Professor Alan Finkel
Office of the Chief Scientist
10 Binara Street
Canberra City ACT 2601 Australia

2 December 2016

Dear Professor Alan Finkel,

RE: The Finkel Review and the need for a reformed National Electricity Objective

We welcome the establishment of the Finkel Review "to develop a national reform blueprint to maintain energy security and reliability in the NEM", and note that the review is also seeking to consider how to best integrate climate and energy policy. This review also comes as the Federal Government has signed on to the Paris Agreement to limit global warming to below two degrees and to reduce Australia's emissions by 26-28 per cent by 2030.

This letter from a diverse range of energy consumer, industry, local government and environmental organisations argues the need for the National Electricity Objective (NEO)[1] to be reformed as part of any effective national reform process. From our collective experience, the current Australian electricity market framework perpetuates carbon-intensive patterns of electricity generation, and its legal frameworks limit the ability for change to occur[2].

We consider that the current wording of the NEO is no longer fit for purpose as it defines the long term interest of consumers in terms of economic efficiency alone, and does not provide decision makers with the appropriate framing to deliver a decarbonised energy system in the coming decades.

Even in strictly economic terms, Australia's energy market bodies have failed to interpret the NEO consistent with the *long term* interest of consumers. Multiple major climate change reviews such as Stern and Garnaut have emphasised that climate change mitigation, including the decarbonisation of the electricity sector, are far less costly the quicker they are undertaken.

Meanwhile, Australia's national emissions reduction and renewable energy policies have been implemented as externalities. This is one of the main drivers of significant inefficiencies in the market reform process that has led to concerns about system security, and the need for this very review. It is not technology change per se that impacts power system security. Rather it is *failing to prepare for technological change* that lets system security down.

[1] As it currently stands the NEO is
"…to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—
(a) price, quality, safety, reliability and security of supply of electricity; and
(b) the reliability, safety and security of the national electricity system."
[2] http://www.unswlawjournal.unsw.edu.au/sites/default/files/394-12.pdf

We also understand that this review needs to examine gas and electricity markets as a whole. As such it may be appropriate to examine the need for seperate electricity and gas objectives and to review the role of gas and governance issues associated with gas in the east coast market and the energy market as a whole.

It is clear that while external policy levers such as the Renewable Energy Target (RET) have been successfully delivering massive technological change, the market's regulatory bodies – being guided by the current NEO – have not acted in expectation of this rapid change. Thus the NEO as it stands has demonstrated itself to be incapable of delivering its core objective of a secure system for the long term interests of consumers, in the presence of significant external forces on the NEM.

This narrow approach is not the only one available to market bodies. The current *Australian Energy Market Agreement* has as one of its objectives to "address greenhouse emissions from the energy sector, in light of the concerns about climate change and the need for a stable long-term framework for investment in energy supplies." The AEMC itself notes the integration of energy and emission reduction policy as a key requirement to maintain and enhance an efficient, safe, secure and reliable energy system[3]. However, policy-makers, rule makers and regulators to date have largely ignored the non-legally binding AEMA.

Evidence[4] of our collective experiences of NEM reform that highlight the limitations of the current NEO in achieving an equitable, just and smoother transition to a decarbonised energy system include the following:

1. The generally glacial pace of reform, with reviews, rule change processes and implementation delays together leading to reforms taking up to a decade to implement.
2. The Transmission Frameworks Review, and subsequent Optional Firm Access Review in which the AEMC appeared to undertake an academic exercise in economic perfection rather than designing a practical solution for the electricity market.
3. Incomplete assessment by the AEMC of the recent Local Generation Network Credit rule change proposal, or viable alternatives that would incentivise efficient local generation and reduce total system costs as proposed by the City of Sydney, Property Council of Australia, and the Total Environment Centre.
4. Barriers imposed by the networks to cost effective connection of renewable and low carbon energy generation, particularly for mid- and smaller-scale projects
5. Challenges facing the economic viability of mid-scale renewables projects, including the difficulty negotiating a good power purchasing agreement (PPA) with a retailer; the cost of grid-connection; and the high cost of using the grid, even if just transporting energy a short distance.

[3] http://www.aemc.gov.au/getattachment/d253a27d-cc1e-4dc8-9bd3-ed5e629db2a2/AEMC-Year-in-Review-2015-2016.aspx

[4] We would be happy to provide more detailed evidence of these issues if requested.

6. Lack of consideration of non-network options, including the social and environmental costs and benefits of different investment decisions, in revenue determinations and Regulatory Investment Tests and the delayed consideration of and then implementation of the Demand Management Incentive Scheme.
7. Slow and inconsistent tariff reform
8. The poor performance of Australian networks in relation to demand management and related R&D of new technologies and services.
9. How generator or gentailer investment decisions affect the wholesale market merit order.
10. Consideration of the role of energy storage, dispatchable renewables, smart inverters etc in increasing power system security.
11. The lack of any mechanism to reduce network asset valuations in light of reduced grid utilisation.

Should the Finkel Review be open to recommending reform of the NEO, we would like to offer the following suggestions for possible mechanisms:

A. By reinterpreting the current NEO. This could be achieved by separating out the long term interest of consumers from the 5 sub-objectives (price, etc.), or by arguing that price should include the costs of climate change mitigation and adaptation and the health impacts of fossil fuel generation.

B. By including a decarbonisation or broader environmental sub-objective such as:

   i) Australia's national and international carbon pollution reduction targets, or

   ii) The environmental consequences of energy supply and consumption, including reducing carbon pollution, considering land use and biodiversity impacts, and encouraging energy efficiency and demand management.

   iii) Alternately the NEO could be changed to refer to “Total system cost” instead of price, to permit a broader interpretation of the long term interest of consumers.

C. By the COAG Energy Council issuing a Statement of policy principles pursuant to Clause 8 of the National Electricity Law, requiring the AEMC to consider either:

   i) Decarbonisation or a more general environmental objective, or

   iii) A longer term, broader and more inclusive definition of economic efficiency, in carrying out its rule-making a reviewing functions.

D. As a fallback option, by proposing a rule change to require market bodies and participants to issue carbon impact statements in relation to major regulatory or investment decisions.

To be clear, we are not arguing that market bodies should be responsible for achieving decarbonisation policies and targets. Rather we are seeking to ensure that the National Electricity Rules in particular do not effectively hinder the achievement of those outcomes by

slowing the pace of reform or otherwise placing unnecessary barriers in their way. Instead we seek a situation where market bodies foster rules, policies and regulatory decisions that create win-win situations.

Other jurisdictions (including California, Ontario, Denmark, New York and the UK) have successfully integrated climate or environmental objectives in their energy system regulatory regimes. The NEO already has multiple potentially conflicting sub-objectives (especially price versus reliability), and overseas experience shows that environmental outcomes can be integrated without making life impossible for regulators and other market bodies.

Finally, we note that we are not alone in calling for the NEO to be reformed. A diverse range of prominent and experienced Australians who commissioned the new report *Our Energy Future: A plan to transition Australia to clean energy* also recognised the need for urgent reform.

We wish you all the best with your challenging task and look forward to working closely with you on reforming the energy market to more comprehensively consider the long term interests of consumers. Our organisations would welcome the opportunity to contribute further during the public consultation phase of your review.

Regards,

The Northern Alliance for Greenhouse Action
Total Environment Centre
Community Power Agency
Goulburn Broken Greenhouse Alliance
Moreland Energy Foundation
City of Sydney
Alternative Technology Association
Central Victorian Greenhouse Alliance
Australian Sustainable Built Environment Council

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