops, a public forum and a discussion paper. We talked to a range of stakeholders – including individual consumers and consumer representative bodies – about their key concerns for the sector to help identify priority areas for our future work program.

We are due to publish the final report next week where we will confirm our three priorities. In brief:

The consumer priority is about strengthening consumer participation in energy markets. This includes providing greater opportunities for consumers to effectively participate in the monopoly network sector (through participation in regulatory processes, for example – I believe Andrew will talk more about that after the tea break) and to participate in competitive retail and generation

markets, perhaps more directly. The two rule changes I will talk about shortly are part of our work program under this priority.

The gas priority is about the development of gas market trading mechanisms, the need to examine the efficiency in downstream market arrangements. That is, it is about the mechanisms through which gas is traded (the means of exchange), rather than upstream supply issues, which are outside of the AEMC's remit. Though the two are obviously related.

At the end of September the AEMC published a gas market scoping study, which provides an overview of changes in the east coast gas market. The study revealed that the existing gas market and regulatory arrangements have served us well, but that the scale of the changes which are occurring in the gas sector means that it is now important to evaluate whether they continue to be well suited to the new environment in which they are now placed, taking into account the commercial and practical needs of participants.

The market priority, is somewhat of an overarching priority, concerned with the way market, regulatory and policy environments interact and impact prices and investment. This reflects the importance of predictable but flexible market arrangements, and of open and transparent processes for change. This priority emphasises the importance of policy decisions taking account of impacts on all sectors they are likely to affect. We are most likely to get

integrated policy outcomes when decisions are taken in a transparent manner and after full consultation with all affected parties.

Overlaying all of these things though is the underlying rationale for the market and regulatory arrangements that we have – productivity growth in a sector that is so vital to Australia's longer term potential economic growth.

For those that have been around long enough to recognise the relationship between the microeconomic and competition policy objectives and the domestic energy sectors; - perhaps many of the issues that have arisen in the sector over the last few years owe their origin to those links not being front of mind.

Rule changes

The rule changes I would like to focus on today fall into the two areas where the AEMC has most influence, namely the regulated and competitive sectors.

The first relates to how network costs are reflected in price structures. The second represents a greater opportunity for users to directly offer demand reductions into the wholesale market at the prevailing spot price.

These two projects are yet to commence and they represent an opportunity to engage with the AEMC over the coming months as we consult on whether and how to implement the changes. We will be asking for views and

information from any interested stakeholder about how we can better promote the long term interests of consumers through these rule changes.

Both projects were recommendations of the AEMC's Power of Choice review, which presented a package of recommendations to Commonwealth, state and territory ministers in November last year. The package focuses on supporting consumers of all sizes to actively participate in the energy market. It offers a suite of options to help consumers manage their electricity consumption and, in turn, their electricity expenditure. In short, the objective is consistent with the theme of your conference on "Empowerment through participation."

Flexible pricing

The AEMC's Power of Choice review made a series of recommendations to move towards more efficient and flexible pricing. A key part of this involves changing the way distribution networks structure their tariffs. We have made changes through the network regulation rule change that will affect the size of the distribution cost pie. How the resulting pie is then sliced between consumers depends on the way in which network tariffs are structured. The rule change request from SCER on distribution pricing arrangements is designed to tackle this latter issue.

Distribution tariff reform

SLIDE 3

DISTRIBUTION NETWORK PRICING ARRANGEMENTS RULE CHANGE REQUEST

- Evidence of significant costs and foregone opportunities from absence of clear price signals
- Rule change seeks:
 - a better linking of costs to peak demand use
 - greater consultation between distributors and their customers in structuring their prices

Consultation paper	Draft determination	Final determination
NOVEMBER 2013	Q2 2014	Q3 2014

SCER

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SCER submitted the rule change request last month after considering the evidence that there are significant costs and foregone opportunities arising from the absence of clear price signals to consumers.

The rules currently provide a framework and guiding principles for how network businesses should structure their network tariffs. The proposed rule change would amend these principles and other provisions to encourage more efficient network price structures. It would require network charges to be based on the drivers of network costs as far as possible so that consumers are paying prices that reflect the impact of their consumption decisions on network costs.

The SCER rule change also seeks to build in greater consultation between distributors and their customers in structuring their prices. Part of this would involve distributors consulting with consumers in developing a pricing structure policy to accompany the distributor's regulatory proposal. In assessing the rule change, we will be considering how to include a conversation about the structure of tariffs throughout the regulatory process, rather than the structure just coming out at the end of the process.

It is important that, when distributors develop new pricing structures and charges, consumers are engaged and have an understanding of any changes so that they can make informed choices and decisions. The AEMC recognised this in the Power of Choice review, and proposed that there should be a greater role for consumers and retailers to review pricing options set by network businesses. This has also been raised by IPART in a separate rule change request to the AEMC, which we will be considering in tandem with the SCER request.

The main benefits of changes of this nature may be felt over the medium to long term. They could shrink the size of the pie further, as changing consumption patterns in response to new prices will focus infrastructure investment where it is needed and valued most. But consumers with a flat load profile or those who have some flexibility to respond to the new prices will also tend to benefit in the shorter term by shrinking the size of the slice they have to pay for.

We plan to publish a consultation paper early next month and I encourage you to provide submissions to inform us of your views on these important issues.

I would also note that this rule change is part of a broader package. SCER is pursuing a wide range of reforms aimed at ensuring that network infrastructure is built, priced and utilised effectively.

Demand response mechanism

SLIDE 4

DEMAND RESPONSE MECHANISM RULE CHANGE REQUEST

- Consumers currently limited in their ability to respond to changes in the wholesale electricity spot price
- Demand resources would be treated in a similar way to generation
 - would be paid the wholesale electricity spot price for reducing demand
- AEMO drafting request
 - anticipate submission in December 2013
 - AEMC consultation in first half 2014

AEMC

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Power of Choice offered another recommendation which could provide opportunities for large energy consumers to reduce their expenditure. We recommended the introduction of a new demand response mechanism, which would allow consumers, or third parties acting on consumers' behalf, to

directly participate in the wholesale market and to receive the spot price as a reward for reducing demand.

Some consumers find it feasible to physically adjust their consumption in response to spot prices under specific contractual arrangements such as interruptible tariffs, spot pass-through and scheduled demand. However, these involve a degree of risk, transaction and 'hassle' costs that are difficult to manage for many commercial and industrial users.

Under our proposed mechanism, demand resources would be treated in a similar way to generation, and would be paid the wholesale electricity spot price for reducing demand.

At the request of SCER, AEMO has been tasked with drafting a rule change proposal to give effect to the mechanism.

AEMO has developed a detailed design proposal covering the design principles including metering, the baseline consumption methodology, settlement and prudentials, reporting and governance. The document is available on the AEMO website.

We anticipate that AEMO will submit the rule change proposal to the AEMC by December 2013. The EUAA has recognised the benefits a mechanism like this could offer for consumers and I would encourage you to participate in the AEMC's process on this rule change, as the proposed mechanism could

provide a significant revenue stream for businesses that have some flexibility in their electricity use.

Concluding remarks

I have focussed on these two rule changes as they are still somewhat in the formative stages, and both have the potential to materially affect the electricity expenditure of end users. I would of course encourage you all to engage with the AEMC's consultation processes for these two rule changes once they are initiated.

We expect a consultation paper on distribution pricing principles to be published in November. A consultation paper for demand response mechanism will likely be published later in 2014, depending on the outcome of AEMO's processes.

The rule changes form a part of the Commission's wider work program, all of which is aimed at improving long term outcomes for energy consumers. Our rule change and review processes represent an important opportunity for energy users to get involved in shaping future outcomes in the market. The value of our work will be greater if we are exposed to a variety of views in assessing proposals against the national electricity, retail and gas objectives. Thank you again for the opportunity to address you all today.