# ELECTRICITY

## PUTTING CONSUMERS FIRST

December 2012

Working together, the Australian Government and state and territory governments have agreed to the most comprehensive set of national energy market reforms since the adoption of the foundation Australian Energy Market Agreement (AEMA) in 2004.

The reform package is designed to put downward pressure on rising electricity costs while ensuring Australians continue to enjoy expected levels of reliable supply.

## *Introduction*

Electricity prices have risen sharply in recent years, with average retail electricity prices increasing by about 40 per cent nationally over the past four years and by as much as 60 per cent in some states.

The Standing Council on Energy and Resources (SCER) has agreed to advance a range of measures to put downward pressure on this trend and, over time, provide consumers with greater choice and innovation in the retail services they may seek to sign up to.

Governments across Australia have agreed to make improvements to energy sector frameworks with the aim of providing consumers with access to a reliable and competitively priced supply of electricity, protecting the most vulnerable in our society while seeking to maintain the economic competitiveness of our business sector.

Much progress has been made since the opportunities to reform the energy sector were first identified by the Hilmer Review (1993) and later by the Parer Review (2002). These included recommendations such as developing a competitive wholesale market, establishing various energy market institutions and the development of national electricity and retail laws.

While many of the reforms are focussed on the National Electricity Market (NEM), progress has also been made in Western Australia and the Northern Territory which are not physically connected to the NEM. However, opportunities for further reform exist across all of Australia's electricity markets.

The new package of energy market reforms seeks to restore the focus on the consumer by providing greater choice and innovation through competitive generation and retail markets, while delivering a reliable service at minimal cost through the regulated aspects of our electricity system (the networks).

Across Australia, each state and territory is at a different stage of the energy market reform process, but collectively governments have developed a package which sets a pathway towards delivering on many of the outstanding reforms.

The Queensland Government has participated actively in this process, but is in the middle of its own electricity sector review. Accordingly, it has reserved its position on matters that are the subject of that review. All other jurisdictions have however agreed to progress the reforms outlined in this package.

## *The Electricity Package*

SCER has developed and agreed to 14 new energy market reforms to support investment and market outcomes in the long term interests of consumers and these have been endorsed by the Council of Australian Governments (COAG).

The reforms consist of four key areas that will drive better outcomes for consumers:

**Strengthening network regulation**

- Fairer network rules
- A Stronger Australian Energy Regulator (AER)
- Improvements to the appeals mechanism

**Empowering consumers**

- Strengthening opportunities for consumer engagement
- Enhanced access to better consumer data
- Opt-in deployment of smart meters
- Opt-in time-of-use pricing
- Greater demand-side participation opportunities
- Enhanced consumer protections

**Enhancing competition and innovation**

- Greater retail competition and innovation
- ‘Fair and reasonable’ return for all micro generation

**Ensuring balanced network investment**

- A national framework for reliability standards
- Investigating demand responsiveness of the regulatory framework
- Ensuring efficient transmission investment

## Strengthening Network Regulation

Network charges, the costs associated with the ‘poles and wires’, have been the biggest driver of electricity price increases – accounting for over half the rise in an average household electricity bill.

The need to upgrade and replace ageing network infrastructure to maintain a reliable supply of electricity while meeting peak demand has been a substantial factor in this increase.

To ensure only necessary network investment occurs while delivering an adequate return for network businesses, Australian governments have agreed a range of improvements are necessary. This includes the implementation of new and fairer rules applied to the operation and expenditure of electricity networks, and improvements to the AER and the appeals mechanism.

### Fairer Rules

After extensive public consultation and assessment by the Australian Energy Market Commission (AEMC), the network rules have been changed to give more power to the AER. This will give the AER greater discretion in challenging business submissions and setting the rate of return the network businesses are allowed to earn.

A small change in the cost of borrowing can have a huge impact on the revenue requirement of a network business and the resulting prices for consumers. With network businesses having regulated asset bases that range from hundreds of millions, to over ten billion dollars an increase in the rate of return on that asset base can have significant implications for consumer bills.

SCER supports the speedy introduction of the new rules in advance of the next round of network regulatory determinations, so that potential benefits can flow to consumers. This will commence in New South Wales and the Australian Capital Territory in mid-2014, with other jurisdictions to follow.

### Stronger Regulator

To ensure these new rules can be effectively enforced, the Australian Government has committed to provide additional funding of $23.2 million (over four years) to the AER to deliver a stronger, better resourced and more accountable regulator.

The AER will be given extra resources to access greater expertise when undertaking a determination and clear powers to collect and publish information. This will help the AER to benchmark network businesses and improve network efficiency.

The AER approved over $48 billion in network capital expenditure in the last five years – all of which has an impact on consumers' electricity bills. Therefore it is essential the regulator has the resources and expertise to effectively scrutinise and challenge the proposals put forward by the network businesses.

SCER welcomed these improvements to the AER and agreed to strengthen the performance and accountability frameworks of both the AER and the AEMC by December 2013. However, concerns continue to be held by some state governments that the structure of the AER within the Australian Competition and Consumer Commission could be limiting its ability to perform its operations effectively.

Accordingly, COAG agreed to an independent review of the AER in 18 months, including its structural arrangements. The review will ensure that the AER's resourcing is adequate, and its operational arrangements are effective, to meet the demands of the new regulatory regime.

## Improvements to the Appeals Mechanism

The third key aspect of the network regulatory regime is the appeals mechanism or 'limited merits review' where network businesses can challenge a decision of the AER. An independent review of the limited merits review regime found a number of shortcomings in its ability to deliver on the original policy intent and consequently identified areas of improvement.

Between June 2008 and October 2011 under the current limited merits review regime 13 decisions by the regulator have been overturned. These decisions involved around $2.9 billion of network revenue, highlighting the importance of getting the regime right.

SCER agreed to accelerate improvements in the appeals process for revenue and price decisions made by the AER, to ensure this process is focused on delivering overall outcomes that are beneficial for consumers while providing an effective back-stop for network businesses.

A consultation process on options to improve the regime will begin mid-December 2012 through the release of a Regulatory Impact Statement, with SCER to decide on the structure of the new regime in May 2013. The revised regime is expected to be in place in 2014.

## Empowering consumers

The National Electricity Objective seeks to deliver secure and reliable electricity in the long term interests of consumers. However the complex nature of the energy market can make it difficult for energy consumers to engage effectively in the many regulatory and policy processes. Better information and tools are also needed to help individuals to understand and manage their day-to-day energy use.

Restoring the focus to put consumers back at the forefront of the electricity system, and incorporating well-informed consumer views into all major decisions, will be critical to delivering an electricity supply that best meets the needs of consumers.

### Strengthened National Consumer Advocacy

SCER has endorsed the strengthening of consumer input into network pricing decisions and appeal processes and noted the Commonwealth's proposal to establish a Consumer Challenge Panel within the AER as a first order priority in the first half of 2013.

This will ensure network spending will be scrutinised by independent technical experts who will work on behalf of consumers to interrogate complex business submissions and provide advice to the AER on whether the proposed network expenditure is justified in terms of outcomes for consumers.

This is the first step towards a broader proposal by SCER to develop, in close consultation with consumer bodies and other stakeholder groups, a stronger national consumer voice. SCER has initiated work on a proposal on the form, scope and funding of an institution that would be a strong national advocate for consumer interests, well equipped to contribute constructively to energy policy and market development issues.

SCER will be consulting with key stakeholders in 2013 to develop improved national energy consumer advocacy, including investigating ways to put a greater focus on the needs of average energy consumers through the existing Consumer Advocacy Panel.

### Enhanced access to better consumer data

Empowering consumers to make better choices about their electricity use, through more accessible, relevant and timely information is an essential part of driving better outcomes in Australia's electricity markets.

Households and small businesses can use easily-accessible, trusted data on energy consumption to help them understand their energy use and make better energy choices.

Easier access to their own consumption data would assist consumers to compare energy market offers via price comparison services such as the AER's "Energy Made Easy" website. This could assist them to compare retail offers and choose the best deal for their circumstances.

SCER agreed to submit a rule change proposal to the AEMC in early 2013 to provide consumers with better access to their electricity consumption data and improve arrangements for third party access, where a consumer gives explicit consent and where appropriate privacy provisions are in place.

### Opt-in deployment of smart meters

Victoria is the only state to have mandated the roll-out of smart meters, with some other states conducting small-scale trials to assess the potential costs and benefits of advanced metering technology.

Compared to the traditional accumulation meters, smart meters and interval meters typically provide a 30 minute digital read of how much electricity is used by a household or business. Where advanced meters are not installed, the meter needs to be read manually each quarter. This is not only costly but increases the risk of an incorrect reading being recorded or none at all if the meter reader is unable to gain access to the property and can lead to difficulties in billing accuracy.

In addition to resolving these billing issues, smart meters enable a range of new products and services to be made available to consumers to track their energy use such as in-home displays, web portals and iPhone apps, some of which might allow consumers to control appliances remotely. A more advanced meter is essential should consumers wish to move to time-of-use pricing.

Smart meters unlock an array of benefits aimed at providing consumers with better services, such as more frequent accurate billing if a consumer wants to avoid the quarterly bill shock, plus opportunities to save on electricity costs by being able to manage their energy use better. For example, where a consumer chooses to move to time-of-use pricing they have the opportunity to shift their discretionary consumption away from peak times, such as putting the dishwasher on in the morning to take advantage of the cheaper tariff.

SCER agreed to develop arrangements to encourage the voluntary, market-driven (business-led) competitive roll-out of smart meters and other advanced metering. This means that customers will be able to choose the best retail package to suit their needs, which may include a smart meter and the option to move to time-of- use pricing.

Victoria will continue its mandated roll-out, and will shortly introduce the option to switch to flexible time-of-use pricing, while voluntary arrangements may be available in other states from 1 January 2014.

## Opt-in time-varying pricing

Time-varying pricing varies the price of electricity for different periods of the day. This gives customers more options to reduce the cost of their consumption when compared with ‘single rate’ or ‘flat’ tariffs available with traditional metering technology.

Customers can benefit from time-varying pricing if they are able to shift some of their consumption away for the higher price peak periods, or if they have a relatively flat consumption pattern. Time-varying pricing also has the potential to stimulate greater demand-side participation, which has the potential to reduce the network and generation investment required by levelling out the peaks.

The AEMC's Power of Choice review found that switching to a time-varying tariff could save consumers with a relatively flat consumption pattern $50 off their annual bill, even if they don't change the way they consume electricity. This saving could increase to an extra $100 a year if consumers are able to shift around 20 per cent of their use from the peak afternoon period (2pm to 8pm) to other times.

SCER agreed to develop the market settings to provide consumers with the option of cost-reflective retail pricing structures incorporating time-varying network tariffs. SCER proposes to do this on a voluntary basis where consumers have the choice to move to a new tariff.

SCER recognises that it is crucial that this work be accompanied by appropriate consumer engagement and education for all consumers, and protections for vulnerable consumers.

### Greater demand-side participation

It is estimated that 25 per cent of retail electricity costs are derived from peak events that occur for less than 40 hours of the year. Moving consumption away from these periods could avoid or defer the need to invest in generation and network infrastructure.

Demand-side participation refers to the ability of consumers to make informed decisions about the quantity and timing of their energy consumption. Different consumers can benefit from their consumption decisions which reduce peak demand in different ways.

For example, a distribution business could offer to pay small consumers to have the option of controlling appliances such as air conditioners and pool pumps remotely for short periods. The consumer would receive a financial benefit, and the distribution business would have another option to manage its network at lower cost.

Large industrial and commercial consumers which are able to make large, reliable reductions in their electricity use could compete with generation in balancing supply and demand in the electricity market.

As part of the package of reforms recommended by the AEMC Power of Choice review, SCER agreed to progress an additional option for direct demand-side participation in the NEM. This will provide more opportunities for consumers to be rewarded for their demand restraint.

The AEMC has released the final report of its review of demand-side participation in the NEM. SCER agreed to progress further work on the Power of Choice recommendations and will report to COAG on the progress made in June 2013.

### Enhanced consumer protections

The National Energy Customer Framework (NECF) is underpinned by the National Energy Retail Law which sets a nationally consistent approach for the sale and supply of electricity to consumers.

It seeks to protect energy consumers by requiring retailers to include model terms and conditions in their contracts; provides protections for consumers experiencing longer-term payment difficulties; provides for limitations on disconnections; and facilitates requirements for more information to be included on customer energy bills with respect to energy pricing.

Full implementation of the NECF across the NEM will also streamline the regulatory environment for retailers, helping to reduce administrative costs. For example, the NECF requires only one retail licence for retailers operating across jurisdictional boundaries which should make it easier for smaller retailers to access new markets, assisting retail competition to provide customers with more choice.

A key element of the NECF is a new website designed to help consumers make informed choices through a new online energy price comparison service www.energymadeeasy.gov.au.

Not all jurisdictions have implemented the NECF. SCER agreed that all NEM jurisdictions would commence the NECF as soon as practical and no later than 1 January 2014, subject to the resolution of some jurisdictional specific issues.

**National Energy Customer Framework Implementation**

| **Jurisdiction** | **Implementation date** |
|---|---|
| Australian Capital Territory | 1 July 2012 |
| Tasmania | 1 July 2012 |
| South Australia | 1 February 2013 (proposed, tbc) |
| New South Wales | 1 July 2013 (proposed) |
| Victoria | 1 January 2014 (proposed) |
| Queensland | Under consideration in Queensland electricity sector review |

SCER also agreed to complete its specific work on consumer protection for smart metering and time-varying pricing as a priority.

## Enhancing competition and innovation

Past reforms have provided a strong foundation for competitive national energy markets. However, several major areas of reform remain outstanding.

Moving towards competitive and efficient wholesale and retail markets requires a re-commitment to deliver on the AEMA commitments to deregulate retail price controls where effective competition exists, or developing a pathway to effective competition and deregulation where it does not.

Improving competition in the retail sector will encourage retailers to innovate and offer consumers better services, including a suite of information and 'smart' tools to help them control their energy use and keep costs down. This can occur while maintaining state-based community service obligations.

### Greater retail competition

Victoria deregulated retail prices in 2009 and is recognised as having one of the most competitive energy markets in the world. Other jurisdictions are yet to follow. South Australia and the Australian Capital Territory have had retail competition in their markets assessed by the AEMC and retail competition is currently being assessed in New South Wales.

Retail prices set by market forces allow retailers to compete to offer consumers a better deal and encourages greater innovation in a wider range of products, similar to the benefits customers have experienced in the telecommunications sector.

Where price deregulation is introduced retailers have an incentive to find creative ways to capture market share, which could include offering consumers a retail package with a variety of new measures such as advanced energy management services (including metering), time-of-use pricing and other services so customers have more options to manage costs.

Good quality information, strong consumer protections and respected standards of practice must accompany a move to retail price deregulation so that consumers can make informed choices.

SCER agreed jurisdictions would report back to COAG in 2013 on the state of competition and policy settings in their respective jurisdictions and pathways towards retail price deregulation, where effective competition exists.

SCER further agreed to task the AEMC with developing a revised approach to its retail competition reviews, to fast-track the process.

SCER also tasked the AEMC to develop a best-practice methodology for retail price regulation that jurisdictions can choose to adopt to facilitate greater competition in their retail markets as a stepping-stone to retail price deregulation, or for use where regulation remains necessary.

### 'Fair and reasonable' return for micro generation

Feed-in tariff policies are set by state governments and vary across the country. COAG has agreed to a set of National Principles for Feed-in Tariff Schemes to provide a level playing field to enhance competition in electricity generation.

It is recognised that residential and small business consumers with grid-connected micro generation, such as solar rooftop panels, small wind turbines or ceramic fuel cells, should have the right to export energy to the electricity grid and should also receive payment for exported electricity which reflects the value of that energy in the relevant electricity market, taking into account the time of day when energy is exported.

Changes to the national guidelines set out that all micro generation should have access to ‘fair and reasonable’ tariff as well as providing owners with a clear understanding of their rights and obligations for connections, while also providing stability for industry.

Premium feed-in-tariffs, where exported energy attracts payment greater than its value, have resulted in the deployment of large volumes of micro generation systems at a significant cost to consumers. In particular, consumers who do not have systems receive little or no benefit and effectively cross-subsidise those who do. Further, the often-criticised cycles of 'boom and bust' have created business uncertainty for suppliers and installers of micro generation systems.

COAG agreed to SCER’s recommendation to amend the National Principles for Feed-in Tariff Schemes to include all forms of micro generation and to close remaining premium schemes to new participants by 2014.

The changes do not affect existing premium feed-in tariff contractual arrangements.

## Ensuring balanced network investment

Maintaining efficient and reliable networks is critical to providing a high-quality supply of power to consumers. The cost of providing these services is also a major factor in the price of electricity for consumers.

The rapid rise in Australian network costs has been the most significant driver of recent electricity price increases. Most of this cost pressure is concentrated in the distribution system – the poles and wires you see in your street.

These increasing costs have focused attention on the performance of network businesses, the drivers of network investment, and the rigour of the regulatory framework. In particular, there are some concerns that the current framework provides insufficient incentive for least-cost investment outcomes.

It is essential that consumers have confidence that network costs are efficiently based and clearly targeted at providing a high-quality service. This includes assurance that network regulation is placing enough weight on the long-term interests of consumers.

### Reliability standards

Australians have a right to expect a highly reliable supply of electricity, however maintaining or improving reliability is increasingly challenging and expensive, given the ageing nature of networks and new demand pressures.

A review by the AEMC into reliability standards in New South Wales indicates that consumers are broadly comfortable paying a slightly higher cost to maintain the levels of reliability that they have come to know and expect, but it is essential that these standards are set in a way that is efficient and appropriate.

SCER agreed to task the AEMC with developing a nationally consistent framework for expressing, delivering and reporting on distribution and transmission reliability outcomes. In doing so, the AEMC will ensure that the approach taken to meet reliability standards by network businesses reflects economically efficient outcomes that reflect consumers' willingness to pay.

COAG subsequently agreed in-principle to transfer the application of this framework once developed to the AER.

Jurisdictions will report to SCER by the end of 2013 on their decisions on the transfer of this responsibility.

### Changes in demand

Historically, Australia's energy demand has steadily trended upwards year-on-year, driving the on-going need for investment in generation and network infrastructure. In order to ensure reliability, networks must build sufficient capacity to meet peak demand.

A number of recent and unexpected changes in Australia's economy have impacted on overall demand for electricity. These factors include a downturn in the manufacturing sector, consumers using less electricity in response to higher prices, milder summer weather and the installation of solar panels.

Greater deployment of demand-side participation and time-of-use pricing are also expected to moderate growth in peak demand.

In view of these developments, it is necessary to assess whether the forecasting and investment frameworks are sufficiently flexible and dynamic to adjust to changed conditions.

SCER agreed to task the AEMC with investigating the implications of differences between actual and forecast demand within the operation of the network regulatory frameworks by May 2013.

SCER also agreed to task the Australian Energy Market Operator (AEMO) to develop demand forecasts which may be used by the AER to inform its future regulatory determination processes.

These measures are designed to ensure that any benefits associated with reducing demand can be shared between network businesses and consumers. SCER recognised it is critical that any investigation into these issues continues to maintain investment certainty for network businesses.

### Transmission framework

The AEMC is currently examining arrangements around how transmission networks, the major high voltage lines which transfer power between generation and local distribution networks, deliver services to the energy market.

The AEMC work is aimed at ensuring the most efficient combination of generation and network investment based on market and technology-neutral signals.

The Review seeks to ensure appropriate incentives are in place to invest in transmission and electricity generation.The AEMC has issued two interim reports, with the final report due in March 2013.

SCER agreed to finalise its policy response to the AEMC's Transmission Frameworks Review by June 2013 with respect to opportunities to improve connections, access and planning processes.

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