



1 February 2017

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

Sent by: online lodgement

Dear Sirs

**Electricity Network Economic Regulatory Framework Review
Approach Paper
EPR0050**

Major Energy Users Inc (MEU) is pleased to provide its thoughts on the Electricity Network Economic Regulatory Framework Review Approach Paper.

Overall, the MEU considers that the Approach Paper defines the issues well and identifies many of the aspects that need to be monitored as part of assessing the needs to address future changes as they impact the electricity 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.

Pricing as a signal to incentivise change

The MEU considers that the issue of pricing is a core aspect of monitoring the technology changes faced by networks and the security issues that arise, and the MEU notes that the primary priority identified by the AEMC is that of pricing reform. The MEU agrees with this as it is pricing that provides the incentives to implement (or not) actions by consumers. High pricing drives actions to reduce the use of energy and/or find alternatives to reduce the costs (eg solar PV at the residential level).

This means that pricing has to reflect the way electricity is used. Except in the Victorian region, usage of electricity in the NEM is generally measured by volume rather than demand, and even in Victoria volume is still the primary measure used by the vast majority of consumers. It is also noted that the cost of providing network services is the single biggest element driving the cost of electricity supply at the point of consumption yet it is widely recognised (and discussed during the AEMC workshops on pricing reform) the cost of network services is driven by demand rather than consumption.

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If the signal to make change is inconsistent with the desired outcome, then the monitoring will deliver the wrong solution. This is the issue facing consumers – that the measure used by consumers to identify how to reduce electricity costs (ie consumption) is inconsistent with the driver of the single biggest cost of electricity supplies (ie demand). Until this issue is resolved, market signals will not drive the desired outcome of networks – to reduce the cost of network services.

The AEMC makes reference to the rule changes it has made to make pricing more reflective of costs yet this pricing reform is unlikely to deliver the outcomes sought because:

-) In most cases the metering (except in Victoria) is not installed to enable the delivery of the cost reflective price signal
-) Delivery of the price signal to consumers is provided by retailers which are not constrained to provide their prices on cost reflectivity bases
-) The price signal that is delivered to consumers provides an incentive to reduce consumption rather than reduce demand¹. Because of this, residential consumers are being incentivised to make investments that might be overall less efficient than them not investing
-) Governments require that consumers of the same class should have the same tariffs. This provides an incentive only to those that can or are able to take such actions and those that can't (eg the aged, those on low incomes, renters, etc) are not able to respond to the incentives
-) Tariff changes tend to be on an opt-in basis which again provides an incentive only to those that will benefit to change tariff, allowing those that would otherwise be paying more under a demand basis due to their usage pattern to continue to benefit from a distortion created by mis-aligned incentives.
-) The new rules for network pricing provide little direction as to how the residual costs are to be recovered allowing networks to recover these in ways that do not necessarily reflect the cost drivers for the network
-) Tariffs are being changed over extended periods (eg transition periods as long as 10 years and even longer) have been built into networks' Tariff Structure Statements, leading to very slow change and providing networks with a signal to continue to invest at high levels over the transition period

The MEU points out that its members are subject to tariffs that provide very clear signals as to usage of electricity and therefore can see that the new pricing rules do not provide a clear and appropriate signal to enable incentives to moderate the electricity usage and/or make appropriate investments by the many small consumers that have such an impact of the electricity market.

¹ For example, in the reports provided by Ausnet Services in Victorian region as part of their regulatory reset process identify that residential consumers with solar PV have a higher peak demand than residential consumers without solar PV

Diverse supply and support options for networks

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 currently selling electricity is not permitted by networks, noting that network sized storage is being promoted as an option for providing network support and even system security. 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

There is an assumption that there is a price (and a cost) to address the issues of the current market where there are large amounts of intermittent generation. The implication of the assessment by the AEMC is that consumers should pay for any shortage of frequency control or inertia yet these features were inherent in the price offerings from synchronous generators.

Another consideration

There is a basic assumption implicit in the Approach Paper, that price signals are the most efficient method of getting change and delivering the most efficient outcome. This is derived from the basic economic assumption that consumers will 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 what is 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 levels who are unable to provide funds to improve their ability to interact with the electricity market.

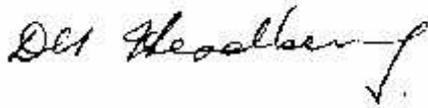
The import of the National Electricity Objective (NEO) is that the electricity market is not to be efficient for consumers with an interest in electricity but for all consumers. This means that the electricity market must not be operated so as to disadvantage those consumers which cannot interact with it.

With these thoughts in mind, the MEU considers that the monitoring function required of the AEMC to test the effectiveness of the electricity market to withstand the changes

that it is facing needs to have a wider focus than that implied by the Approach Paper, and should assess the effectiveness of the pricing regime that has been implemented to reflect the usage made of the market by consumers and of the rules introduced to accommodate the effects of the changes that are occurring as technology changes.

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

A handwritten signature in black ink, appearing to read "David Headberry". The signature is written in a cursive style with a long horizontal stroke at the end.

David Headberry
Public Officer