Unplugging the National Energy Market The ACCC tackles Australia's Energy Affordability Crisis

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On 11 July 2018, the Australian Competition and Consumer Commission (the "ACCC") released the final report in its year-long Retail Electricity Pricing Inquiry, calling for a complete overhaul of Australia's "broken" National Electricity Market ("NEM") and setting out 56 specific recommendations designed to restore energy affordability and market confidence.

The NEM

With over 10 million end users and a total generating capacity of almost 54,421 MW as of December 2017, the NEM is the network of transmission lines and cables that provides wholesale electricity across most of Australia (excluding only Western Australia and the Northern Territory). Energy retailers buy electricity through the NEM before on-selling it to residential, commercial and industrial consumers. The NEM became operational in 2006 and was intended to open generation and retail markets to competition with the aim of reducing energy costs. But, twelve years on, concerns about concentration and energy security still linger and, as electricity prices continue to skyrocket, it is clear that the NEM is not working as originally envisioned.

Key Challenges in the NEM

Concentration: Market concentration in the NEM has increased as a result of a number of acquisitions and closures.

Capacity and reliability: A generation shortage currently exists due to increasing demand coupled with decommissioning of generation assets, unreliability of aging infrastructure assets and under-investment in new generation, with South Australia's statewide blackout in 2016 and the 2017 load-shedding events in New South Wales and South Australia highlighting these capacity and reliability challenges.

These challenges have had a knock-on effect on pricing and market confidence. Over the last decade, residential consumers have experienced a real increase of 35% in their bills and a price increase of around 56% per kWh over the last decade. Between 2015 and 2017 alone, wholesale electricity prices on the NEM rose an average of 130%.

Previous enquiries into the NEM

The ACCC report is the latest result from a long line of enquiries into the NEM and the way it can be improved. After a previous enquiry, the 'Finkel Report' was released in June 2017 with three primary recommendations:

1. the establishment of a clean energy target
2. 3 year notice periods for retirement of existing large power stations
3. new reliability obligations for electricity generation

Following the Finkel Report, the Australian Government announced the National Energy Guarantee – a proposed policy mechanism designed to encourage new investment into the NEM in a way that balances reliability with lowering of emissions, requiring electricity retailers to invest in enough dispatchable energy resources to cover a set percentage of their peak load, whilst also meeting a defined emissions level for the electricity they purchase from the wholesale market.

The ACCC Report

With growing public debate surrounding the interplay between price, reliability, and sustainability, in March 2017, the Australian Government directed the ACCC to hold a consumer-based inquiry into the retail supply of electricity.

1. Why have electricity prices increased so quickly?
2. Is the current system fair to consumers?
3. What can be done to improve energy affordability?

On 11 July 2018, the ACCC delivered its findings and its blueprint for comprehensive and wide-ranging reform of the NEM.

What does the ACCC Report mean for you?

The suite of ACCC recommendations is broadly aimed at lowering network and supply chain costs, increasing capacity and competition in the energy sector and improving outcomes for consumers and businesses. Implementation of all or some of these recommendations will affect you - whether you are involved in the energy sector at the regulatory level, as a market participant or simply as a consumer of electricity.

What are the key proposals?

Reduction of network and supply chains

The ACCC found that the bulk of the electricity price increase across the NEM over the last decade can be attributed to higher network and supply chain costs, with billions of dollars of over-spending on network assets and the cost of compliance with government reliability standards being passed through to electricity users.

To reduce these costs, the ACCC recommends that State governments write-down the value of their energy assets in order to remedy past over-investment. This is likely to have the greatest effect in Queensland and Tasmania, where energy assets remain publicly owned. Where electricity networks have been privatised, the ACCC proposes other counter-measures to offset the impact of over-investment, including government rebates for network charges in NSW and removal of network tax in Victoria.

The ACCC also supports State government funding of premium solar feed-in tariff schemes, tightening of eligibility for existing tariffs and a wind-down of small scale renewable energy schemes, all designed to minimise the pass-through of costs. According to the ACCC, the renewable energy subsidies distort investment towards renewable energy generation without regard to reliability of energy supply to the market.

Increasing capacity and boosting competition

The ACCC identified monopolisation as another driving force behind higher energy prices and is calling for the regulatory framework to be strengthened, giving the Australian Energy Regulator wider powers to investigate and punish market manipulators.

To reduce market concentration and diversify ownership of generation assets, the ACCC proposes a ban on acquisition of additional generation capacity by market participants with a market share of 20% or more in any region or across the NEM as a whole, although investment in new generation would still be permitted. The ACCC also endorses the division of the Queensland government's generation assets into three separately owned and operated portfolios to create wholesale competition in the region.

At the same time, the ACCC recommends the introduction of government support to encourage smaller players in the energy sector to invest in dispatchable generation, including the use of renewables supplemented by gas battery storage and hydroelectric generation as an alternative to traditional coal and gas-fired power and federal government-backing of long term contracts for large commercial and industrial users. These initiatives align with the National Energy Guarantee objectives, incentivising investment that balances capacity with sustainability as part of a settled policy framework.

The ACCC also targets market manipulation through hedging, proposing transparency measures requiring reporting of "over the counter" wholesale trading to a central registry.

Improving consumer and business outcomes

The ACCC Report is particularly critical of energy retailers who "have made pricing structures confusing and have developed a practice of discounting which is opaque and not comparable across the market". The ACCC's recommendations in the retail sector include new requirements for the calculation and advertising of pricing and discounts. In particular, the ACCC recommends moving away from "standing offers" to a "default rate" established by the energy regulator and requiring discounts to be benchmarked against default rate to improve consistency and comparability across the market. The ACCC also proposes an overhaul of arbitrary, excessive and punitive "pay on time" discounts and removal of these and other conditional discounts from headline advertising claims.

In addition, the ACCC seeks the implementation of mandatory codes of practice which would require comparator websites to make recommendations on the basis of customer benefit, without regard to commission-earning potential as well as improvement of government concession schemes.

The ACCC consumer affordability measures are intended to apply equally to businesses, with additional specific recommendations designed to improve business outcomes, including the establishment of targeted initiatives for improving electricity market awareness among small businesses and the funding of organisations to provide tailored retail electricity market advice. The ACCC also highlights the potential implementation of hardship policies in the future to assist small businesses struggling to pay their energy bills.

How Can We Help?

Implementation of the ACCC recommendations will undoubtedly translate into lower earnings in the energy sector unless practical measures are taken to counteract the impact – we will be keeping an eye on government responses to the ACCC Report and can guide you in navigating this dynamic landscape, ensuring that you get ahead and stay ahead of the curve.

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