The South Australian Council of Social Service (SACOSS)

Submission to the AEMC Review of Energy Market Frameworks in Light of Climate Change Policies

AEMC REF: EMO0001

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ISBN 978-0-908293-66-7

First published in August 2009 by the
South Australian Council of Social Service

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Scope of interest

SACOSS is the peak body for social services in South Australia, and is an independent non-government organisation with a proud sixty-year history of advocating for disadvantaged and vulnerable South Australians. SACOSS is a not-for-profit independent organisation whose members represent a wide range of interests in social welfare, health and community services. SACOSS is part of a national network assisting low income and disadvantaged people, and shares with its members the vision of *justice, opportunity and shared wealth for all South Australians.*

In its role as a peak body for community services in South Australia SACOSS covers a broad range of policy areas including the impacts of disadvantage on the most vulnerable South Australians. In recent years SACOSS has led or participated in debate and advocacy in the areas of consumer credit, electricity and gas, telecommunications, financial counselling, payday lenders, food security and gambling.

SACOSS welcomes the opportunity to provide a submission to the 2nd Interim Report of the AEMC (the Commission) Review of Energy Market Frameworks in light of Climate Change Policies (the Review). This submission is part of the Consumer Advocacy Panel-funded National Energy Market Reform Advocacy Capacity Building Project – South Australia.

SACOSS' interest in this review and this report is from the perspective of the vulnerable consumer. While it is a SACOSS view that all consumers have a strong, long term interest in energy markets adapting to more sustainable energy generation technologies, and in the market and infrastructure being resilient to the impacts of a changing climate, the ways in which this is achieved must remain cognisant of protecting the interests of the most vulnerable in society.

In the context of the Review, it is not the intention of this submission to provide detailed critique or endorsement of all of the elements discussed. The issue of retail price regulation stands out from this piece of work as being the odd one out. The removal of retail price regulation has long been a solution looking for a problem to solve, and it is unfortunate that this review has been used as another opportunity to reframe an issue as presenting a problem that can only be solved through the removal of retail price caps.

Introduction

This submission has as its main focus the area of price regulation in the context of the likely and possible negative effects of climate change policies on low income and vulnerable South Australian energy consumers. In this regard, SACOSS is concerned that the advice provided to the Ministerial Council on Energy (MCE) as the final step in the review process will be heavily weighted towards the concerns of energy retailers, and to the argument that additional price risks borne by retailers following the implementation of the Carbon Pollution Reduction Scheme (CPRS) and Renewable Energy Target (RET) are best transferred to consumers.

SACOSS finds that such an approach would ignore fundamental equity issues as well as the findings of a number of quantitative analyses that conclude low income consumers spend more on energy as a component of weekly expenditure than those on higher incomes, and can ill-afford to bear the brunt of additional carbon-related costs. Due to these concerns, this submission will focus mainly on Chapter 5 of the Commission's 2nd Interim Report and the recommendations contained therein.

SACOSS feels that the issue of consumer needs has not been met in the recent work of the AEMC, and that this is reflected in the 2nd Interim Report as in other AEMC publications. It is vital that low income and vulnerable consumers are adequately accounted for in any advice supplied to the MCE by the AEMC.

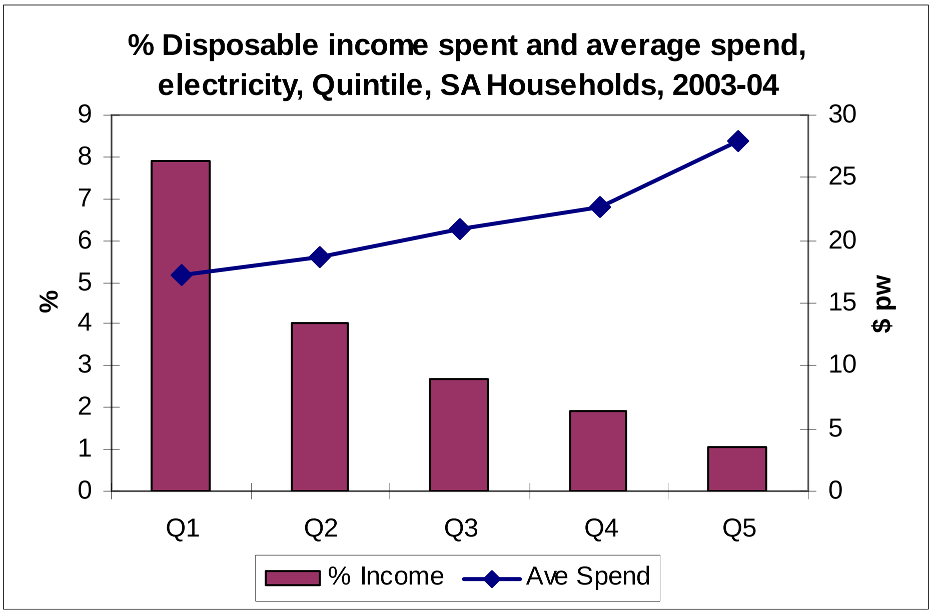
The AEMC has also not taken into adequate account the interaction between the impacts of the CPRS on the National Energy Market (NEM), and commitments made by the Commonwealth Government to assist households and coal-fired electricity generators through the Electricity Sector Adjustment Scheme (ESAS). This scheme will provide nearly $4 billion in assistance over five years to offset the negative effects on the competitiveness of coal-fired generation. The ESAS represents a significant measure in mitigating the carbon costs for coal-fired generators, and therefore for end users, and should to some extent offset the additional price risks for retailers in the first five years of the scheme.

Household assistance measures as outlined in the CPRS White Paper (Commonwealth of Australia, 2008), are considered in their approach to mitigating the worst price impacts of the CPRS on households. However, at the principle level, these commitments merely represent taxpayer funding of concessional treatment of generators and retailers alike if carbon costs are able to be passed through in an unsophisticated manner. Moreover, they represent an inadequate approach to what will be a significant additional burden on low income households. By not linking the approach to retail price regulation and the CPRS household assistance package, the ability of retailers to pass on any down-side risk is assured, without the same ability being provided to consumers.

The cost of energy in South Australia

It is no great secret that low income households spend significantly more on energy as a proportion of income than do others. Data from the 2003-04 ABS Household Expenditure Survey (ABS, 2005) shows that while electricity expenditure goes up with income, the percentage of income spent is significantly higher for the lowest income quintile (see Figure 1).

Figure 1: Electricity Expenditure by Quintile, SA



The recently released SACOSS *Cost of Living* (COL) paper (SACOSS, 2009) highlights the issues faced by low income and disadvantaged South Australians in providing for the essentials of life – housing, energy, food and transport. The COL found that electricity costs as reflected in the pricing tiers (standard and default contract prices) have risen at a faster rate than CPI (8.8%) since 2006 – ranging from 7.7% for Tier 2 to 14.7% for Tier 3. Significantly, electricity supply charges have risen by 21.2% over the same period. For a household with an annual usage of 4,900kWh, total costs have increase by around 11% over the 3 year period to March 2009 (SACOSS, 2009, p. 15).

Further data analysis shows that a single person household on Newstart Allowance (NSA) using 4,900kWh per year would spend around 7.5% of their weekly income on electricity, after accounting for the $120 per year state energy concession (SACOSS, 2009). This concession does not go so far as to cover the annual cost of the supply of electricity, which currently stands at $157.

Additional data also shows that the number of South Australian electricity consumers receiving the state energy concession has risen dramatically since Full Retail Contestability, from approximately 184,000 in 2003-04 to over 234,000 in 2007-08 (ESCOSA, 2008). This represents a rise of just under 28%. When considered in the light of a marked increase in the number of customers on instalment plans (119.5% between 2003-04 and 2007-08), the picture is clear — South Australian consumers are groaning under the weight of rising electricity prices before the onset of proposed retailer-driven carbon cost pass-throughs.

Household Assistance Measures outlined in the CPRS White Paper (Commonwealth of Australia, 2008b) may represent a commitment on the part of the Commonwealth Government to mitigate the worst effects of the CPRS on low- and middle-income consumers, but will only go so far. Treasury modelling indicates that electricity prices may rise by as much as 18% when the scheme is introduced, assuming an initial carbon cost of $25 per tonne (Commonwealth of Australia, 2008a).

This equates to an additional $4 on the weekly electricity bill for a household using 4,900kWh per year, or an additional 1.4% of weekly income for an NSA recipient (at March 2009), which will be offset by an increase to payments of 2.5%.

While electricity costs may be offset by the assistance package, it is unclear whether it will offset the full costs of the scheme. Energy embedded in other essential goods and services will cause further price rises which are unpredictable and which will impact disproportionately on low income and disadvantaged consumers. In South Australia, this will become evident as the water desalination plant comes online and the costs of infrastructure and the energy required are passed on to consumers. It is evident that the costs of energy need to be considered in the context of the aggregate costs of living in general, and that this needs to be reflected in any decision-making process such as the current Review.

Modelling undertaken for the Commission paints a slightly different and more disturbing picture, given the Commission's retailer-oriented focus. According to this modelling, there will potentially be a 'step change' in wholesale energy costs on a Long Run Marginal Cost basis of 10-30% in the first two years of the scheme (Frontier Economics, 2009, p. 14). Further modelling shows a potential difference in retail prices between a 'reference case' and the CPRS -5 scenario of 27% in South Australia over the 2010-2020 period (MMA, 2008), representing significant potential financial burdens on households should unregulated or mal-regulated price risk pass-through be allowed.

In this context, SACOSS is of the view that the Review must make allowances for consumers in its treatment of the additional burdens of the CPRS and RET, and not focus solely on the supposed needs of retailers and generators. It is vital that the Commission not lose sight of these needs, nor lose sight of what is essentially one of the key roles of retailers in the NEM: to hedge risks not just for their own sake, but for end users who do not possess the means to do so for themselves.

The AEMC case: regulated retail prices

It is unfortunate that the AEMC has invested vast resources in gauging the possible effects of the CPRS and RET on retailers, while largely ignoring the effects on consumers. The main recommendation of the AEMC in its 2nd Interim Report is to effectively hand the power for changes to regulated prices to retailers, if not to eliminate price regulation altogether. On page 50 of the Report, the AEMC states — in reference to its recommendation to provide more flexibility to retailers in price setting arrangements — that:

> *The case for this additional flexibility is strongest if products enabling retailers to hedge carbon-inclusive energy cost risk do not emerge in the short to medium term. This is more likely in the initial years of the CPRS.*

This statement is at odds with the Commonwealth Government commitment to a soft start for the scheme, which includes a delayed start; a fixed carbon cost for the first year; and the setting of relatively modest targets and slow early trajectories. Further it does not appear that the Review has adequately investigated why these hedges may not appear and whether or not there is a role to protect the consumer interest by doing so.

On Page 10 of the Report, the AEMC states that:

> *The CPRS and expanded RET will result in large and possibly unpredictable cost increases for retailers. These increases predominately flow from increased wholesale energy costs and the direct costs to retailers of climate change policies including acquiring carbon permits and RECs. Increases to prices and price volatility will place pressures on retailers to meet their prudential and credit support requirements in the relevant markets.*

There are a number of points to make regarding these comments. Firstly, the reference to the 'direct' costs to retailers of acquiring carbon permits and renewable energy credits is false. These costs will only *directly* affect energy generators, not retailers.

Secondly, analysis undertaken for the Commission during the Review process (AEMC, 2008) claims that the wholesale and (consequently) retail energy costs will rise significantly under the CPRS and RET. It is further claimed that these rising costs will be accompanied by price volatility, in many cases due to network congestion. This does not fit with further comments made in the survey of evidence – and based on work undertaken by ROAM (2008) on behalf of the Commission – which notes that network congestion caused by increased wind generation will be mitigated by the increased use of fast-start gas-fired generation plant. This will be contingent on the network operator (formerly NEMMCO, now AEMO) improving forecasting frameworks for wind generation. If this scenario eventuates, then congestion issues will largely be sidelined as a reason for changing regulation models to increase flexibility for retailers.

Finally, the Commission also contends that the trade in international carbon emissions credits will contribute to unpredictability in wholesale electricity markets, inhibiting the ability of retailers to sufficiently forecast or hedge against wholesale price rises. However given the wholesale price spikes caused by unprecedented weather events in recent years, it would appear that current hedging arrangements are either sufficient to manage significant price variations, or else retailers are not able to manage risks to themselves and therefore cannot be trusted to manage risks to customers, many of whom simply cannot afford to bear the costs of wholesale price volatility. Furthermore it is likely that the need to import international permits will be limited in the early stages of the scheme, and that international permit prices will not play a significant role in setting the national permit price.

Further, the Commission states that:

> *These costs will need to be passed through so that end use consumers receive the carbon signal embedded in energy prices and to ensure the effective competition in retail markets. Increases to energy prices should, in effect, increase the incentives for end use consumers to pursue energy efficiency strategies.*

This paragraph seems to imply that even an inefficient pass-through of costs to consumers is to be recommended, since they must be incentivised through increased prices to pursue energy efficiency strategies. It is important to remember that the purpose of a cap and trade emissions trading scheme such as the CPRS, as applied to something like the National Energy Market, is primarily to shift the merit order of the variously carbon intensive inputs to the market. If the purpose was to simply increase the cost to consumers to lower their consumption then a simple energy tax could have been implemented with much less grief.

In the context of incentivising household energy efficiency measures, it must be noted that there is less flexibility in this area for low income households than in those with higher incomes. While current schemes such as the Commonwealth insulation package may have some impact, low income owner-occupier and especially renter households are still limited in their capacity to purchase more energy efficient appliances, and do not have the same capacity to cut down on energy use as those with higher incomes.

These are just a few of the number of issues involved in the simple pass-through of wholesale costs to consumers that have not been adequately dealt with by the Commission, despite numerous submissions to the 1st Interim Report. SACOSS would draw the attention of the Commission to the positions of numerous consumer advocacy groups throughout the Review process to date. SACOSS broadly supports the principles behind these submissions, and notes that additional costs will undoubtedly be passed on to consumers in some form through current regulatory regimes, and these should be sufficient to avoid retailer failure under the new policies.

On this subject, SACOSS finds itself in the position of agreeing with the South Australian Minister for Energy. In his March 15th letter to the AEMC (Conlon, 2009), he states:

> *In regards to the flexibility of current retail price regulation arrangements to deal with potentially significant cost increases associated with the CPRS and expanded RET, the Standing Contract regulatory framework in South Australia has been shown to be flexible when adjusting for changes in underlying costs, while maintaining a transparent, justifiable process ....*
>
> *The AEMC's approach in this area has a strong focus on the needs of retailers. The public confidence achieved by independent oversight of retail pricing is considered to be especially important at a time of implementing such major changes as will occur with the commencement of the CPRS and RET.*

It would appear that these comments have not had any influence on this second report.

A principled approach to retail pricing

SACOSS believes that any approach to retail pricing and retail regulation in the energy sector needs to be informed by a principled approach that considers the needs of the low income and vulnerable in our community. While the need to take a considered approach to the issues raised by Commonwealth climate change policies for the NEM is recognised, it is important that the Commission not lose sight of the basis of any market: consumers. The Review process to date has not viewed issues around the market impacts of the CPRS and RET through the lens of social equity, or even the affordability of what are essential services – electricity and gas.

The attention of the Commission is drawn to the following set of principles, which if incorporated into its work would make its work more complete:

1. All Australians, regardless of socio-economic status, are entitled to reasonable access to sufficient quantities of essential services to maintain a healthy life.

2. Reasonable access is to be considered in terms of unit prices, any other fees and charges, as well as the terms and conditions of access imposed from time to time by private operators or private regulators.

3. The consumer experience of essential services encompasses a range of factors that tend to be far broader than the narrower scope of particular government agencies and portfolios or private companies.

4. While not all consumption of essential services is 'essential', not all is discretionary.

5. The circumstances of an individual or household may mean that demand for services is much higher than 'average', or that 'average' costs are unaffordable – a one-size-fits-all approach is likely to exclude the particularly vulnerable.

6. Affordability needs to be considered in the context of the overall cost of living.

SACOSS recommends that the Commission undertake to treat consumer issues with a level of modelling and sophistication equal to those applied to the retail and generation sectors.

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