

Energy White Paper
Department of Resources, Energy and Tourism
GPO Box 1564
Canberra ACT 2601

secretariat.ewp@ret.gov.au

Dear Sir/Madam

Energy White Paper: Response to Governance Institutional, Legal, Regulatory Frameworks and Community Engagement and the Investment Competitive Markets and Structural Reform papers.

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide input to the Energy White Paper consultation process. We have limited our comments to the discussion papers most relevant to us: *Governance Institutional, Legal, Regulatory Frameworks and Community Engagement; Investment Competitive Markets and Structural Reform*.

The ERAA is an independent association representing fifteen retailers of electricity and gas throughout the National Electricity Market (NEM) and the jurisdictional gas markets. ERAA members collectively provide electricity to 11 million customers in the NEM and are the first point of contact for end-use customers for both gas and electricity.

The ERAA believes that in order to best meet Australia's energy needs, both in terms of supply and cost, the institutional arrangements relating to the electricity and gas markets must promote competitive outcomes. This will facilitate the entry of new market participants and timely investment in the energy sector. As such, the ERAA only supports the introduction of regulation where there is demonstrated market failure, impacting on the competitiveness of the markets.

Additionally, the efficient operation of energy markets is dependent on effective coordination of the regulatory arrangements between the Federal Government and States and Territories, to minimise duplication and regulatory burden on energy businesses.

It will also be important that energy market frameworks are sufficiently robust to cope with the anticipated impacts of the climate change policies. This will ensure that investment signals are not impeded and that reliability and network security are maintained.

Our detailed comments on the discussion papers are set out below.

Governance Institutional, Legal, Regulatory Frameworks and Community Engagement

The ERAA believes that competitive markets deliver the best outcome for retail energy customers. This is based on the principle that the entry or threat of entry of new firms into a market forces incumbent firms to operate efficiently and make the most competitive offers to customers in order to gain market share. However, to realise the development of such markets, policy makers must focus on ensuring the barriers to market entry are kept as low as possible. This necessitates a light-handed approach to consumer protection with intervention only considered as an option where consumers and suppliers have been shown to be unable to develop adequate solutions to specific problems or 'market failures.' Importantly, any such intervention should only be as a last resort and only after efforts to resolve such problems have been attempted and failed. Interventionist policy based on the assumption that suppliers and consumers will be unable to resolve these problems should only be considered in exceptional circumstances.

1. Energy Specific Regulation

The Association believes the current consumer protection arrangements governing the retailing of gas and electricity are complex, divergent and inefficient. Compliance with these multi-jurisdictional regulations impose significant costs upon retailers, which both deters the entry of new retailers and diminishes the benefits that would otherwise flow from energy market reform to consumers.

In the retailing of gas and electricity the ERAA has been a strong supporter of the national reforms that are occurring through the Ministerial Council on Energy (MCE) to encourage competition through the harmonisation and streamlining of the electricity and gas markets across Australia. The ERAA is currently involved in the Retail Policy Working Group (RPWG) which is looking at the harmonisation of the regulations governing the retail energy markets to create the National Energy Customer Framework (NECF).

The ERAA was concerned by the MCE's announcement in its 12 December 2008 Communiqué that the NECF legislation may not be introduced into the South Australian Parliament by September 2009. With the South Australian election in early 2010 such a hold-up would mean that the framework would not come into effect until 2011. This is over six years after the original Gilbert & Tobin paper which provided the starting point for the RPWG, and does not include the additional time needed for each State and Territory to fully implement the NECF.

The NECF is one of the most important pieces of energy market reform, which will streamline the current system of multi-market, state-based jurisdictions into one national body. The

ERAA believes the completion of this policy must be suitably resourced to ensure it is completed as soon as possible.

2. Energy Retail Price Regulation

Energy price regulation represents a significant barrier to new energy retailers entering existing state and territory markets. Retail price regulation is a transitional measure introduced to protect customers while the energy markets were maturing. The ERAA therefore supports the current process by the Australian Energy Market Commission (AEMC) to review the competitiveness of the retail energy markets which have introduced full retail competition. These reviews are undertaken with the objective that for those markets where competition is found to be effective that price regulation should be removed. In 2007 Victoria was the first market where the level of competition was reviewed by the Australian Energy Market Commission. The AEMC found that that retail energy competition in the State of Victoria was highly effective and is leading to beneficial outcomes for households and businesses. On 1 January 2009 the Victorian Government abolished all regulation of retail energy tariffs for all household customers.

In 2008 the AEMC undertook an assessment of competition among energy retailers in South Australia. At the conclusion of that process the AEMC found that there was a vigorous level of competition among retailers and a high degree of customer awareness about retail competition. The Association is awaiting the response of the South Australian Government.

The ERAA is nevertheless concerned by the lack of progress in other markets. In NSW the Government is committed to introducing legislative amendments to extend independent retail price regulation to 2013 or beyond until it is satisfied that there is sufficient competition in the retail energy market.¹ The Queensland Government has also ruled out abolishing the regulation of retail energy prices.² Where such circumstances do not allow for the removal of price regulation the ERAA believes that cost reflective pricing must nevertheless be implemented.

The ERAA is concerned about the impact on energy retailers in those states where price regulation continues as result of the introduction of Government schemes such as the Carbon Pollution Reduction Scheme (CPRS); the Expanded Mandatory Renewable Energy Target (eRET); the introduction of smart meters³; energy efficiency policies⁴; and solar feed in tariffs.

¹ NSW Government, "Response to the Energy Consultative Reference Committee's Terms of Reference" 29 February 2008, p.vi

² The Hon. John Mickle, Minister for Energy & Aboriginal and Torres Strait Islander Policy "Queensland to retain electricity price control" 19 May 2006

³ The Ministerial Council on Energy agreed to the roll-out of smart meters in Victoria and New South Wales. See http://www.ret.gov.au/Documents/mce/_documents/MCE_Communique_15thMeeting_13_June_200820080613143729.pdf

⁴ Such schemes include the Victorian Energy Efficiency Target, the Residential Energy Efficiency Scheme and the New South Wales Energy Efficiency Target.

Without the abolition of retail price regulation or the introduction of cost reflective pricing (if price regulation is to remain) retailers will be unable to pass through the additional costs relating to these Government schemes.

The existing retail tariff regimes are already somewhat imprecise as there are inherent complexities involved in trying to estimate future costs in an environment of imperfect information. These difficulties will be exacerbated under the CPRS where clarity around future carbon prices will be lacking, particularly in the early years. There is therefore an increased likelihood of the tariff not capturing the true cost of energy.

A prime example of this would be that if the carbon price is underestimated, retailers would be forced to bear the burden as the inflexible nature of the regulated regimes makes it difficult to make adjustments. This increases the likelihood of retailer distress which has negative implications for the entire market. The ERAA believes the only way in which retailers will be able to fully recover all their costs associated with the various Government policies is through the removal of retail price regulation.

3. Energy Efficiency Schemes

The ERAA supports the need to establish a policy framework that promotes the use of renewable energy at least cost. The ERAA believes the CPRS should form the basis of Australia's response to tackling climate change. Such a scheme must set meaningful targets which balance the need to reduce greenhouse gas emissions with the significant financial impacts on business and households. In establishing the CPRS, the ERAA acknowledges the Government's decision to use the eRET to increase the uptake of renewable energy technologies in the early years of the scheme. Over time it is hoped that both the CPRS and eRET will assist households and business to reduce their greenhouse gas emissions in an efficient and timely manner.

The ERAA considers the current approach to energy efficiency being pursued by the Federal Government and the States and Territories is uncoordinated, ineffective and costly. While the ERAA supports the promotion of energy efficiency to assist households to manage their transition to the low carbon economy, the Association does not support the introduction of white certificate schemes such as the Residential Energy Efficiency Scheme (South Australia), the Victorian Energy Efficiency Target or the New South Wales Energy Savings Scheme. The ERAA believes that such schemes are not cost effective due to their high transactional costs⁵, and the fact that the schemes fail to address the main barriers to improving energy efficiency such as education, split incentives and the under pricing of energy due to price regulation.

⁵ Pricewaterhouse Coopers, 'Review of Energy Efficiency Policy Options for the Residential and Commercial Building Sectors' p. 56 See http://www.eraa.com.au/db_uploads/Energy_Efficiency_Report_-_FINAL_-_10Nov08.pdf

The ERAA believes a national approach towards energy efficiency policy, coordinated by the Australian Government would be far more effective than the existing state-based schemes. This is demonstrated by the Federal Government decision to introduce its Energy Efficient Homes Package announcement. The ERAA believes the clear overlap between the Federal Government's \$1600 insulation rebate with the existing white certificate schemes highlights a clear failure of policy as the rebate has inadvertently increased the cost of the State schemes, removing the ability for retailers to create energy savings certificates through the installation of insulation. (There has also been no change to retailers targets even though a major activity for creating certificates has been removed)

While allowing for innovation and regional differences the involvement of the Australian Government to coordinate the improvement of energy efficiency would help to reduce the duplication and inconsistency experienced in some markets. The ERAA also believes the coordination of existing jurisdictional policies and related programs and the pursuit of full convergence of existing jurisdictional energy efficiency policies should be the overriding objective of any national energy efficiency policy. Such an objective would ensure such policies associated with energy efficiency were also consistent with the CPRS and the MCE's energy market reform program to create national energy legislation and rules for the retailing of electricity and gas. The ERAA believes that the Federal Government would also be well placed to both coordinate the collection of data in relation to energy efficiency and also the education of the community about the benefits of saving energy.

The ERAA endorses the Council of Australian Government's (COAG) set of principles in relation to the design of mitigation measures in addition to the CPRS to guide State jurisdictions in reviewing their energy efficiency activities. The ERAA also supports the COAG proposal to develop a National Strategy for Energy Efficiency to encourage energy efficiency efforts across all governments and to assist consumers with the transition to a CPRS. The ERAA encourages all State Governments to apply the COAG principles in evaluating their energy efficiency activities and to sign up and use the National Energy Efficiency Strategy to streamline and nationalise energy efficiency activities.

4. Solar Feed In Tariffs

Solar Feed in Tariffs (FITS) have been introduced in a number of states as a way to increase the uptake of solar energy. The ERAA supports the need to establish a policy framework that promotes the use of renewable energy at least cost. In light of the introduction of the CPRS and the expanded MRET the ERAA would question the need for such policies especially as there will be a multiplier as part of the expanded MRET to encourage small generation such as household photovoltaic systems. The ERAA has received little evidence from any of the states as to whether introducing these schemes are cost effective or efficient. Given that

small scale solar photovoltaic cells do not represent the most cost effective method for saving energy, the ERAA would question the value of these policies.⁶

While it is often argued that the regulation of electricity prices needs to be retained to protect those in the community who are vulnerable due to financial status, age, health and literacy, the introduction of a solar feed in tariff are counterproductive to assisting such customers.⁷ Because the costs of most FIT schemes are smeared across all energy consumers through higher energy charges, vulnerable customers will be disadvantaged as they will be subjected to increased electricity tariffs to subsidise those consumers (more likely wealthy ones given the significant upfront cost of installing solar panels) who wish to install solar panels.

The ERAA is particularly disappointed at the haphazard way in which the Solar FITs have been introduced across the States. While the ERAA would prefer that Governments had not introduced FITs, it strongly believes that their approach must be harmonised in order to minimise the administration costs to both retailers and distributors. The ERAA is of the view there must be a concerted effort by the States to ensure their schemes are consistent with the COAG principles for FITs especially in relation to the scheme not impacting on competition in retail markets. In this regard the ERAA would support the Ministerial Council on Energy reviewing the regulation of the schemes in all states to ensure these schemes are nationally consistent. Where these schemes are found to be inconsistent, steps must be put in place to ensure the FIT schemes become nationally consistent.

⁶ Independent Competition and Regulatory Commission, 'Comments to ACT Feed-In Tariff Discussion Paper' (Canberra 2008), p.4

⁷ Unsworth, B. Impact Statement from the Energy Consultative Reference Committee,' (Sydney 2008),p. 5.

Investment Competitive Markets and Structural Reform

1. Potential impediments to investment

The ERAA anticipates that climate change policy will have a significant impact on energy sector development to 2030. The transition to a low carbon economy will require a change in how we produce and use energy, with far reaching implications for energy markets. In order to facilitate the necessary transition in the energy sector it is important that policy makers discern the anticipated impacts of the climate change policies, with the aim of implementing any required changes to existing frameworks in an expeditious manner. We consider the AEMC review into the robustness of energy market frameworks in light of the CPRS/eRET as a vital step in this process. The AEMC review has identified a number of issues some of which in our view could have negative implications for future investment if not resolved. These issues include:

Uncertainty

Uncertainty surrounding the climate change policies, particularly CPRS is a major impediment to investment. The longer this uncertainty persists the greater the delay in investment. This is worrisome particularly in the context of the projected tight demand supply balance in some regions of the NEM and the illiquidity of contract markets beyond 2010.

Impact on retailers

The ERAA is concerned about a possible increase in financial distress on retailers. As highlighted earlier in this submission, continued retail price regulation under the CPRS could lead to retailers under recovering costs given the difficulties regulators will face in accurately calculating the regulated tariff in an increasingly dynamic cost environment. Possible financial impacts of the CPRS on some high emission generators could further destabilise the financial foundations of the industry.

It should also be noted that besides the impact of the CPRS, wholesale energy costs are likely to increase due to the planned increase in the Maximum Market Price/Value of Lost Load from \$10,000 to \$12,500. The forecasted tight demand/supply balance in Victoria and South Australia should also put upward pressure on prices and increase volatility in the market. These events will have the effect of increasing the prudential burden of retailers. We have already observed the tripling of the maximum credit limit (MCL) in Victoria this year alone.

The combination of an increasing prudential burden along with the possible under recovery of costs under the regulated tariff regimes could lead to instability in the retail sector forcing otherwise efficient retailers out of the market. The energy sector is interconnected and thus distress in retail will also impact on investment in generation, to the extent that it limits the ability of retailers to contract with generators.

Congestion and transmission access

The NEM is an open access regime which does not guarantee generators getting their output to market. An increase in network congestion will further highlight issues surrounding this lack of 'firm' access. The eRET in particular will lead to a large increase in renewable generators entering the market, which could result in an increase in material congestion in the transmission network and the 'constraining off' of generators located in these areas. An increasing inability of generators to get their generation to market is bad for investment as it has a negative impact on the economics of investment projects. Additionally, concerns about being constrained off can deter generators from entering into contracts with retailers, since they could incur losses if they are unable to sell their generation on the spot market. Given this, the ERAA considers it important that this issue is addressed and would urge policy makers to make the necessary changes to the congestion management regime.

2. Reliability and security of supply

The policy response to the impediments to investment will have a direct impact on market reliability in the long term. However, low levels of reserve generation and the projected shortfalls in Victoria and South Australia in 2010/11 brings into focus the issue of reliability in the short term. Given the lead time for the building of new generation, it is unlikely that supply side responses will be able to alleviate this situation. It is our preference that efficient market responses including the contracting of demand side measures be given the opportunity to work. We are not supportive of extensions to distortionary market intervention mechanisms such as the Reliability Emergency Reserve Trade, which place unhedgeable cost burdens on Market Participants.

Additionally, the adjustment of the reliability settings in response to changes in the market should assist in stimulating investment and ensuring that the reliability standard is maintained. The proposed two-yearly review of the reliability settings should facilitate this process.

3. Demand side arrangements

Demand side measures will play an important role in the transitioning to a low carbon economy and thus should be given every opportunity to enter the market where cost effective (i.e. when the avoided supply-side costs outweigh the loss of value to consumers from using less electricity).

One of the key issues in bringing demand side measures into the market is ensuring that price signals are truly cost reflective. This will ensure that economic demand side alternatives will be supported by the market.

Key reforms needed to assist the development of demand side include:

- Removal of retail price regulation;
- Removing red tape barriers to direct market participation, around technical standards, metering and NEM registration for small players. The concept should be that generators at small scale should have similar metering and registration requirements to customers of similar size.

Any case for increased subsidy – such as the proposed enhancements to reserve trader, or other government or policy assistance should be avoided unless clear market failures can be identified, and the policy can be specifically targeted to address these.

Should you require any further information in relation to this matter please feel free to contact me on (02) 9437 6180.

Yours sincerely

[Transmitted Electronically]

Cameron O'Reilly
Executive Director
Energy Retailers Association of Australia