Australian Energy Market Commission

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Responding to consumer demands, promoting competition and preparing for change

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Thank you for being here today to discuss developments in the National Electricity Market.

Before we begin, I'd like to acknowledge the traditional owners of the land on which we meet and pay my respects to their elders both past and present.

Most of you would be familiar with the company Uber. For anyone who's been under a rock, Uber is a global company that's sent shock waves through the taxi business and government agencies.

The business model is essentially an app, which anyone can download. Potential drivers like you and I, can sign up, download an app on our smart phone, and start picking up passengers, dropping them off and charging a fare.

Passengers simply download the app, make a booking and hope they get an Audi A5 and not a busted up Ford Falcon.

The taxi industry hates it, because it's challenging their business model, stealing business, providing a better customer service experience for many people. Plus, it's an Audi A5.

Government doesn't know what to do with it. Drivers aren't necessarily registered in the way taxis are, meaning the community safety measures that come with regulation are not there to protect passengers.

But the community has been crying out for a shake-up of the passenger service (taxi) industry for a long time and many believe this is it.

Let’s go to Washington on 8 July this year.

Ryan Simonetti, a CEO of New York-based business Convene was planning to take an Uber car from 7th Street to his new offices. It was nothing unusual because he was a diehard Uber fan and used the services all the time.

As he approached the Uber car, he spotted a D.C. taxi inspector talking to the driver. Simonetti got into the car, the inspector turned around and the Uber driver took off.

The inspector turned his lights on and started to follow and Simonetti says “that cop’s following you. What’s going on?” To which the Uber driver responds - “Oh no, he’s not a real cop… but I’m sorry, we’re going to have to run this red light.”

What followed was a high speed pursuit.

The Uber driver then headed for the 9th Street tunnel, got on I-395 and proceeded to race down the highway going well above the speed limit.

Simonetti described it later as “like an episode of ‘Cops which ends one of two ways. Either the car crashes or the guy jumps out and runs. And he had plenty of opportunities to slow down and jump out and run, and he wasn’t doing that.”

He also found the time to tweet from his phone: “Was just kidnapped by an @uber driver in DC, held against my will, and involved a high speed chase across state lines with policy #Crazy.”

Simonetti was naturally interviewed by media and said he still thinks Uber is a great business, but the incident made him wonder about the screening process.

“The question is what the vetting process is for drivers?” he said. “As they get bigger, how do you prevent stuff like that from happening? How do you screen crazy people out?”

This is what happens when industry gets ahead of government and regulation and the regulators are left playing catch up – when regulators, and indeed industry, are not prepared for change and not responding to the demands of consumers.

This is what regulators like the AEMC have to be smart about with the fast pace of change confronting us in the energy sector.

With technological and other changes dramatically changing the energy landscape and the way people consume energy, we have to keep pace with this change.

And most importantly, as we move into the next chapter of energy market reform in Australia, we must ensure we have a system which is both strong and flexible enough to respond to changing consumer demands, promote competition, and withstand any shocks that may come in the future.

So today I thought I'd talk about the work of the Australian Energy Market Commission in working towards, in terms of those three objectives.

1. Responding to consumer demands,
2. Promoting competition, and
3. Preparing for disruption and change in the future

I believe this work will allow us to build on energy market reform in Australia, which is part of one of the most important and enduring microeconomic reform and productivity improvement stories in our nation's history.

Responding to consumer demands

In 2012, the AEMC completed its Power of Choice review into demand side participation in the energy market.

We set out a plan which would set the conditions for greater engagement and participation in energy markets by consumers, so that their preferences could drive energy market development.

You might call it the democratisation of the Australian energy market.

This year, we move from consultation and reviews, to delivery of changes arising from Power of Choice.

The rule changes we are dealing with right now will empower consumers with tools and information, as well as resetting the market parameters, to allow their choices – informed choices – to drive energy market development in the years ahead.

One of the Power of Choice building blocks currently under way is the distribution network pricing rule change, which aims to make sure network prices paid by individual consumers, through their retail bills, better reflect the cost of providing network services to them.

Currently, many consumers pay more than the costs caused by their energy usage, while others pay less. This is because the way the network tariff structure is set means prices over-recover for use outside peak times and under-recover for peak use.

A good example of this is solar PV – a typical consumer will save about $200 a year in network charges by adopting solar PV. But because most of the solar energy is generated at non-peak times, it only reduces the network's costs by $80, which means other consumers are left to pay the $120 shortfall.

The changes we propose to make require distribution businesses to comply with new pricing principles:

First, each network tariff must be based on the long run marginal cost of providing the service. If consumers choose to take actions that will reduce future network costs, such as by reducing peak demand, then they will be rewarded with lower prices.

Second, the revenue to be recovered from each network tariff must recover the network business' total efficient costs of providing services.

Third, tariffs are to be developed in line with new principles that prices should be easily understood. Because consumers are more likely to be able to respond to price signals if they understand the connection between their usage decisions and the network price structures.

These changes will give consumers the information they need to decide what technologies might work best for them to manage their usage, and help reduce their energy charges.

From a market and overall system point of view, it will mean consumers' choices are the driving force behind market development and provide the conditions for a more effective and competitive energy market.

Going forward, network distribution businesses need to step up and take some ownership because, ultimately, they are responsible for sending consumers price signals about the costs of using their networks.

Another important Power of Choice building block, which 'dovetails' with the network distribution pricing rule change is creating opportunities for a competitive energy services market.

Consumers' technology uptake can be a huge part of the process in driving change and market development in coming years.

This is one of the many unpredictable areas for players in the energy market to grapple with: whether the increasing uptake of electric cars will drive another major increase in demand; whether the uptake of smart technology like smart thermostats and smart meters will result in more efficient energy use and contribute to a dampening of demand; and indeed how much of an ongoing impact the uptake of solar PV will have on demand.

Fortunately for me, these are all issues for businesses to make predictions about. My role is to make sure whatever the future holds, the Australian energy market is fleet-footed and flexible enough to adapt to change.

A competitive energy services market will allow consumers to benefit from a wider range of energy services, tools and smart technologies to respond to time of use pricing, off-peak charging of electric vehicles and faster retailer switching.

To make these reforms a success we need all players to play their part – government, regulators like the AEMC and business all need to make sure these reforms are a success and give consumers confidence in meters and their capacity to be a positive demand side tool.
The rule change to promote competition in metering and related services; the open access and common communications standards framework for smart meters; and arrangements to allow multiple trading relationships at the consumer's connection point – these reforms will all work together to help the energy services market evolve in a way the supports consumer choice.

These are just a couple of examples of the reforms we are moving on this year as part of implementing the Power of Choice.

Others include better arrangements for connecting embedded generators, improving customer access to information about their energy consumption and the Australian Energy Market Operator obtaining better demand side participation information.

All these reforms aim to put consumers in the driver's seat – to understand what affects their energy bills and to be able to do something about it.

Promoting competition

Demand side management is important for promoting competition.

Moving toward full retail competition across Australia is also important.

We recently completed the AEMC's first national review of competition in retail electricity and gas markets.

The review found that while the level of competition ranges from effective in South East Queensland, New South Wales, Victoria, and South Australia, to less effective in the Australian Capital Territory and is yet to emerge in Tasmania and regional Queensland.

Australian retail energy markets are pretty competitive by world standards.

A full 90 per cent of all consumers were aware they could choose their energy company. Up to 40 per cent had actively investigated their options. And up to 28 per cent had actually switched during 2013.

In terms of getting people comfortable with shopping around in the energy sector, that is a fantastic result, and means more consumers are shopping around for better deals for electricity than they are switching insurance companies, or phone and internet providers.

We have new retailers entering markets and all providers offering discounts and other incentives, with conservative estimates of savings ranging from $60 to $240 or more a year. And in some areas the number are much higher.

But the biggest barrier to consumers confidently shopping around to save is a lack of clear information, and that came through very clearly in the AEMC's recent consumer consultations, so there is room for more work in that area. To overcome these barriers, the AEMC has recommended a range of measures, including:

- Simplifying the switching process to make it easier for consumers to shop around,
- Raising awareness of the tools available for comparing offers,
- Reviewing concession schemes to target financial assistance to those most in need, and
- Continuing to harmonise and implement National Energy Customer Framework, with removal of price regulation.

The good news on that front is that the AEMC has considered competition in South East Queensland in light of the Queensland Government's plan to remove retail price regulation on 1 July 2015.

We've concluded that conditions in the South East Queensland electricity market are right for the removal of price regulation, with increased competition set to benefit customers when that occurs.

And the Queensland Parliament has recently passed legislation to implement the removal of price regulation.

Preparing for shock and change in the future

While our work on Power of Choice and retail competition is central to the AEMC's strategic priorities around consumers and market development, some other reforms are equally as important.

I started by talking about the risk of not being prepared for the future, and ensuring the energy market is both resilient and capable of handling shocks and change.

While the changes I've outlined – introducing greater competition and flexible market structures which effectively respond to change – hold us in good stead, I want to outline two other AEMC market reviews which will help future proof our electricity market: the Optional Firm Access and NEM Financial Market Resilience reviews.

<u>Optional Firm Access</u>

For all the reasons I've already talked about, the National Electricity Market is experiencing a period of significant change and uncertainty.

Against that backdrop we have proposed an integrated package of market arrangements during the Transmission Frameworks Review, termed Optional Firm Access or OFA.

The OFA arrangements create the ability for generators to pay for a specified level of network access to manage the effects of periodic network congestion. The model would change the way generators access the market during times of congestion and the way transmission operational and investment decisions are made. And it would introduce more commercial drivers on transmission businesses and more commercial financing of transmission infrastructure.

It should result in an improved coordination of generation and transmission operations and investment, which has the potential to minimise prices for electricity consumers in the longer term by minimising the total system cost of building and operating both generation and transmission.

Why is this important? It's not long ago that congestion was regarded as one of the most significant issues in the National Electricity Market due to rising demand. And while it is true slowing demand has taken pressure off the system, we don't know what the future holds.

We're genuinely 'in the testing phase' at this point and open to a broad range of views about OFA's necessity – whether it will work, how it might work and so on. But there is a strong argument that we shouldn't bet on one single future in terms of demand projections and investment.

Put simply, "you don't know, what you don't know" and an important part of the Commission's work is to ensure our system can handle shocks and change in the future.

We will publish a draft recommendation as to whether or not Optional Firm Access should be implemented, along with our draft assessment of the benefits and costs of Optional Firm Access in early 2015 and I look forward to the industry and consumer feedback on this important piece of work.

On Financial Market Resilience, despite the strong track record in financial and banking markets in Australia, following the Global Financial Crisis in 2007, there has been a general rethink in the financial sector in Australia and other jurisdictions about the strength of our structures.

The work taking place now in financial markets all around the world aims to avoid governments being placed in a situation – as was the case with the GFC in many countries, most famously in the US – where their urgent intervention is required to prevent the failure of a large institution. Particularly where the extent, nature and terms of such intervention are unknown.

It is on similar principles that the AEMC has embarked on an important piece of work looking at the resilience of the NEM itself to potential future shocks.

While, the NEM has operated effectively to date, its operating environment has evolved significantly since market start.

Today, a participant with a large retail business experiencing financial distress or failure could cause flow-on effects to other participants, potentially leading to financial system instability.
Last month, we released a second interim report for stakeholder comment on our recommendations to improve the ability of market arrangements to manage and respond to a participant failure in the National Electricity Market.

Our proposed a package of changes to better prepare for a potentially failure of a market participant with a large retail load. The key elements of the proposed new set of arrangements are:

- Participants whose failure would cause significant and immediate financial disruption to the electricity market and would likely threaten financial system stability in the NEM, should be classified as 'systemically important market participants' (SIMP).
- Establishment of a separate framework to facilitate a timely, proportionate and suitable response to a SIMP experiencing significant financial distress or failure.
- All of the decisions on the management of, and response to, a SIMP failure should be made at a single decision-making point. To facilitate this, decisions regarding suspension and revocation of retailer authorisations, currently taken by AEMO and the AER, would also be made at that single point.
- Decision-making focussed on maintain financial system stability in the NEM by minimising the impact of the SIMP failure on consumers and the market.

Given the nature of the decision-making needed in these structures, we consider it is best held by a body that has overall responsibility for the market.

Government is best placed to make these decisions, but within government, there needs to be a single decision-maker and we believe the Chair of the COAG Energy Council should be that ultimate decision-maker, in close cooperation with State and Territory energy ministers.

To help government – particularly the COAG Energy Council Chair - in its decision-making, we recommend a 'NEM Resilience Council' to include the AER, AEMO, AEMC and the Australian Securities and Investment Commission.

This framework would enable timely and appropriate taking of key decisions like whether to allow the SIMP time to rectify its financial situation; where the SIMP must be suspended from the market, a choice between applying the ROLR scheme, or an alternative stability arrangement and so on.

Submissions on this important piece of work on financial market resilience are due this Thursday 25 September and we expect to publish our final report by the end of the year.

The energy sector is confronting a great deal of change.

Some of that change – that which has drawn the most attention – has been driven by government and public policy reform – carbon pricing (and then repeal of carbon pricing), the Renewable Energy Target review, changes to network regulation, to name a few. Much of this, is important reform.

Then there's been change in demand driven by Australia's economic position, decline in the manufacturing sector, new energy services technology and take-up of energy efficiency measures by consumers.

In the context of all this change, the challenge for the Australian Energy Market Commission in terms of our strategic priorities, is: how do we provide a market framework which is strong and steady enough to provide investor confidence, yet flexible enough to deal with change?

And the work I've outlined today sets us on the right path to deal with change. Because in my view, although there has been a great deal of change in recent times, change is not behind us. The big change is still in front of us.

We are, in my opinion, entering the next chapter in one of Australia's most important productivity improvement stories. A new phase in energy market development which will put consumers squarely in the driver's seat with an unpredictable, but exciting, future.

I look forward to continuing to work with all of you as we embark on a busy work program to deliver on the promise of the reforms that remain ahead of us.

Thank you.

ENDS

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Australian Energy Market Commission

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