

The NEM is broken, bring on NEM 2.0

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Until about 12 months ago the National Electricity Market was world renowned for its consistent economic and technical performance under a wide range of market conditions over a long period.

Over the years I have been asked why had the NEM been so stable while other electricity markets had suffered from damaging policy flip flops and regulatory and government meddling which played havoc with investors and raised prices.

Until recently, I would reply that the reason we had such an effective, stable market was because we had a solid basis of market governance that would provide investors with confidence to make the necessary investment decisions and a price setting mechanism that could withstand just about any market or technological challenge.

The NEM used to be a marvel of micro-economic reform in this country and was a shining example of what could be achieved with co-operative federalism. But no more.

Sadly, successive Federal government policies over recent years have undermined the effectiveness of the NEM and, with the adoption of Finkel's recommendations, we are set to follow the same course as other markets into the interventionists' pit. This will lead to a never ending loop of price rises and meddling, like it has in other markets. Investors will sensibly abandon such a market, leaving governments to fill the void.

While there has been a distinct downward trajectory in the NEM, starting from 2008 onwards with the 'carbon wars', there was a particularly sharp downturn with the blackout in SA. This event unleashed a political firestorm, started by the Prime Minister. He immediately attacked SA for its warm embrace of renewables – remembering of course every facility in SA has been funded by the Commonwealth and the ACT governments. This is a fact the Prime Minister does not want to become public knowledge so he repeats his attacks on SA loudly and regularly.

From that point on the PM and his Energy Minister, Josh Frydenberg, threw co-operative federalism out the door in an effort to shift the blame for the rapid deterioration in system security as far away from them as they could.

Frydenberg unilaterally established the Finkel Review, headed by a scientist with no working knowledge of the market.

So desperate is the industry and States for any improvement they latched on to this report hoping that Turnbull would adopt a carbon price as part of a package. Well the joke is on the industry. It was the one recommendation rejected by Turnbull and Frydenberg.

Finkel made crucial governance recommendations that will, as it works its way through an interventionist Federal government and a market operator hungry for control, fundamentally undermine the operation of the NEM. It is a recipe for a centrally controlled power sector – the very structure we came from that was a proven disaster for consumers.

The Minister then began to systematically vilify the entire NEM supply chain to divert attention from their own policy ineptitude, and Finkel gave him time and cover.

He vilified the networks for legally challenging the AER's decisions, even though it is allowed in the Law. He only just stepped back from criticising the Courts for largely ruling in favour of the networks.

He then unilaterally declared he would put the AER, who had suffered a series of humiliating losses in the courts simply because of their poor

economics, in an unaccountable position. He did not want the merits of the decisions of the AER to be challenged by the court. He wants the AER in an unaccountable position, a position that exposes the AER to political interference. This will present an extreme and unmanageable risk for investors.

Turnbull and Frydenberg vilified gas suppliers for selling their scarce supplies into the most valuable markets and threatened them with regulatory intervention, even though they did nothing wrong.

Turnbull and Frydenberg then vilified the generators and retailers for passing through their costs to consumers and threatened them with regulatory intervention. He then set the ACCC on to these businesses so they could re-prosecute in the media every case they have lost in the courts over the past dozen years or so.

And the real villain in all this?

The Federal Government and its inability to fix the key policy problems – a renewable policy not integrated with the energy market and a lack of a carbon price.

The Federal Government has lost its social license to participate in the operation of the power market.

It is time for the States to walk away from the NEM.

It is not politically fixable.

The States now need to strike a new multi-State accord, without the Federal Government, and develop a new set of market arrangements – NEM 2.0.

This new market should take what is good of the NEM and leave the Finkel, Turnbull and Frydenberg interventionist, centrally planned model behind.

NEM 2.0 should properly integrate energy and green markets and a compromised Clean Energy Target is not the answer. An EIS will fix the generation investment problem and is the lowest cost option.

NEM 2.0 should modify the energy only market design to address the ‘missing’ ancillary services markets. This will help integrate new technologies into a comprehensive, coherent competitive framework.

NEM 2.0 should ensure a revamped merits review process for networks to sharpen incentives for networks to take on only meritorious arguments while keeping the AER properly accountable.

NEM 2.0 should tighten governance so that there is a bright line between rule maker, system operator and regulator.

The States need to distance themselves from the confusion of these roles by Finkel otherwise it entrenches a conflict of interest and weakens accountability.

This has already started. For example, the new American CEO of AEMO has commissioned American advisers to develop their vision of the Australian market. It is not and should not be their role. We simply cannot have a system operator setting up a market in their image.

NEM 2.0 should have a system operator, not a market operator.

The rule maker should be clearly accountable for market outcomes to the States. They should be the 'one throat to choke' for Ministers.

If the States are unhappy about the rules that are being passed or not passed then Ministers should use their current power to issue a Statement of Policy Principles if they want the rule maker to do something.

After Finkel there is no "M" in NEM. The States need to start on NEM 2.0 now. There is no time to waste.