

28 May 2013

Australian Energy Market Commission

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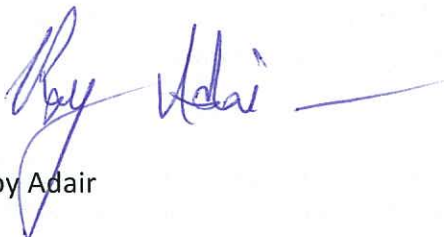
**AEMC Strategic Priorities**

Dear Mr Pierce,

Thank you for the opportunity to comment on the AEMC Strategic Priorities. Please find attached our submission.

If you have any questions in relation to this submission, please contact David Bowker on 03-62305775.

Yours sincerely,



Roy Adair

Chief Executive Officer

## Hydro Tasmania Submission on AEMC Strategic Priorities

### 1. Overview

Hydro Tasmania is very supportive of this process which has been initiated by AEMC to develop Strategic Priorities. It represents an opportunity for participants to come together every two years to consider the key strategic activities which are needed to develop the market.

We have identified another potential priority related to the possible “death spiral” for distribution businesses if material numbers of customers disconnect from the network. We suggest dropping the Consumer Advocacy priority as there is already significant activity in this area to maintain three priority areas and replacing it with the Distribution Priority.

We comment below on the proposed priorities.

### 2. Strengthening Consumer Participation Priority

The Power of Choice review underscored the vital role that demand side participation, and in particular energy efficiency and emerging technologies, can play in helping Australian energy consumers to better use energy and where possible save money. That review highlighted the important role smart metering and time of use pricing will play in achieving these goals.

But technology choices on their own will not ensure, firstly, that any particular consumer will make rational cost minimising energy decisions, or secondly, that a critical mass of consumers will reduce and shift their consumption in a way that reduces and shifts load to an extent that makes a meaningful contribution to network planning going forward.

The potential benefits of energy efficiency and technology choices must be unlocked by a combination of (a) appropriate price signals that incentivise consumers and (b) consumer awareness measures that are proven to provide energy consumers with a platform to take action to reduce their energy bills.

The Victorian smart meter roll out experience is instructive in a number of ways. The focus on the what and how of the roll out, to the exclusion of the why, led to very low consumer understanding of the benefits that smart metering has the potential to facilitate. Even worse, the lack of consumer engagement about the purpose of the program helped allow suspicion and myths to spread.

It follows that further consumer awareness measures are appropriate only if those measures go beyond mere information (for example, explanations as to why energy prices are rising) and actually empower consumers to take advantage of new pricing and technology choices. The AEMC should resist attempts to use its Strategic Prioritises process to impose consumer awareness measures that don't have that practical purpose. Widespread and understandable concern about rising energy prices should not lead to additional consumer awareness measures that would impose an additional regulatory burden on retailers, especially because this is potentially going to result in longer and more complex contracts that are more difficult for consumers to comprehend, and contrary to the objective of improving consumer awareness. It is important that the regulatory approach recognises that energy costs are very important to people whose circumstances are such that they are materially affected by rising energy prices, but less so and not at all to a high proportion of other consumers.

Hydro Tasmania believes that consumer representation can have a role in improving consumer awareness. Representation of consumers will be improved with the establishment of the Consumer Challenge Panel and the National Energy Customer Advocacy Body (NECAB). It is important to allow time for these measures to impact consumer awareness before new initiatives are considered and consequently we believe it should not be a central priority for the AEMC at this time.

### **3. Efficient Gas Market Priority**

Hydro Tasmania strongly supports the inclusion of gas market development as a priority of the Australian Energy Market Commission (AEMC). Hydro Tasmania considers that gas market development to date has delivered significant improvements in the ability to trade gas in the short term through the Short Term Trading hubs (STTMs), the Victorian Declared Wholesale Market and the possible brokerage trading hub at Wallumbilla. Each of these existing arrangements provides some assistance to longer term contracting through daily price discovery and by facilitating operating efficiency.

However, the process to develop gas supply contracts, is time consuming and costly. Price discovery is poor. This situation is consistent with a tightly held bilateral market environment but not well suited to development of a broader and more diverse participant base. In years to come the trading hubs, or yet to be developed financial exchange platforms, may be the principal means for trading, but for the foreseeable future Hydro Tasmania expects bilateral contracts to be a fundamental trading instrument.

Accordingly Hydro Tasmania considers that bilateral contract formation could be more efficient and effective than at present and that initially greater focus is required on facilitation of long term contract formation.

In the light of this gas environment, some progress is clearly being made but on a rather ad hoc basis. In particular the specific arrangements which have developed over many years during a very different era, are somewhat convoluted. What is missing is the “light on the hill”. Hydro Tasmania proposes that AEMC, as a part of this priority, should facilitate the development of a blank sheet approach to market design. This would involve taking the existing gas assets in Australia and designing an ideal market arrangement without any recognition of the current ownership or the long term contracts which exist.

This “ideal” market would then become an objective to be reached in the long term and it should provide a guide for the decisions which need to be made in the shorter term. Whilst this area is a priority, the current ownership and contractual arrangements will inhibit rapid progress.

#### 4 Market Arrangements Priority

The description of this priority identifies the need to attract investment by providing policy stability and flexibility with transparent processes. The need to attract investment appears to be grounded in the paradigm when demand growth was the only conceivable future. In today’s world of carbon constraint and declining demand, investment is being driven by the RET which is delivering wind projects and there is little new thermal generation planned.

The three major uncertainties facing the electricity market today are

Issue	Cause
Carbon policy/pricing	Potential change in Federal Government Global direction unclear
Gas pricing and availability	Major discontinuity in gas demand from LNG introduction Market response
Transmission rules	Market development review initiated by SCER

The first of these, carbon pricing, could be fixed by a bi-partisan response to the issue. Given the current state of play, this is unlikely to happen. Gas pricing is largely an outcome from world events and the response of a market to an opportunity. The third item has been initiated by SCER and could well lead to a significant pause in new investment. Although there has been a declining demand, there is still a need for new RET-driven investment and these investments will be looking for regulatory certainty for their projects.

AEMC have identified five projects where they are doing work in this area. The Transmission Frameworks Review is the project which has generated the third issue in the table above. The other four projects could be characterised as fixing the symptoms of the problem.

The most significant initiative which AEMC could take under this priority is to ensure that Governments are well informed about the impact of their decisions. It is very easy for Governments to commission a review into some issue but every review has a price. This price is not only reflected in the direct costs of those undertaking and responding to the review but also the indirect costs of the businesses who respond to the review and the investments which are deterred by the review.

The other potential work for this area would be an initiative to reduce the level of regulation for the NEM. One of the key drivers for markets is that competitors can innovate to achieve a commercial advantage. In a very prescriptive market, there is less room for innovation and markets are less effective. One source of excessive regulation is as a security blanket in the early days of a market. When policy makers lack faith in a market they tend to regulate in an attempt to control outcomes. Now that the NEM is over a decade old, it would be a good time to reduce the level of regulation in the market and encourage some more innovation.

The process which could be adopted for this workstream would be to identify areas of the market where experience has shown safeguards are not used. One such example is the Reserve Trader Provisions. Such a workstream would also be aligned with the original intent of the NEM to have light handed regulation.

## **5 Distribution Priority**

One of the key strategic challenges facing the NEM is the significant growth of small embedded generation. This includes rooftop solar PV's, embedded cogen and small wind farms. This trend is accompanied by three power system needs/responses. These are power system stability, increased costs from the need to cater for bidirectional distribution networks and a revenue dilemma for distribution businesses as their volume from connected customers declines. The likely evolution of this trend is for customers to disconnect from the network as solar PV's decline in cost and storage technologies improve. AGL have referred to this as the "death spiral" as less customers face increasingly high distribution costs from a lower customer base on which to spread the largely fixed costs.

Hydro Tasmania believes that this issue should be the focus of a priority. The issue is still relatively small but it may be possible, if this is seen as a credible scenario, to institute some policies to minimise the impact. In these situations early action can be very beneficial for small increases in cost. Some of the possible solutions could be to assume a much shorter life for vulnerable distribution upgrades, limitation of investment in new network capability with it being replaced with local generation. Local generation, if this scenario plays out will eventually be superseded by embedded generation owned by customers and can then be relocated.

The opportunity exists to act early on this issue and it is consequently a very strategic issue. The potential benefits to society from early action on this are, we believe, significant.

