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Re: COAG Taskforce on regulatory and competition reform

Dear Ms Page

The Energy Efficiency Council welcomes the opportunity to provide input to the COAG Taskforce on regulatory and competition reform (the Taskforce). The Taskforce has proposed processes to accelerate:

- Reforms to interconnected energy markets, to improve competition and efficiency of electricity networks to that energy regulation places greater weight on the outcomes for consumers.
- Reforms to rationalise carbon reduction and energy efficiency policies that are not complementary to a carbon price; or are ineffective, inefficient or impose duplicative reporting requirements on business; and

The Taskforce has proposed that the aim for this program of accelerated reform would be “lowering costs for business and improving national competition and productivity.”¹ The Energy Efficiency Council strongly supports this aim. If COAG wishes to deliver outcomes that substantially meet this aim, the data clearly indicates that it should focus on:

- **Reducing energy costs for businesses**

The majority of electricity price rises in recent years have been caused by network expenditure. Better network regulation, demand management and distributed generation would address peak demand and improve energy productivity, delivering the largest reductions in energy costs relative to business-as-usual. Increasing funding for consumer engagement and improving governance in the National Electricity Market (NEM) would support longer term change.

- **Eliminating duplication and ineffective programs**

Critical energy efficiency programs like the Energy Efficiency Opportunities (EEO) program and the proposed Energy Savings Initiative (ESI) aim to protect households and businesses from rising energy prices, and do not duplicate the carbon price. COAG should focus on eliminating genuine duplication between state and federal programs and eliminating ineffective state-based programs.

The Energy Efficiency Council will undertake a stock-take of current policies and consult with members to identify which programs should be eliminated. The Council already recommends establishing a national ESI to harmonise the state-based energy efficiency schemes in NSW, Victoria and South Australia.

- **Reducing red tape**

Red tape is best understood as unnecessary administration processes and duplication. In addition to reducing duplication, the biggest opportunities to reduce red tape are reducing overlapping reporting between EEO, the National Greenhouse and Energy Reporting Scheme (NGERS) and other programs.

¹ Taskforce Paper 2012 ‘29 June 2012 Taskforce Consultation - Summary of Reform Proposals’

Genuine outcomes in these three areas could deliver substantial benefits for businesses. The Council urges the Taskforce to avoid taking actions that may appease certain stakeholders, but would actually result in longer-term increases in energy costs. Removing key energy efficiency programs would reduce the ability of businesses to respond to rising energy prices and could exacerbate the rise in peak demand.

Furthermore, eliminating critical policies would increase uncertainty in sectors of the economy that have already been strained by legislative risk. The review of policies that are 'complementary' to a carbon price needs to recognise that:

- While some programs may deliver reductions in greenhouse gas emissions, this is incidental to the main goal of these programs. For example, the main goals of Minimum Energy Performance Standards (MEPS) are consumer protection and reduced consumer energy bills. Therefore, while these programs are 'complementary' to a carbon price, they are better framed as 'non-duplicative'
- For investors, whether they are energy users, energy suppliers or energy service suppliers, there is considerable uncertainty regarding the longevity of the current carbon pricing regime. Eliminating effective policies in 2012-13 that could be reinstated as early as 2013-14 would have major cost implications for governments and businesses.

The Energy Efficiency Council looks forward to working with the Taskforce to ensure that it delivers outcomes that genuinely benefit the community. Please contact me on 03 8327 8422 should you wish to discuss any of the issues raised in this submission.

Yours sincerely



Rob Murray-Leach
Chief Executive Officer

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1. Reducing energy costs for businesses

Electricity bills in Australia are rising rapidly. COAG should focus on tackling those measures that would have the most impact on ameliorating energy price rises by:

- Addressing the key factors driving up energy prices;
- Strengthening key measures that help households and businesses become more energy efficient; and
- Strengthening the role of consumers and competition in the energy market

1.1 The impact of peak demand on electricity prices

Increased network cost is the main factor driving up energy prices. In 2010 Professor Ross Garnaut estimated that 68 per cent of recent electricity price rises came from increases in distribution and transmission costs (see Figure 1). Network costs have continued to be the main driver of energy price rises, and distribution and transmission charges are now the largest component of electricity prices. In 2012-13, network charges account for 42 per cent of electricity prices (see Figure 2).

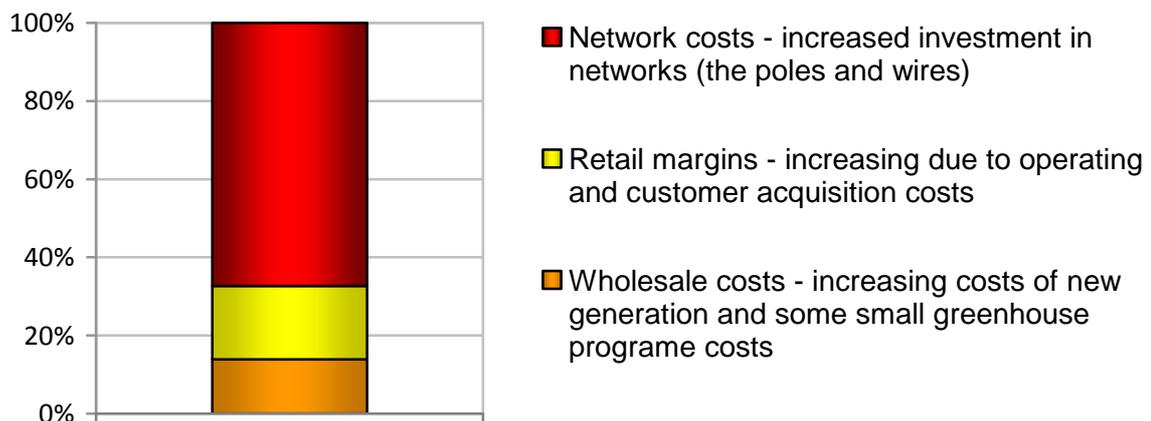


Figure 1: Contribution to electricity price rises

Source: Garnaut (2010) *Garnaut Climate Change Review Update Paper 8: Transforming the Electricity Sector*, Garnaut Climate Change Review, Melbourne.

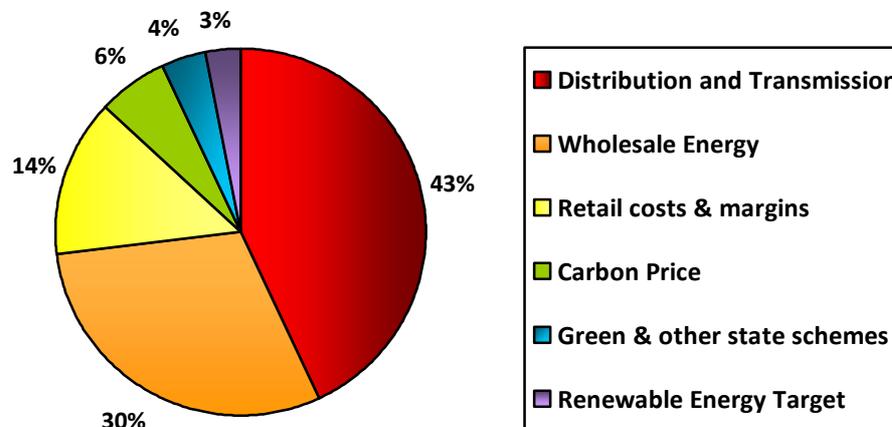


Figure 2: The main components of electricity prices 2012-13

Source: COAG Taskforce on regulatory and competition reform

Distribution and transmission costs are rising because the monopoly Network Service Providers (NSPs) that manage distribution and transmission are spending around \$45 billion over a five year period to upgrade the network. Much of this expenditure is considered avoidable. The Council suggests that the main factor driving expenditure distribution and transmission is rapidly rising peak demand (demand on a few hot hours each year), coupled with distorted incentives for NSPs to increase expenditure and regulated returns.

Peak demand also affects the second and third largest components of electricity bills - wholesale energy (30 per cent of prices) and retail costs and margins (14 per cent of prices). Wholesale prices have been falling, in part because renewable energy and reduced electricity demand have been suppressing wholesale prices. However, rising peak demand means that wholesale prices during peak periods are substantially higher than average prices. Furthermore, retailers need to expend significant sums on hedging to deal with peak demand periods that last just a few hours a year.

Peak demand is rising much faster than overall demand. Peak demand has grown by 30 percent between 1999 and 2010, from 26 GW to 34 GW. High peak demand means that billions are being spent on network and generation infrastructure that are only needed for a few hours a year. Recent work included in the Australian Government's Draft Energy White Paper suggests that around 10 to 25 percent of total energy bills are due to peaks that last just 0.5 per cent of the year. In other words, assets that are used for less than 40 hours a year account for a significant proportion of energy costs.

Unless peak demand is tackled urgently, low asset utilisation rates will become a far more serious problem than it already is. While energy consumption has declined in recent years, peak demand is still growing rapidly. The Australian Government's Draft Energy White Paper projects that \$240 billion of investment in infrastructure will be needed by 2030, and much of this is required to meet peak demand. The Draft Energy White Paper notes major challenges to deliver this scale of investment. Furthermore, as the cost of this infrastructure will be divided between fewer units of energy consumed, this scale of investment would see the cost per unit of energy increase substantially.

The reasons for this rapid growth in peak are well understood. Australia does not have a more serious peak demand problem than other high-income countries because of weather patterns or declining costs of air-conditioning units. It has a serious peak demand problem because the economic framework for cost-effectively reducing peak demand is under-developed. Currently, the vast majority of consumers pay only a fraction of supply during critical peaks and, unsurprisingly, this has led to overconsumption during critical peak periods.

Conversely, establishing an effective market system would reduce overconsumption during critical peaks and unlock the potential for energy efficiency, demand-response and distributed generation to reduce expenditure on network and generation infrastructure.

1.2 Key recommendations to reduce peak demand

While time-of-use pricing offers one route to unlock demand-response, practical issues and public concerns mean that full time-of-use and location-specific pricing will be exceptionally challenging to introduce in the next one or two decades. Furthermore, even with time-of-use pricing, there will still be significant information and bounded rationality problems that prevent consumers from acting on their own to optimise their energy demand patterns.

However, providing consumers with separately contestable services for energy supply and provision of demand-response into the wholesale energy market would enable consumers to be rewarded for reducing their demand during critical peaks, without requiring them to dispense of the valuable risk management services that they currently receive from energy retailers. Creating a new class of market intermediary to assist consumers to optimise their

energy demand patterns would benefit from the development of rules for intermediaries to provide consumer protection.

The Council believes that if this demand-side market was established it would also enable meaningful volumes of peak demand reduction to be developed by, and sold to, NSPs. This would help reduce expenditure on transmission and distribution infrastructure and partially address the split incentive, whereby the benefits of DSP are split between several parties.

However, fully realising the benefit of demand-side reduction to reduce investment in network infrastructure will require reforms to the way that NSPs are regulated and incentivised, to ensure that they are motivated to undertake and procure demand-side reduction. This should include:

- Ensuring that NSPs have the right incentives to invest in demand-side activities when they are more cost-effective than augmenting the grid;
- Strengthening the Australian Energy Regulator (AER)
- Setting minimum goals for peak-demand reduction that offsets grid investment; and
- Opening up some services to competition, such as demand-side deferral of network infrastructure and streetlight management.

This last point is critical. While some forms of infrastructure services may be suitably provided by regional monopolies, NSPs currently have near-monopoly control of other services that should be contestable, such as management of streetlights. In particular, where energy users and other market intermediaries can deliver demand-side services that reduce the need for network expansion they should be rewarded. Currently, energy users and other parties need to negotiate with monopoly NSPs to be rewarded for deferring network expenditure, despite the fact that in this role they are effectively competing with NSPs.

Finally, the nature of the energy market is evolving as the economics of generation technologies change. The NEM is currently designed around a model where a few large generators provide the majority of electricity, and this is transmitted over long distances to the site of energy use. Technology and price changes mean that distributed generation technologies like cogeneration, where electricity and other forms of energy are generated and used onsite, are becoming substantially more attractive. However, there are substantial barriers that impede the uptake of distributed generation.

For example, when an energy user wants to connect a cogeneration system to the grid they have to deal with the NSP. Connection times and costs are highly uncertain, can be ad hoc, and there is substantial asymmetry in negotiations between the energy user and the NSP. Furthermore, while the installation of cogeneration system could defer network augmentation, it is exceptionally rare for a cogeneration proponent to receive any payment for this service.

The Energy Efficiency Council set out a number of recommendations to improve the operation of the NEM in a recent submission to the Australian Energy Market Commission (AEMC)'s 'Power of Choice' review (attached). The Council recommends that:

- The AEMC continue this work on its current timetable; and
- COAG highlight its commitment to improving the role of demand-side activity in the NEM as quickly as possible.

1.3 Improving household and business energy productivity

Improvements to the NEM are vital, but some of these changes will take some time to implement and, on their own, these reforms will not address a number of price and non-price barriers that make it hard for households and businesses to respond to rising energy

prices. Measures that help households and businesses overcome these barriers will complement peak reduction programs and drive significant reductions in energy bills. While these measures may also reduce greenhouse gas emissions, this is only a side-effect of their primary aim, which is reducing barriers to optimal energy-use patterns.

Many businesses have the opportunity to reduce their energy use by well over 30 percent, including very low cost opportunities to reduce their use by 5 to 15 per cent. Australia is one of the least energy efficient developed countries, and this puts our economy at a competitive disadvantage. Between 1973 and 1998 Australia's energy efficiency increased by just 0.7 per cent a year, compared to 1.6 per cent a year in most other developed countries. The Council recommends a number of measures to improve energy productivity, including:

- Information programs like the Commercial Building Disclosure scheme
- Capacity building programs like the Energy Efficiency Opportunities program
- Minimum standards for appliances and buildings; and
- Establishing a National Energy Savings Initiative (ESI), which would both improve energy productivity and reduce red-tape by harmonising existing state scheme.

The intent of the ESI is to make it easier for households and businesses to respond to rising energy prices. The ESI is discussed more on page eight of this submission.

1.4 Governance in the NEM

The previous sections highlight the need for the energy market governance structure to respond smoothly and efficiently to changes in technology and other factors. The COAG Taskgroup consultation session with industry representatives in Canberra on 29 June 2012 highlighted widespread concern from across industry about the pace of adoption of retail price deregulation and other changes to the energy market.

The Council believes that consumers and other market participants need to have a much stronger role in governing the energy market. Participating in debates around the design and operation of the NEM in an informed and meaningful way is resource intensive. This creates a barrier to involvement in energy market policy and, as a result, consumer groups, non-profit organisations and industry associations have historically had limited involvement in energy market design. As a result, energy policy debates have been dominated by a small number of well-resourced NSPs and other organisations.

The Council recommends that COAG commission a review on how to improve consumer engagement in the design of the energy market. As a short-term measure, COAG should triple the amount of funding that is available through the Consumer Advocacy Panel to build the capacity of consumer and other groups to engage in energy market policy.

Secondly, the Council notes that it is extremely difficult to secure smooth and efficient change to the energy market while it is run by a system of seven governments. The Council strongly urges that the NEM governance be improved by:

- State and Territory governments transferring power for decisions to the Commonwealth; and
- Governments divesting themselves of electricity assets, which create conflicts of interest in regulatory decisions.

Finally, the AER needs to be substantially strengthened in order to improve its ability to regulate NSPs. The Council recommends that funding for the AEMC and AER be transferred from general revenue to a small surcharge on electricity.

2. Reducing duplicative / ineffective policies and red-tape

The Energy Efficiency Council believes that there is a genuine and legitimate need to:

- Eliminate climate and energy efficiency policies that are genuinely duplicative;
- Eliminate policies that are demonstrable ineffective; and
- Reduce red-tape, with a particular focus on reducing overlapping reporting between the EEO, the National Greenhouse and Energy Reporting Scheme (NGERS) and other programs.

However, it is vital that COAG focus on policy reforms that would deliver genuine benefits to businesses, rather than simply appease certain stakeholders. Eliminating some key policies under the banner of 'reducing red tape' would actually increase energy costs for business and increase uncertainty in sectors of the economy that have already been strained by legislative uncertainty.

2.1 Removing duplication and ineffective programs

The Council believes that the review should focus its assessment on programs that are duplicative and ineffective, rather than focus on the more nebulous term 'complementarity'.

There are a large number of programs that deliver substantial reductions in greenhouse gas emissions, but this is incidental to the main goal of these programs. For example, the EEO program is designed to build the capacity of energy users to improve their energy management. The EEO program has significantly improved the productivity of Australian businesses, helping over 200 companies to find over \$1.2 billion of annual energy savings. The result of improved energy management is significant reductions in greenhouse gas emissions, but that is not the main purpose of the EEO.

The EEO program tackles market failures that are not addressed by the carbon price, and therefore it is 'complementary' to a carbon price. However, EEO was not introduced to 'complement' a carbon price – it has its own rationale that is separate to reducing greenhouse gas emissions.

Similarly, the Energy Savings Initiative (ESI) is being considered to help households and businesses adjust to rising energy prices, rather than reduce emissions. The ESI should:

- Provide a positive price signal for demand-side activities to correct distortions in energy costs that are practically difficult to reform, such as cross-subsidisation for installing and using air conditioners.
- Enable third-parties to help consumers undertake coordinated demand-side activities at scale. This would address the structural imbalance in the energy market which encourages supply-side activities at scale but impedes delivery of demand-side activities at scale.
- Create an incentive for businesses to find ways to overcome well-known market failures that prevent the take up of privately cost-effective energy efficiency, including information barriers, bounded rationality and split-incentives.
- Enable market-transformation in the supply of energy efficiency goods and services, such as high-efficiency motors.

In fact, the intent of the ESI is to improve regulatory efficiency and reduce red-tape by replacing three state-based schemes, the NSW Energy Saving Scheme, the Victorian Energy Efficiency Target and the South Australian Residential Energy Efficiency Scheme.

Therefore, the Energy Efficiency Council recommends that COAG focus on reducing duplication between jurisdictions. While this is a more complex task than reducing duplication between policies within jurisdictions, it is far more valuable for business.

The Energy Efficiency Council will undertake a stock-take of current policies and consult with members to identify which programs should be eliminated. The Council already recommends establishing a national ESI to harmonise the state-based energy efficiency schemes in NSW, Victoria and South Australia.

2.2 Reducing 'Red Tape'

The term 'red-tape' is often used as a rhetorical device by groups to criticise effective policies that they do not support, sometimes simply because the group disagrees with the intent of the policy. Therefore, it is important to clearly define 'red tape' as unnecessary paperwork or effort.

The Council believes that the most effective ways to reduce red tape are to:

- Eliminate policies that are genuinely duplicative or ineffective
- Reduce overlapping reporting between EEO, the National Greenhouse and Energy Reporting Scheme (NGERS) and other programs.