Martin Jones, speech to AEMC Consumer Priorities Forum, 10 August 2015

We find ourselves, from the AEMC's perspective, in the purgatorial period after a rule change has been completed but before it has reached its final resting place. "Purgatory" perhaps isn't quite the right term – theologically, one enters purgatory only if one is ultimately destined for heaven. The fate of distribution network tariff reforms, however, has yet to be determined. Thankfully the AEMC has the power to 'reincarnate' its reforms should one fail. Enlightenment is a destructive process.

Theology aside, network tariff reform has the potential to materially change how consumers participate in the electricity market. Cost reflective prices, if implemented well, can reduce unjust cross-subsidies and lead to greater efficiency in network investment and electricity consumption, forming the basis for greater coordination of producer costs and consumer desires.

The AEMC's rule recognises that the tariffs' impact on consumers is important for their participation, and includes requirements for DNSPs to consider how consistent and understandable their tariffs are. Requirements for tariffs to be cost reflective and non-distortionary in tandem seek to ensure that consumers participate in the right way – that is, in response to the right price signals.

Importantly, the 'right' response for a particular consumer to new tariffs might be to do nothing at all. This is not a reform that requires behavioural response in order to be successful. Consumer participation will occur in many different ways, and there is no normative "correct" response to a change in price signals.

The obligation to implement network tariff reform rests on DNSPs, and they will freely admit they are not the best at engaging with consumers. CUAC has for over a year been engaging with DNSPs to both present a consumer perspective and help DNSPs get views from other consumers.

In June, CUAC released a report called "Cost Reflective Pricing: Engaging with Network Tariff Reform in Victoria" to help consumer and community advocates understand the complexities of the reform and put their views to their local distributor. We've received lots of positive feedback on the report, including from several people in this room, and thank you for that.

For households with interval meters – which includes almost all Victorian households and growing proportions of other states' – we expect some form of demand charge to be introduced in the next few years. Being charged for usage at a *given point in time*, rather than *total usage across time*, will be a big change for consumers, and we expect opposition to the reform simply on that basis.

The fact that cost reflective pricing would unwind cross-subsidies is also likely to cause consumer angst, particularly for those who expect they will be 'losers'. All of the evidence CUAC has reviewed for our report, and seen since, suggests that no single demographic group will consistently face higher charges from the reforms. Rather, households whose demand is high relative to their consumption will face higher charges. Because the relationship between demand and consumption varies strongly within almost all groups, the 'average' gain or loss for a demographic can disguise that 10 or 15% may face a large swing in either direction.

While no group will be singled out, we instead face a different problem: for some DNSPs, as many as 70% of consumers may end up with higher network charges. How much higher? Again, it varies: from tens of dollars to hundreds of dollars per year.

This doesn't take into account behavioural change, nor cost changes arising from AER revenue determinations, but it doesn't really matter: if the narrative becomes that 'we don't know exactly who will pay more, but it will be most people', and 'we don't know exactly how much more they'll pay, but it might be several hundred dollars', the uncertainty that creates won't do market participation any favours.

The widely dispersed impacts also make identifying and responding to the 'losers' of network tariff reform difficult. No-one has a desire to see households marginalised by either leaping demand charges or crushing fixed charges, but the flip side of "no one group is the losers" is "lots of different groups will need help".

Complexity and negativity needn't become the narrative, of course, and we're trying hard to make sure they don't. CUAC supports network tariff reform, and we want consumers to understand it, accept it, and respond to it appropriately. Communication with and understanding of consumers is critical in this context.

Gaining consumer acceptance and understanding of a tariff is at least as important as the choice of tariff itself. The most useful end pint of network tariff reform is likely to be tariffs that trade cost reflectivity for understandability, consistency across DNSPs, and public acceptance.

An inherent difficulty of the reform is that it focuses on price signals, while most household electricity consumption decisions are divorced from prices. Nobody regards turning on a light switch as a purchase; nobody switches on their kettle and thinks, 'Now I am buying electricity."

Because the relationship between billed price signals and behaviour is so abstract and separated, and because consumers have such little engagement with electricity, implementation of network tariff reform must look beyond simply implementing tariff change and waiting for consumers to respond. Implementation must involve adequate time to build consumer understanding and acceptance of the reforms, internalising the need for behavioural change that is then reinforced by price signals.

A precondition of successful tariff implementation will be socially priming consumers for their introduction – particularly if the tariffs are not mandatory.

This brings me to retailers. Retailers are better at communication than DNPSs, and they understand customers at least a little more. But their incentives in this reform are very different. Cost reflective pricing is a giant hassle for retailers, and for many, if they can avoid losing money and avoid fielding thousands of complaints, I think they'll be reasonably happy. They're certainly not falling over themselves to implement it.

But this reform is really interesting for retailers, because while we're taking all this cross-subsidisation out of the network side, it's just moving into the retail space. Will retailers pass through cost reflective tariffs? Maybe. Maybe not. If they don't, that's a cross-subsidy that retailers have chosen, not market designers.

Is this a problem? I'm not sure. We're moving cross-subsidies from a monopoly market to a competitive market, and if there's a 'natural' state of cross-subsidisation I tend to think it will be found in the latter. Even if you doubt the competitiveness of the retail energy market, retailers are still more competitive than monopolists.

So what does competitive cross-subsidisation look like? Perhaps it will be a single rate for all your power, like Powershop. Perhaps we'll see 'quota' plans, as for internet and telephony, with charges for excess consumption. Maybe we'll see full hedging services, where retailers offer you a flat rate for the year based on your 'electricity risk profile' and gamble on the 'overs' and 'unders'. Perhaps it will be all of those, each targeted at specific usage demographics or linked with contestable metering. If retailers are willing to try "free power at 6am", surely they'll try this.

Network tariff reform has a ways to run yet, and I expect each round of Tariff Structure Statements to be a refinement on the last. I think this will be an ongoing, or at least repeating priority for the AEMC, and we will have plenty to monitor to decide whether this reform requires salvation.

Thank you.