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National Electricity Market Campaign

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Submission to the AEMC

Strategic priorities

May 2013

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Total Environment Centre's National Electricity Market Advocacy

Established in 1972 by pioneers of the Australian environmental movement, Total Environment Centre (TEC) is a veteran of more than 100 successful campaigns. For nearly 40 years, we have been working to protect this country's natural and urban environment, flagging the issues, driving debate, supporting community activism and pushing for better environmental policy and practice.

TEC has been involved in National Electricity Market (NEM) advocacy for eight years, arguing above all for greater utilisation of demand side participation — energy conservation and efficiency, demand management and decentralised generation — to meet Australia's electricity needs. By reforming the NEM we are working to contribute to climate change mitigation and improve other environmental outcomes of Australia's energy sector, while also constraining retail prices and improving the economic efficiency of the NEM — all in the long term interest of consumers, pursuant to the National Electricity Objective (NEO).

Strategic priorities

TEC appreciates the opportunity to make a submission to the AEMC regarding its proposed strategic priorities for 2013. TEC's interest is primarily in electricity issues, and we limit our response below to the two priorities concerning electricity.

Consumer priority: strengthening participation, promoting competition

TEC acknowledges and appreciates the increased focus on consumer participation in recent years. All regulators should be commended for redoubling their efforts to engage consumers. In addition, the AEMC's Power of Choice review represents a considerable step forward in engaging consumers in the energy market.

There are, however, some improvements that could be made. In particular, we would like to see the AEMC, AER, and other regulatory bodies, provide more research and information that helps consumer groups understand how a particular rule change or regulatory determination will affect consumers. The AEMC and other bodies tend to assume that all consultees have equal capacity to assess such matters, but consumer advocacy is poorly resourced by comparison to large organisations and industry. The provision of improved information regarding consumer impacts would greatly assist smaller organisations advocate in the best interests of consumers.

Furthermore, while efforts to engage consumers in regulatory processes are valuable, there is a need for increased transparency to enable more proactive advocacy from consumers. Strengthening participation requires better access to information and more openness surrounding the performance of various aspects to the NEM. The NEM Report Card found that the reporting of performance in the NEM is deficient in a number of areas, stating:

there is quite limited publicly available data on the performance of the NEM in relation to the long term interest of consumers... it is crucial that more relevant, reliable and consistent data be collected

*and reported. It is therefore recommended that more comprehensive reporting be undertaken with regards to NEM performance.*¹

Likewise, a recent TEC report inquiring into the fuel mix of retailers found that there is little publicly available information on the fuel mix of retailers.²

There are three main steps that should be taken to improve this situation:

1. Publication of annual performance of the NEM in relation to the 5 stated criteria by which the current NEO is assessed.
- 2 Extension of reporting to the demand side of the market.
3. Publication of retailer fuel mix data.

Such reporting could be included in the annual State of the Energy Market Report and would highlight where the NEM is performing well and help to identify potential areas for improvement and advocacy.

This should include annual reporting against the NEO and against specific quantitative and qualitative performance indicators and benchmarks relevant to the long term interests of electricity consumers. In particular, there is currently a pronounced lack of information available on the demand side-of the market, e.g. regarding energy poverty, efficiency, DM and overall customer satisfaction.

Market priority: efficient investment and flexibility

While TEC agrees with the goals of efficiency and flexibility in principle, our concern is that the market priority does not currently describe in sufficient detail what is meant by efficient investment, nor for whom the flexibility it refers to is intended.

Efficiency

Efficient investment is not defined in the National Electricity Law, despite the fact that the NEO is “to promote *efficient investment* in, and *efficient* operation and use of, electricity services for the long term interests of consumers of electricity”. The AEMC has typically interpreted efficiency in terms of short run marginal cost, yet this limited conception of efficiency is not in the long-term interests of consumers because it is myopic and short-term.

The focus should not be on short run marginal cost within the market, but on long-term overall costs to consumers, factoring in long-term costs currently dismissed as externalities. There are two facets to the interpretation of efficiency that the AEMC should clearly acknowledge in its strategic priorities. Firstly, there is a need to ensure that the interests of the consumer, not efficiency in itself, that is the central consideration. Secondly, the AEMC must view efficiency as a holistic concept that explicitly recognises the need to balance different types of efficiency:

¹ Institute for Sustainable Futures, NEM Report Card (TEC, 2012) xii.

² Institute for Sustainable Futures, Electricity Retailer Disclosure Study, Briefing Note (TEC, 2013).

- Allocative: the most efficient allocation and use of resources
- Productive: producing outputs at least cost
- Dynamic: new or innovative ways to produce outputs, but also recognising that decisions about investment have long term impacts
- Social: maximising affordability and minimising inequities
- Environmental: the allocation and use of resources consistent with the principle of sustainable development – ie the use of resources to meet the needs of the present without compromising the ability of future generations to meet their own needs.³

There are trade-offs among these various dimensions that must be resolved by balancing or weighting of the different elements. This balancing requires a value system beyond the notion of pure economic efficiency alone. This is what the reference to ‘the long term interests of consumers’ in the NEO is intended to mean, and the AEMC must therefore interpret the NEO as requiring that this balancing take place.

The intersection of price and environmental issues provides a pertinent example. The current interpretation of efficiency in terms of price is the short-run marginal cost of producing electricity, i.e. \$/MWh to generate and sell electricity at a given moment in time. However, if pricing is to be genuinely reflective of long-term costs, externalities should be factored in. The Australian Academy of Technological Sciences and Engineering, in their 2009 study *The Hidden Costs of Electricity: Externalities of Power Generation in Australia*,⁴ estimates that, based on a CO2 cost of \$31/tonne, “greenhouse gas damage costs for currently deployed fossil fuel technologies in Australia range from \$A18/MWh for natural gas to \$A39/MWh for brown coal”.⁵ By contrast, the externality costs for renewables varied between \$1.50 for wind to \$5 for solar PV.

The expert panel reviewing the Limited Merits Review Regime noted that the current focus is misplaced and that the regulatory framework is making the “manifest economic error that promoting economic efficiency necessarily serves this purpose” [of serving the long term interest of consumers].⁶ The panel called for this to be rectified, saying that the long term interests of consumers is “the ultimate test” and that “there should be no displacement of ends (consumer interests) by means to those ends such as economic efficiency, not least because not all efficient outcomes are in consumers’ interests”.⁷

While the AEMC has claimed to take a broad approach to efficiency, acknowledging that “improvements in economic efficiency and the long term interests of consumers may not coincide”,⁸ it appears that in fact efficiency is now the driving rationale and end goal for the NEM. This reflects a NEO, and a broader regulator mindset, that was borne of the 1990s shift in the dominant model for provision of essential services from a vertically integrated, state-based model, to a market model. While it is doubtful that pure

³ From the UN World Commission on Environment and Development (the Bruntland Report), 1987, Ch 2.

⁴ Australian Academy of Technological Sciences and Engineering, *The Hidden Costs of Electricity: Externalities of Power Generation in Australia* (2009).

⁵ Additional to the existing wholesale price.

⁶ George Yarrow, Michael Egan & John Tamblyn, *Review of the Limited Merits Review Regime: Stage Two Report* (2012) 4.

⁷ Ibid 4.

⁸ AEMC, personal communication, December 2012.

economic efficiency was appropriate even then, it is definitely not a helpful driver for a modern electricity market.

Flexibility

As the NEM opens up to become the two-sided market that was initially intended, there will be an increase in DSP as the system transitions from a one-way grid to a two-way grid, with energy being increasingly supplied locally in a decentralised manner.

It is therefore critical not to lock in investment with 30-50 year lifespans that might, even if needed now, become stranded within a short time. The energy system needs to avoid the 'death spiral' observed with the landline telephone network, where failure to appropriately manage a paradigm shift in technology resulted in serious equity implications. Yet these long-term considerations do not currently form part of the Regulatory Investment Tests, nor seem to be otherwise factored in to decision making.

There has been some positive progress made in ensuring that the flexibility is there for the market to change radically, e.g. the small generator aggregators rule change and the rule change on connecting embedded generators. However, the AEMC, in stating that

"it will be important to build on the institutional, regulatory and market framework in Australia to attract the capital necessary to fund future investment",

is perpetuating a top-down approach that appears to assume a particular future for the NEM. The suggestion that high-level regulation is needed to draw investment contrasts to the growing investment made at a small-scale. E.g. there are now 1 million homes with solar PV systems, 750,000 solar hot water systems installed,⁹ and a growing interest in community renewable energy projects.

In light of this trend, flexibility does not dictate that the regulatory frameworks need to attract large investment, but instead poses the question: What would help households, small businesses, communities and institutions, such as schools, hospitals, universities and councils, to take control of their own generation and consumption? This could be enabling them to sell their net output, which remains an onerous task under current rules; or it may involve enabling networks to charge differentially according to the extent of the network used. Whatever the answer, it is clear that flexibility must be conceived more broadly if the NEM is going to develop organically and according to current trends, bearing in mind the likelihood of disruptive technologies and severe climate change impacts, rather than according to a top-down model.

Ad hoc environmental policies

We broadly agree with the AEMC that ad hoc environmental policies are problematic. However, we are concerned with the direction that environmental policy is currently heading in Australia. For example, while

⁹ <http://www.climatechange.gov.au/en/government/initiatives/~media/government/initiatives/solar-hot-water/rebs-final-report-pdf.pdf>

state feed-in tariffs (FiTs) have been challenging from a policy design perspective, there remains no movement towards a national FiT, thus reinforcing uncertainty in the market and the need for flexibility.

Likewise, State governments have removed many otherwise successful environmental initiatives on the basis that they are superfluous now there is a price on carbon, yet this is often patently untrue, and ignores doubts over the permanence of the carbon price in Australia, not to mention likely future volatility in the price following the decision to link it to the EU trading scheme. Given the poor coordination across states and the abdication of climate policy in the wake of the carbon price, we feel it would be better to develop a truly *national* market. This would, however, likely require significant reform.

We also feel that this is another area where the AEMC is contradicting itself. On the one hand, the AEMC complains that policy uncertainty from environmental policies external to the NEM is destabilising, but on the other hand, it has been consistently reluctant to take the lead by internalising environmental issues. The AEMC cannot define the long-term interests of consumers very narrowly, eschew any responsibility for internalising environmental costs, and reject the idea that it could balance these issues with the existing NEO criteria, yet also lament policy uncertainty. The logical alternative is to adopt a broader agenda that factors in additional issues, such as the environmental sustainability of the NEM and international markets.

The missing link: environmental priority

In order to reflect the biggest recent and likely change to energy markets, and in view of the long-term interests of consumers, it is clear that the AEMC needs to adopt a fourth strategic priority, which is to ensure that the NEM develops in a way that is consistent with ensuring a transition to renewables and a safe climate. This priority could be worded in a number of ways. For example, the Energy White Paper refers to “accelerating our clean energy transformation”. Alternatively, it could be modelled on the gas priority, i.e. promoting development of efficient clean energy markets.

Recommendations

1. Assist consumer advocates during rule change processes by providing research and information that highlights the potential impacts of various options on consumers.
2. Improve opportunities for consumer engagement by providing greater transparency, in particular by requiring a much greater level of reporting.
3. Ensure that long term consumer interests are at the heart of all NEM processes, rather than economic efficiency.
4. Expand the outdated conception of efficiency currently used to include long-term externalities and consumer interests currently outside the NEO.
5. Take a long-term view to flexibility to ensure that the NEM does not lock-in yesterday's technologies and decision-making processes.

6. Ensure that the AEMC does not take a top-down approach, but instead aims to encourage greater consumer empowerment.
7. Work towards the internalisation of social and environmental policy goals to obviate the need for stop-start external policymaking.
8. Adopt an environmental priority.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jeff Angel', with a stylized, cursive script.

Jeff Angel

Executive Director

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