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Australian Energy Market Commission
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Australian Energy Market Commission – review of energy market design in light of CPRS and MRET

This submission has been prepared by the Consumer Utilities Advocacy Centre Ltd (CUAC), an independent consumer advocacy organisation, established to ensure the interests of Victorian consumers, especially low-income, disadvantaged, rural, regional and indigenous consumers are effectively represented in the policy and regulatory debate on electricity, gas and water.

The submission has been formally endorsed by the following organisations:

- St Vincent de Paul Society
- Alternative Technology Association
- Queensland Council of Social Service
- Ethnic Communities' Council of NSW.
- Victorian Council of Social Service
- Tasmanian Council of Social Service
- Kildonan UnitingCare
- Australian Council of Social Service
- Western Australian Council of Social Service
- Consumer Action Law Centre
- ACT Council of Social Service

We welcome the Review and are supportive of the aims of the Review, particularly the need to determine what market adjustments may be necessary to ensure market frameworks, with regard to market objectives, deliver efficient, safe, secure and reliable energy supplies in the long term interests of consumers. In the context of energy market reform and the pressing task to ensure energy markets can achieve desired policy objectives, this is an important review for consumers.

Our concerns primarily include the scope of issues under consideration and the framing of the scoping paper itself. Primarily, we contend that the adequacy of consumer protection frameworks should be considered as part of this review. We also believe there are risks of systemic energy market dysfunction that have not been sufficiently explored in the scoping paper. The remainder of the submission addresses these, and other issues.

Given the importance of the Review and potential to better align the interests of markets, policy makers and consumers, we are disappointed that an amendment of energy market objectives has been explicitly ruled out. The disconnect between energy market objectives and policy objectives will continue to undermine market functioning until resolved, an issue we elaborate on towards the end of the submission.

Consumers are also concerned at the limited range of issues identified in the scoping paper for discussion and indeed the nature of the paper itself which invites no comment on issues broader than those covered in the paper. We would expect a scoping paper be designed to identify not only the materiality of issues identified, but to seek input on those issues not identified by the AEMC or its stakeholder reference group.

Specifically, at the AEMC's initial stakeholder meeting, the adequacy of the consumer protection framework to manage the risk of disconnections and energy hardship caused by current and impending price rises was raised as an issue facing consumers. We strongly encourage the AEMC to include this issue in its deliberations as part of this review.

Treasury modeling indicates households are likely to spend an extra $4-5 per week on electricity and $2 per week on gas and other fuels due to CPRS alone. Additionally, consumers will be expected to pay for interval meters, MRET and network upgrades (estimated to increase retail prices by 20%[1]). Large price increases have already begun to flow through to consumers, recently 17% in Victoria, 26% in NSW around 15% in Queensland and 19% in Tasmania. Additionally, further price shock due to water scarcity remains a serious issue.

We believe the AEMC should explicitly recognise and note in its deliberations that for every risk and uncertainty markets face, from illiquidity in financial markets to the design of the emissions trading scheme, consumers are faced with the same risks and uncertainty when managing energy costs. Unlike businesses, many consumers are not adequately equipped to manage uncertainty and risk. They are unable to take out hedge contracts against rising energy prices or vertically integrate into generation, customers can be employed with low job security making financial planning and saving for unforeseen scenarios difficult, or they may be on fixed incomes with a severely constrained capacity to deal with unexpected energy price shocks.

[1] ABARE, BCA, ESAA, EUAA, in energy response at http://energyresponse.com/uploads/managing%20peak%20demand%20by%20m%20zammit.pdf

We would welcome the opportunity to work with the AEMC to gather the detailed information required to determine who is most at risk of disconnection and energy hardship, and how market frameworks could be best adjusted to manage these risks. This analysis should include the potential for significant variations across jurisdictions in costs incurred from new network and generation investment resulting from CPRS and MRET.

We note that no attempt has been made by government to account for the full price effect of all future factors influencing energy prices, and the impact this could have on energy affordability.

In the interim, any suggestion that removing the negotiated price path (sometimes erroneously referred to as a price cap) is necessary for retailers to manage risk – implicitly that the only way retailers are able to manage risk is to pass it on to consumers - is ill considered. A thorough and complete review of the effectiveness of competition, jurisdiction by jurisdiction, is absolutely essential before any recommendation to remove price regulation across jurisdictions can be made.

Market uncertainty has already seen a move to industry consolidation and vertical integration. Removing the negotiated price path would serve to heighten the risk of market power abuse. Market regulation, and its interplay with policy, should encourage competition at every opportunity as a way of preventing market failure. Investigating and penalising market failure 'after the fact' is not sufficient by itself.

Related to the pressure for market consolidation, we believe that market behaviour and the design of policy and regulation will increasingly face systemic dysfunction caused by a combination of private asset ownership, vertical integration and until the issue is resolved, the conflicting objectives of the energy market and policy makers.

Energy market participants, in many instances private asset owners, have desired outcomes that affect policy and market regulation. For instance, private investors in coal fired generators have a desire to remain financially viable over the useful operating life and/or extended life of the asset they have purchased and so will actively work to shape market rules and Government policies to accommodate this. This creates conflict of interest between the asset owner and policy makers – who in this case are seeking to reduce emissions. Such tensions have profound effects on the ability for policy makers to act in the interests of the public and subsequently, the ability for policy makers to ensure markets act in the long term interests of consumers.

This conflict of interest creates two important systemic risks. The first is that policy makers can only deliver policy objectives as fast or effectively as private industry can do so, or are willing to do so profitably. The second risk is that if policy makers do act, or are perceived to act in a way which undermines the viability of private asset owners, those asset owners may be able to exert market power and distort market prices, or they will seek compensation for the devaluation of their assets. In this way, implicitly, Government is under significant pressure to underwrite private investment risk in energy assets. This has the potential to significantly undermine market discipline in buying, selling and operating energy assets.

The precedent may appear tangential, but we believe the experience of financial markets in the United States, as well as the experience of highly leveraged investment vehicles and private companies in local markets should alert policy makers, rule makers and regulators in energy markets. That a privately owned company operates in a competitive or regulated market does not ensure management efficiency or efficient market equilibrium. In many cases, private investors will manipulate either the perception or experience of risk and incentive to maximise private profit and where possible, socialise risks and ultimately costs - they have an incentive to do so. Where essential services are being delivered by private enterprise in monopoly or oligopoly markets, the risk that inefficient costs are socialised is particularly high as they are too big and too important to fail.

We believe this Review should be used to examine the extent to which these systemic risks exist in energy markets, what impact they have on the ability of the energy market objectives to be met and if deemed necessary, how these issues can be resolved.

Specifically, we believe the review should investigate the risk that domestic gas reliability and affordability is, and will be further undermined by the move to price parity with international markets, CPRS and expanded RET. To the extent that it is, we believe the AEMC should investigate market adjustments that may be necessary to ensure market frameworks, with regard to market objectives, deliver efficient, safe, secure and reliable energy supplies in the long term interests of consumers. The review should also pay attention to new arrangements for Retailer of Last Resort (ROLR), which are in the process of being developed, and how allocation of risk may affect market incentives.

Lastly, understand the need to ensure investments in new and potentially untried generation technologies at a large scale do not become stranded assets. The AEMC has signaled an interest in whether the market design is likely to result in efficient investment in network connections. We reinforce the importance of ensuring the market faces an appropriate balance of risk and incentive so that consumers and/or government do not underwrite the risk of inefficient investment.

To summarise, our key recommendations are as follows:

- That the AEMC explicitly recognise energy consumers face equally important and significant risk as businesses
    - That this necessitates including an investigation into the adequacy of the consumer protection framework as part of this review
    - That this requires a complete and thorough review of the effectiveness of competition before consideration is given to removing the negotiated price path
- That the AEMC investigate systemic risk caused by the interplay of private interests, increasing levels of vertical integration and policy and regulatory settings in energy markets, what impact they have on the ability for the energy

market objective to be met and if deemed necessary, how these issues can be resolved.
    - Specifically, investigate the risk that gas markets will fail to deliver efficient, safe, secure, reliable supplies in the long term interests of consumers; and
    - Consider the impact ROLR arrangements may have on market incentives
- Lastly, that the AEMC ensure that an appropriate balance of risk and incentive is maintained to mitigate the risk of stranded assets being paid for by consumers and/or government.

We look forward to further consideration and discussion of these important issues throughout the Commission's review process.

In the first instance, please contact Tosh Szatow on 03 9639 7600 should you have any questions about this submission.

Yours sincerely

Tosh Szatow
Policy Officer