



Australian Energy Market Commission

SPEECH BY CHAIRMAN JOHN PIERCE AT CEDA ENERGY SERIES – THE NEM IN TRANSITION

*“The restaurant at the end of the universe: Evolution of
the energy market”*

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Thank you and good afternoon ladies and gentlemen.

It's a pleasure to be here today with so many who have a stake in the future of our energy market.

All of us are seeing accelerating change in the dynamics of the sector. A sector made up of diverse organisations, often with different world views – from competitive retail services and energy generation; to the regulated networks; government policy-making and regulatory agencies; and consumer and environmental organisations.

It is the interconnectedness among all of us that is remarkable.

What unites all of us is a shared stake in a resilient energy sector – one that is flexible and can adapt to whatever the future may bring. One that is efficient, secure and reliable, keeping prices as low as possible for consumers.

One of the main themes emerging from our extensive consultation has been the critical importance of policy integration. Environmental policy, which has tended to be developed externally to the energy market, can directly influence how effectively the market operates, and outcomes, including movements in wholesale and retail prices. Critically, the relationship between the two, and more fundamentally, changes to risk allocation as well as the level of consumer market.

Fundamentally, markets and regulatory arrangements can be thought of as mechanisms for allocating risks between the parties involved. In a sector such as energy, the ability of the system to operate effectively and ultimately, the outcomes for consumers, depends on

the various policy and regulatory interventions taking a consistent approach to risk allocation.

Setting environmental and social policy objectives is, of course, the role of governments. That's what they are paid to do. Our role lies with the *mechanism* used to achieve the objective and in seeing it done in a way that supports the efficient operation of the energy market and the long-term interests of consumers.

Successful policy integration needs to satisfy three conditions:

1. It is done in a way that supports the efficient operation of the electricity market and the long-term interests of consumers.
For this to happen, it should be compatible with the pricing mechanisms used to trade electricity
2. It must be consistent with the allocation of risk between, say, businesses and consumers that underpins an efficiently operating market.
3. It should have the ability to meet an emissions target, and meeting its objectives whatever the future brings - in demand growth, technological changes and relative input prices. That is, it should not be dependent on today's expectations or forecasts of these variables.

Integration of the tools used to control emissions with the energy market is really the only means of achieving both energy and emission reduction policy objectives.

But it's not just policy integration that needs to be addressed. We are also seeing changes in:

- technology on both sides of the meter
- new business models based on offering energy services, not just energy, and
- Consumer preferences in sourcing and using these services.

The simple truth is that change will always be a feature of energy markets, and hence, policy and regulatory arrangements. What's important is the way that policy and regulatory change is managed – it must be transparent, based on clear objectives and relatively predictable.

To this end, we consult widely with the increasingly broad array of organisations that have a stake in the future of our energy market. We have just completed one of our key market development exercises and today I'm very pleased to be releasing the results of our stakeholder consultation on the Strategic Priorities for Energy Market Development. Looking around the room, I see many who gave valuable and considered input to our recommended focus areas for market development.

So let me give you some context around each of the three Strategic Priorities.

1. *Consumer Priority: Enabling consumers to make informed decisions in competitive retail markets*

The first is our Consumer Priority – enabling consumers to make informed decisions in competitive retail markets.

Starting with the proposition that it is consumers themselves who are the best judges of what works for them, much of our work over the past five years has been driving more opportunities for consumers to make informed choices about the way they use electricity

based on the benefits that end-use services provide to them.

The Power of Choice reforms, in particular, have laid the foundation for the energy system to be positioned to respond to new technologies in a way that is in the consumer's interests. These technologies are changing how consumers participate in energy markets and include battery storage, microgeneration, smart devices and connected home products and services.

These technological changes sometimes drive either predictions of achieving an energy nirvana or imminent Armageddon. Regardless, we need to look beyond the widgets to focus on the *function* they perform and adjust the regulatory and market processes where necessary to accommodate them. Many of the functions they perform are not new – what is new is that the technology allows these functions to be performed much closer to, and within the control of consumers.

We call this the 'consumer-driven transformation' of the energy sector.

Some of you might remember Douglas Adams' trilogy of five books, 'The Hitchhiker's Guide to the Galaxy'. Consumers are increasingly sitting at the 'centre of the universe', not waiting to be served 'in a restaurant at the end of it'.

While some may take the view that the best form of consumer protection is effective competition, the peculiarities of energy have meant that governments have in place an energy-specific consumer protection framework that places obligations on businesses that go beyond those required by the more general Australian Consumer Law.

Given changes in business models and the move from selling kilowatt hours to a broader range of energy services, the Energy Council is undertaking a review of the energy specific consumer protection framework including the jurisdictional derogations.

Successful implementation of the distribution network tariffs reforms that is currently underway, is a vital step in the development of an effective retail energy services market.

But these price reforms alone will not be enough.

People need information in a form that allows them to make informed choices.

So over the next two years, the Consumer Priority will focus on protection, engagement and participation so that consumers can benefit from the innovations in energy markets.

2. Gas Priority: Promoting the development of efficient gas markets

Turning now to our second priority: the promotion of efficient gas markets.

We saw the first LNG cargos exported from Gladstone in January this year - an historic moment for the east coast gas industry. The market has now entered a transitional period to a new supply and demand balance - by 2020, natural gas used for LNG production will account for over 70% of total east coast demand.

The Energy Council asked the AEMC to consider the direction that east coast gas markets should take, given the new LNG industry market dynamic and the Victorian government asked us to look in detail at specific arrangements for Victoria. We are guided by the Council's Vision for Australia's future gas market which will, over time, provide market participants with a more flexible and transparent way of buying and selling gas.

We are looking at some important issues in developing recommendations for the Energy Council, which will be released publicly next month. These include the extent to which different gas market development pathways promote trading and risk management, preserve signals for investment in pipeline capacity, and address new levels of complexity. Lower transaction costs and fewer barriers to entry will promote more competition in the wholesale markets which can be expected to benefit retail prices.

The focus over the next two years will be implementing those recommendations endorsed by the Council.

3. *Markets and Networks Priority: Encouraging efficient investment and flexibility*

Our third priority focuses on encouraging efficient investment and flexibility in markets and networks.

We are at an inflection point in energy markets with changes in the costs, technology, consumer preferences, patterns of demand and environmental policy. The pace of change is creating new opportunities for new business models to emerge that demand greater flexibility to maintain market resilience.

So it's critical that market and regulatory arrangements create the right conditions for business evolution that promotes the long-term interests of consumers.

Companies are now competing to offer energy services, not just energy. They will manage an individual consumer's energy needs:

- managing the risk of buying energy in a more dynamically-priced environment
- provide tools to respond to time-of-use pricing
- optimise appliance settings
- choose when to charge electric vehicles
- And when to sell stored energy back to the grid.

This is driving a redefinition of where the lines are drawn between functions that are subject to economic regulation and those that can be provided through competition. It is also redefining the relationships between different parts of the sector, where they potentially compete, and the circumstances under which they co-operate.

This has important implications for how competition for retail energy services develop, how we think about the role of the retailer and the evolution of networks, in particular, at the distribution level. Distribution businesses are evolving from 'one-way' energy delivery systems into multi-directional 'smart grids'. The regulatory frameworks must support these innovations in a way that clearly distinguishes between those that relate to functions of the network and hence are subject to regulation and those that belong in a competitive energy services market.

To use a sporting analogy, every player on the energy sector playing field should understand the position they are playing and the rules of the game.

To this end, we will continue our work program focused on technology and provide recommendations to the Energy Council where changes are required to the regulatory frameworks.

Let me finish by saying in the face of change, we are not operating with yesterday's logic.

The intensive consultation that helps shape our thinking on Strategic Priorities for Energy Market Development, also helps us provide policy advice and changes to the regulatory frameworks that are adaptive to changing circumstances, without losing sight of the objective.

And that objective remains the same as it's always been: a resilient energy sector – one that is flexible and can adapt to whatever the future may bring. One that is efficient, secure and reliable, keeping prices as low as possible for consumers and providing meaningful choices to help them manage their energy needs.

I invite you to continue to help us shape our thinking, to actively participate in our reviews and forums and to request change when it's needed. I look forward to continuing the conversation.

Thank you.

ENDS

John Pierce

Chairman

Australian Energy Market Commission

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