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EnergyAustralia

John Pierce
Chair
Australian Energy Market Commission
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Dear Mr Pierce

AEMC - Strategic Priorities for Energy Market Development

EnergyAustralia welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) discussion paper titled *Strategic Priorities for Energy Market Development*.

We are one of Australia's largest energy companies with over 2.5 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. We also own and operate a multi-billion dollar portfolio of energy generation across Australia, accounting for about 10 percent of generation in the National Electricity Market.

The AEMC has proposed three strategic priorities that will guide its work over the coming years. Within each priority three areas of focus areas have been identified with supporting questions used to prompt stakeholder responses (included in *italics* throughout the submission). This submission is structured according to the AEMC's proposed priorities and consultation questions.

EnergyAustralia supports the proposed priorities and encourages the AEMC to focus attention on: reducing the regulatory burden on retailers, ensuring information is simple for consumers to engage in the energy market, integrating effective climate change policy into the energy market, ensuring a level playing field for new entrants to the energy sector and ensuring that non-network solutions to meet demand capture the full value of benefits to consumers and are factored into decision making.

Should you require further information regarding this submission please contact Lee Evans, Policy and Advocacy Lead, on (03) 8628 1185 or lee.evans@energyaustralia.com.au.

Yours sincerely

Lisa Gooding
Government and Policy Leader

1. Consumer Priority

Engagement

Do consumers have enough useful information to shop around and choose the best deal for their needs?

EnergyAustralia supports the AEMC looking at ways to reinforce customer awareness and their understanding of the energy markets and ensuring customers have the right information that is simple to understand.

However, we note that with the introduction of cost reflective network pricing, competition in metering and smart metering, information is getting more complex and often the common response to this is to provide more information to customers.

Research undertaken by the CSIRO¹ determined that there is a limit to the amount of information that customers will absorb and added complexity will often cause customers to disengage with the market. Any focus should be on determining the minimum information that consumers need and ensuring this is delivered in a simple format. The market will continue to develop and therefore it will be difficult to determine what future information requirements are useful to customers.

Additionally, information requirements could inadvertently constrain development of new types of product offerings, for example, ones where the energy and upfront appliance purchase and installation costs are bundled together.

The introduction of flexible pricing into the Victorian market is an example of how difficult it is to encourage consumers to consider and take up a new tariff concept. The Victorian government and industry worked closely to ensure that time-of-use flexible pricing tariffs were uniformly structured, with similar time periods, across all networks, for peak, shoulder and off peak periods. However, even when flexible pricing was promoted by a broad reaching Victorian government education media campaign, retailer media and print advertising, the take up by customers was very small.

The AEMC has found considerable evidence of effective competition in its reviews of Retail Competition across the NEM in both 2014 and 2015. Retailers in this environment have a strong interest in differentiating themselves from other retailers and in making their offers the most appealing to customers. Customers generally do not opt to take up offers that they don't understand, don't trust or don't feel comfortable with in some way. Thus, retailers already have a strong incentive to facilitate and encourage customers to shop around by providing useful information and to continually improve the accessibility and value of that information. It is hard to see how a regulatory approach could assist in providing any more useful information than is available already.

If there is an area in that the AEMC could help to explore, it is around lack of engagement and interest in shopping around, and the perception on the part of some customers of significant transaction costs. Improvements may rest in making information simpler and comparisons easier so switching between retailers is more straightforward for customers. Previous surveys have shown that many people are time poor or see no value in spending their time shopping

¹ CSIRO - Australian Consumers' Likely Response to Cost-Reflective Electricity Pricing June 2015

around. This is common to many other competitive markets and therefore it is important to ensure the information is simple for the limited time people take to think about their electricity provider.

How do consumers with divergent interests engage with the regulatory process?

Since the last AEMC review of strategic priorities, there has been a large increase in the engagement of customers and consumer groups in regulatory processes. Some of this has come from the initiatives outlined in the Discussion Paper (page 13) and some has been driven by rising prices and energy affordability concerns. Customers are also represented in regulatory forums by retailers and other businesses who see opportunities to evolve the market to provide greater value to customers.

Ensuring balance in the representation of consumers with divergent interests in regulatory processes is a challenge. It should be a focus for any customer focussed forums to consider if their participants do reflect the cross-section of views of all customers. This will be a key role for Energy Consumers Australia to effectively represent a cross section of consumers.

Participation

Do the prices consumers pay for energy reflect the costs of supplying them? Do consumers have the ability to respond to these price signals, particularly through access to new technologies? Is supply responsive to changing consumer preferences and choices?

The changes to distribution pricing, deregulation of prices and introduction of smart meters are aiding improvements in retail prices more accurately reflecting the cost of supplying energy to residential and small business customers. EnergyAustralia supports cost reflective network tariffs, in principle, but believes that economic purity in determining cost reflectivity should not come at the expense of consistency and simplicity.

EnergyAustralia understands that each network has particular topographies and differences in their various customer types and consumption profiles, however care must be taken not to increase tariff complexity beyond a point that can be consistently reflected in a retail tariff in the hope of having pure cost reflectivity. We support uniformity in tariff structures across each state and nationally where possible.

The proposed transition to demand-based network tariffs will undoubtedly cause customer confusion. To minimise this confusion Governments seeking to introduce these reforms need to ensure they are supported by effective education campaigns and are introduced gradually to avoid bill shock. Once in place, helping customers to understand and choose the best pricing and technology option for their needs is the role of retailers.

While EnergyAustralia agrees that new technologies, like battery storage and electric vehicles, have the potential to change how customers use energy in future years, care must be taken to allow the market to evolve before implementing costly system changes for a cost-competitive market that isn't established yet. This is because prescriptive regulation that gets ahead of the market may lock in second best outcomes.

For example, it was only a few years ago, with the introduction of smart meters, that policy makers were convinced that every home would have an in home display (IHD) to assist customers to monitor their consumption and assist with managing their energy needs. This information is now more likely to be delivered via the internet or a mobile phone in a more efficient manner than via a smart meter. Allowing the market to evolve without overly prescriptive regulation allows for greater consumer choice and efficiencies to emerge naturally.

Protections

*What consumer protections are required in response to technology and new business models?
How should the National Energy Customer Framework evolve?*

The National Energy Customer Framework (NECF) provides a strong set of protections for customers and has gone some way to unify energy regulation in the southern and eastern states of Australia.

EnergyAustralia is still concerned that Victoria continues to maintain its own separate energy regulation and has not adopted the NECF. This arrangement has reduced the benefits of national consistency which would otherwise be reflected in retail energy bills. Despite efforts to align the Victorian regulatory regime with the NECF, inconsistencies remain and proposed new legislation by the Victorian Government and recommendations made by the Victorian Essential Services Commission threaten to widen the gap in regulatory frameworks.

Further, other jurisdictions that have adopted the NECF have done so with derogations to the framework. This does not support the original concept of consistent national energy regulations and the efficiencies this would deliver. We support the COAG Energy Council review of NECF derogations to consider the impact of jurisdictional government decisions.

Maintaining an appropriate level of customer protections, irrespective of the mechanism through which customers obtain energy is important. Energy markets are evolving at a rapid pace and emerging technologies could be capable of providing the entire energy solution for an increasing proportion of residential and small business customers within a relatively short period of time. Indeed, it is conceivable that some customers may completely disconnect from the grid, moving away from the provision of energy by licensed distributors and authorised retailers. The COAG Energy Council and Australian Energy Regulator have both considered the appropriate framework for the evolving energy industry in their respective reviews during 2015².

Consumers must be protected as the market evolves and supporting regulatory frameworks should not confer benefits on specific technologies or business models. EnergyAustralia considers that the following minimum consumer protections should apply to the sale of energy, irrespective of how it is sold:

- A requirement to provide a clear statement of the terms and conditions of their commercial arrangement with customers (including pricing, effective interest rates and repayment terms) and to obtain explicit informed consent to offer or vary arrangements;
- Privacy obligations consistent with national *Privacy Act*;
- Specific obligations to manage hardship and the appropriate handling of debt;
- Limitations on the ability of energy sellers to recover unbilled amounts beyond a prescribed timeframe (i.e. restrictions on backbilling);
- Prohibitions on disconnections, including appropriate arrangements for life support customers and obligations to follow certain procedures – such as a positive obligation to ensure there is continuity of supply – prior to disconnecting the service;

² See COAG Energy Council Consultation paper – New products and services in the electricity market (December 2014) or AER Issues Paper – Regulating Innovative Energy Selling Business Models under the National Energy Retail Law (November 2014).

- Measures to promote competition, such as prohibitions on technical or other elements of commercial arrangements that limit a customer's choice of retailer. This is important where the alternative or innovative service provider has some form of commercial arrangement with an authorised retailer;
- Access to alternative dispute resolution mechanisms, such as Ombudsman schemes;
- Maintenance of records and obligations to provide customers and authorised third parties with access to consumption data (i.e. to mirror the recent AEMC decision to facilitate customer access to data); and
- Mandatory reporting to the Australian Energy Regulator as currently applicable to authorised retailers to guide further policy consideration of innovative business models.

Setting minimum consumer protections on competitively neutral basis supports those that choose to take up a new energy product or service that is off (or partially off) grid. It also supports those that inherit a full or partial off grid arrangement.

The AEMC should consider whether these protections are best placed within the energy regulatory framework or generic consumer protection legislation (eg. the Australian Consumer Law), and what instrument is best placed to deal with evolving technology.

Consideration should also be given to non-energy laws, such as real estate regulations, to ensure non-standard supply arrangements are disclosed to potential buyers at the time of property sale and that information is available to explain the consequences of such an arrangement.

2. Gas Priority

Wholesale gas trading markets

How should the gas trading markets be structured to maximise efficiency of trade and minimise transaction costs?

The AEMC has been tasked by COAG Energy Council to establish a road map for the continued development of the gas market in order to meet the Council's gas market vision. The market structure is evolving with the growing LNG export industry. With the domestic market set to be a price taker in an international market, the objectives of the facilitated markets must be re-examined alongside greater support of new upstream investment.

Australia's resources will ensure gas remains a substantial part of our energy mix in the future. The gas market should enable participants to make efficient decisions about the allocation of gas and reduce transaction costs for gas to flow to its highest value use. Gas market development should remain a priority for the AEMC as improvements are implemented arising from the East Coast Wholesale Gas Market and Pipeline Frameworks Review.

The current East Coast markets are not designed to cope with the large and temporary swings in supply/demand conditions expected. We believe transparent markets that enable users, participants, pipelines, and producers to signal the price at which they are willing to transact, as well as facilitation of these transactions, improves the position of all parties.

Theoretical concepts of how the gas market could operate have been developed as part of the current review. We need to see them applied to the physical infrastructure and operational aspects before making a decision on a preferred model. Where there is coordination issues between parties and duplication of roles, there could be an argument for centralisation of some operations.

Pipeline capacity trading

How should the transmission pipeline framework promote efficient investment and allocation of capacity, while supporting trade in wholesale gas markets?

We support a hybrid approach to pipeline frameworks similar to the current arrangements. Long-haul pipelines should remain contract carriage with virtual hubs at Wallumbilla and Victoria where pipeline utilisation and liquidity are key. Virtual hubs require central planning and network regulation, however this has worked well in Victoria where no significant congestion or over-investment has occurred until recently forecast for summer flows west though South West Pipeline.

For contract carriage pipelines, capacity must be traded to ensure efficient utilisation. Currently there are a lack of opportunities to trade, but this will change as participants structure their position around a new capability to trade. Transaction costs are high and there is no established market. We believe facilitation of these trades through standardisation of contracts is the best way forward. This should be the initial step and only when it has been deemed to have failed should compulsory acquisition of capacity be introduced.

Information

What information does a liquid wholesale gas market require to function effectively?

The current information provision obligations on gas market participants are a reflection of the maturity of the market. We support transparent markets as they give confidence to market players and assist with decision making. The counterpoint to this is confidentiality and regulatory burden and these must be considered in any decision to increase reporting requirements. More importantly, information must be reliable and comprehensive to enable confident commercial decisions.

Information needs to provide the following to market participants to function effectively:

- A level playing field. No participant should be in a position of advantage over another when in competition due to additional information available through vertical integration or a large portfolio. This will ensure a level playing field and give confidence to new entrants;
- Increased efficiency. Information which allows the market to function more efficiently either by assisting portfolio optimisation, forecasting, planning, or trade should be made available if it provides overall benefits. A clear case should be made by proponents of new information on how it will be used and how their operations will be more efficient; and
- Information symmetry. Participants should have confidence in negotiations and trade that their counterparty is providing a product or service on reasonable terms.

3. Markets and Networks Priority

Technology and new business models

How does regulation need to evolve to permit innovation in new products and services to the benefit of consumers, without eroding the customer outcomes that regulation intends?

EnergyAustralia recommends that regulation evolves with the following principles in mind:

- Technology and innovation should be guided by consumer preferences;
- Regulatory frameworks should support consumer access to reliable energy and associated services at a reasonable price;
- Good regulatory practice denotes that Government intervention is only necessary where there is a market failure and identifiable gap in existing legislation addressing this failure; and
- New entrants in the energy sector ought to be subject to the same (or similar) regulatory obligations as incumbents to ensure a level playing field.

The exempt sellers regime which has seen an influx of non-traditional participants in the energy sector, largely solar providers and embedded networks, provides a useful example of energy regulation not being adaptive to new business models. To illustrate this, solar leasing companies are not obliged to be part of energy ombudsman schemes under the current exemption regime. Nor are they required to provide hardship programs or take on connection obligations.

There is a risk that all market participants are not treated equally and some customers will experience reduced protection. EnergyAustralia supports the AEMC's intentions to review this aspect of NECF but believes a level playing field for all energy providers should be a key principle in this review. This will ensure consumers enjoy sufficient protections and that the market evolves in an efficient manner, rather than to the benefit of a specific technology or business model.

Network evolution

What will be the effect of evolving technology on network investment and operation over the medium term? Will current regulation be appropriate for the business model evolution that may be required?

We expect that the widespread deployment of storage and other distributed energy resources will significantly alter the future for distribution networks as reliance on centralised grid connection reduces and the increasing number of individual connection points become multi-directional. This will present technical and economic challenges for distribution businesses to maintain the network.

Development of the distribution system will also challenge the current distribution regulatory framework which is based around long term monopoly owned assets with a regulated rate of return. We have already started to see some distribution business seek to include batteries in their regulated asset base as part of proposed network augmentation.

The AEMC in its draft rule change on the Demand Management Incentive Scheme recognised the rules should encourage distribution businesses to identify and pursue the most efficient (or least cost) solution, irrespective of whether that solution is a network or non-network option or, in the case of the latter, whether it is provided by the distribution business in house, or by a third party through a competitive tender³. EnergyAustralia endorses this position and highlights the inherent risks of maintaining competitive neutrality when the procurer of a

³ AEMC, National Electricity Amendment (Demand management incentive scheme) Rule 2015, p.19

service, the information holder and decision maker, is also competing for the provision of that service.

Non-network solutions will involve a range of benefits, often to multiple parties. The focus of any regulatory framework should be to ensure the full value of those benefits can be delivered to consumers and factored into decision making. To address this issue requires strong ring-fencing provisions in the rules and powers for the AER to administer such rules.

EnergyAustralia recommends that distribution businesses be required to evaluate and tender for non-network solutions for any material network investment proposal (augmentation and replacement). A competitive tender process would consider the full value of any activity and consider the best way to deliver that to consumers.

Careful consideration should be given to whether a distribution business should be prevented from providing non-network solutions to itself, especially where it can influence the competitive process, and as a minimum the network business should be ring-fenced to ensure competitive neutrality is maintained.

To enable this process to work effectively third parties must have access to adequate information. EnergyAustralia recommends that distribution businesses be required to publish regular information on network constraints and network planning strategies to enable third parties to consider non-network solutions.

Policy integration

How can policies in other portfolios be better integrated with energy markets?

As the energy sector evolves it will increasingly intersect with other portfolios. We are already seeing this with respect to climate change policy. We would welcome the AEMC and the Climate Change Authority leading a dialogue with interested groups on climate change policy and how to deliver effective abatement that best integrates with the energy market.

Other portfolios in the energy sector will increasingly intersect include planning, housing and transport regulation as distributed generation, battery storage and electric vehicles become more common. We encourage the AEMC to continue to be an advocate for the energy sector and highlight potential issues and solutions to policy makers to ensure the integration of new technologies can be as seamless as possible.

4. Other Issues

EnergyAustralia considers that the AEMC's Strategic Priorities should include a focus on regulatory burden in the energy sector.

The history of the sector (where assets originally were built and owned by State Governments) has seen increased public focus on energy and the impact of environmental policies (for example carbon pricing) leading to energy companies becoming some of the most highly regulated and scrutinised businesses in Australia. To illustrate this point, EnergyAustralia recently undertook an assessment of its regulatory obligations across the business and found we have 9000 different obligations across over 600 instruments (State and Federal).

Much of the regulatory burden in the energy sector stems from replication with differentiation across and amongst States/Territories and the Commonwealth. Given this situation, we are surprised that energy is not one of the COAG Deregulation Priority Areas.⁴

⁴ COAG Deregulation Priority Areas: Housing and commercial building and construction, road freight, exporters, food and dairy manufacturing, fish processing, agriculture, tourism business licensing, cafes and restaurants, clothing retail, eco-lodge and marine tour operators and native title in mining, gas and exploration.

As in other sectors, regulatory proposals should be subject to rigorous impact assessment to ensure they are proportionate and directly targeted at quantified market failures.

EnergyAustralia also views regulation as a dynamic concept and therefore recommends that the AEMC make it a priority to identify ineffective, duplicative and inefficient obligations and rules as ones of its strategic priorities as a means of making the energy sector more productive.

Energy markets are evolving and there will be examples of regulation that was intended to address actual or perceived market failures that have not emerged or declined in significance; this suggests a need for ex post evaluation of the efficiency and effectiveness of regulation.

A framework that recognises the maturing nature of the market will have a positive impact through lower operating costs that will be passed onto consumers through lower energy bills.