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Australian Energy Market Commission
Strategic Priorities for Energy Market Development
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Dear Madam/ Sir,

AGL submission to AEMC 2015 Strategic Priorities for Energy Market Development

AGL Energy (AGL) welcomes the opportunity to make a submission in relation to the Australian Energy Market Commission (AEMC) 2015 Strategic Priorities for Energy Market Development Discussion Paper ('the discussion paper').

AGL is one of Australia's leading integrated energy companies, operating across the supply chain with investments in coal-fired, gas-fired, and renewable electricity generation and upstream gas exploration, storage and production projects. AGL is Australia's largest private owner, operator and developer of renewable generation in Australia and is also a significant retailer of energy, providing energy solutions to over 3.7 million customers in Victoria, New South Wales, South Australia and Queensland.

Australia's energy markets are undergoing a significant period of transition. The development of liquefied natural gas (LNG) export projects in Queensland are linking eastern Australia to international gas markets for the first time. Government policies have been introduced to reduce greenhouse gas emissions and to incentivise the entry of new renewable generation, and the decarbonisation of the electricity sector will continue over the coming decades. The way energy consumers interact with the market is also changing. Over a million households already generate their own power with solar PV, with Australian markets now having some of the highest rates of distributed solar penetration globally. Emerging technologies are also giving rise to new kinds of demand-side participation, facilitating the development of an increasingly decentralised energy marketplace, in which consumers choose from a range of new and existing energy supply products. It is therefore timely to review whether Australia's wholesale and retail energy market settings should be adjusted to ensure that these transitions occur in an orderly manner and that benefits to energy consumers are maximised. Such opportunities should form the basis of the AEMC's work in the coming years.

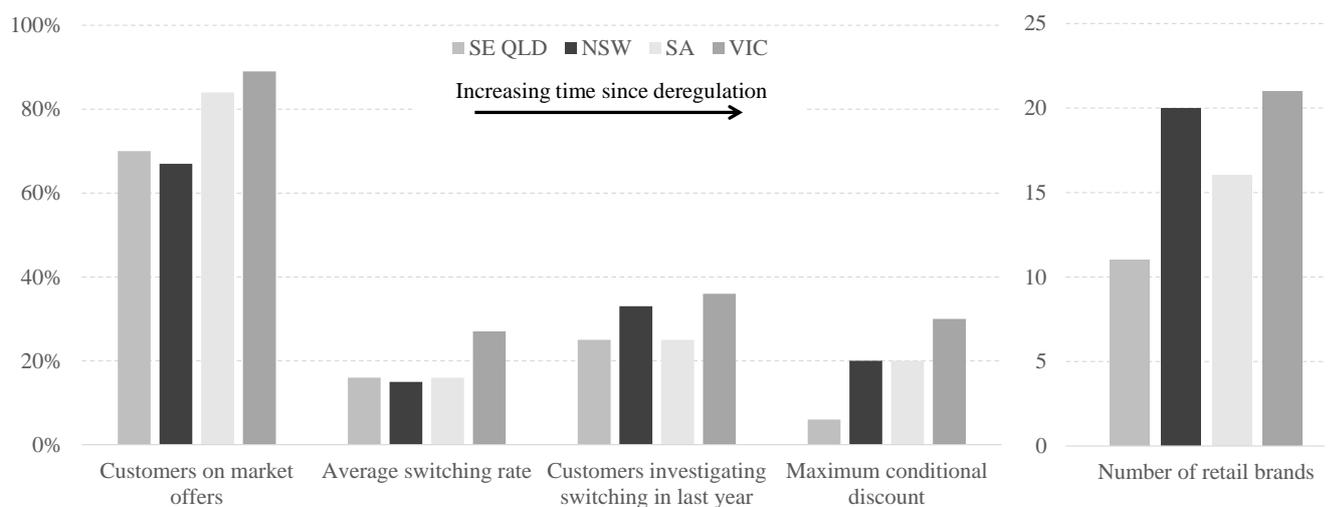
AGL considers that the strategic priorities identified by the AEMC represent important areas of focus for market development, and we support their continuation. Specific comments in response to the discussion paper follow.

1. Competitive retail energy markets

AGL considers that customers are best served by competitive retail markets, with strong competition in energy markets producing more innovative products and lower retail price offers for consumers than price regulation (where markets are shown to be sufficiently competitive). Customers need to be empowered to make informed choices about the way they use energy, and are best placed to select energy products and services that suit their circumstances, and avoid ones that do not. AGL agrees that markets need to facilitate consumer engagement and participation, as well as ensure that all consumers have access to the energy supplies they need, and that vulnerable customers, in particular, are supported. Innovative new products and technologies are likely to emerge over time, and while it is difficult to predict which will be most popular in the future, it is critical that regulatory frameworks are flexible and customer-focused to allow these offerings to compete on their merits, so that consumer preferences drive success.

Since 2002 the gas and electricity markets in eastern Australia have been progressively opened to full retail contestability, allowing customers of all sizes to select their retailer within a competitive market. Subsequently, energy prices for residential and small business customers have been deregulated across most jurisdictions as markets have exhibited effective competition, although in many cases deregulation has only occurred fairly recently. Across a range of competitive market indicators, Victoria (the market with the longest history of reform, with electricity prices deregulated in 2009) performs better than more recently deregulated (or yet to be deregulated) markets, including: the number of retail brands competing in the market, the average rate of customer switching, the rate of customers investigating switching options, and the maximum market discount on offer (see Figure 1). As a result, 89% of Victorian small-market electricity consumers have elected to engage with the energy market by moving from a default 'standing offer' to a discounted 'market offer' – a higher proportion than in any other market¹. It is therefore likely that the competitive environment in recently deregulated markets is likely to continue to develop and mature over time, with further trends towards consumer engagement and participation.

Figure 1: Competitive residential electricity market indicators



Source: AEMC, 2015

¹ Data from the AEMC 2015 Retail Competition Review.

As greater discounts become available, a greater proportion of customers are likely to choose to 'switch' to these competitive offers, as the advantage of doing so is significant. AGL research released in 2015² identified that following deregulation, electricity prices commence a natural drift from a regulated 'average cost' uniform tariff to competitive differential prices whereby a greater diversity of offers in the market produces significant discounts for consumers that seek them out. Analysis of customer discounts in Queensland and Victoria found that in southeast Queensland, the most common market discount was around 8% (relative to the standing offer), which was taken up by around 22% of customers, whereas around 45% of Victorian customers received discounts of 15% to 30% (with others also receiving lower-level discounts). In Victoria, competition between retailers seeking to win market share is intense, with the 'marginal' market offer reflecting the marginal costs of supply (i.e. the break-even cost with no profit margin), at 20% below the average total cost of supply.

While the natural evolution of competitive markets is likely to see customer engagement increase over time, the provision of high-quality and meaningful information will play a critical role in assisting customers assess their options and choose products that meet their needs (from a marketplace including conventional energy plans, as well as distributed generation and energy management products). This information may take several forms, including direct advertising by energy providers, price comparison services, and impartial information and advice provided by governments and trusted third parties, such as consumer advocates and community non-government organisations. In particular, it is essential that vulnerable customers are able to take advantage of savings available through market offerings. AGL encourages energy users to shop around to find the best deal, and welcomes initiatives to educate customers about their options in competitive energy markets.

Innovations in customer service are also likely to drive customer engagement and improved satisfaction. In recent years, AGL has delivered 'first to market' customer service offerings, including the introduction of:

- 'AGL Energy Online' and 'My AGL IQ' web portals that enable customers to manage their energy account and access near real time information and tools to manage their energy usage and bills;
- 'True Monthly Billing' whereby customers can receive accurate monthly bills, issued on a convenient date;
- Interactive e-bills providing a convenient, paperless bill viewable on mobile devices;
- 'AGL Anytime' providing customer service available 24 hours, 7 days;
- 'My AGL' smartphone application allowing customers more control, including energy consumption information, alerts and budgeting tools;
- 'AGL Solar Command' which provides real-time energy and weather monitoring information, along with sophisticated analytics to assess the performance of rooftop solar PV.

2. Demand side participation

New technologies such as digital meters, distributed generation, in-home energy management and battery storage (along with the products and services that are enabled by these technologies) provide the opportunity for increased demand side participation for consumers and have the potential to unlock widespread benefits in Australia's energy markets, including increasing customers' comfort and control over

² See 'Reforming reform: differential pricing and price dispersion in retail electricity markets' available: <http://aglblog.com.au/wp-content/uploads/2015/07/No.49-Price-Discrimination.pdf>

their energy use, improving the utilisation of energy supply infrastructure, increasing the use of renewable energy and reducing energy bills. AGL strongly supports the guiding principle set out in the AEMC's 2012 'Power of Choice' review - that customers are best placed to select energy products and services (including new technologies) that best meet their needs from a competitive market.

Future energy markets will be considerably more customer-focused and decentralised than they are today, and it is important that regulatory settings that were developed for a fundamentally centralised energy system with clearly defined market participants (generators, networks, retailers, consumers) are reviewed to ensure they are suitable for the future. To facilitate this market transformation, regulatory frameworks need to be technology-neutral and flexible to support a range of innovative new business models to enter the market, and AGL considers that there are four key regulatory priorities:

- Appropriate standards for new technologies to ensure that products in customers' homes are safe, fit-for-purpose and of high quality.
- Provision of demand side services on a competitive basis, to drive down costs for consumers and to enable the market to innovate a range of products and services for customers choose from. Regulated revenues should not be able to be used to support business activities in contestable markets. AGL supports decisions by the Australian Energy Regulator (AER) to reduce allowances for network businesses, and further reform to network pricing regulation may be required to ensure that cost recovery and investment by networks is efficient, transparent and justifiable.
- Ring fencing of network businesses wishing to compete for the provision of new products and services. AGL supports the establishment of a nationally consistent ring fencing guideline to address the structural and financial separation of network businesses wishing to participate in the competitive market so that competitive neutrality between market participants is maintained. Situations where conflicts of interest may arise need to be carefully considered, such as where network businesses are seeking to offer contestable services, but continue have discretionary powers to authorise the connection of technologies to the grid by their competitors.
- Network tariff reform, to transition to cost-reflective tariff structures, to ensure that those with and without solar PV and other technologies (such as air conditioning) contribute equitably to costs of providing shared energy networks.

AGL supports the nationally consistent, market-led and contestable roll out of digital meters, which are a key enabling technology for increasing the range of innovative products and services available to customers. AGL considers that the AEMC's metering rule change is fundamental to enhancing metering competition in the National Electricity Market (NEM), although there are some issues raised in the recent Additional Consultation process that we believe may restrict competition and customer choice. In particular, AGL considers that provisions related to 'network devices' which network businesses could install to bypass commercial negotiations with competitive metering coordinators, and ambiguous network-related services that could be undertaken without customer consent are contradictory to the 'Power of Choice' principle that customers should be able to choose demand side products and services (rather than have them imposed)³. Moving to a fully-contestable metering environment will take time, and special arrangements may be required in certain circumstances to ensure that this transition occurs smoothly. However, AGL recommends that time-limited, regional

³ See AGL's submission to the AEMC on the 'Expanding Competition in Metering and Related Services: Additional Consultation on Specific Issues' for further information

solutions may be a more appropriate way to accommodate legacy arrangements (such as with Queensland load-control and Victorian AMI), rather than introducing rules that cement the role of monopoly businesses across specific market services (which should be contestable).

The persistence of 'average cost' electricity pricing for end-users (despite the availability of digital meters) has meant that many electricity customers have not received price signals to limit energy use at peak times, and shift consumption to off-peak periods. Consequently, peak energy demand growth has outpaced underlying energy demand growth, leading to deteriorating capacity utilisation as infrastructure built to meet peak demand remains unused for much of the year. This is thought to have contributed to the significant increases in electricity prices between 2007 and 2015. Households responded to higher bills by saving energy (installing solar PV, buying more efficient appliances, etc.), with residential customers in the NEM now using around 17% less grid electricity than they did in 2009, although consumption has been reduced at times most convenient, rather than at peak times. Allowing network and retail tariffs to shift towards greater cost-reflectivity will encourage efficient energy use and reduce cross-subsidies between consumers. Such reforms also provide the right market settings for the development of sophisticated home energy systems that allow consumers to make decisions about whether to import, export, store, or consume energy based on price signals from the market – whereby customers that optimise their demand side participation will not only save money on their energy bills, but will also reduce the costs of providing shared network services.

According to data from the Australian Bureau of Statistics, electricity prices in Australia have been declining for the past year, and forecasts by the AEMC (amongst others) suggest that prices are likely to remain fairly flat (with below-inflation increases), or fall further over the next few years. A continued emphasis on 'behind the meter' products and services will be important in ensuring that energy efficiency improvements achieved by customers in recent years are not eroded as retail electricity tariffs decline in real terms and households may be less focused on energy savings.

3. Consumer Protections

AGL accepts and acknowledges the need to meet community expectations in supporting vulnerable customers and believes that the industry needs to take a shared responsibility approach with Government and the community sector for sustainable improvement to be made. As an essential service, the consumer protections afforded to energy users ensure that they have access to competitively priced, reliable and high quality energy supplies.

In December 2014, AGL launched a \$6 million Affordability Initiative, developed in consultation with over 35 community groups and which will be delivered over three years to provide greater support for vulnerable energy customers. This initiative includes a focus on early intervention for customers that are struggling financially, special training for relevant staff, the introduction of a dedicated phone line and email address for financial counsellors and community workers to access AGL hardship specialists as well as the allocation of funding for payment incentives, independent financial counselling services and energy audit services. Funding will also be targeted towards energy efficiency and solar services to assist vulnerable customers reduce the costs of ongoing energy consumption.

AGL acknowledges that a small proportion of customers are unlikely to engage with competitive markets (for a range of reasons) and is looking for ways to ensure that vulnerable customers are not adversely affected and are able to take advantage of savings available through market offerings. For example, AGL has announced that from

January 2016 Victorian concession card holders who are on a standing offer will receive an automatic 10% discount on their electricity usage rates. Other initiatives include the removal of early termination fees and the development of a transparent fixed energy plan as an alternative to variable energy contracts.

With the emergence of a range of new energy technologies, and business models, the existing regulatory frameworks that provide consumer protections in the energy sector (such as the National Energy Consumer Framework) may not be fit for purpose for future energy markets. AGL considers that all providers of electricity or related products and services should have obligations to electricity consumers to ensure that their access to this essential service is upheld. The consumer protections afforded to energy users should not be eroded or diluted as a result of the products and services they choose to use to meet their energy needs. A framework based upon a 'primary' relationship through a grid connection with a licensed retailer and 'supplementary' energy supplies from other sources (for which suppliers have no or limited responsibility to provide consumer protections) is unlikely to provide the flexibility required for the future when some consumers may wish to go "off-grid" or have multiple trading relationships with suppliers. Any revisions to consumer protection frameworks should be nationally consistent, technology-neutral and scalable for application to future products and services. Short-term, piecemeal solutions are not ideal as they do not provide the consistency and predictability of policy positions required to underpin new business models. Situations where new products and services can exploit 'regulatory arbitrage' loopholes should be eliminated, consistent with the principle of a competitively neutral market place.

AGL welcomes initiatives to improve regulatory consultation and engagement with energy users. With the emergence of a growing diversity of customer preferences, it is important to ensure that the interests of all kinds of consumers are fairly represented, including those that are highly engaged with the market, and those that are not. AGL welcomes the establishment of the Energy Consumers Australia advocacy body, and supports increasing the level of consumer representation in decision making across all levels of policy development and market governance.

4. Wholesale gas markets

AGL supports open, liquid and transparent gas markets that operate efficiently, allowing gas to flow to its highest value point of consumption or use, and with transaction costs as low as possible. The eastern Australian gas market has already changed with the development of LNG export facilities and market dynamics associated with LNG will be present for the foreseeable future. AGL notes that the gas market is still in transition, with the LNG trains not yet at full capacity and their full effect on the market yet to be realised. AGL therefore considers that caution should be exercised in recommending significant changes to the market design or function until it fully adjusts to the new market conditions.

This said, we consider there is merit in reviewing the following market settings:

- Restrictions on the development of onshore gas reserves in eastern Australia: In a market characterised by a tripling of demand (as a result of LNG export projects) and a tight supply/demand balance, the development of additional gas supplies can help to ease supply constraints and place downward pressure on gas prices. New gas supplies require a scientifically-based regulatory framework that balances environmental considerations, community expectations and security of supply.
- Access to gas transmission capacity: AGL considers that access to economic and tradeable transmission capacity is fundamental to an efficient gas market and

ensuring supply is maximised. While the existing contract carriage model has delivered substantial private sector investment in gas transmission infrastructure in the eastern Australian gas market, some stakeholders consider that contractual terms are limiting transparency. There is merit in investigating whether the contract carriage model remains appropriate and further work could include assessment of the relative costs and benefits of secondary capacity trading, moving from 'contract carriage' to 'market carriage' and adjusting pipeline settings to support new trading hubs. These investigations should consider implications for future investment in infrastructure, and appropriate transition settings to recognise existing property rights.

- Proposals for the development of 'virtual hubs': AGL considers that further analysis is required, giving due regard to ongoing work on pipeline capacity trading.
- Provision of information for market participants: Several stakeholders have observed that gas markets are fairly opaque and that information on available gas supplies, capacity and prices are difficult to access. AGL supports initiatives to aggregate publically available information, further develop the Gas Bulletin Board and otherwise facilitate greater access to non-confidential information where such provision would enhance liquidity or improve confidence in market outcomes – where the benefits outweigh the costs.

AGL does not support the introduction of additional gas trading hubs (at Gladstone, Iona and Longford – in addition to Wallumbilla and Moomba), which are likely to increase market complexity and transaction costs, and potentially create barriers to entry. With eastern Australia's gas market having relatively few market participants (buyers and sellers), it is not clear what benefits the additional hubs would produce. Without a sufficient level of participation, trade at each new hub is likely to be too low for substantial liquidity and transparency to eventuate.

AGL notes that there are currently several reviews underway investigating opportunities for gas markets to become more efficient and competitive, including by the Australian Competition and Consumer Commission (ACCC), and the AEMC.

5. Wholesale electricity markets

A significant challenge currently facing the operation of the NEM is the application of multiple policies to limit greenhouse gas emissions and promote the deployment of renewable energy. While these policies have implications for the sustainable operation of energy markets, they generally fall outside of the regulatory and governance frameworks for the development and operation of these markets. AGL considers that energy and climate change policy objectives are inextricably linked, and that energy market design needs to give due consideration of not only energy reliability and affordability, but also to relevant environmental objectives. Integrated policies are required to ensure that these objectives can be jointly pursued over time. The decarbonisation and modernisation of the electricity sector will span several decades, and a long-term vision and trajectory for this transition is essential.

Research completed by AGL economists⁴ has shown that the interaction of energy-only markets and renewable energy targets may give rise to unsustainable market outcomes. In an environment of falling demand for wholesale energy in the NEM, the entry of new generation capacity incentivised by government policy has resulted in

⁴ See 'Energy-only markets and renewable energy targets: complementary policy or policy collision?', available: <http://www.sciencedirect.com/science/article/pii/S0313592615000156>

significant oversupply in some regions. Despite significant surplus capacity, there appear to be barriers to exiting the market for coal-fired power stations nearing the end of their design lives, such as first-mover disadvantage, significant site remediation costs and ongoing uncertainty in relation to climate change, and broader energy policies. As a result, wholesale electricity prices are well below the level required to incentivise new investment in electricity generation (renewable or thermal), and under current market settings, forecast revenue streams to be received over the life of a new project are not necessarily sufficient to justify the capital expenditure. AGL supports government policies that effectively incentivise the development of new renewable and low-emissions electricity projects, as well as complementary policies to address oversupply and ensure that there is an orderly exit of older, emissions intensive power stations (similar to those in place in North America)⁵.

Market settings in the NEM need to support the orderly decarbonisation of the electricity sector over time. AGL considers that there is considerable merit in the AEMC working closely with the Australian Energy Market Operator (AEMO) and other academics and technical experts to investigate whether any regulatory responses may be required to address market changes, including the entry of significant intermittent renewable generation (including growing quantities of small-scale, non-scheduled, distributed generation) and the mothballing or retirement of synchronous generation. This is a particular issue in South Australia, where the closure of several thermal power stations will occur in the coming years (most recently Alinta has announced of the full closure of its Northern Power station by March 2016), raising clear risks associated with system reliability and stability (or widespread outages in the event of interconnector failure). Detailed analysis and stakeholder engagement are needed to determine whether the NEM's design or function should be adjusted to support the transition⁶.

Closing remarks

Should you have any questions or comments, please contact myself on (02) 9921 2516 or tanelson@agl.com.au or Fiona Orton on (02) 9921 2165 or forton@agl.com.au.

Yours sincerely,



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⁵ See AGL's 2015 Greenhouse Gas Policy for further information, available: http://www.agl.com.au/~media/AGL/About%20AGL/Documents/Media%20Center/Corporate%20Governance%20Policies%20Charter/1704015_GHG_Policy_Final.pdf

⁶ contrary to commentary in the discussion paper, AGL does not advocate for payments for generators to exit the market, nor for the introduction of a capacity market.