



20 December 2013

Economic Regulation Authority  
Inquiry into Micro-economic Reform in Western Australia  
PO Box 8469  
Perth BC WA 6849

Lodged (by email): [publicsubmissions@erawa.com.au](mailto:publicsubmissions@erawa.com.au)

### **Inquiry into micro-economic reform in Western Australia**

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Economic Regulation Authority's Inquiry into micro-economic reform in Western Australia discussion paper.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 36 electricity and downstream natural gas businesses. These businesses own and operate some \$120 billion in assets, employ more than 51,000 people and contribute \$16.5 billion directly to the nation's Gross Domestic Product.

This submission focusses on two aspects of the ERA's discussion paper: time-of-use (TOU) pricing for the use of government infrastructure and the domestic gas reservation policy. These are two key issues for the energy industry. It is also necessary to discuss other energy market issues in order to set the scene for a discussion on TOU pricing.

#### **Pricing structures in energy markets**

A full consideration of pricing structures in energy markets must go beyond consideration only of TOU tariffs. A range of different tariff structures exist, of which TOU is only one variant. New tariffs must be accompanied by strategies to encourage customer adoption and acceptance. The esaa has engaged Deloitte to investigate the merits of different tariff designs by examining the effectiveness, simplicity, stability, equity and likely consumer acceptance of a range of current and potential tariff designs. The esaa will make this report available to the ERA following its public release.

The ability to introduce certain types of tariff structures, including TOU pricing depends on appropriate metering technology. Upgrading the metering stock in a cost-effective manner will take time.

In the meantime, simpler reforms to energy pricing are needed to encourage more efficient use of the WA energy systems.

### *Cost reflective tariffs step 1 – recovering the costs of supply*

First of all, tariffs need to reach cost-reflective levels. Despite recent price rises, retail energy prices in WA are currently below cost reflective levels. WA is still catching up after ill-advised policies to freeze electricity prices for over a decade. Recent increases have only partially made up the shortfall between the retail tariff and the cost of supply. In its recent report into the efficiency of Synergy electricity tariffs, WA's Economic Regulation Authority found that prices remained around 23 per cent below cost-reflective levels.

With network prices only increasing at close to CPI in Western Power's current access arrangement period and the repeal of the carbon tax likely, there is an opportunity for electricity prices to reach cost-reflective levels without drastic price rises.

### *Independent price setting*

While the esaa considers effective competition to be the best way to determine efficient gas and electricity prices, we acknowledge that there is a role for a regulator to set a 'back-stop' price while competition develops.

The recent Strategic Energy Initiative (SEI) Final Paper acknowledged this. It stated that "establishing independent price setting for regulated tariffs in retail electricity and gas markets, subject to a transparent and consistent regulatory framework based on economic principles and adequate customer protection frameworks," could be considered.

The esaa considers that an independent regulator should be able to set regulated tariffs for both retail gas and electricity. Allowing an independent regulator, to determine and set prices allows for a more transparent and consultative process. The state government should remove itself from the business of setting energy prices, as the spectre of political intervention will otherwise overshadow the development of a robust, competitive retail market. There are two pre-existing bodies that could fulfil this role: the state economic regulator (ERA) and the national Australian Energy Regulator (AER).

### *Opening up markets to competition*

Effective competition will also help to keep prices in check. This can also spur innovation in pricing which could help reduce the impact of peak demand and delay or negate network infrastructure upgrades. The situation in eastern states is an excellent example of the benefits of competition for consumers, as households have the option to sign on to a variety of market offers which are up to 20 per cent below the regulated price.

To drive competition in energy markets, two changes are needed: prices need to reach cost-reflective levels, and the retail electricity markets needs to be opened up to businesses other than Synergy. Small gas users are starting to see the benefits of competition since Kleenheat began supplying gas to WA households. But without prices in both the gas and electricity retail markets reaching cost-reflective levels, there will be minimal incentive to enter the market.

Once prices are at cost-reflective levels, electricity markets should be opened up to full retail contestability. WA households should be able to choose their electricity provider and benefit from competition in the sector.

### *Cost reflective tariffs step 2 – price signals for network usage*

The way we currently pay for electricity was designed in the 1960s and 1970s. It was based on a relatively simple electricity system, with power being dispatched from huge generators to our homes and businesses via an intricate network of poles and wires. Most of the cost of paying for this network was just added to the price of each kilowatt-hour of electricity we used. It was a relatively simple system that served energy consumers adequately in a simpler time.

Those days are gone. The 21st century has seen the start of a transformation in the electricity system. The big changes have been the rapid uptake in energy-hungry domestic appliances – especially air conditioners – and rooftop solar PV panels. Together these technologies have done two things: drive new costs in upgrading the capacity of the electricity network and rendered the old flat rate network charging scheme redundant and inequitable. An increasing proportion of consumers no longer pay their fair share of network costs. What most of these consumers do not realise is that the costs they avoid are pushed onto other users, in particular low income households and those in rental accommodation.

If this problem is not dealt with as the Government unwinds the current electricity subsidies it could lead to a “death spiral”, where the effect of more solar and more air conditioners is driving up tariffs and making more households switch to solar to reduce their power bill. If electricity tariffs aren’t corrected to reflect the new realities of generation and use, power pricing will continue to become more and more unfair with some households forced to carry a disproportionate burden of the cost supplying electricity.

The way we charge for using electricity networks needs to better reflect the way we generate and use electricity. Electricity networks have been transformed by the increased uptake of new technologies like air conditioners and solar PV. And there are more changes coming, from battery storage to electric cars. It's important the way we charge for using the network reflects these changes and remains fair for everyone.

In this context, TOU may play a role, but even more important is to recognise the largely fixed costs of providing network services. Ideally, this element of tariffs would vary with a customer’s maximum demand, but this requires appropriate metering equipment and customer education. Rebalancing tariffs towards fixed costs may assist in the interim, although the industry and Government must be mindful of the welfare impacts of such a move. These may be addressed with well-targeted concession framework.

The issues are not as acute for gas as for electricity. Nonetheless, the mismatch between peak demand as the driver of network costs and a tariff structure primarily based on variable usage exists in gas too. Accordingly, similar principles apply in considering how tariffs may be made more cost-reflective.

## **Domestic Gas Reservation Policy**

The Western Australian domestic gas market has had to compete with Australia's lucrative liquefied natural gas (LNG) export industry for some time. This is principally due to the extensive gas fields located off the Western Australian north-west coast requiring a scale of operation in excess of that needed to satisfy domestic demand. While this has historically provided domestic customers with access to gas – subject to some form of government intervention – that may not have otherwise been available, the supply/demand balance has tightened considerably in recent times.

Unlike the east coast, the existence of a range of wholesale gas market rigidities specific to Western Australia have constrained the development of a competitive and secure domestic gas market. Current characteristics of the Western Australian wholesale gas market include: limited diversity of supply; infrastructure capacity constraints; limited price transparency; and increasing energy costs.

In recent years, a number of initiatives have been pursued, supported by the findings and recommendations of the Gas Supply and Emergency Management Committee's Report to Government and the Inquiry into Domestic Gas Prices. These include the development of a Western Australian based Gas Bulletin Board and Gas Statement of Opportunities, as well as investment in additional gas storage at the Mondarra Gas Storage Facility. Despite this progress the reform process remains largely incomplete, particularly with respect to the upstream gas market.

Given these constraints, domestic gas users have concerns as to whether or not LNG producers would commit to providing domestic gas supply at volumes and prices more consistent with a well-functioning market in the absence of a gas reservation policy.

While the Western Australian Government continues to apply a gas reservation policy, the esaa is supportive of measures that ensure it is applied in a manner that promotes certainty and allows predictability of new supply in the domestic market. Variable application of the policy can create uncertainty, which increases the risks for LNG producers subject to domestic gas obligations as well as for domestic gas producers and consumers trying to anticipate new sources of supply.

Any questions about our submission should be addressed to Ben Pryor, by email to  
or by telephone on .

Yours sincerely

**Kieran Donoghue**  
General Manager, Policy