ANNE PEARSON

CHIEF EXECUTIVE, AUSTRALIAN ENERGY MARKET COMMISSION

ACCC/AER Annual Regulatory Conference

DAY TWO: PANEL SESSION

Achieving the electricity industry of the future

28 July 2017

*** Check against delivery***

Markets facilitate change

Faced with a regulatory-dominant audience, I wonder how many of you share my sense that ‘market’ is becoming a somewhat unpopular word. In response to any scepticism about the role of markets, I would agree that questioning what they can achieve on their own is valid.

Markets do have limitations – or failures as economists would say. It was ever thus.

So I **do** risk repeating messages that you may have heard before from the AEMC and many others.

Our role at the Commission is to keep regulatory frameworks up to date so energy markets can evolve in a way that delivers the best outcomes for customers, over the long term. Our approach adopts a few key principles:

- Supporting effective consumer choice;
- Promoting competition where it is possible and well-designed regulation where it isn’t;
- Creating signals to drive efficient investment; and
- Acknowledging uncertainty, so that instead of trying to **make** things happen we create an environment to **let** things happen if they deliver the best outcomes.

In our experience to date, markets offer the most efficient and lowest cost way of discovering what technologies and services work best for consumers, and shepherding change in that direction.

We can see evidence of this today with new energy service providers entering the market taking advantage of an increasingly wide range of technologies, products and services so that customers can get what they want. Yesterday I went through some of what is available by the likes of GreenSync, Power Ledger, Telstra and Honeywell, as well as the traditional energy retailers.

We have an energy market that puts consumers in the driver seat if that's what they want and we set up a regulatory framework around them so it supports what they choose rather than dictates what they are given.

Markets are not perfect.

But at the Commission we don't blindly accept markets. We support markets when the evidence shows they deliver the best outcomes for consumers. And we make tweaks when they don't.

We have been doing that for many years in energy. And the same approach applies in other regulated markets such as financial and telecommunications.

Like I said at the start, markets tend to offer the most efficient way of evolving…Of discovering the things energy consumers want, in the quantities they need, and delivering these at the lowest cost.

But we acknowledge that markets suffer when there is information failure, inadequate competition, or other factors that distort price and other important signals.

There are a range of tools we can and do use to overcome these without wading in boots and all and taking over. And we do use them. I have some examples that highlight the Commission's approach.

- We use information and reporting requirements to even-out the playing field and increase transparency – recently we've done this for transmission.
- We facilitate interactions between participants to minimise the likelihood of disputes and stalemates – Again recently done in the context of transmission - we have introduced an. But one of the more obvious and very successful interventions is the creation of industry ombudsman schemes
- Short term regulatory obligations can be used as a stepping stone to transition to market mechanisms over time.
- Finally, transition periods more generally are a good way to manage expectations and risks.

A recent example of these last two approaches can be seen in our current work.
System security – the ability of the power system to remain stable as demand and supply fluctuates – is a hot topic. We have proposed short term regulatory obligations for inertia and system strength to keep the light on now, but with an intention to transition to market mechanisms in time.

Ideally, we'd use a market mechanism to value, buy and sell these security services, to keep the power system stable – whether that be inertia from large spinning generator or fast frequency response services from new technologies like batteries. But the variety and depth of technology to required provide these services is not there yet -. So we have put in place a regulatory fix – a minimum level of inertia - until the range of technology develops for a market mechanism to take over.

We are also considering future changes to align dispatch and settlement in the NEM in our five minute settlement rule change. While the genesis for this rule change was different, the proposal is relevant in light of the changing generation mix. More intermittent generation requires certain technologies to provide system security. It is increasingly important that the market design provides the right signals to value these technologies.

Our approach to Five Minute Settlement recognises the disruption a move from 30 to Five Minute Settlement in the spot market would bring, for example:

- existing IT systems,
- infrastructure such as data recording devices and
- hedge contracts.

So our initial view is that, if we make the rule, to provide a transition period of three years to minimise these costs and risks.

<u>Balance.</u>

However, each time we use one of these regulatory tools, we have to think "how much extra cost, and how much extra risk will consumers have to bear as a result of this?"

That's the key trade-off: we could regulate everything, but it would be more expensive and it would stifle innovation……We could regulate nothing, and consumers would be completely exposed. So we have to strike a balance.

We also have to allow time for developments or interventions in the market to be understood before layering on further measures.

Going back to the key questions, can markets deliver, or do we need regulatory intervention to get us to move to a better future? The answer is yes to both.

Markets are a low cost way of shepherding change while encouraging innovation.

Are they perfect? No. And carefully designed and implemented regulation is the answer to that.

ENDS.