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Professor Ian Harper
c/o: Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Level 9
99 Gawler Place
Adelaide SA 5000
Postal Address:
GPO Box 2010
Adelaide SA 5001
T 1300 858 724
F 08 8410 8545

Dear Professor Harper

AEMO submission to the Competition Policy Review Draft Report

AEMO is the independent operator and developer of physical energy markets in South Eastern Australia. We have a range of operational and planning functions which we pursue in accordance with the National Electricity Objective, which is to promote the long term interests of electricity customers with respect to price, safety, reliability and security of supply.

AEMO welcomes the Competition Policy Review. In the 1990s, the Hilmer Review was a key driver of the reforms that led to the establishment of the National Electricity Market (NEM). Those reforms created successful competitive markets for retail and wholesale electricity where previously those services had been provided by monopolies. The Competition Policy Review represents an important opportunity to give fresh impetus to the reform process initiated by the Hilmer Review.

Australia's energy landscape is changing. Centralised investment in traditional electricity infrastructure is under pressure as consumers are adopting new technologies. This is due to rising electricity retail prices and lower costs of new technologies such as energy efficient appliances, local generation options, rooftop PV, smart metering, and energy storage technologies.

In this context the role of electricity network businesses requires careful consideration. Energy market policy needs to keep pace to avoid limiting emerging competition and innovation.

While overall competition is putting pressure on regulated network services, these services will continue to be critical to electricity services for an extended period. Electricity networks have natural monopoly characteristics, however, a range of services provided by networks can be provided on a competitive basis. This submission identifies a number of opportunities to introduce competition to services which were previously considered monopoly services.

Pro-competitive reforms have the potential to benefit customers through lower prices and more innovative service offerings. The opportunities to introduce competition in domains which have historically been considered to be the exclusive preserve of network businesses include:

- **Network augmentations.** Uniquely in the NEM, the Victorian regulatory framework provides for the contestable provision of major transmission augmentations. If a required transmission upgrade is separable from the existing shared network, AEMO

conducts a competitive tender to procure the service. This approach has given rise to lower cost outcomes compared to the traditional model and recent changes in market conditions are enhancing its effectiveness. AEMO has observed a significant increase in the level of competition in its tender processes. The increase in competition applies both between rival providers of network solutions (as network businesses seek new opportunities) and between network and non-network solutions such as embedded generation and demand management.

- Metering services. Metering services can be provided on a competitive basis, lowering costs and creating opportunities for innovation. Competition in metering also has important consequences for retail competition. The Australian Energy Market Commission is currently considering a request from the COAG Energy Council to establish arrangements that would promote competition in the provision of metering and related services in the NEM.¹ AEMO supports this review.
- Connections. The NSW regulatory framework establishes a competitive market for connections to the distribution network, whereas in other NEM jurisdictions this service is provided by the local monopoly service provider. A review by the NSW Better Regulation Office found that this arrangement “allows greater customer choice and fosters efficiency”.²
- Financing. At present network infrastructure is financed by the network businesses and they receive a regulated return on capital. The AER’s most recent electricity determination granted a rate of return of 7.87 per cent to Ausnet Services.³ A number of previous decisions granted rates of return in excess of ten per cent. There is scope to explore opportunities for infrastructure projects to be financed by capital markets using a contestable procurement process. Contestability could help to reduce margins and manage risk.

Going forward, important policy issues will need to be resolved about the role of network businesses in emerging energy markets. In the long term, technological developments offer the prospect of electricity supplied to consumers without the need for a costly electricity network. However, Australian network businesses have recently sunk billions of dollars in upgrading their networks, and customers are having to pay for these investments.

Over the next few decades, the most efficient service model is likely to involve a combination of the efficient use of existing infrastructure combined with new technologies that reduce the need to invest in new network assets. Network businesses are exploring opportunities to move beyond their traditional market models. For instance, United Energy is trialling a project to install and operate solar PV in combination with storage facilities in residential homes⁴ and Ergon Energy has started to use battery technology to reduce the need to invest in network assets to meet peak demand.⁵ These activities are to be welcomed insofar as they improve the efficiency of electricity network services.

However, by offering such services, electricity distributors pose a daunting challenge to potential competitors who are not able to provide network services and new technologies as

¹ <http://www.aemc.gov.au/Rule-Changes/Expanding-competition-in-metering-and-related-serv>

² NSW Government, *Review of contestable services on the New South Wales electricity network, Final report*, July 2010, pg 5.

³ AER, *A guide to the AER’s transmission final decision for SP AusNet*, January 2014, pg 13.

⁴ United Energy, *Distribution Annual Planning Report, 2013-14 to 2017-18*, pg 269.

⁵ Ergon Energy, “Battery technology on electricity network an Australian first”, Media release, 16 October 2014.

a combined package. The costs associated with a solar PV/storage package which allows a customer to avoid peak demand periods are much smaller than the investment required to disconnect from the grid altogether.

Competitively neutral access to electricity networks is therefore a key emerging policy issue. Distribution businesses should be able to develop their business models, but they need to do so in a manner that does not inhibit the development of competitive markets. The market framework should provide for the efficient use of existing infrastructure whilst also moving towards the low carbon, competitive energy market of the future. For instance, network charging structures should not create disincentives for the uptake of energy efficient technology.

Access and Pricing Regulator

AEMO notes the draft recommendation to divest the Australian Energy Regulator (AER) and other infrastructure regulation functions of the Australia Competition and Consumer Commission (ACCC) to a new federal access and pricing regulator. If this were to occur, it would be important to ensure that the AER's market functions are maintained.

The AER currently fulfils important functions beyond network regulation. It monitors and enforces compliance with the energy market rules, including by monitoring and reporting on wholesale electricity market outcomes. AER oversight is an important feature of the wholesale electricity market since it creates incentives for market participants to fully comply with the rules. It is crucial that this function continues to be provided in the event of any institutional restructuring.

Conclusion

The Review Panel should consider opportunities to support innovation and competition in a market dominated by network monopolies. AEMO would be happy to discuss these opportunities with the Review Panel. There is scope for us to provide more detailed information if it would be helpful. If you would like to discuss this submission, please feel free to contact me on (08) 8201 7371.

Yours sincerely



David Swift
Executive General Manager Corporate Development