



19 January 2017

The Commissioners
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Sent by: online lodgement

Dear Sirs

**Distribution Market Model
SEA004**

Major Energy Users Inc (MEU) is pleased to provide its thoughts on the Distribution Market Model Approach Paper.

Overall, the MEU considers that the Approach Paper defines the issues well and identifies many of the aspects that need to be considered as part of assessing the needs to address future changes as they impact the distribution networks. However, the MEU would like to make the following comments and observations as it considers that they also should be addressed by the AEMC as it develops its views.

It should be noted that there is a basic economic assumption that consumers address issues "rationally" but this assumption has been demonstrably shown to be erroneous. Despite this, those consumers who do act irrationally at times (whether through apathy or circumstance) should not be subject to long term disadvantage when accessing an essential service. While irrational behaviour in the provision of a non-essential service might be overcome at a later time via other means, this does not necessarily apply with an essential service.

Electricity usage is now so pervasive that it needs to be considered as an essential service. This means that issues need to be seen not only from the viewpoint that "interested" consumers can operate more effectively in the electricity market but that those consumers that either cannot or do not want to get actively involved in the electricity market are not disadvantaged through their lack of interest, ability or understanding of the issues. In addition to consumers who are apathetic regarding the electricity market, the AEMC has to consider the interests of those who might not be able to be active in the market such as the aged, renters, technologically challenged and consumers in the lower income quintiles who are unable to provide funds to improve their ability to interact with the electricity market.

The import of the National Electricity Objective (NEO) is that the electricity market is not to be efficient for consumers with an interest in electricity but for all consumers. This means

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that the electricity market must not be operated so as to disadvantage those consumers which cannot interact with it.

The assumption underlying the distribution market model is that pricing in the market will send appropriate signals for consumers to interact with the electricity market yet unless these signals are correct, the consumer response actions could lead to inefficient investment. For example, the price signal to a consumer could be that the prices paid for electricity could be reduced by investing in self generation (eg rooftop solar PV with battery storage) yet, if this apparent saving is based on inefficient network tariffs (eg those based on consumption rather than demand), then such investments could be inefficient from a market perspective¹.

For example, if the prices paid for energy reflect the volume of electricity used, then investment to reduce the usage of energy appears to be efficient. As has been discussed many times, such an apparently clear signal to invest is not efficient because the outcome does not include the cost to provide backup supplies to the consumer in the event that their independent system is inadequate. If the full cost to provide back up (eg a demand based tariff) was included, the consumer response could be different and no investment made.

The model proposed by the AEMC is predicated on the view that consumers of the same class should see the same price signals and it is noted in the approach that consumers might have the ability in the future to respond to price signals by use of an algorithm and/or through investment. However, if a consumer does not have the ability or understanding to implement actions in response to the price signal (eg as an older person or one technologically challenged, a renter, through a lack of funds, etc) yet another consumer of the same class does have the ability take action, then there is a disproportionate impact on those without the ability to respond as the saving generated by the consumer investing imposes a cost on the consumer not able to take action.

Great care is needed to ensure that the model does not enhance the inequity that we currently see where consumers without the ability to invest in ways to respond to price signals do not end up cross subsidising those that can.

In assessing the Approach Paper, other issues also arose and require attention.

-) The rules on networks need to be addressed as to how networks (using network sized storage systems) are to be reimbursed for the arbitrage costs of buying and selling electricity. As buying, storing and selling electricity might be more profitable than using storage to address network constraints, there is a need for more than ringfencing to ensure that assets funded by consumers are not used to maximise profits for networks.
-) The model is based on the assumption that there is a price (and a cost) to address the issues of the current market where there are excessive amounts of intermittent

¹ Energy Consumers Australia has released a report that cites the most driver of the actions taken by consumers in the electricity market are driven by price (see <http://www.energyconsumersaustralia.com.au/research/consumer-participation-in-solar-and-battery-storage-markets>)

generation. The model assumes that consumers should pay for any shortage of frequency control or inertia yet these features were inherent in the price offerings from synchronous generators.

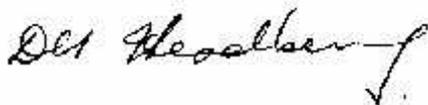
A major issue for consumers (especially business consumers) is the time needed for the transition from the current market arrangements to the market of the future. While all of the pundits speak of the “new” market and how it will integrate all of the technological advances already available and likely to occur, there is no discussion of the harm done to consumers in the period as the transition occurs. There are currently residential consumers that cannot afford the current prices inherent in the energy markets although, to some extent, these consumers are assisted by consumer support agencies and governments. However, industry is also exposed to high energy costs and these can lead to those industrial users ceasing to operate and provide employment.

This issue has been seen most recently in the case of Alcoa Portland refinery where the high cost of electricity foretold the imminent closure of the facility. This closure has been staved off by government subsidies being provided. What is important to note is that if Alcoa Portland had closed, it would not have reopened even if energy prices reduced.

While the Alcoa Portland example is high profile, the MEU is aware that other large, medium and small businesses are closing due to high energy prices. This means that a core aspect of the model has to reflect the potential loss of the industrial energy consumption base as the market transitions². While the MEU accepts that the AEMC is not responsible for ensuring the continued existence of industrial users of energy, it is responsible to include in its assessments of the loss of this industrial usage base as the loss of these users will mean that the remaining users will have to carry the standing costs of the infrastructure previously used to provide supply these end users. The MEU considers that the NEO requires the AEMC to recognise that it has a responsibility to ensure that the transition does not result in the loss of the financial contribution from those consumers forced out of business due to high costs.

The MEU is happy to discuss the issues further with you if needed or if you feel that any expansion on the above comments is necessary. If so, please contact the undersigned at davidheadberry@bigpond.com or (03) 5962 3225

Yours faithfully



David Headberry
Public Officer

² For example, the most recent AEMO NGFR forecasts reducing gas consumption by industry. This reduced demand is primarily caused by closures which are direct response to the very high gas prices now applying