

MCC's submission on the AEMC's draft terms of reference

It is our pleasure to introduce MCC Economics and Finance (MCC). We are an international advisory firm specialising in economic regulatory frameworks. Our experience spans multiple jurisdictions and sectors, but we have a particular passion for energy issues.

Given our interest and experience in the space we offer a few suggestions on the AEMC's draft terms of reference (ToR).

The ToR is good – here's our strategic-trade-offs for pricing reviews

Pricing reviews face difficult trade-offs, including:

- Implementation time for change(s) versus benefit of status-quo stability
- Near-term WACC increases versus long-term efficiencies
- Incentive pricing versus cost-reflective pricing
- Simplicity versus flexibility (or complexity)
- Historical cost reflective pricing versus future cost/benefit pricing
- Electricity for heating/cooling versus electricity for transport/trading
- Residential pricing versus commercial pricing
- Fixed pricing (eg daily charge) versus variable pricing (eg volume)
- Demand-side pricing versus Supply-side pricing

For example, in the UK, years were spent analysing pricing changes, only to become stuck on the fact that the changes would create uncertainty and take years to implement (eg 5 years). A long period of uncertainty, like 5-years, is enough to derail progress, even if the benefits of pricing changes are worth billions of dollars/carbon-units.

The ToR is consistent with these trade-offs.

But we wanted to emphasise these as directly and as early as possible to help you plan ahead.

The review is timely and welcome

Drawing on our international experience, we think there is much to be gained for consumers from better pricing in energy and we see key enablers for future success.

The Australian energy system has been resilient to changing patterns of supply and demand, but this resilience is under increasing pressure. On the supply side the proportion of intermittent generation is increasing. On the demand side there is a shift from gas to electricity and the proportion of electric vehicles is increasing. Better electricity prices can help manage these trends.

Consumer outcomes at the centre

The words “consumer” and “consumers” appear 50 times in the space of 6 pages in the draft ToR. The word “customer” appears another 7 times. We think it is important that the AEMC has signalled the centrality of consumers so strongly.

However, we think the focus on consumers could be strengthened even further. The current title of the review leads with electricity pricing. We think a better title would be “Enhancing consumer outcomes through better electricity prices”. This would signal that electricity prices are the servant of consumers rather than an end in themselves.

We also think more could be done to signal that the review is seeking the best interests of all consumers. For example, there is no mention of vulnerable consumers and the special accommodations and protections that may be needed to support them.

Rewarding consumers

Pricing reform in electricity has a bad reputation. It is commonly seen as a mechanism for punishing consumers (for example, the sun tax). This need not be the case. The ToR rightly place a strong emphasis on benefits and rewards. We suggest this could be strengthened by exploring innovative approaches to delivering benefits to all consumers. It is also worth considering whether it is possible to have an outcome where no consumer is worse off.

Pricing alone will not get the job done

Our analysis is that pricing in combination with technology will result in far superior outcomes. While this is recognised in the ToR, we think this complementarity would benefit from greater emphasis. For example, off-peak prices for hot water and pool pumps are facilitated by load control and the technology to enable control. There is great risk and much reward to be gained from technology and standards that will allow electric vehicle charging to support the energy system.

50% of something is better than 100% of nothing

It is terrific that the AEMC has signalled an open and ambitious approach. There is much to be gained for consumers. However, there is also considerable risk and community suspicion fuelled by high-profile policy disasters and so some caution is needed.

Our analysis is that it is not necessary for everyone to respond to price signals perfectly. You just need enough people to respond a bit to deliver a high level of benefits. We therefore suggest that the ToR also indicate that the AEMC will take a pragmatic approach. For example, changes might be phased in over an extended period.

Competition in the retail sector is not currently sufficiently strong

Consumers receive better outcomes through competition rather than regulation where it is feasible and effective. Much of benefits from this review are likely to be delivered through the actions of retailers. Unfortunately, the actions of retailers in Australia have demonstrated that they are not sufficiently motivated by the best interests of their customers. Their application of the loyalty tax has led to the introduction of default market offers and their reluctance to roll-out smart meters has led to mandated targets.

Our view is that the outcomes of this review will likely require specific obligations on retailers and the AEMC should signal these requirements early.

Conclusion


We welcome this review and the enhanced outcomes it offers for consumers. We would be pleased to assist further.


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