Submission to: Review of Governance Arrangements for Australian Energy Markets

Providing clean, green, affordable energy services

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The Committee's decision to take an expansive approach to the terms of reference for this governance review is welcome. Accordingly this submission comments broadly on the governance of Australia's energy systems, focusing mainly on the National Electricity Market (NEM).

The NEM was designed as part of the 1990s wave of micro-economic reform and envisaged the creation of national, privatised, 'economically efficient' energy markets for electricity and gas designed to attract private investors. The then predominantly state-owned electricity utilities would be broken up into generation, distribution and retail arms and sold off. 'Consumers' were the assumed beneficiaries of the changes but were given no say in the system or its decision-making other than eventually through being able to choose amongst retailers.

Since then the energy world has changed radically and the pace of change continues to accelerate. Technology has moved decisively against large centralised fossil fuel generators with demand side management and renewable energy at all scales increasingly competitive. The imperative to act on climate change is globally accepted. The centralised system envisaged by the NEM reforms is the opposite of the decentralised provision not just of electricity but of energy services preferred by many households and communities.

Even in its own terms, the NEM is failed micro-economic reform. For example, the just concluded Senate inquiry into networks heard 'compelling, consistent evidence about the depth of the regulatory and institutional failures of the National Electricity Market (NEM) and the inexcusable gouging of consumers'.[2] Before that the Productivity Commission pointed to 'flaws in its (ever more) complex regulatory and institutional arrangements' that produced outcomes 'inimical' to consumers' interests.[3]

Australia needs a new approach to energy that is more democratic, acts on climate change and enables local power. Its aim should be to provide clean green and affordable energy services for all. It should actively support the emergence of new technologies by limiting the market power of incumbents that benefit from historical subsidies and status. Above all, the transition process should actively engage communities in designing the energy future they want.

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[2] Senate, 2015, *Performance and management of electricity network companies, Interim Report.* Dissenting report from the Australian Greens
[3] Productivity Commission, 2013, *Electricity Network Regulatory Frameworks*. Productivity Commission Inquiry Report, No. 62

1. Over-arching governance

Question 2[4]

Governance of Australia's energy markets -- electricity and gas -- is vested in the COAG Energy Council (previously the Ministerial Council on Energy) through the 2004 Australian Energy Market Agreement (AEMA). Under the Agreement, states, territories and the Commonwealth are bound to act in accordance with its terms and must give 12 months' notice to withdraw.

AEMA's scope is circumscribed. It covers only electricity and gas, rather than energy services more broadly, and its objectives are mainly to do with providing an attractive environment for investors on an ongoing basis. In the decade since it was signed some objectives have been selectively ignored - demand side management (objective iv) has still not been attended to despite being under continuous review since 2007; greenhouse gas emissions from the energy sector (objective vi) have not been addressed.

The governance role of the COAG Energy Council through AEMA is unsustainable. In an environment of fast-moving and unpredictable change, decision-making is painfully slow and compromised by its narrow objectives and the conflicting interests of the states, most of whom are owners of energy assets as well as rule-makers in the energy sector. Decisions that should be exposed for debate and parliamentary scrutiny are made by energy ministers behind closed doors. The community has no effective voice in the process either directly or even through the involvement of ministers from other affected portfolios.

As an agreement, AEMA is outdated. As a mechanism it is profoundly anti-democratic. On both grounds it should be abolished.

Recommendation
Wind up AEMA and remove the COAG Energy Council from its legislated roles in energy governance.

2. Objectives and interests

Question 2

Governance takes place within a framework that defines the objectives and interests to be served. A fundamental problem with AEMA, and the energy 'markets' and institutions it governs, is that both its objectives and beneficiaries are narrowly drawn in purely economic terms. AEMA's over-arching objective is:

> the promotion of the long term interests of consumers with regard to the price, quality and reliability of electricity and gas services

[4] Refers to questions in the *Issues paper* for the *Review of Governance Arrangements for Australian Energy Markets*

In the National Electricity Law, this is expressed as the National Electricity Objective (NEO) which is:

> to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to-
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

'Consumers' are ostensibly the beneficiaries of the system but the term is ambiguous and not defined in the National Electricity Law.[5] What is the status of distributed generators for example?

Whatever its legal meaning, it is clear that the intention of the NEO is to confine 'consumer interests' to economic interests alone,[6] and further to constrain the factors that NEM institutions can consider in carrying out their roles. These are limited to:

> supply issues – price (not affordability or the total cost of service provision),[7] quality, reliability, safety, security
> system issues – reliability, safety, security

The NEO does not recognise the interests of the community at large. Even if 'consumers' were interpreted as the entire community of electricity users the dissonance between their interests and the circumscribed range of issues listed in the objective is extreme. It is no wonder that demand management has languished in electricity limbo for over a decade, that climate change is not considered, and that prices have risen dramatically.

The National Electricity Objective needs to be re-drawn to sit within a modern and rapidly changing context where community and consumer interests are much more than just economic and electricity is but one option for delivering energy services. Social and environmental objectives need to be made explicit and the community brought into the decision-making process.

Recommendation

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[5] It may mean anyone who consumes electricity, however obtained (effectively the entire community) or alternatively and more restrictively one who buys electricity. By contrast, the term 'end user' is defined (and inter alia 'customer') as: 'a person who acquires electricity for consumption purposes, and includes a retail customer'.

[6] "*The new NEL objective is an economic concept and is intended to be interpreted as "acting in the long term interests of consumers". If the National Electricity Market is efficient in an economic sense the long term economic interests of consumers in respect of price, quality, reliability, safety and security of electricity services will be maximised.*" [emphasis added] KPMG 2013, *National Electricity Market: A case study in successful microeconomic reform.* AEMC.

[7] Without a carbon price integrated into electricity pricing how can the NEM be regarded as an economically efficient market operating in the long term interests of consumers?

The National Electricity Objective should be re-written to include environmental and social objectives and to give communities a genuine role in deciding their energy futures.

3. More democratic governance

Questions 2, 4, 7, 46

Under existing arrangements, the COAG Energy Council not only sets overall policy and direction for energy services, it plays an active role in the management of the NEM and its institutions. It is empowered to:

- issue statements of policy principles which AEMC is required to 'have regard to' (there do not appear to be any current such statements)
- direct AEMC to conduct reviews
- require AEMC to provide information, reports or other services
- decide on the appointment of AEMC Commissioners (which creates a strong incentive for commissioners to 'have regard' to the views of the Ministerial Council)
- decide on the appointment of AER members
- appoint the directors of AEMO
- appoint the directors of ECA

The Ministerial Council is not accountable in these roles - it does not report on its activities to parliament and chooses who to appoint to the NEM institutions without public consultation or scrutiny.

Governance of the system should be made more democratic, open to parliamentary scrutiny and community input. AEMA should be abolished. To the extent that a national framework for energy services is required, it should be provided through national legislation subject to normal parliamentary processes. To minimise disruption, the existing National Electricity Law can be introduced as federal legislation with provision for review and amendment as the system evolves and modernises. The federal energy minister would become responsible and her/his specific roles and powers would be defined together with requirements for parliamentary reporting.

At present, the AEMC has dual roles as both adviser to the Ministerial Council and rule-maker. It should be freed from its advisory role and the functions of rule-making and regulation combined in a single statutory authority, bringing the AEMC and AER together under a board that includes defined skills and experience. Appointments to the board should be made through a transparent process.

Recommendation
The National Electricity Law should become a federal law.
Legislative and other provisions embedding the Energy Council in the operation and management of the NEM and its institutions should be unwound.

4. Acting on climate change

Questions 4, 7, 43, 46

The present federal government notwithstanding, action will be taken to tackle climate change, whether by state or local governments individually or by a future federal government. Targets to reduce emissions under international rules will become increasingly stringent. The Renewable Energy Target remains in limbo but is a vital transformative mechanism that should be maintained and strengthened. Targets to improve energy productivity and efficiency are flagged in the government's Energy White Paper.

Nationally, electricity generation accounts for about 35% of non-LULUCF emissions and so must play a key role in Australia's emission reduction task. Currently the NEM has no power to require or facilitate emission reductions or to prevent its institutions or registered participants from actively resisting Australia's transformation to a low carbon economy. For example, the emergence of 'gentailers' dominating increasingly deregulated electricity retailing to households is allowing pricing to be structured in favour of continued fossil fuel generation. At the same time networks are able to limit and delay renewable energy connections to the grid using the market power they have been given by the misguided decision to treat them as 'natural monopolies'.

There is a clear case for including environmental costs into pricing structures and/or regulatory requirements, especially for climate change. The minister and the energy market institutions should be required to meet legislated targets to eliminate greenhouse gas emissions from the NEM, with registered participants, public and private, required to act in ways that facilitate the transition.

Recommendation
In accordance with an expanded NEO, introduce legislated emission reduction targets for the NEM.

5. Enabling local power

Questions 20, 41, 45

The NEM and the energy market institutions were designed to regulate a small number of large 'registered participants' who would have the resources to participate in its complex processes. In line with this, there are currently around 200 unique registered participants in the NEM, primarily large generators, networks and retailers. 'Consumers' are reduced to essentially passive users of electricity, excluded from decision-making about the system.[8]

From about 2008 the picture changed dramatically for four main reasons - the price of solar power plummeted, opportunities to improve energy efficiency expanded, electricity prices sky-rocketed, and interest in community climate action escalated. Now non-registered but

[8] The newly created 'Energy Consumers Australia' has only an advocacy role and must act within the parameters of the NEO

‘active’ NEM participants number in the millions – these include exempt generators, networks and retailers; demand side activity; households and commercial premises generating their own power or investing in storage and negawatts; community energy projects; and various projects to decarbonise neighbourhoods and towns. Their numbers will be augmented as electric vehicles gain popularity. Collectively this group of ‘local power’ producers and managers is highly disruptive to the centralised NEM and its registered participants, both through the energy services they choose and through active political engagement. They have already contributed to an overall fall in demand and changes to time of use that threaten network businesses in particular.

Local power is a viable and attractive alternative to centralised power (see for example RMI scenarios, New York State Reforming the Energy Vision). In the face of the rapidly moving energy revolution, the NEM needs diversity to test new solutions and the flexibility to adapt quickly. It should be restructured to remove the privileged position of existing large-scale participants in the centralised system and allow for and encourage diversity at multiple scales while protecting the right of communities to have clean, safe and affordable energy services.

Recommendation
Remove barriers to local power and put it on an equal footing with centralised options. Empower communities that choose to take responsibility for providing their own energy services subject to meeting social, environmental and safety standards.