



# A PLAN FOR AFFORDABLE ENERGY

OCTOBER 2012

Electricity prices have risen by over 50 per cent in the past five years. Without decisive reforms, electricity bills will continue to rise, largely due to network costs and coal and gas prices.

The Australian Industry Group, Brotherhood of St Laurence, CHOICE and the Energy Efficiency Council are deeply concerned about rising electricity bills and their impact on the businesses, consumers and vulnerable households we represent. We have joined forces because we share the same goal - making electricity affordable for Australians. We have agreed to a comprehensive package of essential reforms to achieve this goal, which includes:

- Developing a proposal to set distribution network companies minimum targets to reduce spending on new peak-driven infrastructure (poles and wires) through demand side activity.
- Helping consumers to improve their energy efficiency and get more out of each dollar that they spend on electricity.
- Ensuring that there is a robust system for protecting consumers, particularly vulnerable consumers: a national consumer energy advocacy body; giving consumers a formal role in the regulatory process; and giving consumer groups access to energy market experts.

The cost of building new network infrastructure was responsible for around 50 per cent of electricity price rises over the last five years, and network costs now account for around 40 per cent of household electricity bills. Replacing ageing

infrastructure, on its own, accounted for less than half of this cost. Without decisive action to ensure the networks are as cost-efficient as possible, network costs will push up electricity prices even further.

One way to help networks become more efficient is to reduce 'super peak' demand, which occurs on just a few days a year, normally during very hot or cold days. Around 25 per cent of electricity bills are driven by these 'super peaks', because we built infrastructure to meet peak demand and generation is more expensive during peaks. If we reduce super peaks it will help to make electricity affordable, while ensuring that the network is still reliable and households receive the energy services they need.

However, network costs aren't the only driver of future electricity price rises. Over the next decade the prices electricity generators pay for gas and coal are also predicted to increase, in turn pushing up electricity prices. This means it is essential to help energy users get more out of each dollar that they spend on electricity. Boosting energy efficiency will help households stay comfortable and improve business productivity while cutting electricity bills.

We commissioned energy market experts Oakley Greenwood to conduct a wide-ranging review of options to reduce electricity prices. The Oakley Greenwood report is an independent analysis and does not necessarily represent our views - it is intended to support public debate.



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We reviewed this report and jointly agreed to a number of recommendations. The key messages are:

- **Governments must take action now to reform the electricity market.** Some reforms can be implemented quickly and some will take time, but if we don't start the process now we will lock in billions of dollars in unnecessary infrastructure and higher bills for years to come.
- **Australia needs a package of strong policies, not just a silver bullet.** Any one policy, on its own, will only have a limited impact on electricity prices. A mix of policies is needed that engages all parts of the market: generation, networks, retailers and customers. We endorse a number of the recent recommendations by the Productivity Commission and Australian Energy Market Commission (AEMC) on demand-management and networks, but we need more than just these recommendations to make the energy sector as cost-effective as possible and support and protect consumers. Our package goes further by covering all sectors of the market, and also focuses on targets for networks, energy efficiency and protection for consumers.

Consumers, economists and regulators all now agree that electricity reforms are essential. It is time for action.

## A Reform Package for Affordable Energy

The Australian Industry Group, Brotherhood of St Laurence, CHOICE and the Energy Efficiency Council call on all governments and parties to support these urgent and long-term reforms:

1. **Enable consumers to sell demand response to the wholesale market at times of 'super peak' demand.** This would make electricity more affordable for everyone by reducing price spikes during periods of intense demand and by reducing the need to build new generation and network capacity for these very high demand periods. It would also increase competition in the energy market. This recommendation has also been proposed by the AEMC, and could be in place within two years. (Oakley Greenwood Report Option G-1)

### 2. Ensure that network companies are as cost-effective as possible.

- **Develop a proposal to set distribution network companies minimum targets** to reduce infrastructure investment driven by new peak demand. Network companies have a lot of experience in building infrastructure to meet demand, and very little history with peak-reduction projects that can be much cheaper. On their own, incentives will take a long time to change this. Setting network companies a minimum target to reduce new peak-demand-driven infrastructure investment, for example by 10 per cent against a baseline scenario over the regulatory period, would help them develop the experience and skills to use demand side measures. With the right incentives (see below), this learning process should ultimately allow network companies to reduce their spend on new peak infrastructure by far more than 10 per cent. Further work is needed on design options for these targets. (Option N-3c)
- **Increase the power and resources of the Australian Energy Regulator,** to ensure that it can properly oversee network investment decisions and make sure that they represent value for money. (Option N-1a)
- **Set network incentives to encourage cost-efficiency.** The way that network companies are currently remunerated doesn't maximise the incentive to avoid capital expenditure. Regulated rates of return for network expenditure must be reasonable, and should be set up to encourage cost-savings. Measures should include using either a capital efficiency carryover mechanism or a system that remunerates them based on the 'total' of both capital expenses and operating expenses, (sometimes called 'tot-ex'). This would provide an incentive for networks to be more economically efficient in their capital expenditure. (Options N-2a, N-2b)
- **Review the system for charging all generation (including cogeneration and local renewables) to connect to, and use, the network,** to ensure the system is fair and cost-effective. A well-designed system will result in better investment decisions, ultimately saving all end-users money. This would build on existing reviews,



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such as the AEMC review of the process for distributed generation connection.

- **Examine network reliability standards** and consider moving to a probabilistic system that would reduce the need for overbuilding networks, while meeting the critical needs of business and residential customers, including the most vulnerable. Victoria already uses this system and has both lower costs and good reliability. (Option N-4)

**3. Strengthen key energy efficiency programs** to help homes, businesses and government agencies save money. Key programs include the Clean Technology Investment Program, low-income energy efficiency programs and schemes like the Victorian Greener Government Building Program.

Governments should seriously consider a national Energy Savings Initiative (NESI), which must be developed carefully with thorough consultation to ensure that it will deliver overall community benefits without net costs for vulnerable households and trade exposed industry. Governments should consider program features in the design of a NESI that would reduce both peak and general demand, to reduce network expenditure, as well as features that would ensure low income households are able to benefit. (Option P-3)

**4. Take a segmented approach to time-of-use pricing and interval meters.** All energy users currently subsidise the higher cost of supplying energy during a few hours of 'super peak' demand each year. Time-of-use pricing can reduce 'super peaks' by 30 per cent and would put downward pressure on average energy bills. (Option N-3a)

However, governments must evaluate the impact of changes on vulnerable households and businesses, and bring in appropriate consumer protections, before they make changes in pricing and metering systems for smaller consumers. Governments should:

- Bring in time-of-use network pricing for large businesses now.
- Immediately undertake further work on the benefits and costs of time-of-use pricing for various segments of the community, particularly vulnerable consumers.
- Set up a series of roundtables in 2013 with business, consumer and welfare groups to look at options

for reducing peak demand in households and small businesses, including voluntary opt-in time-of-use pricing.

**5. Undertake monitoring of retail costs and margins to ensure the retail sector is competitive, flexible and meets consumers' needs.** Retail prices are still regulated everywhere outside Victoria, despite most regions having full retail contestability. Price regulation may not be the best way to protect consumers. However, the net impact of Victoria's deregulation remains poorly understood, with considerable competitive activity but community concerns about marketing efforts and retail costs. Governments should monitor retail costs and margins and assess the effectiveness of competition in all states as they deregulate prices, starting with Victoria, and publish the results. (Option R-2)

**6. Ensure consumers are protected:**

- Implement the National Energy Consumer Framework (NECF), as agreed by COAG, without further delay. Stronger protections to address time-of-use pricing and technologies like smart meters have been developed in Victoria, and should be introduced into the NECF as soon as possible. In the meantime, these additional protections should continue and be expanded on a state-by-state basis. (Option R-3)
- Ensure robust consumer protections for businesses, households and particularly for vulnerable consumers by: establishing a national consumer energy advocacy body; giving consumer groups access to energy market experts; and giving consumers a formal role in the regulatory process. (Option N-1b)
- Provide better tools so that consumers, including businesses and households, are able to engage effectively with their energy usage and receive the full benefits of future reforms, including providing consumers access to their consumption data, and allowing them to share this with third parties subject to privacy safeguards.



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