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Australian Energy Market Commission – Review of the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events: 2nd Interim Report and Consultation Paper

The Consumer Utilities Advocacy Centre Ltd (CUAC) is an independent consumer advocacy organisation. It was established to ensure the representation of Victorian consumers in policy and regulatory debates on electricity, gas and water. In informing these debates, CUAC monitors grass roots consumer utilities issues with particular regard to low income, disadvantaged and rural consumers.

CUAC would like to thank the Australian Energy Market Commission (AEMC) for the opportunity to provide feedback on this important review. The issues examined in the AEMC's review will have a significant bearing on electricity consumers in the National Electricity Market (NEM). Of particular significance, will be the proposed approach to setting reliability standards and the assessment of the value that consumers place on reliability. The appropriate balance between reliability and affordability is a vexed question for policy makers and consumers alike. Thorough consideration and analysis of the implications of any changes to the current regime is required to inform this process. Similarly, different approaches to setting the NEM market price cap (MPC) in the future could have major consequences for Australian consumers.

In this submission, CUAC will respond to some of the issues raised in the 2nd Interim Report of the Review and in the subsequent Consultation Paper.

Broad issues for consideration by the AEMC

CUAC is concerned that setting blanket reliability and security standards for the whole NEM is excessively blunt given the diversity of consumers in the NEM. Different customer types in the NEM will place different values on reliability and security. Unfortunately, the current market rules set reliability and security standards for the whole market. This results in customers that place a high value on reliability and security being, in essence, subsidised by customers who may place a lower value on reliability and security. Conversely, customers

who place a lower value on reliability and security are paying more for their electricity than they may wish. CUAC emphasises the need for an examination of innovative approaches to reliability and security standard setting across the NEM to better ensure that all customers receive the service that they want at an affordable price. Such innovative approaches are particularly important given the fast increasing price of electricity.

CUAC also notes that there are a significant group of consumers in the NEM who place a very high value on supply reliability and security but have difficulty affording it. Many consumers who require life support equipment as well as heating and cooling for their health and wellbeing already struggle to pay their energy bills. Nonetheless, high reliability and security is essential for these customers. In any consideration of reliability standards, issues of equity, access, affordability and consumer wellbeing need to be a priority consideration. CUAC is cognisant of the need for greater policy direction around reliability standards and settings and therefore supports the provision of a set of policy principles around reliability standard setting to guide the actions of the relevant regulators. The contents of these principles will be discussed later in this submission.

A further issue of note is that, despite uniform reliability standards, some customers do not actually receive the same level of reliability, even if they place a premium on reliability. Rural and regional customers at the end of low reliability distribution feeders are subject to more frequent black outs and brown outs than the majority of customers in the NEM. Rules around reliability and security should be strengthened to ensure that services to customers experiencing consistently low reliability and security are improved. Sanctions should be imposed on electricity providers who fail to achieve this.

In regards to the second interim report of this review, CUAC is concerned about suggestions that the MPC would be set at different levels in different regions of the NEM. In a national market for electricity, it seems counterintuitive that a regulatory tool like the MPC should be set differently in different NEM regions. This would represent a significant market distortion with the regulator providing "locational signals" to potential investors as to where peaking plant should be situated. With interregional interconnectors it seems logical that the MPC should be set uniformly across the NEM. The cost of transmitting and distributing peak load to load centres provides the incentive for the appropriate location of generation capacity and reflects the different values that different regions may have for peak load.

CUAC is also concerned that reliability and security standards in the NEM encourage investment on the supply side of the NEM rather than encouraging demand side response to reducing peak energy demand. Despite recent reviews by the AEMC that addressed the issue of demand side participation, CUAC is concerned that current reliability settings may encourage supply side investment at the expense of more affordable demand side options. The AEMC should carefully consider in this review whether there are any innovative approaches that ensure affordable, reliable and secure supply with no discrimination between demand side and supply responses.

Do you have any observations in relation to the interaction between the investment regimes (for reliability) between each stage of the electricity supply chain?

In the context of extreme weather events, CUAC notes that the reliability and security of the electricity network is more vulnerable than other levels of the supply chain. CUAC believes that the major focus of this review should be on network security and reliability. For example, the supply issues in Victoria during the extreme weather of February 2009 were primarily as a result of network failures. CUAC emphasises the low levels of network reliability experienced by many people in rural and regional areas at the end of long distribution feeders. It would seem that, in spite of the current reliability standards, these consumers continue to receive poor reliability in the NEM.

The current 2009 Victorian Bushfires Royal Commission has examined issues associated with network reliability, security and safety. A number of fires during the 2009 Victorian fire season have been attributed to poor maintenance of electricity networks. A likely outcome of the royal commission will be the strengthening of network safety regulation in Victoria. This regulatory reform may include requirements for more regular inspection of network infrastructure and will likely have a bearing on reliability and security in the Victorian network. Strengthening of the safety regime may well improve Victorian network performance.

Other options that are being canvassed within the context of the Royal Commission include:

- undergrounding and bundling of single wire earth return wires (SWER), for high risk areas, or for the entire network;
- insulating high-voltage lines;
- upgrading targeted assets; and
- cutting power supplies to high risk towns on catastrophic fire alert days.

These options each raise a significant range of issues to be addressed taking into account the different consumer impacts. These include the extremely high cost impact of each option (eg. SPAusNet estimates burying and bundling all its SWER and 22 KV lines would see a 20 per cent rise in power costs to its customers every year for 20 years). Secondly, the option of cutting power in particular circumstances raises extremely serious health, welfare and business implications for the affected communities.

The AEMC should consider how changes to standards around network reliability emanating from its review will interact with any changes that occur to safety regulation and planning laws at the State level. CUAC would also urge local jurisdictions to ensure that electricity safety regulation complements rather than competes with regulation at a national level. This will require close cooperation between different levels of Government.

Do you consider setting the MPC as a ten year trajectory as more appropriate to provide investment certainty in the future?

CUAC does not believe that current energy demand forecasting techniques are adequate to set a ten-year trajectory for the MPC. All sorts of factors that influence peak price and demand for energy cannot be adequately worked into economic models. The global financial crisis, for example, was not forecast by many but has significant implications for investment in generation capacity and peak demand. Similarly, forecasts of climatic change and extreme event frequency remain insufficiently well developed to allow for the MPC to

be set for a ten year period. Given this, CUAC supports the maintenance of the existing system of two year reviews.

Do you consider the current two year reviews of the MPC as appropriate or would less frequent reviews provide greater investment certainty?

CUAC is satisfied with the maintenance of the current system of two years reviews of the MPC. CUAC believes that the current system provides adequate investment certainty given that it still ensures that peak generators will receive a reasonable price for the energy they generate.

CUAC also notes that the MPC is not the only driver of investment in peak demand as many generators are able to provide both intermediate and peak generation capacity. Such generators simply bid more of their capacity into the NEM at higher prices at times of peak demand. In reality, there are few, if any, generators in the NEM that only operate for the few hours a year that the MPC is reached. Under the current system of setting the MPC, there is no substantial evidence that investment uncertainty is preventing the development of peak capacity. CUAC re-emphasises the need for prioritising network reliability rather than generation reliability at this time.

What do you consider are the wider non-reliability impacts to the NEM of raising the MPC as a mechanism to achieve reliability, in a future of more frequent extreme weather events?

CUAC is of the view that the MPC, if set at the appropriate level, is a useful check on the abuse of market power and uncompetitive bidding by generators. Increasing the MPC liberally or unnecessarily for the sake of reliability may result in uncompetitive behaviour among electricity generators as they bid during peak times. CUAC notes that, while the wholesale market for electricity can be competitive, competition is reduced as supply becomes constrained. Electricity supply is not limitless at a given point in time. This is the rationale for the price cap. It is appropriate that this supply constraint cannot be exploited to the detriment of consumers.

CUAC is also concerned that changes to the MPC may come at the expense of measures aimed at reducing peak demand for energy. By increasing peak supply capacity through increases to the MPC, there is little incentive for consumers to reduce peak demand. Even in the presence of price signals, it seems that peak energy, on very hot days for example, remains stubbornly inelastic. The MCE and the AEMC should examine demand side approaches to reducing peak demand along with supply side approaches. Given the price inelasticity of demand at peak times, it may be appropriate to examine information, education and cultural change programmes. These may deliver reductions in peak demand at a lower price than new generation capacity with no detriment to consumers.

CUAC supports the analysis by the AEMC that more frequent extreme weather events may, in fact, reduce the need to increase the MPC. It is likely that extreme weather events will allow peaking generators to run more frequently and, thus, sell their electricity at lower prices.

Do you consider that it is appropriate for the MCE to provide a statement of policy principles regarding the community's expectations and valuation of reliability? If so, what should the form and level of that guidance?

CUAC strongly supports the provision of policy guidance from the MCE around the community's expectations and valuation of reliability. CUAC has been concerned that reliability standards have been set with the aim of achieving near-perfect reliability rather than with a considered estimation of costs, benefits and community expectations. Regulatory decision making will be strengthened if regulators are given the necessary policy frameworks within which to work.

The right approach to assessing the cost of higher reliability against the benefits is difficult to achieve. Different approaches to calculating consumers' willingness and ability to pay for reliability could lead to different assessments of the costs and benefits. Furthermore, regulators have to grapple with the fact that currently there is a single reliability standard for the NEM but a diversity of consumer values as to the appropriate cost of that reliability.

Policy principles from the MCE should include guidance to the regulator on:

- the appropriate approach to establishing the value placed on different levels of reliability by the community;
- the appropriate approach to making reliability standards work for all different customer classes in the NEM including rural and regional, older, low-income, disadvantaged and consumers with particular health concerns;
- consideration of equity issues in the establishment of reliability standards including consideration of how standard setting will impact on consumers with low incomes and how consumers with a high value and high need for reliability but with limited means can maintain access;
- innovative approaches to setting reliability standards in the NEM given varying values and needs among consumers; and
- obligations to consider issues of affordability and access in its standards setting process.

Once again, CUAC would like to thank the AEMC for the opportunity to participate in this consultation process. If you have any queries or would like to discuss the issues raised in this paper further, do not hesitate to contact David Stanford on 9639 7600.

Yours sincerely,

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