SUBMISSION

TO | **Australian Energy Market Commission**
By email: www.aemc.gov.au

TOPIC | **Investigation into intervention mechanisms and system strength in the NEM. Reference: EPR0070**

DATE | May 2019

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Executive Summary

The ACCC energy pricing report of 2018 identifies that nationally, the largest component of energy bills where price reductions can occur is for wholesale costs and suggests that SA customers are paying $227m per year (by 2020-21) more than they should for wholesale electricity costs. Meanwhile a recent ElectraNet report puts the cost of compensation for system strength directions in South Australia at $34 million per annum.

This ACCC suggests to us that consumers are already paying too much for the wholesale component of their electricity bill and we are convinced that intervention pricing and "participant" compensation are important contributors to the already unacceptably high wholesale prices being paid by customers across the NEM.

High, rising and uncertain energy costs, coupled with fixed or declining real incomes are putting significant pressure on a large and growing number of households and small businesses.

Uniting Communities is convinced that intervention pricing should not apply in connection with directions for services that are not traded in the market, since there is no relevant price signal to preserve.

In addition to compensating directed generators, it is deeply concerning that SA consumers are also bearing the cost of compensating scheduled generators across the NEM, whose dispatch targets are impacted as a result of system strength directions being issued in South Australia.

South Australian consumers are bearing the cost of compensating directed generators based on the 90^{th} percentile price. We are convinced that this compensation framework provides incentive for generators to retreat from the market when they believe that they can earn more by being directed to participate compared with participating in the market because that is the business that they have chosen to be in. This behaviour imposes inefficient costs on SA consumers and is quite contrary to the national energy objective.

Much greater transparency is urgently needed regarding compensation and related payments being paid to generators who are directed by the market operator.

About Uniting Communities

Uniting Communities works across South Australia through more than 100 community service programs, including: aged care, disability, youth services, homelessness intervention, foster care and family counselling. Our team of staff and volunteers support and engage with more than 20,000 South Australians each year. We strive to build strong and supportive communities, and help people realise their potential and live the best life they can.

We have a long-standing role as a provider of financial counselling services and have observed over recent years that energy affordability set number one presenting issue across our financial counselling services. Consequently we have actively engaged in advocacy and engaged with energy businesses and regulators to seek to make energy more affordable.

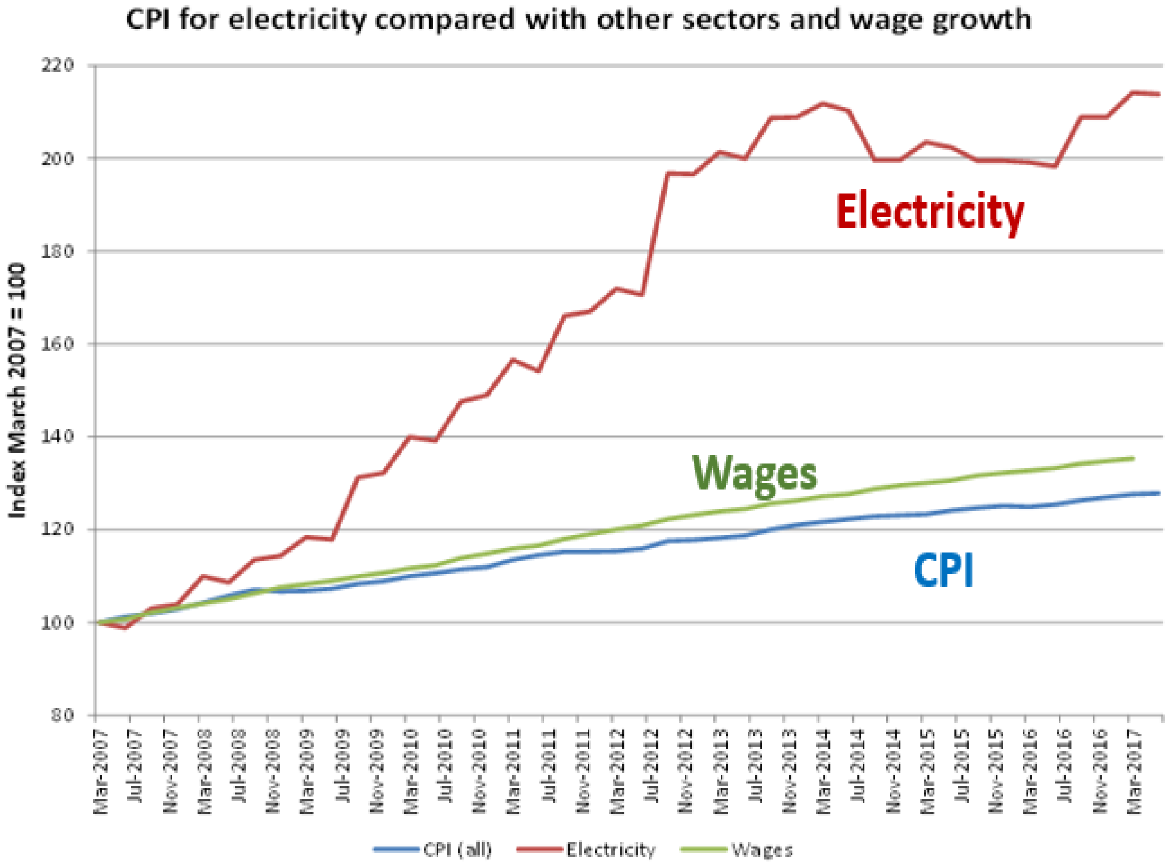
This submission builds on the experience of thousands of financial counselling interviews, provision of a diversity of other support services lower income and disadvantaged households along with a decade and a half of active engagement in energy policy and regulation advocacy.
Context re Intervention Mechanisms and System Strength

Electricity Affordability

In July 2018, the ACCC released a report that considered the cost of electricity and produced the following graph (figure 1) showing the cost of electricity Australia wide, compared to CPI and wages change over the last decade.

The reality is that electricity prices have escalated rapidly over the period, despite a short period of falling prices in June 2014 and a couple of years of stable prices. This flattening of prices for a short period was not experienced as price relief for lower and modest income households nor for many small businesses.

In July last year, the ACCC released their report considering ongoing high energy prices, "Restoring electricity affordability & Australia's competitive advantage."[1]



[1] https://www.accc.gov.au/publications/restoring-electricity-affordability-australias-competitive-advantage

Figure 1: Source - ACCC report: Restoring electricity affordability & Australia's competitive advantage, July 2018.

The price change story for South Australia is shown in figure 2, the index of electricity retail prices for various jurisdictions for nearly 2 decades. The graph shows that for South Australia there was a rapid price rises June 2003-04 when full retail contestability commenced in the state. Since then there have been significant price rises from 2007 through to 2012 and a further period of steep price rises from 2015, with some levelling off over recent months.

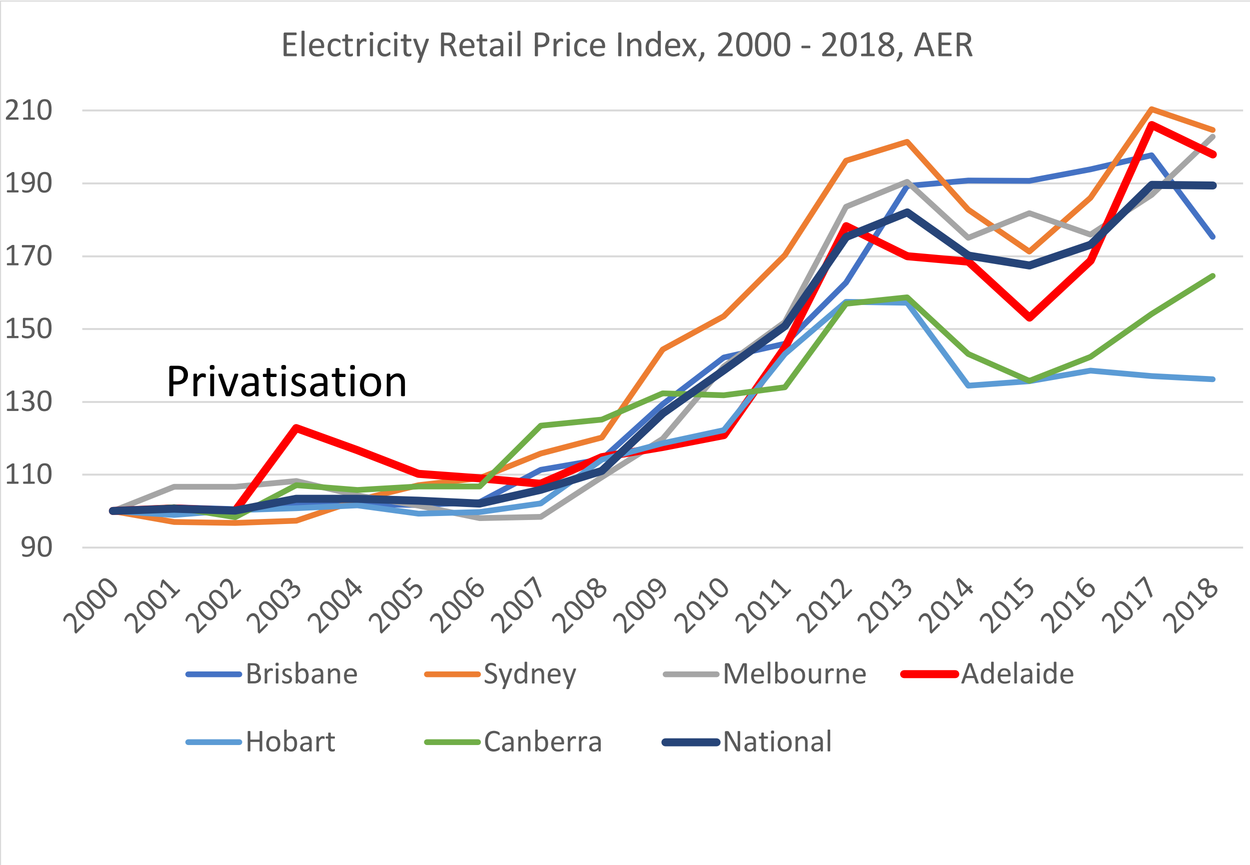


Figure 2: Source - AER, State of the Energy Market, 2018.

These very high electricity prices and continuing price increases have had significant deleterious impact on South Australian consumers. About 10,000 households per year are disconnected from electricity supply in South Australia due to inability to pay and electricity bills remain the number one presenting issue for financial counselling clients. The following

> Amanda is a 26-year-old single mother. She lives alone in a privately rented property. The lease is held jointly with her mother who makes a contribution to the rent as this was an affordability issue for Amanda. She has been in receipt of Parenting Payment and FTB since the birth of her daughter in February 2018. She was previously in receipt of Newstart Allowance. Her total utility arrears are $2,987 with electricity at $1,831 and gas $1,156. She is in receipt of concessions and a discounted plan with a provider. She has had several failed payment plans. She had a disconnection raised which triggered her contact with a financial counsellor.
>
> Amanda has tried to have Centrepay deductions for her utility costs. The last plan failed due to the change in her Centrelink payments and she did not renew the arrangement. The provider had requested that Amanda make a lump sum payment of $510 before being put back onto a new payment plan.
>
> During a call from the financial counsellor the provider agreed to cancel the disconnection but cannot guarantee that a further disconnection will not be raised. They will not enter into a payment plan until a lump sum payment has been made.

case study from a Financial Counsellors notes provides one person's experience:

There is other evidence of the upheaval being experienced by energy customers. Figure 3 shows electricity disconnections for an inability to pay electricity bills, for South Australia households over the last eight years. High levels of electricity disconnections have been experienced for the last six years in particular. We do not regard the reality that more than 10,000 households are disconnected from the supply of electricity each year as a reasonable occurrence in an advanced society.

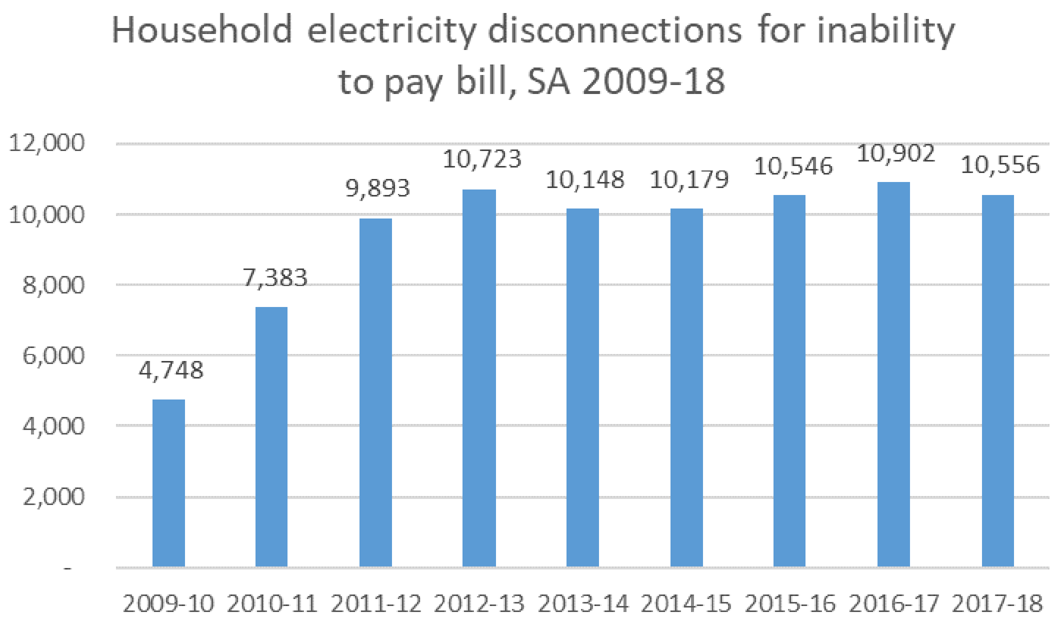


Figure 3: Source - AER, State of the Energy Market Report.

The following case study from a Financial Counsellors notes highlights the upheaval vulnerable energy consumer's experience:

> This person has mental health concerns & is struggling to pay living costs based on the income he receives - Newstart Allowance. The client has in increasing electricity bill that is causing him stress and adding to this depression & anxiety.
>
> Regular payments have not been made to the electricity account as the client feels he cannot afford the increasing his bill. Seasonal electricity use is high due to heating & cooling costs. Client lives in community housing and feels the lack of insulation contributes to his high electricity account.
>
> He owes more than $2,000. This means that he is not eligible for an EEPS payment. Benevolent society options are being explored to reduce the account to below $2,000 so that an EEPS application can be made.
>
> The client indicated he is applying for DSP, which is a long & difficult process.

The cost of electricity is one part of energy bill stress. The other part is income and consequently the amount of money that households have got to be able to spend on energy. The following table gives current rates of Newstart allowance.[2] We observe that the single rate of Newstart is approximately equal to the current median rent in South Australia, so clearly renting modest housing is out of reach for Newstart recipients. We further observe that an extra $23 per week to meet the costs of a child also fails to recognise true cost of living.

If you're	Your maximum fortnightly payment is
Single, no children	$555.70
Single, with a dependent child or children	$601.10
Single, aged 60 or over, after 9 continuous months on payment	$601.10
Partnered	$501.70 each
Single principal carer granted an exemption from commitments for any of the following: • foster caring • non-parent relative caring under a court order • home schooling • distance education • large family	$776.10

Table 1: *Current Rates of Newstart Allowance* Source – Department of Human Services.

In figure 4 we present current labour market data for South Australia showing that the labour under-utilisation rate, i.e. underemployment, is at a rate more than double the unemployment rate and this we suggest gives a better indication of the number of people who do not have adequate income from employment.

In addition to high rates of underemployment, we also highlight that wages are not keeping up with cost of living with figure 5 showing that all wage price index forecasts for the last seven years have dramatically overstated the actual outcome. The reality is that wage growth is stagnant for many Australians. Inadequate hours of work coupled with low wages for hours worked means that people who are working poor as well as those on benefit payments are extremely financially stressed.

Any increases in electricity bills have detrimental impacts on the ability of people to live healthy lives. Rising energy bills impact on the health of struggling households for a number of reasons:

Limiting energy use for heating and cooling means there is a higher likelihood of sickness; and

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[2] https://www.humanservices.gov.au/individuals/services/centrelink/newstart-allowance/how-much-you-can-get.

Electricity is generally the second bill paid by lower income people after rent and health expenditure. In particular medicines can be forgone in order to pay electricity bills

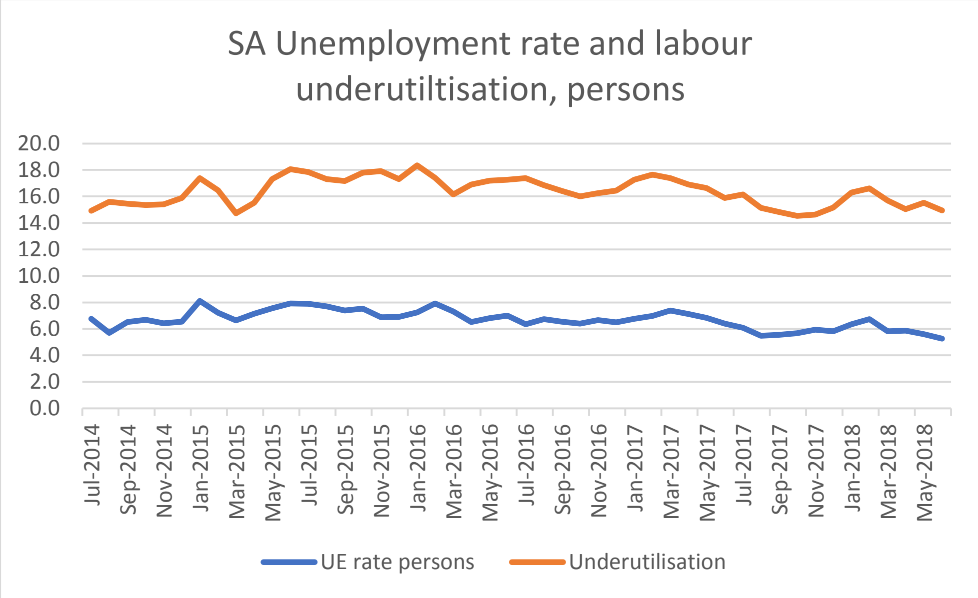


Figure 4: *SA Labour Utilisation* Source - ABS, Cat. No. 6202.0 - Labour Force, Australia.

Uniting Communities is also particularly concerned about private sector renters who are generally the poorest people in our communities and who have the least capacity to act to reduce energy (and other) costs because of poor housing design and general disinterest from landlords to make rental housing energy efficient. Figure 5 shows that renters are more likely to experience any of the financial stress measures that are commonly recorded by the ABS

Percentage of renters and homeowners facing at least one financial stress, 2015-16

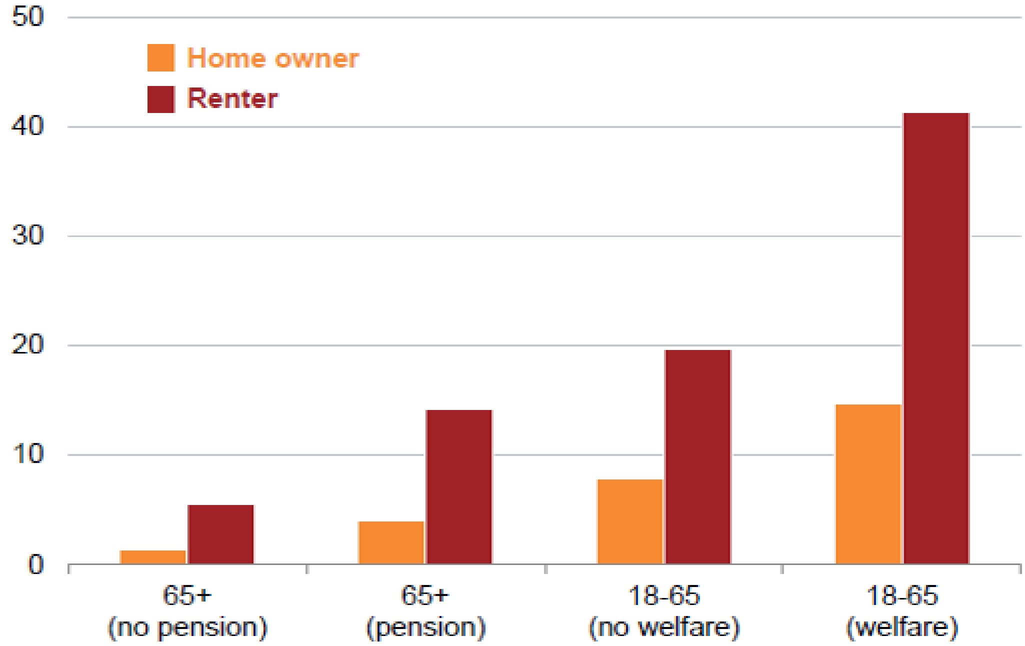


Figure 5, Source: Grattan Institute, Housing affordability: re-imagining the Australian dream

This figure shows that renters, whether or not they receive a pension or welfare support, experience financial stress at much greater levels than homeowners.
The lowest income quintile of households already pays more than three times more of their disposable income on electricity and gas compared to the highest income quintile. The bottom 40% of households by income are four times more likely to not pay their utility bills on time compared to the richest 20%[3] (illustrated in graph below). We note that lower income people often use less electricity than higher income people, though there are exceptions, including larger families. The key point is that proportionately higher energy bills are a function of income, much more than of use.

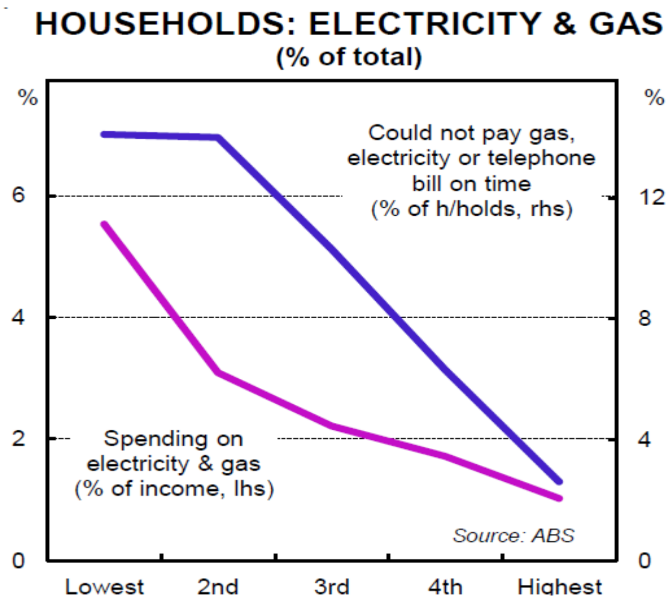


Figure 6 , Source ABS, Financial Stress

The proportion of Australians in private rental is higher than ever before, with more than one quarter (26%) of the population renting in 2013–14, compared with just 18% in 1994–95. Over the same period, renters have had a 62% (or $144) increase in average weekly housing costs. This is substantially higher than for owners with a mortgage (42%) or public housing renters (45%) over this time[4].

Generally renter households are also living in properties which have not taken advantage of the range of measures deployed by homeowners to reduce energy consumption through initiatives such as the deployment of energy efficient household appliances, insulation and solar photovoltaic cells installation.

In particular, Uniting Communities is deeply concerned about the large number of low-income households that are in the private rental market and already experiencing housing stress (paying more than 30% of their income on rent) or worse still, housing crisis (> 50% of income on housing). 10.2% of all renters in South Australia are experiencing housing stress[5]. These figures are not surprising given that 31.2% of private renters in South Australia

[3] CBA Global Market Research, Economics: Issues 9th October 2017 pg2
[4] Australian Institute of Health and Welfare, Australia's welfare 2017, 19 Oct 2017
[5] CBA Global Market Research, Economics: Issues 9th October 2017 pg2

(57,912 households) are on a low income (below $34,000pa)[6]. These households are particularly vulnerable to rising power costs given their diminishing disposable income after having met their housing costs. Yet they are the least likely to have access to rooftop PV generation.

Proportion Of Households With Solar Panels, by tenure type, 2012 to 2015-16

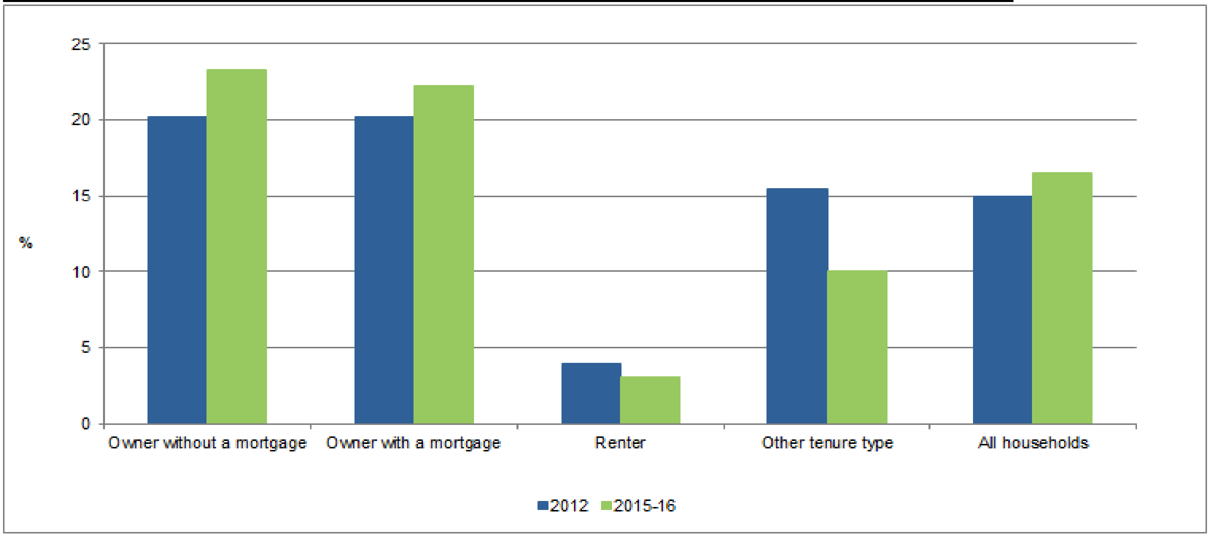


Figure 7. Source. ABS Survey of Income and Housing, 2015–16, ABS Household Energy Consumption Survey, 2012

Factors of High Energy Costs

The following table which is based on figures from the ACCC report on energy affordability provides their estimate of savings that were possible for annual residential electricity bills, by 2020 to 21. They provide estimates for savings for each main element of residential electricity bills. We have added the last column which simply shows the percentage of reduction in bills that the ACCC suggests can come from wholesale costs. for all regions except New South Wales, wholesale is unequivocally the highest contributor, nationally, to suggested residential customer savings, for New South Wales wholesale is the second largest component.

ACCC average annual residential bill savings by 2020-21, by region

Region	2017-18 ave Bill	Network		Wholesale	Envir't	retail	reduction	% Wholesale in reduction
Victoria	1,457	39		192	34	26	291	66%
NSW	1,697	174		155	43	37	409	38%
SE Q'land	1,703	147		192	18	62	419	46%
SA	1,727	13		227	89	42	371	61%
Tasmania	1,979	113		226	75	-	414	54%

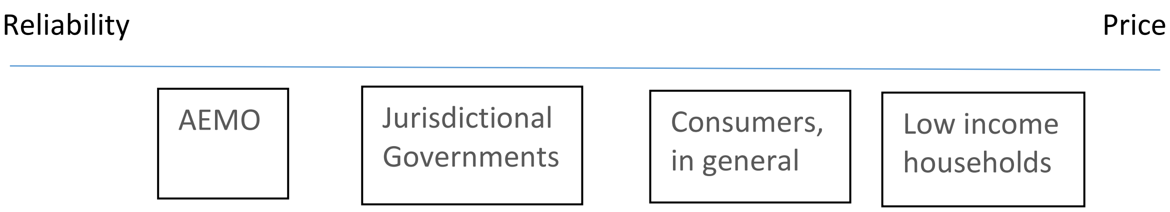
Table 2 Source; ACCC report re energy affordability, table 3.1

[6] http://www.abs.gov.au/websitedbs/D3310114.nsf/Home/2016%20search%20by%20geography

This table suggests to us that consumers are already paying too much for the wholesale component of their electricity bill and we are convinced that intervention pricing and “participant” compensation are important contributors to the already unacceptably high wholesale prices being paid by customers across the NEM.

Intervention mechanisms and risk

We observe that there is a trade-off between reliability and price and that different parties to the national electricity market have differing perspectives of the relative importance of the two elements of the trade-off. The point at which various parties line up on the price reliability continuum is a function of the risk or perceived risk that they confront. We observe the following:



AEMO, as market operator, has responsible for system reliability and so, we observe, places a higher premium on reliability than on the price customers pay. Jurisdictional governments on the other hand are held accountable (though they are not responsible for market operations) for both price and reliability, but are more sensitive to price than the market operator because of voter backlash to rising prices.

We are aware of a number of surveys conducted by network businesses where end consumers are asked about priorities; “keeping prices down” is invariably given as the highest priority, though we recognise that customers who can afford their electricity bills put some value on reliability to. For the people that Uniting Communities sees day in day out, there is much more concern about price than reliability. They would go without power for some hours on a semi-regular basis if it meant their electricity bills reduced.

We also recognise that risk is experienced by generators, retailers, even regulators but that most risk is passed through to consumers. Considerations about intervention pricing and generator compensation need to very carefully consider the share of risk being borne in these transactions; we suggest that the reality is that consumers are paying an unreasonable risk premium and that this needs to be redressed. It is our observation that businesses tend to overstate their risk and fail to recognise the risks to consumers that accompany high and rising prices.

Intervention Pricing and generator Compensation.

The following extract from the AEMC information pages summarises the issue at hand, we share the Commission’s concern about the growing number of directions that are being issued, by AEMO, in South Australia and in particular the cost of these directions for consumers.

The AEMC writes:

> *"In its final report of the Reliability Frameworks Review in July 2018, the Commission recommended that the appropriateness of the interventions framework, and the cost implications of the compensation framework associated with it, be reviewed in light of the increased use of interventions. The Commission considers it necessary to review the interventions framework in light of not only the recent use of the RERT but importantly because of the growing number of directions that are being issued by AEMO to maintain minimum levels of system strength in South Australia."*

In the same information pages, the AEMC also states:

> *"There is very limited transparency about the cost impacts of intervention pricing and compensation payments. While some high level data on compensation costs is published, no information is readily available about the impact of intervention pricing on wholesale energy prices. A recent ElectraNet report puts the cost of compensation for system strength directions in South Australia at $34 million per annum. In addition, the report refers to the wider impact of intervention pricing on wholesale market outcomes as exceeding $270m as at September 2018."*

The ACCC suggests that SA customers are paying $227m per year (by 2020-21) more than they should for wholesale electricity costs. While there is limited direct relationship between intervention and compensation payments, it is still not unreasonable to suggest that the $34m per year in these costs could be considered to make up 15% of the ACCC's wholesale cost savings for SA consumers.

Uniting Communities has very limited capacity to respond to the full detail of the AEMC Consultation Paper, but we wish to respond briefly to a couple of the most significant questions.

Questions 6 and 7

QUESTION 6: ARE FURTHER CHANGES TO INTERVENTION PRICING WARRANTED? Is there merit in making more fundamental changes to intervention pricing? For example,

1. *Should intervention pricing only apply in circumstances where there is scarcity of a market traded commodity?*
2. *If not, what is the economic rationale for applying intervention pricing?*
3. *Should consideration be given to adopting a different approach to pricing when the RERT is activated - for example, setting the spot price to the MPC?*
4. *Are there other issues relating to intervention pricing that warrant consideration as part of this investigation?*

QUESTION 7: CHANGES TO THE RRN (Regional Reference Node) TEST Do stakeholders consider that the RRN test should be extended to encompass the RERT?

1. Do stakeholders consider that the RRN test should be clarified?

2. If so, how is this best achieved?

3. Are changes required to clause 3.15.7A to bring it into line with any changes made to the RRN test?

The impacts of intervention pricing on wholesale energy costs are deeply concerning, noting that, as the AEMC observes *"the directions issued in South Australia do not respond to a scarcity of energy or FCAS."* We recognise that there is a range of views about the relative impact on consumers of spot prices when compared to contract prices, but we are convinced that the impact of intervention pricing on wholesale energy prices is too large to ignore, across the NEM and particularly in South Australia.

AEMO says in their rule change request relating to the regional reference node test that intervention pricing *"may not always result in optimal price signal outcomes when interventions are required for system security reasons (unrelated to supply shortfalls)."* They also state that changing the RRN test to limit the range of situations when intervention pricing applies has the potential to *"reduce the costs of intervention for consumers"* This is on page 2 of AEMO rule change request. AEMC says "*SA directions respond to inadequate system strength - a service which, like inertia, is not traded in the market. As described in AEMO's South Australian Electricity report, they are directions for the provision of fault current not for energy. This raises questions about whether there is an economic rationale for implementing intervention pricing in such cases. The Commission is concerned that intervention pricing in connection with system strength directions may be producing inaccurate price signals."*

Uniting Communities is convinced that intervention pricing should not apply in connection with directions for services that are not traded in the market, since there is no relevant price signal to preserve and since, as noted by AEMO (and we suggest the ACCC) notes, there is potential to reduce costs to consumers by not applying intervention pricing in such circumstances.

We support the proposal to amend the RRN test to narrow the situations when intervention pricing applies. This should occur both in relation to directions and in the activation of the Reliability and Emergency Reserve Trader.

Question 10

QUESTION 10: COMPENSATION FOR AFFECTED PARTICIPANTS Should compensation be payable to affected participants? If so, why? If not, why not?

1. *Should there be any distinction in the NER between intervention events that respond to reliability events and those that respond to security events (noting that constraints may not be suitable to respond to reliability events but may be suitable substitutes in the case of system security events)?*
2. *Are there any other approaches that should be considered?*

In addition to compensating directed generators, it is deeply concerning that SA consumers are also bearing the cost of compensating scheduled generators across the NEM, whose dispatch targets are impacted as a result of system strength directions being issued in South Australia.

The consolation paper says *"A direction is a way of meeting, or satisfying, a physical constraint on the system, where that constraint is not, or cannot, be represented in NEMDE. If it were possible to implement the system requirements as constraints AEMO would do so. In that case, there would be no compensation for being constrained down, because generators have no right to be dispatched in the NEM."*

So compensation would not be payable if dispatch targets were to change as a result of AEMO imposing a constraint via the NEM dispatch engine (NEMDE). Uniting Communities supports changes to the compensation framework that eliminate, or at least minimise costs to consumers where there is not a clear and transparent case that it is in the best interests of consumers for paying such compensation. We note that NEMDE optimises dispatch targets every day in order to keep the system secure.

We emphasise the importance of greater transparency in relation to the payment of any necessary compensation to affected participants. This is particularly important given that, unlike directed participants, there is potential for affected participants to optimise their position with respect to compensation. In other words, there is potential for affected participants to behave in a manner that we do not consider to be in the best interests of consumers.

Question 11

QUESTION 11: QUANTUM OF COMPENSATION FOR DIRECTED PARTICIPANTS Is the compensation framework for directed generators creating perverse incentives?

1. *Is the use of the 90th percentile appropriate given the increasing penetration of variable renewable generation?*
2. *Would another level of compensation be appropriate?*
3. *Would it be preferable to determine the quantum of compensation through a different means, such as estimated costs per participant?*

South Australian consumers are bearing the cost of compensating directed generators based on the 90th percentile price. We are convinced that this compensation framework provides incentive for generators to retreat from the market when they believe that they can earn more by being directed to participate, compared with participating in the market because that is the business that they have chosen to be in. This behaviour imposes inefficient costs on SA consumers and is quite contrary to the national energy objective (NEO) whereby the market should act in the best long-term interests of consumers. We support efforts to ensure that any compensation framework is fair. This means fair for consumers who have paid for and continue to pay for the central service of electricity. A fair framework also allows generators to recover their costs when they are directed to provide services, and additional costs are associated with operating as directed. Incentivising inefficient bidding practices that will adversely impact the interests of consumers is not acceptable.

As noted in the paper, it is worth considering alternative approaches such as that used in the market suspension compensation methodology. An approach like this could ensure that generators can recover their costs but remove the risk that generators will profit at the expense of consumers.

Uniting Communities is also a strong supporter of greater transparency and greater engagement with end consumers in relation to costs. Consequently, much greater transparency is urgently needed regarding compensation and related payments being paid to generators who are directed by the market operator. This transparency should include reporting, most probably on a quarterly basis but at least annually, on all intervention pricing and compensation payments made on a generator by generator basis.

We note the recent release of a national energy charter[7] developed by a number of energy businesses. We would hope that the energy charter will provide another imperative for generators to take a consumer - centred approach to all aspects of their business operation, including eliminating any attempts to bid in a way as to maximise compensation and direction payments to the detriment of consumers, particularly poor and lower income households and small businesses have limited capacity to fend off higher prices.

23rd May 2019

[7] https://www.theenergycharter.com.au/