



public interest
ADVOCACY CENTRE

**Submission to the Standing Committee on
Economics Inquiry into impediments to
business investment**

11 May 2018

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training.

Energy and Water Consumers' Advocacy Program

The Energy + Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales, developing policy and advocating in energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- St Vincent de Paul Society NSW;
- Physical Disability Council NSW;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association;
- Tenants Union; and
- Mission Australia.

Context and background

Affordable, sustainable and reliable energy services are an essential component of the quality of life for Australians. Without this, the detriment to residential, small business, commercial and industrial consumers – and, as a result, the broader Australian economy – is significant.

The energy sector is currently in the middle of a major transformation in terms of technology, economics, business models, consumers' willingness and ability to take a more active role in their energy supply, and, necessarily, the supporting regulatory arrangements.

This transformation can deliver more efficient energy services to individual consumers and also deliver system- and economy-wide savings by allowing more cost-effective ways of providing affordable, sustainable and reliable energy services. But at the same time, it presents new risks, both to consumers and investors. The cost of managing these risks, and of the potential consequences where they are unmanaged, stands to grow over time. The risk of underutilising or stranding assets, both in the competitive and monopoly sectors, is prominent among these.

Energy policy and regulatory frameworks that balance appropriate levels of protections so consumers continue to enjoy energy supply now while enabling the innovation and investment needed for the future, will be key to realising the potential benefits and managing these risks in the transformation.

Response to the terms of reference

The interaction between regulatory frameworks across all levels of government and how the cumulative regulatory burden can be reduced to support greater business investment

While the policy and regulatory framework for energy is complex and imposes burdens on businesses, the essential question to consider is whether these burdens are proportionate to the harms they intend to prevent.

The potential harms to consumers stem from the fact that electricity is an essential service in a modern society. Broadly speaking, these harms are:

- Unnecessarily high prices due to inefficient markets – consumers may fail to receive the benefits of competitive markets due to a variety of factors including concentration of market power, barriers to new entrants, the existence of perverse incentives or a lack of transparency allowing for excessive profits to some participants.
- Inability to make informed choices – a lack of transparent, accessible and understandable information for consumers means that many are unable to choose products and services which reflect their actual preferences. PIAC considers that the retail electricity market has consistently failed to facilitate informed choices by consumers, resulting in what has been called a 'confusopoly'.

In order to address these potential harms to consumers, energy regulations must strike a balance by providing appropriate levels of protection whilst also removing barriers to entry and providing

the long-term certainty needed to enable the innovation and investment needed to unlock the full benefits of this transformation.

The following are examples of regulatory burdens which would need to be addressed:

- Proportionate obligations for new energy service providers – the transformation of the energy sector is leading to new products and services being offered which can supplement or completely replace the traditional, grid-connected electricity supply for many consumers. However, regulatory obligations imposed on the providers of these products and services have not kept pace. As a result, providers of some services are subject to unnecessarily onerous registration obligations, which discourage new entrants and raise costs for consumers without any commensurate improvements in consumer outcomes.

For example, under the current framework providers of demand response must register as retailers. Registering as a retailer includes significant obligations including prudential requirements which, while appropriate for a party providing a customer with their primary source of energy supply, is disproportionate for a party providing a complementary service such as demand response.

- Removing duplication in reporting requirements – energy businesses have multiple reporting requirements to different regulatory and oversight bodies, sometimes with overlapping data. Streamlining this and removing unnecessary duplication would remove a burden on the reporting business itself, and potentially remove a burden on stakeholders in managing potentially conflicting data sets.
- Ensuring consistency in reporting between businesses and jurisdictions – the format, content and data reported can vary between businesses and across jurisdictions. Removing unnecessary differences would remove a burden on regulatory bodies and stakeholders by making it easier to accurately compare different businesses and, as a consequence, improve transparency.
- Ensuring consistency in application processes between businesses and jurisdictions – energy businesses have often developed different processes and requirements for prospective customers, such as for customers seeking to connect distributed energy systems (such as rooftop PV systems) or even to get access to their own energy consumption data. Removing inconsistencies would reduce the burden and provide greater certainty to customers and stakeholders.

The impact of innovation policies, at the Commonwealth and State government levels, on business investment and the role of innovation policies in encouraging greater business investment, having regard to approaches taken in other countries

As noted earlier, the energy sector is undergoing a transformation. Innovation in technologies, business models and product or service offerings is vital to unlocking the full benefit of the transformation and sharing the benefits of affordable, sustainable and reliable energy supply throughout the economy.

There is a role for governments, through agencies such as the Australian Renewable Energy Agency (ARENA) and the Clean Energy Finance Corporation (CEFC), to foster innovation and bring energy products and services through to a commercially viable stage.

Further innovation in energy products and services could be fostered through the use of regulatory sandboxes. A regulatory sandbox is, broadly speaking, a framework within which innovators can test business ideas and products on a “live” market. While it remains under the relevant regulator’s supervision, the test is conducted without fear of enforcement actions in case it is determined that the innovation does not comply with existing regulations. This is usually subject to certain restrictions, typically focused on ensuring the protection of consumers and includes a finite amount of time for testing.

PIAC notes that regulatory sandboxes are being used by the NSW Government for relevant state-based regulations¹ and by the Federal Treasury and the Australian Securities and Investment Commission for fintech businesses.² Regulatory sandboxes specifically for innovative energy services are being run by the regulators in Great Britain³ and Singapore.⁴

The role that taxation policy, at the Commonwealth and State government levels, can have on the encouragement of new business investment

It is important that taxation policy does not drive perverse outcomes in the decisions that energy businesses make. Through ongoing engagement with network businesses regarding revenue, PIAC is aware of a perverse outcome arising from assets which are funded by developers being treated as assets ‘gifted’ to network businesses are taxed under the current framework.

In particular, this applies to new and upgraded network assets which are required to connect new customers to the network – for instance, a new release of land for a housing development. The cost of these assets is split between the developers (who recover their portion from building/land buyers/owners) and the network business (who recover their portion from energy consumers through the network component of electricity bills). The allocation of costs between the developer and the network business is set in the network business’ capital contribution policy, which is approved by the AER.

A perverse outcome arises where assets, such as land, are funded by the developer as these are treated as a ‘gifted’ asset to the network business. The up-front cost of assets that are gifted to the network business is recovered by developers through house prices. However, once they are gifted, the assets attract corporate income tax for the network business, which is passed on to consumers through the network component of their electricity bills, an outcome that would appear to be unintended under the relevant tax rules

Therefore, to reduce their tax obligations, the network business has an incentive to pay more of the cost of the assets themselves rather than obtain them from the developer.

¹ https://sandboxes.innovation.nsw.gov.au/ct/c_c.bix

² <http://asic.gov.au/for-business/your-business/innovation-hub/regulatory-sandbox/>

³ <https://www.ofgem.gov.uk/about-us/how-we-engage/innovation-link>

⁴ <https://www.ema.gov.sg/Sandbox.aspx>

However, the portion of the connection costs paid by the network business is added its Regulated Asset Base (RAB) for which they earn a regulated rate of return for its economic life of up to 40 to 50 years. Due to postage stamp network pricing, these costs are recovered from all the customers of the network – most of whom derive no benefit from the new infrastructure. For networks with a high volume of new housing developments this drives affordability issues for consumers.

Energy networks should be exempted from paying tax on assets that are ‘gifted’ as a result of new development, to remove the current unintended cost to all consumers that arises from the otherwise-appropriate causer-pays based recovery of new connections.

The role that energy policies, at the Commonwealth and State government levels, can have on the encouragement of new business investment

As noted previously, energy affordability is a pressing issue for many consumers. As a result, it is essential that the energy regulatory and policy framework allows consumers to make a trade-off between the price and reliability of the energy services delivered through the electricity network. Integral to this, is the fact that the energy supplied through the centralised network is not the only way to meet energy demand. The most efficient solution to providing affordable, sustainable and reliable supply involves complementing the centralised supply with other options including the use of energy efficiency, distributed energy resources (such as rooftop PV systems and storage) or demand response (being rewarded for reducing energy consumption for a finite period) – collectively known as Demand Management.

The role of demand management

Demand Management (DM) can provide far more cost-effective, flexible and scalable alternatives to large, centralised generation or network investments. DM solutions can often be implemented more quickly than other generation or network investments.

DM has the potential to provide multiple benefit streams by offering services and cost-savings to generation dispatch, system security, transmission and distribution networks, as well as to retailers. Therefore, in addition to reducing the electricity bill component of participating customers, it can reduce the total system costs which leads to cost savings for all consumers.

When compared to energy markets with effective mechanisms for demand response,⁵ the amount of demand response in the NEM is trivial. The involuntary load curtailment that blacked out some South Australian households in February 2017, made necessary by generator failures on the day, could have been avoided if just 100 MW (3% of the South Australian load) was voluntarily turned off. By comparison, more than 10% of Western Australia’s wholesale market capacity comes from demand response, as it is allowed to participate directly in the wholesale market.

PIAC agrees with Minister Don Harwin, the NSW Minister for Energy and Utilities, who highlighted the role of DM in meeting electricity demand:

⁵ For example, over 10% of the WA energy market’s capacity is sourced from demand response.

our old paradigm was based upon a notion of a baseload of energy demand being supplied by large thermal generators, and then a peak. Over the coming decades, this will change. This new paradigm is about better forecasting demand, factoring in intermittent sources, and then balancing the rest through dispatch and demand management.⁶

PIAC strongly supports measures to encourage demand-side participation in markets – this includes the wholesale spot market, the various ancillary markets which already exist in the NEM, and any new markets that develop in the future.

State and Commonwealth government (and COAG) energy policy is essential to bring about such reforms. The most pressing, as recommended by parties ranging from the Chief Scientist to the Australian Energy Market Commission, is to allow demand response to be deployed in the wholesale spot market for energy independently of energy retailers.

PIAC’s contention is that no market can be considered truly efficient or effective if it does not have optimal levels of demand-side participation, illustrated by the table below.

Stage in supply chain	Wholesale and system operation	Transmission	Distribution	Retail	Customer (behind the meter)
Role of DR	<ul style="list-style-type: none"> Alternative to expensive generation to meet peak demand Provide system security Provide ancillary services 	<ul style="list-style-type: none"> Avoid or defer capital investment Cost effective alternative to expensive interconnection investment 	<ul style="list-style-type: none"> Avoid or defer capital investment Provide power quality support 	<ul style="list-style-type: none"> Manage wholesale market exposure Manage retail market exposure 	<ul style="list-style-type: none"> Reduce consumers’ electricity costs Provide backup supply during outage
Necessary reforms or outcomes	<ul style="list-style-type: none"> Demand Response Mechanism (that is independent of retailers) 5 minute settlement 	<ul style="list-style-type: none"> Offering DR to consumers Provide products to allow consumers to self-select their cost-reliability level Ringfencing arrangements and network incentives to support DR 	<ul style="list-style-type: none"> Offering DR to consumers Network tariffs for DR Provide products to allow consumers to self-select their cost-reliability level Ringfencing arrangements and network incentives to support DR 	<ul style="list-style-type: none"> Pass on network tariffs and products for DR Provide products to allow consumers to self-select their cost-reliability level Offer retail DR products for wholesale price arbitrage 	<ul style="list-style-type: none"> Consumers are able to self-select cost-reliability trade-off Allow aggregation of individual consumers to provide DR portfolio
Essential	Coordination of services and products to overcome split-incentives and barriers to efficient use of DR				

Figure 1 The role of demand response in each part of the energy market and system

⁶ Don Harwin, “Securing a reliable and responsive energy market” CEDA’s Energy Series Lunch, 29 June 2017 < <http://energyconsumersaustralia.com.au/wp-content/uploads/Minister-Harwin-Securing-a-reliable-and-responsive-energy-market.pdf> >.

Continued engagement

PIAC welcomes the opportunity to meet with the Committee and other stakeholders to discuss these issues in more depth.