Clean Energy Council

5 November 2012

Mr Paul Kerin
Chief Executive Officer
Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

Dear Mr Wilson,

Re: 2011-2014 Electricity Standing Contract Price Determination – Wholesale Electricity Cost (WEC) Investigation

The Clean Energy Council (CEC) welcomes the opportunity to respond to ESCOSAs *Electricity Standing Contract Price Determination – Wholesale Electricity Cost Investigation*[1]

This review comes at a time of heightened concern about the cost of electricity, and also substantial uncertainty in the investment community about the policy environment for new large scale generation projects. As a result the final determination by ESCOSA in this area is of particular significance to many CEC members and the public more generally.

The WEC allowance has a particular impact on the clean energy sector through its influence on the return potential investors can secure from new projects, principally those developed to meet the Commonwealth's Renewable Energy Target (RET) legislation.

Investment risk driven by policy uncertainty has been a major barrier to project proponents, first as a result of debate over the Commonwealth's Clean Energy Future package, then the review of the RET, coupled with state level changes in areas such as planning guidelines and now regulated electricity prices.

ESCOSA has noted in the draft determination discussion paper that the policy uncertainty in recent months has materially affected the energy market, which is why a reversion to the Electricity Purchase Cost (EPC) approach to price regulation was rejected during the previous price determination process.

Although market conditions have, to some extent, improved since then, this should not be misinterpreted as signalling that the investment climate for new projects – particularly new large scale clean energy projects – has dramatically improved in that time.

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1 The views expressed in this submission cannot be taken to represent the views of all member companies of the Clean Energy Council, however they do reflect a broad shared view.

The CEC is therefore wary of any further shifts in policy by governments or regulatory agencies as we approach the critical period for new projects to be committed to meet the statutory RET target. However well-intentioned they might be, further changes in regulation now simply make it more difficult to get new projects financed and developed. This is all the more important if the changes proposed have a material impact on the long-term financial viability of long-lived energy projects. The very fact that ESCOSA, having switched from an EPC to Long Run Marginal Cost (LRMC) methodology previously and is now proposing to switch back, is in itself creating regulatory risk for investors and seems contrary to the objective of long term protection of consumer interests. We also note that the LRMC methodology previously adopted by ESCOSA was generally consistent with the long term character of energy projects. The EPC approach, in short, is not.

The need for new investment

The CEC understands that ESCOSA are aware of the points raised above, and that in simple terms it's their view is that new projects are not inherently needed to meet consumer demand, and that requirements of legislation like the RET are not appropriate considerations for ESCOSA in making its decision in this matter. We fundamentally disagree with this position.

Not only is the RET a national obligation, which state governments endorsed, but the South Australian Government retains its active commitment to a 33 per cent renewable energy target, which whilst not legally binding, is nevertheless the policy of the elected Government and thereby sets the context for the work of ESCOSA. It seems incongruous to the CEC that a government can clearly define a policy position which is then ignored by its own regulator who has the power to see that the commitment is met efficiently and effectively, at lowest possible cost to consumers.

While the SA energy market might have sufficient capacity overall at the present time, energy projects are long lived and have long lead times. Projections about electricity demand by the Australian Energy Market Operator have proved unreliable in recent years and undermining the case for new investment now based on a forecast that is volatile is a major gamble. Following an EPC approach only reinforces that gamble by comparison to the stability that is delivered by ESCOSA's existing LRMC-based methodology.

What this means for the WEC determination

The CECs main concern is how the formula used to regulate prices affects investment conditions. Having the formula change and change again is unhelpful, having a formula that potentially undermines the level of retail competition is also unhelpful, and responding to those concerns by saying that if conditions change yet again in the coming months the formula can then be changed again is particularly counterproductive to creating a positive investment climate.

Lowering consumer prices

There is enormous public concern with the level of increases to electricity prices in recent years. While renewable energy programs have made only a modest impact on those increases, we are acutely conscious that the public's awareness of the real price drivers (such as international market pressures, infrastructure renewal and so on) is limited and their tolerance to pay higher prices is also limited.

However, it is our understanding that the WEC component would be reduced regardless of whether an LRMC or EPC based approach was adopted by ESCOSA due to the falling capital costs for new generation infrastructure. This is clearly important. This fact, coupled with the fact that the cost of the RET and feed-in tariffs are at their peak now and will reduce substantially over the next few years, mean that consumers will see relief in their prices in the short term either way. Reform to the real drivers of price increases – network investment decisions – is being pursued by a raft of bodies from the AEMC, the federal Senate (through their recently released report into electricity prices) and State and federal governments through COAG. The success of these processes is the precondition for containing cost pressures in the medium and longer term. Sacrificing investment grade market settings now, for a temporary relief is a mistake. Moreover, failure to support new investment in the short term could lead to spikes in wholesale prices in the medium term if demand rebounds, as many experts expect it to.

To discuss this submission in more detail please contact me on or 03 9929 4113 or at Russell@cleanenergycouncil.org.au.

Yours sincerely

[original signed]

Russell Marsh
Policy Director