Energy Retailers Association of Australia

23 November 2012

Philip Weickhardt
Presiding Commissioner
Electricity Network Regulatory Frameworks Review
Productivity Commission
Level 12, 530 Collins Street
Melbourne VIC 3000

By email: electricity@pc.gov.au

Dear Commissioner

RE: Electricity Network Regulatory Frameworks Draft Report

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide comments on the *Electricity Network Regulatory Frameworks Draft Report* (the Draft Report).

The ERAA is the peak body representing the core of Australia's energy retail organisations. Membership is comprised of businesses operating predominantly in the electricity and gas markets in every State and Territory throughout Australia. These businesses collectively provide electricity to over 98% of customers in the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas. We recommend that the Productivity Commission (PC) has due regard to any submissions by our member organisations.

The ERAA welcomes the PC's report and have structured our comments to respond to the issues raised in the individual chapters of the Draft Report. The following six points provide a brief overview of our submission:

1. *Demand-side participation (DSP)* – DSP is a worthwhile long-term objective, however the ERAA has concerns with some proposed models and would strongly oppose their introduction into the NEM.
2. *Smart metering* –we do not support the PC's recommendations in relation to this topic as retailers believe a market-driven roll out of smart meters will result in a more cost-effective roll out with faster delivery of more innovative services than a mandated distributor-led roll out.
3. *Flexible pricing* – the ERAA supports the introduction of flexible network pricing, although the challenge of transitioning customers to underlying flexible network tariffs should not be underestimated. It should also be recognised that there a range of precursors that need to be in place before this outcome occurs.
4. *Ring-fencing* – appropriate ring-fencing arrangements are essential to ensure a level playing field in the DSP market.
5. *Retail price deregulation* – the removal of regulated energy retail tariffs is essential to promote competition and innovation, and a necessary precursor to the introduction of flexible pricing.

Yours sincerely

Cameron O’Reilly
Chief Executive Officer
Energy Retailers Association of Australia

Chapter 10 Demand management technologies

The use of services facilitated by smart meters can bring substantial long-term benefits to consumers. For these benefits to be realised a number of challenging issues must first be addressed. The ERAA's smart meter policy position is outlined in a series of five papers released by the ERAA in September 2012. These working papers are included as part of this submission (Attachments 1-5) and will be referenced where relevant. *ERAA Working Paper 1 - Realising the benefits of smart meters for consumers and industry* (Attachment 1) provides a summary of our position and the papers. The ERAA considers these attachments as an essential part of our submission.

A market-driven approach to smart metering

The ERAA does not support the recommendations that the PC has arrived at in Chapter 10 of its Draft Report. As witnessed in Victoria, government-mandated distributor-led roll outs of smart meters can be high cost and may not gain the support of the customers that they are intended to benefit.

The ERAA believes that a market-driven roll out of smart metering is a preferable way of getting new metering technology into homes and businesses. A market-driven roll out is very different to other roll outs experienced in Australia, particularly Victoria, because it is commercially led rather than due to a mandated or regulated undertaking. Under this model, the retailer as the Financially Responsible Participant for a premise is the party that coordinates the installation of the meter and the provision of metering services, such as meter reading.

Competitive metering means better outcomes for customers — lower costs, better services and faster delivery of those services to customers in a form that the customer wants. Competition between retailers underpins the incentives that retailers have to roll out smart meters to their customers and to deliver the range of services and products that customers want at a price they are willing to pay. The ERAA's position on this issue is explored further in *ERAA Smart Meter Working Paper 2 – Market-Driven Smart Meter Roll out* (Attachment 2).

Facilitating a market-driven roll out of smart metering will require changes at a government and distributor level.

- First, governments will need to remove artificial barriers that prevent retailers from providing small customers with competitive metering services. To address this regulatory failure, all remaining exclusivity provisions (including those in Victoria) that provide distributors with a monopoly over the delivery of metering services must end.
- Second, metering charges will need to be unbundled from network charges. The bundling of metering charges in network charges acts as a significant barrier to retailers rolling out smart metering services. If a retailer had replaced a householder's manually read meter with a smart meter, the retailer would still need to pay the bundled network charge making the business case for replacement uneconomic.
- Third, exit fees charged by distributors for displaced meters should be aligned with the early termination fee principles established by the National Energy Consumer Framework so that the fee charged is no more than a reasonable estimate of costs resulting from early termination (ie, the depreciated value of the remaining life of the asset).
- Fourth, the potential or option that governments could mandate an advanced metering roll out within its jurisdiction needs to be removed. The option of a government mandating an advanced metering roll out within its jurisdiction acts as a strong disincentive to a commercial roll out as it

heightens investment uncertainty and financial risk. No market participant will decide to roll out a commercial deployment of smart meters if there is a risk of a future mandated deployment.

The ERAA directs the PC to the attached papers for further elaboration on our views.

Chapter 11 Time-based pricing

The ERAA supports the introduction of time of use (TOU) pricing. However there are a number of issues that will need to be addressed for this to occur. These issues, summarised below, are expanded upon in *ERAA Smart Meter Working Paper 2 – Market-Driven Smart Meter Roll out* (Attachment 2), *ERAA Working Paper 3 - Competitive neutrality in energy service provision* (Attachment 3), *ERAA Working Paper 4 - Privacy of personal information: how to ensure appropriate use and disclosure of smart meter data* (Attachment 4) and *ERAA Working Paper 5 - Third party and distributor sale of energy management services* (Attachment 5). Also attached is the ERAA's submission to the *National Smart Meter Consumer Protections and Pricing Draft Policy Paper Two* (Attachment 6), which provides our position on a range of issues related to the introduction of TOU pricing.

Mandating TOU Prices

The ERAA opposes the proposed mandate of TOU network prices for all customers as recommended by the PC. The introduction of TOU network pricing must be accompanied by education and appropriate tools that help customers understand the impact to them of TOU pricing and help them adjust their consumption patterns to minimise that impact. Mandating a reassignment to TOU network prices does not allow customers the time that they need to make decisions that are appropriate to their circumstances because the decision to go onto a TOU network price is taken out of the consumer's hands. As a result, they will reject TOU network pricing as something being forced upon them and refuse to see the benefits that new pricing structures could provide to them

Education

Where new pricing arrangements are justified, they need effective customer education and engagement and should deliver identifiable consumer benefits (noting the differentiation of consumer segments) in a timely manner.

The ERAA notes that certain progress is already being made to build on consumer awareness. For example, the AER's price comparator website www.energymadeeasy.gov.au will provide information on costs and use of appliances, as will other government websites, such as the Department of Climate Change and Energy Efficiency's site www.livinggreener.gov.au. Many energy retailers also already provide this information.

As TOU tariffs become more widespread we can also expect retailers to more actively promote energy saving suggestions and information to best make use of the opportunities available to shift load. For example, information portals showing customer consumption and cost in a clear and easily understood manner are an example of services that can be provided by energy retailers.

It is essential that information provided to customers is done so through their existing retailer. Multiple points of contact have the potential to create consumer confusion ('consumer schizophrenia') which would extenuate the poor perceptions already experienced in the Victorian market with their Advanced Metering

Infrastructure (AMI) program. The ERAA though must stress that it considers education separate to information provision. The former is a shared responsibility of all industry participants inclusive of government, whilst the latter is facilitated by retailer involvement.

Transitioning to TOU Prices

It is essential that retailers not be obliged to absorb costs as a result of network tariffs they cannot pass through to consumers under existing commercial arrangements. Equally, the transition to TOU network tariffs must be done in a way that minimises distortion to price signals for end customers. The ERAA would be concerned if stakeholders sought to introduce further regulatory intervention in pricing in an attempt to protect consumers during the shift to cost reflective pricing, as this will only serve to further distort market efficiency. Instead, Government should look at supporting customers who face difficulty in paying bills through direct transfer payments. Retailers' ability to price competitively and efficiently should not be confused with any hardship assistance – the Retail Code already deals with this.

The ERAA would caution against the introduction of bill protection mechanisms without further consultation. Mandated bill protection would result in operational complexities, with resulting costs passed through to customers. Retailers would need to change billing systems to account for the separate retail price structures and associated potential network tariff considerations. This would involve new reconciliation processes following a request for billing using a different tariff structure under the same contract. The ERAA does not discount that bill protection is a worthy product to help protect consumers, rather that the market should be left to develop such products. Competition will ensure consumers' transition to companies that offer these services as part of their product offerings.

Network Tariffs

The ERAA supports the recent proposal put forward by IPART to the AEMC to amend the annual network price setting arrangements in Chapters 6 and 6a of the NEL. The current timetable for network pricing doesn't provide retailers with enough time to set retail prices, with an inadequate period between when determinations are finalised and network prices are notified. This means that retailers are forced to rush retail price setting decisions into a period of days or alternately to base pricing decisions on draft determinations and estimated network tariffs. The ERAA supports bringing forward the publication date of distribution prices.

Privacy

As smart meter use increases, so to do the risks that smart meter data may be misused. The security of consumers' personal information is a core concern for retailers. As such, the ERAA has recently been concerned where governments have suggested that meter data should be uploaded to third party sites without the customer's express consent required by the National Privacy Principles (NPPs), or where smaller third parties are currently exempt from the NPPs because of size. These issues are explored in the *Working Paper 4: Privacy of personal information: how to ensure appropriate use and disclosure of smart meter data (Attachment 4).*

Chapter 12 Complementary reforms to support demand management

Retail Price Deregulation

Energy market reform has resulted in governments introducing competition, privatisation and deregulation of parts of the energy industry. Utility companies have now been separated into discrete companies responsible for generation, transmission, distribution and retailing. The final stage of deregulation is the phasing out of regulated energy retail tariffs. Without the removal of price regulation the espoused full benefits of flexible prices and smart meters will be difficult to be realised.

Under the Amended Australian Energy Market Agreement (2006) Council of Australian Government's (COAG) agreed to phase-out retail energy price regulation per jurisdiction where competition is found to be effective by the AEMC. With the exception of Victoria, every State and Territory government is yet to phase out regulated retail prices. Retail price regulation is inefficient; it stifles product innovation, impedes price and service competition, and prevents the full range of benefits resulting from competition from being realised. Competition offers the best form of protection to consumers, not setting retail price caps.

Victoria phased out regulated retail prices on 1 January 2009 following the advice of the AEMC that competition was effective. Since then, competition has developed strongly; offering customers more diverse and innovative energy products, and consumers can save on their power bills by shopping around. Victoria's market is the most active in the world, with switching rates being consistently greater than 25%. This is substantially more than other markets in the NEM which have not yet deregulated retail energy prices. Furthermore, the Victorian market has the least concentrated market share in Australia, where non-incumbent retailers have been able to secure one quarter of the market.

Recently the AEMC has claimed that it "does not agree that retail price regulation should discourage retailers from introducing innovative time varying tariffs" whilst also recognising that price regulation does add to compliance costs and reduces flexibility for retailers.[1] However, the Productivity Commission has found that retail price deregulation is a necessary pre-condition to the community realising the full benefits of cost reflective pricing. The ERAA disputes this statement by the AEMC. Price deregulation does stifle innovation as price deregulation distorts market efficiency and introduces material risk to retailer operations. Setting inaccurate tariffs could be detrimental to both energy retailers and consumers. If prices are set too high, consumers could pay too much for energy, although competition from market contracts could mitigate this risk. If prices are set too low, retailers will be unable to recover costs and may discontinue operating in the market. Furthermore, there are documented dangers of price discounting to households when actual price rises are later applied. As a result of these challenges retailers are always cautious about introducing innovative tariffs in markets where exposure to financial risk is heightened by price regulation intervention or threat. The best way forward to mitigate such challenge is to promote strong competition in the retail energy market and to deregulate retail energy prices.

This position is supported in the recent release of the Energy White Paper where it was stated that:

"Regulated tariffs are inherently less flexible and efficient, and there is an almost certain risk in markets where effective competition exists that regulators will set prices at levels that do not reflect the competitive price of supply. While it can be tempting for governments to set prices below the cost of supply, this is not in the long-term interests of consumers because it ultimately results in sharper catch-up costs and can lead to a loss of competition in the market.
Having prices set through competitive markets provides for a more efficient and responsive adjustment of business margins based on costs and performance. This introduces extra incentives for efficiency and competition—all to the benefit of consumers.

While regulated retail markets can provide a range of services, a deregulated business environment has greater potential to accelerate and deepen competition and innovation. Deregulated markets are more

[1] AEMC (2012), Power of choice – giving consumers options in the way they use electricity – Draft Report, p.111.

likely to respond to consumer needs, leading to a wider range of services and products (as has happened in the telecommunications sector). New products could include time-differentiated tariff packages and advanced energy management services (including smart metering), giving customers more options to manage costs.

More cost-reflective pricing is an important (but not the only) step in driving more efficient use of energy and infrastructure. This would lower supply costs for all consumers. Regulated uniform tariffs may also be generating an inequitable distribution of costs between peak and non-peak customers. This may mean that households that use less energy in peak periods are paying more than they might otherwise need to."[2]

State and Territory regulators around the country have indicated that as the energy industry transitions to a low-carbon future, setting cost-reflective (as they are required under their terms of reference) under regulated retail tariffs is becoming increasingly difficult. Once all states commit to the deregulation of retail prices then this will facilitate the transitioning of customers onto innovative flexible tariffs that will shift consumption to lower cost time periods.

Ring-Fencing

Appropriate ring-fencing arrangements are essential to ensure a level playing field in the DSP market. The current regulatory framework does incentivise a network business to engage in DSP projects. However, incentivising a monopoly businesses with a regulated capital that is demonstrated by demand increases and caveats associated with the cost impost on customers is not an effective incentive in any situation. Where overall performance is measured against operational performance that is the result of capital spend, and where capital spend is the result of regulatory approval, there is no incentive to defer that spending where there are mechanisms for avoiding liability.

The ERAA's position on this issue is explored further in *Working Paper 3: Competitive neutrality in energy service provision (Attachment 3).* The following points are of particular relevance:

- The products and services that can be delivered through smart metering technology do not possess characteristics that would define them as monopoly products and services, such as declining economies of scale. The contestability of smart metering services and products has been recognised by the ACCC and NER.
- Distributors must be appropriately ring-fenced to compete on equal grounds.
- Where distributors seek to provide non-emergency load control and other forms of demand side participation to relieve the need for network augmentation for peak load (outside the applicable regulatory mechanisms) distributors should first go to the market and engage with authorised parties to deliver mass market demand side response programmes.

Third Parties

The ERAA's view on third parties and distributors entering the competitive home energy market is simple: all participants selling certain energy services in the competitive market should adhere to the same consumer protection regime and distributors selling these services should be appropriately ring-fenced from their regulated network businesses. These views are expanded on in *Working Paper 5: Third party and distributor sale of energy management services (Attachment 5).*

---

[2] Department of Energy, Resources and Tourism (2012), *Energy White Paper 2012 – Australia's energy transformation*, p.160.

Demand-response model proposed in Power of Choice Draft Advice

The ERAA supports DSP in the NEM. Retailers have long worked with customers to provide DSP options where mutually beneficial. Large electricity users with interval metering already have an opportunity to engage in demand response. They can do this by seeking supply contracts that expose them to spot market prices, or with sufficiently shaped time of use pricing structures that demand can be shifted away from higher priced periods, or through demand response contracts with generators or third party aggregators. Most of these customers are choosing not to do so. It is a mistake to assume this is a market failure. For most customers, price certainty is what they want from their retailer. For other customers that are engaged in demand response, the efficient level of demand response is already being delivered – these consumers are making a rational decision to cease using electricity when its cost exceeds that required for them to maintain profitable production in their business. The benefit of them choosing not to take electricity is its avoided cost. We therefore suggest that efficient market outcomes are currently being achieved in this segment of the market where customers already have a choice whether to engage in demand response. In fact ERM Power recently released in its Annual Report the following statement:

"The business continued to develop its demand response ("DR") capability during the year with a team dedicated to both help customers use power more efficiently and cost effectively, and enhance portfolio risk management. Although still in its infancy, the DR program now has more than 50 MW in the portfolio and will provide benefits to both our customers and ourselves. Our customers will benefit from lower energy and network costs and we will benefit from customer loyalty and lower costs of sales."[3]

Whilst the aim of increasing DSP in the market is valid, the new model proposed in the Power of Choice Draft Advice requires further work to address a number of issues. The costs of this proposed model (including market inefficiencies and increased hedging costs) will outweigh the potential benefits (money saved by energy consumers from not consuming energy). Whilst the AEMC has indicated that unlocking DSP is in the long interest of consumers, this should not be done at the cost of efficient investment and operation of the NEM. The National Electricity Objective (NEO) clearly states that "the objective of the Law is to promote efficient investment in and efficient operation and use of electricity services for the long term interests of consumers."[4] The AEMC's proposed efficiency test for efficient DSP, being that the costs of subsidising demand response is less than the benefit shared by other consumers from lower electricity prices, is not consistent with the market efficiency principles promoted by the NEO.

Recently the Energy Supply Association of Australia and the National Generators Forum commissioned an economic study into this proposed model, *Economic implications of the proposed Demand Response Mechanism – Report for the Energy Supply Association of Australia and the National Generators Forum,* available online. The ERAA strongly supports this report, and urges to the PC to consider its findings. In summary, the report demonstrates that the net benefit to society of a DSP event under this proposed model is limited to the difference between the avoided cost of generating additional electricity output, and the opportunity cost to the customer of reducing their consumption.[5] Therefore, whilst this proposed model does not provide any incentives that do not exist in the market today, it does introduce new direct and indirect costs.

[3] ERM Power (2012), ERM Power Annual Report, p.11.
[4] New NEL, s.6.
[5] SFS Economics (2012), Economic implications of the proposed Demand Response Mechanism – Report for the Energy Supply Association of Australia and the National Generators Forum, p.9.

Hardship

At any one time there will be members of the community facing financial hardship. This can be either temporary hardship, where someone might be going through a difficult period, or chronic hardship, where people are indefinitely in a financially disadvantaged position. Energy retailers provide hardship programs for people who are having temporary difficulty paying for their energy consumption.

Energy retailers accept that some of their customers might not be able to pay their energy bills from time to time. To help these customers out, retailers have support mechanisms to assist customers to manage energy debt. These include payment plans, flexible payment arrangements and advice on how customers can save on their energy bills. While these might assist those in temporary hardships, these support mechanisms alone are not the solution to more chronic hardship.

Addressing energy hardship is a shared responsibility of governments, energy retailers, community groups and individuals. While energy retailers make efforts to identify and contact customers who are having difficulty paying their bills, they are limited in their ability to proactively identify customers who require support. It is ultimately up to the customer to engage with the retailer to advise of a need for support, and to then participate in their hardship support program.

The role of an energy retailer is not to administer social welfare policy: this is a core function of governments. Hardship is best addressed through comprehensive and targeted social welfare policies. Recent increases in energy prices, largely driven by the need to invest in network infrastructure, will further add pressures on household bills and this should be met by the Commonwealth with additional assistance to households.

Price regulation is not an effective mechanism to protect people facing hardship. If the regulator sets the price of energy below what the market would set, a subsidy is effectively granted to all members of the community, not just the ones finding it difficult to pay their bills. As a result, competition in the energy market suffers and this has associated repercussions. Artificially restricting energy tariffs simply masks one of the symptoms of financial hardship rather than addressing financial hardship directly.

Competition offers the best form of price protection for consumers because retailers are competing to offer their customers the best energy products at market efficient prices. The only sustainable way in the long run to support people facing hardship is to have comprehensive welfare policies directly assisting those in hardship.

Chapter 13 Distributed generation

Solar Feed in Tariffs

Premium solar feeds in tariffs (FITs) are not the preferred policy option of the ERAA. The ERAA has long held the position that government policies and incentives should be transparent, on budget, and should address market failures. The ERAA contends that in a competitive environment markets are best placed to determine the most appropriate, sustainable and economical value for the electricity that is produced and exported by photovoltaic (PV) units. It is only through the competitive landscape of the energy market that this tariff innovation and value has been able to mature. Requiring energy retailers to fund noneconomic solar subsidies through the setting of minimum mandatory FiTs or establishing an incorrect and over inflated benchmark price would have an adverse impact on retail competition, exacerbate consumer confusion and create unnecessary additional costs. Any mandated additional cost placed on energy retailers would act as a strong disincentive to sign up customers with PV units.

Chapter 21 Governance

Draft Recommendation 21.4
The National Electricity Law should be amended to expedite the making of Rules arising from any appropriately conducted independent review relevant to the National Electricity Market and that are agreed by the Standing Council on Energy and Resources. This should be achieved by giving the:

- Australian Energy Market Commission the power to expedite Rule requests and
- South Australian Minister a broader power to make Rules.

The ERAA does not support the PC's recommendation of broader power to make Rules for the South Australian Minister.

Regulatory uncertainty is a growing issue for the energy industry as rising energy prices are resulting in an increasing level of short-term policy intervention in what is a highly complex industry. This intervention is creating an uncertain environment for investors and is becoming a self-fulfilling prophecy as some of these interventions are escalating energy prices further, which drives even further policy intervention in the industry.

The PC cites the reason for its recommendation as being the burden on stakeholders of reviews. It is true there are a great number of reviews occurring into the energy industry and the current period is particularly intense. This is placing a resource burden on industry stakeholders due to the time that is being absorbed in responding to the various reviews that are occurring. However, a key challenge faced by industry is regulatory uncertainty, and the ERAA would be opposed to any changes that may increase this uncertainty. The key benefit of the AEMC's consultation process is its independent nature, an approach the ERAA believes should be retained.

Another of the key benefits of the AEMC's consultation processes is that industry stakeholders are provided the opportunity to comment on the actual wording that will go into the Rules. The industry does not get the same opportunity with legislative changes that are proposed by government. There are many instances in the existing legislation governing the industry of poor drafting where the wording does not match the intent of the law.

There is a case for fast-tracking Rule changes where another independent review such as the limited merits review has gone through an extensive consultation process and recommended certain changes to the governance of the industry. For this reason, the ERAA supports the PC's recommendation for the AEMC to expedite Rule change requests.