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Dear Energy White Paper Taskforce

Submission to Energy White Paper – Green Paper

The Australian Energy Regulator (AER) welcomes the opportunity to provide this submission to the Department of Industry's Energy White Paper – Green Paper. Our comments on energy policy are based on our experience as the economic and compliance regulator of the National Energy Market. We regulate prices charged for using energy networks to transport energy to customers, monitor wholesale electricity and gas markets, and regulate retail energy markets in the ACT, South Australia, Tasmania (electricity only) and New South Wales.

Regulation in a changing environment

Electricity networks are entering a period of fundamental change. Drivers such as demand uncertainty, network cost pressures, the need to integrate renewable generation and electric vehicles, and the change brought about by new technologies, will impact the way energy is delivered to and by consumers in the future.

The Green Paper recognises the new challenges that have emerged in the energy sector:

Demand is falling and more electricity is coming from distributed generation, mainly from residential solar photovoltaic (PV) rooftop systems. Better tariff choices are available, supported by improved metering, which provides more information for consumers on cost and use. New energy technologies, such as battery storage, also have the potential to cause further change.¹

As discussed in our submission to the issues paper, the electricity network is no longer only about transporting energy from 'A to B'. The network is becoming a platform for the two-way trade of electricity. The convergence of communications and energy transport and the uptake of new network technologies, smart meters and other household devices bring opportunities for innovation and competition. Customers are being actively integrated into the electricity market. New and existing industry participants are offering services that assist users to better manage and understand the cost drivers of their consumption.

¹ Energy White Paper – Green Paper, p. 25.

Competition principles are at the heart of the regulatory framework—and they are fundamental to the success of the regime going forward. Potentially competitive functions should be separated from monopoly infrastructure and, where necessary, open access should be provided to those infrastructure services. In other words, regulation should establish a base for access to the network services to support competition of services.

Regulation should not be about 'picking winners' or rewarding network businesses with guaranteed returns when competing with other services. It is better to allow the market to decide than for the regulator or the policy maker to favour a particular technology or solution and have customers carry the risk.

A market for new and innovative business models is developing in response to consumers changing the way in which they participate in the energy market. A desire by and ability of consumers to manage their energy use and access to renewable energy options has seen the emergence of a range of alternative energy products.² These developments, coupled with changing market conditions which have significantly reduced the costs of renewables, have contributed to growth in this business sector. The reduction in feed-in tariffs and rebates has established a base for efficient and sustainable outcomes in the future for these services. More broadly, innovation in how energy is sold will ultimately lead to greater choice for consumers.

It is important to remove barriers to both competition and the efficient operation of the market. Reforms currently being considered by the Australian Energy Market Commission (AEMC)—including to distribution pricing structures, consumer access to data and meter contestability³—are crucial. These necessary reforms, endorsed by the COAG Energy Council and are supported by the Green Paper, should remain high on the sector's reform agenda.

These reforms should be implemented in a timely manner and be supported by an effective consumer awareness and education strategy. In particular, careful consideration should be given to implementing tariff reforms given the impact they can have on some consumers who are not in a position to change their electricity consumption patterns in response to price signals. Further, a staged move to more cost reflective pricing would help facilitate varying energy selling models (as discussed above). The AEMC's proposed tariff principles and new requirements on distribution networks to develop and engage with their customers on their tariff structure statements should facilitate these outcomes.

A major benefit of these AEMC reforms is they will allow end-users to make genuine, informed choices when it comes to managing their electricity consumption. Customers can be rewarded for reducing local consumption at times when it is most costly to supply that customer. The idea is that customers make efficient decisions as to the best time to, for example, use their electric dryer and dishwasher or, possibly in the future, charge and discharge their electric vehicles. End users would

² Examples of business models for alternative energy sellers include: solar power purchase agreements under which a customer agrees to purchase energy generated from solar panels owned by a third party (installed at the customer's home or business) for a specified period (for example, 15 years); selling energy to customers for a specific purpose at a premises, for example, to charge an electric vehicle (EV) at the customer's home (requiring installation of separate meters at the premises, with the energy being sold to the customer by an EV company); and demand management or energy efficiency products or services.

³ In seeking to expand competition in metering services, it is important to appropriately assess the need for and composition of 'exit fees'—that would recover the residual costs of meter assets and administrative costs. The distribution businesses should be compensated for any sunk costs, though exit fees should not impede competition. Our upcoming electricity network pricing decisions will consider this issue in terms of how we classify the metering services.

also make informed decisions about whether to install an air-conditioning unit and how to run it, or when to invest in energy-efficient appliances.

Moreover, with improvements in IT and communications, all customers are potentially generators too. The term 'prosumers' reflects that consumers of electricity are also often producers of electricity, and may switch from net consumption to net production in response to changes in market signals. Customers can be rewarded for increasing their local production at times when that production is most valued.

Based on recent discussions with the network businesses, we understand they are keenly aware of the challenges ahead. They are starting to think beyond their 'poles and wires' and investigating new business models to adapt to the rapid development in technology and high rate of change.

This 'new market' will revolve around divergent consumer preferences. Some customers will be more actively engaged in the market (as described above) and utilise 'smart technologies'. Others will be passive. It will be their choice. Network businesses have an opportunity to embrace new technologies and business models to develop customer-centric services to match these preferences.

Can the regulatory regime facilitate these developments?

We consider the current regulatory framework can accommodate changes in technology and market developments, and enables competition. The framework has also been strengthened by recent reforms and our Better Regulation guidelines.⁴

The COAG Energy Council plays an important role in policy development and program management to address the opportunities and challenges facing Australia's energy and resources sectors. Further, the regime encompasses a rule change process that allows, for example, the above AEMC reforms to be readily adopted under the regulatory framework.

There are regulatory mechanisms that facilitate emerging competition. First, services that become contestable over time can be classified according to the potential for competition. Under the rules, services may be excluded from regulation. Second, there is the option, through ring-fencing requirements, to define whether and how a distributor can carry out potentially contestable activities in conjunction with its regulated activities. These aspects of the regulatory framework will become increasingly important as more of the network's distribution services become contestable.

Fundamentally, we support the introduction of contestability into services where competition is feasible. The discipline of competition produces better outcomes for customers in the long run than can be achieved through regulation. Moreover, the AER cannot regulate for innovation. We can however create an environment in which innovation may flourish.

We encourage the Government to outline its vision for the future of the energy sector and endorse the underlying competition principles of the current regulatory framework in the Energy White Paper.

⁴ We initiated our Better Regulation program in November 2012 to develop our approach to regulation under the new Rules. In late 2013, we published our final guidelines covering a number of aspects, including how we assess network expenditure proposals, encourage efficient spending by businesses, calculate the allowed return on assets, and engage consumers in the regulatory process. These guidelines provide a solid foundation of regulatory transparency and certainty, and have led to improvements to both how energy network businesses are regulated and consumer engagement in our regulatory processes.

If you would like to discuss any aspect of this submission, please contact Anthony Bell, Director, on (03) 9290 6914.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Paula W Conboy', with a stylized flourish at the end.

Paula W Conboy

Chair
Australian Energy Regulator