18 May 2011

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Lodged by email to submissions@aemc.gov.au

Dear Mr Pierce

Strategic Priorities for Energy Market Development — Discussion Paper

The National Generators Forum (NGF) welcomes the opportunity to provide a response to the Australian Energy Market Commission's (AEMC) Discussion Paper on Strategic Priorities for Energy Market Development.

In addition to its assessment of the priorities for energy market development, the Commission's Discussion Paper provides a useful description of the state of the market and a summary of emerging challenges. The AEMC is to be congratulated for undertaking this task and for inviting stakeholder input.

The NGF represents Australia's major power generators. As at July 2010 the installed capacity of members was 45,625 MW, with an asset value of over $40 billion. Annual electricity sales are over 186,000 GWh, valued at some $7 billion. This represents over 95% of the total Australian market.

The NGF is pleased to note the Commission's view that the establishment of the National Electricity Market (NEM) has delivered substantial benefits to Australians and that market arrangements have proven to be generally robust. The NGF concurs, noting that the establishment of the NEM has delivered:

- competitively determined wholesale electricity prices which have fallen in real terms in several regions since the market commenced;
- consistently secure and reliable supplies of electricity;
- power plant performance which has increased to world class levels;
- increased utilisation of generation capacity;
- timely new investment in generation plant, amounting to more than 10,000 MW in new generation capacity over the last decade; and
- major economic benefits which have flowed through to the nation as a whole.

ABN 83 113 331 623 PO Box 4155 Kingston ACT 2604 T 02 6232 7789 F 02 6232 7781 W ngf.com.au

While these are the undoubted benefits of a wholesale market which has been lauded by the International Energy Agency among others, the unprecedented rise in retail electricity prices now being experienced by households has the potential to undermine public confidence in the energy supply system as a whole. This could, in turn, lead to ad hoc and retrograde interventions by governments in the market, which risk producing sub-optimal outcomes.

The AEMC has identified four emerging challenges facing the energy market over the coming years:

- rising retail prices;
- forecast increases in peak demand;
- investment requirements; and
- market resilience issues, due largely to increased penetration of intermittent generation.

The NGF agrees that these are among the key challenges facing the energy market. The other major issue which has been omitted is the issue of government intervention in the market. A market achieves its best outcome if it has a sound design and is left to run without intervention. Both State and Federal governments have introduced distortions which have, to date, been moderate. It is important that future policies recognize the benefits that a market can bring and are designed to not impact on the performance of the market.

As the AEMC rightly observes, retail price rises, which have been in the order of 30% over the last three to four years, have principally been caused by rising network costs. Upward pressure on retail prices has also been caused by climate change policies, notably the expanded Renewable Energy Target (RET). In NSW, the Independent Pricing and Regulatory Tribunal's most recent price determination sees network cost pass through adding 10% and changes to the RET scheme adding 6%, to give a 17.6% average price increase from July this year. In contrast, generation costs have remained constant in real terms and will contribute only 1% to the increase in retail tariffs in NSW from July 2011.

As the Commission notes, the challenges to the market are occurring within a policy context of initiatives to address climate change, such as the expanded RET and the Federal Government's proposed carbon pricing mechanism. Generators believe that measures to address climate change should be well designed so that they minimise costs for customers and tax payers. This has manifestly not been the case with a plethora of ad hoc and high-cost abatement initiatives, imposed particularly at the state and territory level. As an example, the NGF estimated the cost to consumers of the former NSW Government's Solar Bonus Scheme in the order of $640 per tonne of carbon dioxide abated — some 25 times the forecast CPRS permit price. IPART notes that, had it continued as originally planned, the NSW solar scheme would have increased retail prices by between 5 and 10%. While the NSW solar scheme was subsequently reformed and then closed to new applicants, some jurisdictions retain high cost renewable energy schemes.

Generators agree with the AEMCs assessment that measures to address climate change should not adversely affect the economic efficiency of the energy sector or the ongoing development of competition in generation and retail markets. The NGF contends that stemming high-cost and inefficient climate change schemes and curtailing future increases in network costs should properly be a focus of the Commission's work and policy advice to the MCE.

The AEMC has identified three strategic priorities to address the challenges facing the Australian energy sector:

- a predictable regulatory and market environment for rewarding economically efficient investment;
- building the capability and capturing the value of flexible demand; and
- ensuring the transmission framework delivers efficient and timely investment.

These are appropriate priorities for the development of the energy market, although it is important that the AEMC ensures these strategic priorities are addressed within the context of the Energy White Paper process and within the remit of the AEMC.. Having agreed these areas as priorities, it is important that the AEMC and MCE focus any reviews into these areas. The NGF proposes that the AEMC structure its work programme in such a way as to differentiate those issues which the Commission can directly affect and for which results may be measurable, from those issues which the AEMC can only influence. Further, it would be helpful if the AEMC indicated the timeframes for the completion of the work programme developed under the strategic priorities and/or whether it proposes to issue annually updated market development priorities and an associated work programme.
In relation to the promotion of economically efficient investment in generation, the Commission rightly points out the importance, particularly to the private sector which has accounted for 66% of new investment in the NEM since market start, of policy certainty and transparency, especially in relation to the possible carbon price impost. While limitations on the availability of finance since the GFC have had an impact, policy uncertainty is without doubt the largest impediment to new investment.

In relation to investment in transmission and distribution, the NGF agrees with the Commission's observations that:

> Investment in networks is … important to underpin a reliable and secure supply, but confidence that prices are efficient for this part of the industry depend on confidence in the regulatory framework and institutions.[1]

And that:

> It is important to be confident that regulated allowances for network costs are the minimum necessary to deliver a reliable and secure supply.[2]

To this end, the NGF recommends that the AEMC initiate a review of the economic regulation of networks which, among other deficiencies, appears to put an unusually high burden of proof on the regulator and involves an unbalanced appeals process. State-determined reliability standards also merit review, as does the role and resourcing of the regulator itself. These arguments have variously been made by the Chairman of IPART and by Parry and Duffy in their review for the former NSW Government of NSW electricity network charges.[3] Most importantly, due the high reliance on forecasts of demand for investment decisions, the robustness of methodologies used and their historical accuracy should also be reviewed. This will promote efficient investment.

---

[1] AEMC, *Strategic Priorities for Energy Market Development*, Discussion Paper, p. 5.
[2] AEMC, *Strategic Priorities for Energy Market Development*, Discussion Paper, p. 8.
[3] Dr Tom Parry and Mr Mark Duffy, *NSW Electricity Network and Prices Inquiry*, Final Report, December 2010, NSW Industry and Investment, p. 47; Mr Rod Sims, *Electricity Price and Market Dynamics Review*, Speech by the Chairman of IPART, 29 April 2011, p. 17.

Among the various other actions that the AEMC could take towards realising the strategic priorities identified are promoting the deregulation of retail electricity prices in markets where competition is effective, and streamlining the connections process for generators.

The Commission's Discussion Paper notes that there have been important developments in the gas markets in recent years, but that the AEMC has only recently been given responsibilities in relation to these markets. The NGF believes that the interaction of gas and electricity markets may merit further consideration by the Commission, in spite of the relative immaturity of the national gas arrangements.

If the AEMC would like further input from the NGF into the development of the Commission's strategic priorities the Forum would be pleased to assist. I am contactable on (02) 6232 7789.

Yours sincerely

M. Roberts

Malcolm Roberts
Executive Director