

9<sup>th</sup> October 2015

Mr John Pierce  
Chairman  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

## **Australian Energy Market Commission (AEMC) Discussion Paper, Strategic Priorities for Energy Market Development, September 2015**

Dear Mr Pierce,

The Energy Networks Association (ENA) appreciates the opportunity to comment on the Australian Energy Market Commission's (AEMC) Discussion Paper on *Strategic priorities for energy market development*.

The Strategic Priorities process is occurring at what is arguably a critical inflexion point both in the evolving energy market sector, but also the institutional and governance arrangements governing energy policy and economic regulation. For example, the COAG Energy Council's Review of Governance Arrangements for Australian Energy Markets represents a potentially important milestone in enhancing energy market governance arrangements that will support policy and regulatory reforms that will further drive innovation across the energy sector..

In its response to the Draft Governance Report, and restated in this submission, the ENA has expressed the view that the AEMC should have the unequivocal mandate, and accountability to lead energy market and regulatory design, and have the clear capacity to directly seek and receive regulatory and technical advice from the AER and AEMO.

ENA considers that the transparent setting of strategic priorities by the AEMC every two years, in consultation with stakeholders, has been useful in facilitating stakeholders' engagement with the AEMC on the priority setting and the subsequent work program. However, at a time of significant disruption and transformation of the energy sector, ENA considers that there is a need for the AEMC to identify prospective focus areas that are more likely to emerge beyond a two year horizon.

In this context the development of the Network Transformation Roadmap, being undertaken by ENA in partnership with CSIRO could be a useful information source for the AEMC's consideration of the potential medium to longer term strategic priorities. ENA has appreciated the involvement of AEMC staff in some workshops to date and look forward to providing further engagement.

In the attached submission the ENA has provided a more detailed response to the proposed strategic priorities for 2015 and the focus areas. ENA supports the three priorities and proposed focus areas, as well as proposing two additional focus areas for gas.

I look forward to discussing the ENA's submission with you in more detail.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Bradley', with a long, sweeping horizontal stroke extending to the right.

John Bradley  
**Chief Executive Officer**



# AEMC STRATEGIC PRIORITIES FOR ENERGY MARKET DEVELOPMENT

Response to Discussion Paper, 9 October 2015

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# INTRODUCTION

The Energy Networks Association appreciates the opportunity to comment on the Australian Energy Market Commission's (AEMC) Discussion Paper on *Strategic priorities for energy market development*.

The Strategic Priorities process is occurring at what is arguably a critical inflexion point both in the evolving energy market sector, but also the institutional and governance arrangements governing energy policy and economic regulation.

The COAG Energy Council's Review of Governance Arrangements for Australian Energy Markets, for example, represents a potentially important milestone in enhancing energy market governance arrangements that will support policy and regulatory reforms that will further drive innovation across the energy sector..

In its response to the Draft Governance Report the ENA has expressed the view that the AEMC should have the unequivocal mandate, and accountability to lead energy market and regulatory design, and have the clear capacity to directly seek and receive regulatory and technical advice from the AER and AEMO.

As the Draft Governance Report indicated, numerous stakeholders saw policy integration and coordination as a critical priority. In setting its Strategic Priorities then, the AEMC should seek to represent the primary instrument supporting energy policy development by the COAG Energy Council, in its planning, sequencing and execution. For transparent, robust energy reform, the ENA considers AEMC should have both responsibility and the accountability for confronting fundamental market and regulatory design issues in proposed rule changes sufficient to allow the evaluation of whether proposed changes are in the long-term interest of consumers. The ENA considers that these initiatives are important to ensure that energy market and regulatory design processes deliver benefits to consumers.

## TIME HORIZON OF STRATEGIC PRIORITIES

The transparent setting of strategic priorities by the AEMC every two years, in consultation with stakeholders, has

been useful in facilitating stakeholders' engagement with the AEMC on the priority setting and the subsequent work program.

However, at a time of significant disruption and transformation of the energy sector, there is a need for the AEMC to identify prospective focus areas that are more likely to emerge beyond a two year horizon. By way of example looking over a medium to longer term horizon the consideration of the integration of higher levels of renewables with networks, and the implications for energy market operations and new ancillary service arrangements, could be a prospective focus area under the market and networks priority.

In the medium to longer term context the development of the Network Transformation Roadmap, being undertaken by ENA in partnership with CSIRO could be a useful information source for the AEMC's consideration. The Roadmap is designed to identify the preferred transition which the electricity network industry must make in the next decade, to be ready to support better customer outcomes under a diverse range of long-term energy scenarios. ENA and CSIRO are engaging widely with stakeholders in this process. We anticipate that the outcomes of the Roadmap will be directly relevant to the AEMC's consumer priority and the market and network priority. We appreciate the involvement of AEMC staff in some workshops to date and look forward to providing further engagement.

The remainder of this submission considers the proposed strategic priorities for 2015 and the focus areas.

## BACKGROUND

The ENA is the national industry association representing the businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia. ENA members own assets valued at over \$100 billion in energy network infrastructure.

# RESPONSE

## CONSUMER PRIORITY

The AEMC has proposed three areas of focus for the Consumer Priority for 2015:

- » engagement;
- » participation; and
- » protection.

## Engagement

### Supporting informed choice

ENA supports the AEMC's findings that "more work is needed in terms of raising awareness about how to meaningfully compare energy offers".

In its Information Paper on *Supporting Vulnerable Customers*, the ENA reported on independent research which shows some energy customers could benefit more from shopping around than from government assistance – with potential savings up to 5 times the value of the government assistance. This is consistent with the most recent report (September 2015) from St Vincent De Paul which shows significant differences between retail offers, and the potential for customers to benefit by switching.

Taking into account earlier work by the AEMC on a blueprint for consumer engagement, ENA has identified a number of options for assisting consumers, in particular vulnerable consumers, to make informed choices about their energy use. ENA explored these options with stakeholders in a series of roundtables across five capital cities between June and September 2015. The options included:

- » reviewing the frequency and detail of energy bills, to ensure that energy bills are timely and informative so that customers are able to understand and respond to cost-reflective pricing;
- » consistent use of language and concepts in communication materials;
- » partnerships with trusted community organisations, to distribute information particularly for customers that do not have access to the internet;
- » a global directory of information resources and tools;

- » access to technology that provides information on energy use, such as in home displays etc; and
- » greater assistance for community organisations to provide advice and assistance.

The AEMC has found that there is a low level of awareness of the government comparison websites. While ENA supports governments having a valuable role to play in providing independent trusted information, customer access to data on their own energy usage that is made available by the network businesses could also play an important role for customers to manage their energy bills. This is relevant in the context of the *AEMO Metering Data Provision Procedures*, which will come into effect in March 2016, to support enhanced information provision to customers by distribution businesses and retailers.

In the context of network tariff reform, network businesses are developing partnerships, information and tools to assist customers to make informed choices.

### Engagement with the regulatory process

ENA strongly supports the role enhanced customer engagement can play to ensure energy networks are ready to meet changing customers' needs into the future. There have been a number of regulatory and institutional changes including:

- » Under the national regulatory rules the Australian Energy Regulator (AER) must consider issues identified by electricity consumers in their engagement with networks processes when assessing future network expenditure. There is also an expectation that this occurs in gas network reviews.
- » The AER's Consumer Challenge Panel provides input on networks' engagement with customers.
- » The establishment of Energy Consumers Australia (ECA) provides an opportunity for it to lead and strengthen consumer advocacy across Australia on energy related issues. ECA can influence a national, co-ordinated approach to consumer advocacy, while recognising the need for effective localised approaches given the differences across Australia.

These initiatives are designed to bring consumers voices and perspectives directly into regulatory decision-making and network pricing determinations.

Despite the significant commitment of resources and time by all parties involved in energy consumer engagement, it

is evident that further clarification of institutional roles and processes will be required to fully achieve the objectives of the reforms. Intrusive regulation does not promote cultural change in customer orientation and there is a need, for instance, for:

- » regulatory outcomes which encourage a dynamic customer orientation by energy service providers and strengthened customer relationships, rather than interposing the regulator's views in the service relationship without equivalent valid engagement or research;
- » increased predictability of the requirements and performance indicators of effective engagement as it informs the AER's regulatory process; and
- » a clearly defined role and *modus operandi* of the AER Consumer Challenge Panel which permits interaction and promotes shared confidence in regulatory outcomes which reflect the voice of consumers.

The ENA and network businesses look forward to working closely with consumers and with the ECA to increase the participation of consumers to ensure their voices are heard on issues affecting convenience, price, reliability, amenity and safety of their energy service.

## Participation

### Cost-reflective network pricing

Most consumers do not pay retail prices that reflect the network costs that arise from their energy choices.

The changes to the National Electricity Rules (NER) in December 2014 have introduced a distribution network pricing objective (that prices should reflect long run marginal costs) and pricing principles to underpin the setting of tariff structures and pricing levels. Distribution networks are currently in the process of developing tariff structures and indicative pricing levels, in consultation with consumers and retailers, to be submitted to the AER. Consistent with the pricing principles networks propose to transition customers to more cost-reflective pricing to manage the unwinding of existing cross-subsidies, and reduce the potential for bill shock for some customers.

### Ability to understand and respond to price signals

Studies of demand response internationally by the Brattle Group<sup>1</sup> have identified a number of key findings:

- » 60 per cent of studies show a demand response of 10 per cent or more;
- » the stronger the price incentive, the greater the demand response;
- » enabling technologies have been shown in Australian studies and elsewhere to boost demand response.

In the Australia context, the *SmartGridSmartCity* program reported that vulnerable consumers were:

- » more willing to shift load; and
- » rated the behaviour changes they made as easier (less disruptive) than other households.

### Responsiveness to changing consumer preferences and choices

Effective retail market competition is essential for consumers to be able to make informed choices and choose the retail offer that best meets their needs.

In its most recent markets review, the AEMC has found that effective competition:

- » is yet to emerge for small customers in electricity markets in Tasmania, regional Queensland and the Australian Capital Territory (ACT);
- » is present in electricity markets in Victoria, South Australia, New South Wales (NSW) and South East Queensland (although this is currently under jurisdictional review);
- » is less effective in the smaller gas market, with fewer retailers.

Consumer advocates, including St Vincent De Paul's continue to raise their concern that around 10 to 30 per cent of small electricity customers remain on standing offers, which are generally higher priced, in jurisdictions where there is effective competition.

Effective competition will have a role to play in the pass through of network tariffs into retail tariffs. The AEMC argued in its final determination on distribution network pricing arrangements that competitive market pressures should be sufficient to lead retailers to design tariffs that

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<sup>1</sup> The Brattle Group, Price-enabled Demand Response, July 16, 2014

reflect customer preferences, including how they recover the costs of network services. This could mean that retailers will charge a risk premium to customers where there is a mismatch between the customers' preferred retail tariff structure and the network tariff structure or manage the risk through hedging through demand response incentives.

Given the criticality of customers being able to see and respond to a price signal, to achieve the benefits of the AEMC's 2014 Rule change suggests that the AEMC monitor the extent of retailer pass-through of network tariffs as part of its annual national review of retail competition.

### Protection

The ENA strongly supported the development and implementation of the National Energy Customer Framework (NECF). ENA agrees with the AEMC's assessment that the energy specific, consumer protections framework will require rethinking as it potentially lacks the flexibility to adapt to changing business models, encourage innovation and new products and services but still protect consumers. ENA's position on consumer protection frameworks that are flexible to deal with new business models and services are discussed below in the section on technology and new business models.

ENA notes that similar issues and concerns around the appropriate consumer protection framework have been raised by St Vincent De Paul in the September 2015 St Vincent de Paul's report on retail pricing in the National Electricity Market. They propose that the COAG Energy Council's NECF review consider not only the applicability of NECF to new products and services, but to identify improvements that could be made to the overall competitiveness of the overall retail market design and the consumer protection framework.

## GAS PRIORITY

The AEMC has proposed three areas of focus for the Gas Priority for 2015 that reflect the COAG Energy Council's vision for Australian gas markets:

- » wholesale gas trading markets;
- » pipeline capacity trading; and
- » information.

ENA supports the four actions agreed by COAG Energy Council in July 2015, which are intended to increase the transparency and efficiency of the wholesale gas trading markets, and the key work to be undertaken in Stage 2 of the east coast gas review. The ENA believes such a review may also benefit gas consumers in smaller regional markets by identifying means to open those markets to greater retail competition.

However, ENA considers that the AEMC's strategic priority for the development of efficient gas markets should have two additional focus areas:

- » a level playing field in downstream gas markets; and
- » effective outcome- based incentive arrangements.

### A level playing field in downstream gas markets

Under a level playing field all energy options should be expected to compete on the basis of their value to customers and their ability to contribute to greenhouse gas abatement. This would see the removal of unnecessary barriers to new gas supply, developing measures to promote greater transparency in the gas market and to ensure that energy schemes designed to reduce emissions are fuel neutral.

It is important that the AEMC's strategic priorities also have a focus on gas markets beyond the 'city gate'.

As the AEMC notes in its Discussion Paper, the environmental policy of Governments is not a matter for the Commission, but the *mechanisms* by which they are achieved in energy markets, must necessarily be.

Downstream gas markets in Australia are facing significant challenges due to the internationalization of gas prices and increasing competitive appliance technologies. Significant distortions in policy settings are exacerbating the challenges for the domestic gas sector as it manages the transition. Policy reform is urgently needed to establish a level playing field and the AEMC's strategic priorities should include ensuring that energy policy settings designed to reduce emissions are outcomes focused and technology neutral.

For example hot water appliance markets in Australia are currently distorted by significant subsidies for heat pumps which are more emissions intensive than efficient gas hot water heaters which receive no subsidy.

## Effective outcomes based incentive arrangements

Effective outcomes based incentives arrangements are a way of improving price and service outcomes for gas customers. They are relied on to a greater extent in the United Kingdom than in Australia.

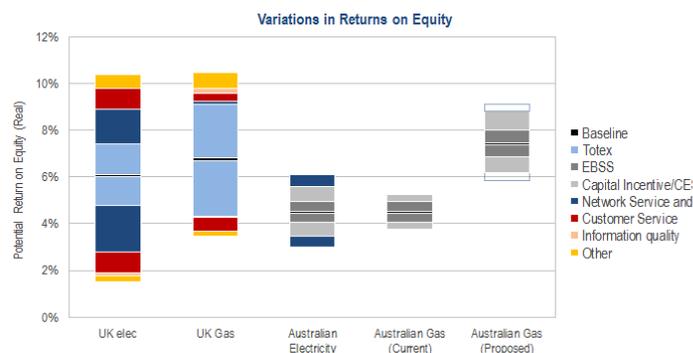
Source: AGN, *Access Arrangement Information*, July 2015

ENA notes that Australian Gas Networks (AGN) has recently proposed a more comprehensive set of arrangements to apply for the next access arrangement period, including:

- » the retention and strengthening of the AER's operating expenditure incentive scheme;
- » the introduction of the AER's capital expenditure incentive scheme;
- » the introduction of an incentive to promote lower cost and/or improved service delivery outcomes through innovation; and
- » the development and introduction of a customer service incentive scheme during the next period.

If introduced, these incentives could increase the scope for the business to make more cost-efficient investments, drive greater cost reductions, while maintaining or improving quality, safety, reliability and security of supply of natural gas for customers.

**Figure 1: Strength of incentives in Australia versus UK**



Source: AGN *Access Arrangement Information*

## Access arrangement timelines

Currently, the National Gas Rules specify that the AER must allow a minimum period of 15 business days for gas distribution networks to revise their Access Arrangement Proposals (AAP) (should the AER consider revision of the AAP necessary). In contrast, electricity distribution businesses are provided with a minimum period of 45

business days to respond to the AER's draft determination.

ENA considers the timeline of 15 days too short for gas distribution networks to meaningfully engage with stakeholders in order for stakeholder views to be incorporated into the revised AAP. This is inconsistent with the AEMC's focus on its Consumer Priority and the ENA therefore encourages the AEMC to review the timelines currently detailed to ensure the National Gas Objective can be appropriately met.

## MARKETS AND NETWORK PRIORITY

ENA welcomes the inclusion of network regulatory arrangements into this priority, noting that this focus should include both transmission and distribution networks.

## Technology and new business models

The ENA and network businesses support the development of a vibrant, innovative market enabling new services and products such as distributed energy resources including onsite generation and storage.

In ENA's view future regulatory frameworks for both transmission and distribution energy networks need to support development of innovative products and services at the same time as achieving the market and customer protection outcomes in the National Electricity Objective (NEO), National Gas Objective (NGO) and the National Energy Retail Objective (NERO).

In this dynamic market environment, it is in the long-term interest of electricity consumers that unnecessary barriers to entry in competitive energy markets should be avoided.

The scale of change to customer energy services does require consideration of changes to the policy and regulatory environment, particularly for energy supply operations and consumer protection.

- » Participation in solar, storage or demand management markets may significantly alter both the physical and financial features of a customer's energy service.
- » Further issues arise where the most efficient option for supply to customers is via micro-grids or Stand-

Alone Power Systems, with or without backup supply from the central network..

- » The extent of choice available to consumers itself may permit re-evaluation of consumer protection frameworks not only for new services but for traditional energy services.

In this dynamic environment, policy makers should carefully evaluate the policy and regulatory framework to ensure it remains fit for purpose, light-handed and supports innovative service delivery to customers by both new and traditional service providers.

## Network evolution

Australia's current regulatory model for electricity networks is effectively based on forms of utility regulation developed in the United Kingdom over thirty years ago. It also incorporates some features of US style 'rate of return' regulation that has a history stretching back to the early 1900s.

Over time this regulatory model has evolved, for example, with the progressive introduction of a series of incentives, and reward and penalties schemes aimed at providing the right signals for capital and operating efficiencies in service delivery, and maintaining or enhancing service quality.

A further wave of institutional and policy reforms, including major regulatory rule revisions, are currently in the process of implementation. This reform wave has followed on from a period of intensive review and policy focus around the regulated energy sector in the past three years.

In the future markets, the pace of change in evolving technologies and cost developments may make a range of previously monopoly delivered services increasingly contestable and competitive. For example increased metering contestability is under consideration alongside the Transmission Connection and Planning Arrangements Rule change. Other elements of traditional monopoly network service are increasingly likely to face competition.

The ENA has considered the implications of these changes for the future of economic regulation. In the ENA's 2015 position paper, *Evolving a future ready regulatory framework*, the ENA highlighted some early potential

future directions of evolution in the regulatory framework so that it remains fit for purpose. These include:

- » ensuring networks are free to deliver valued, efficient energy service solutions to individual customers;
- » facilitating more efficient and collaborative approaches to setting networks' business and investment plans;
- » allowing consumers to be at the heart of regulatory decisions;
- » allow efficient competition to emerge, and ensuring there exist mechanisms to address where regulation can be removed or recalibrated;
- » providing robust independent processes for evaluating the boundaries of competition and contestability;
- » being open to new ways to promote network innovation,;

The ENA considers that an important ongoing feature of sustainable long-term network investment framework is the regulatory capacity to accommodate financeability adjustments, where required, to ensure the ability of the networks to maintain stable credit metrics and therefore source competitively priced finance. Regulatory decisions that provide network businesses the reasonable opportunity to maintain key financeability metrics is in the long term interests of consumers as it leads to lower financing costs over the long-term. A further benefit is ensuring that any decisions made by the AER, which are based on a benchmark credit rating assumption are internally consistent.

A further area of critical importance is providing networks with adequate incentives to improve utilisation of existing network infrastructure in a zero or low demand growth environment facing market and technology disruption, with implications for traditional regulatory depreciation, asset lives, and RAB indexation approaches.

There is also the potential for greater use to be made of incentives in respect of electricity network regulation, similar to the proposed incentives including an innovation allowance discussed earlier in this submission in relation to gas.

## Wholesale energy markets

The AEMC has identified that a focus area under this priority is appropriately designed environmental policy that is integrated with the energy market. Carbon abatement policies that are appropriately designed and integrated with the energy market can minimise costs for consumers.

As noted above, the AEMC should seek to influence policy frameworks influencing energy fuel choices such that carbon abatement policy is outcomes focused and technology neutral.

Similarly the AEMC should have a direct - and coordinating interest – in the effective response of wholesale electricity markets to emission reduction objectives and renewables policy. For instance, carbon and renewables policy has the potential to have significant implications for wholesale energy markets and power system control.

In a joint study<sup>2</sup> by AEMO and Electranet:

- » it was concluded that: "Changing market factors could see less synchronous generation operating in SA, affecting the SA power system's ability to maintain required power system control in the future."
- » noted the influence that increasing renewables penetration including solar panels and wind output, among other factors; and
- » noted the role of the Northern, Pelican Point, and Torrens Island generators providing the required frequency control and regulation to maintain the SA power system in a secure operational state, in addition to power system inertia, and support for management of voltage limits.

It is noted that since this report Alinta Energy announced that Northern and Playford B power stations "...would not operate beyond March 2018 and might close even sooner".<sup>3</sup>

Current renewables policy at both State and Federal Government levels promote technology specific solutions rather than least cost abatement.

The AEMC's strategic priorities should therefore include a focus on the economic and operational implications of technology specific policy settings for wholesale electricity market outcomes in the medium to long term. For example, consideration of the integration of higher levels of renewables in the National Electricity Market, and the implications for energy market operations and potential new ancillary service requirements are a needed focus area that is already getting attention in the context of the high level of renewables in South Australia.

In ENA's view the AEMC has an important role to play in influencing the integration of efficient carbon and energy policy. Australia's energy networks support an efficient transition to a low carbon economy and network infrastructure will be vital to achieving carbon policy objectives and emissions targets.

- » Electricity distribution networks will connect new renewable sources of supply, allowing the phase out of emission intensive generation and unlocking benefits of small and large solar, storage and demand management. In this process technology neutral pricing, is essential to achieving least cost abatement and supporting efficient energy outcomes for consumers.
- » Gas networks will help lower emissions from household hot-water and heating and provide clean energy for industrial processes and gas-fuelled vehicle fleets.

## ENA CONTACT

ENA would welcome the opportunity to further discuss with the AEMC the matters raised in this submission. The contact for this submission is Garth Crawford who can be contacted on 02 6272 1507 or by email [gscrawford@ena.asn.au](mailto:gscrawford@ena.asn.au)

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<sup>2</sup> AEMO and Electranet "Renewable Energy Integration in South Australia", October 2014.

<sup>3</sup> ABC news "Alinta Energy to close power stations at Port Augusta and coal mine at Leigh Creek" 11 June 2015