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**TIME TO THROW OFF THE CHAINS**

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## *Key Points*

- Australia has an energy crisis on its hands – with the continued forcing of renewable energy into the National Electricity Market (NEM), closures of power stations and concerns over the security and affordability of both electricity and gas.
- In October 2016, following a blackout and load shedding in South Australia, the nine-member Coalition of Australian Governments (COAG) agreed to appoint an independent panel to develop by mid-2017 a national reform blueprint to maintain energy security in the NEM.
- In March 2017, the government of South Australia announced that, whilst it would remain in the NEM, it would, for the security of the SA system, build a state-owned gas-fired generator and legislate to give itself powers to direct the NEM in the event of a shortfall or a failure of ‘market forces.’
- Disharmony amongst the Commonwealth and the States over the causes of the energy crisis or its solutions has raised a question of central importance: Is it time for Australia to throw off the chains of ‘cooperative’ energy governance?
- The door is open for a National Energy Commission to be established under Commonwealth law.

*'Man is born free and everywhere he is in chains'*  
Jean-Jacques Rousseau, 'The Social Contract,' 1762.

## **Acknowledgment of an Energy Crisis**

In September 2016, the entire State of South Australia experienced a blackout and there have been several instances of load shedding since then.

In October 2016, the nine-member Coalition of Australian Governments (COAG) Energy Council called an emergency meeting to announce that there would be an independent review into the future security of the National Electricity Market (NEM) led by Australia's Chief Scientist, Dr Alan Finkel.

In announcing the review, the Council said that the Australian electricity market was undergoing a significant transition due to a combination of *'rapid technological change, the increasing penetration of renewable energy, a more decentralised generation system, withdrawal of traditional baseload generation and changing consumer demand.'*<sup>1</sup>

It is now widely acknowledged that Australia has an energy crisis on its hands. At the AFR Business Summit in March 2017, the Prime Minister acknowledged it as such, bemoaning that *'our energy is among the most expensive in the developed world.'* The Chairman of the Australian Competition and Consumer Commission (ACCC) also said at the Australian Domestic Gas Outlook conference in the same week that *'Our energy markets as a whole could be said to be in crisis, both electricity and gas.'*

How did Australia get into this position and how can it get out? We need to start with a brief historical review.

## **The History of the NEM**

Until the 1990s, the Australian electricity industry largely consisted of State-owned, self-sufficient, vertically-integrated electricity systems. There was little competition and no independent regulation. The States were crucial to any reform process because they owned the assets and because it was widely believed that the Commonwealth had no constitutional power over the industry.

### **The 1995 Competition Policy Reforms**

In 1995, the nine-member COAG agreed to implement Competition Policy Reforms to increase the competitiveness of the national economy. The underlying rationale was that competition amongst energy suppliers in a national market would keep energy prices down. The Commonwealth agreed to pay 'competition payments' to the States to compensate them for the loss of their monopoly rents. A National Electricity Code was drawn up.

The COAG agreement was followed by a drawn-out and somewhat disjointed transition to the NEM that took another three years. During this period, there was wide consultation across all stakeholder

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<sup>1</sup> COAG Energy Council, Media Release, Canberra, 7 October 2016.



groups with the close involvement of the Australian Competition and Consumer Commission (ACCC), whose approval was required to the new arrangements before they could commence. They commenced in 1998.

### ***The 2004 Australian Energy Market Agreement (AEMA)***

By 2001, COAG had come to the view that an open and competitive national energy market would improve Australia's economic and environmental performance. It established a Ministerial Council *'to provide national oversight and coordination of energy policy development and to provide national leadership so that consideration of broader convergence issues and environmental impacts are effectively integrated into energy sector decision-making.'*<sup>2</sup>

By 2004, a reform package had been agreed. All COAG members entered into the AEMA under which they agreed that the Ministerial Council would itself play the role of national policy and governance body. They also agreed to establish two other bodies: the Australian Energy Regulator (AER), to monitor and enforce national energy legislation, and the Australian Energy Market Commission (AEMC), to undertake rule-making and energy market development.

In introducing the reform bills to the Australian Parliament in 2004, Minister Ian Macfarlane noted that *'Australia's electricity and gas prices are among the lowest in the developed world.'* He said the reform bills reflected *'cooperation between the States and the Commonwealth in an unprecedented way in the energy market reform process.'*

In hindsight, it was an unprecedented mistake to entrust a nine-member, politically-contrived institution with the role of national energy policy and governance, accountable only to itself. It was a role that confined industry, consumers and other stakeholders to subordinate roles. As a result, political cycles have invariably tended to complicate matters of energy policy.<sup>3</sup>

Under the AEMA, the Commonwealth and the States agreed that national legislation would be applied in each participating state and territory, with South Australia acting as the lead legislator. Other jurisdictions would enact 'application legislation' to give effect to the SA legislation.

The AEMA was however not legally binding and any party could withdraw on 12 months' notice. All parties have nonetheless continued to work within the framework that it created because of the risk that withdrawal would be disruptive to the economy.

In 2009, the Australian Energy Market Operator (AEMO) was established to operate the gas and electricity markets in southern and eastern Australia. AEMO is a company limited by guarantee that operates on a cost recovery basis, owned 60% by government and 40% by the industry.

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<sup>2</sup> Australian Energy Market Agreement (AEMA) dated 30 June 2004 between the Commonwealth of Australia, the States of NSW, Victoria, Queensland, Western Australia, South Australia, Tasmania, the NT and the ACT, Recital A (a). Under clause 3.3, the AEMA may only be amended by unanimous agreement of all parties. Under clause 4.7 (a), decisions concerning the NEM may only be made by Ministers representing jurisdictions that are participating in the NEM.

<sup>3</sup> For instance, the last time the AEMA was amended, with effect as of 9 December 2013, it was signed by Prime Minister Rudd, Premiers O'Farrell, Napthine, Newman, Barnett, Weatherill and Giddings, and Chief Ministers Gallagher and Giles. At the time of writing this paper, only one signatory, Premier Weatherill of South Australia, remained in power.

## ***The 2012 Comprehensive Reform Package and the Effect of Renewable Energy Targets***

In the 2010-2012 period, COAG continued to work on further reforms in the face of rising energy prices, particularly network prices.

By 2012, electricity consumers were complaining so loudly about price rises that the then Prime Minister Julia Gillard jumped into the fray, emphasising in an address to EPIA that, despite the complexity of the design of the NEM, the Commonwealth would use the 'big stick' of price regulation if the rises continued.<sup>4</sup>

In December 2012, COAG, acting on the recommendation of the COAG Energy Council, announced a comprehensive reform package:

*'COAG today endorsed the most comprehensive package of energy market reforms for jurisdictions in the National Electricity Market in a decade ... COAG agreed in principle to adopt the new best-practice framework for reliability standards (to be developed by the Australian Energy Market Commission and which give primacy to affordability for consumers at agreed levels of reliability and take account of regional considerations) and to transfer responsibility for applying the framework to the Australian Energy Regulator (AER), with a final decision by the end of 2013 ... These measures will help ease electricity price pressures, while maintaining the high level of reliability of supply which Australians have come to expect.'*<sup>5</sup>

At the same time, COAG acknowledged that the "challenges facing domestic gas markets" had become of importance to the Australian economy.


In December 2012, EPIA highlighted its concern that interventions in the NEM, such as renewable energy targets and carbon prices, however justifiable, were squeezing coal and gas out of the market and squeezing intermittent renewables in, while nuclear generation was not being considered.<sup>6</sup>

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<sup>4</sup> *'Australia did not need price increases of fifty per cent or more for households over the last four years – and Australians can't afford the same kinds of increases over the next four years. Now, I know there are complex factors driving aspects of these price increases. The catch-up from years of infrastructure underinvestment. The growth in peak demand. Changes which have raised reliability standards and which have come at a high price. And of course, there's the pragmatic, patchwork design of National Electricity Market itself – a complex mix of co-ordination and competition, public and private ownership, national and state regulation. But, recognising that complexity, appreciating the conflicting objectives and incentives, and taking into account the long-term factors at play, I want to say very clearly: the last four years' price rises cannot continue. ... My preference is to work co-operatively with the States through COAG to deliver a better outcome for consumers. We won't lightly use the big stick of regulation, of stronger powers for the Energy Regulator and the ACCC. But it's a stick we hold and which we'll use if required.'* Prime Minister Julia Gillard, 'Electricity Prices: The Facts,' Speech to EPIA, Sydney, 7 August 2012.

<sup>5</sup> COAG Communique, Canberra, 7 December 2012.

<sup>6</sup> *'... interventions in markets can have unforeseen flow-on effects that are difficult to manage and can increase costs and risks for both investors and consumers. Interventions come in all guises. In their purest form, they show up in rationing and price controls, which luckily Australia does not need. Interventions such as renewable energy targets and carbon prices can be justified on environmental grounds but they are interventions just the same. Coal and gas are now being squeezed out of the Australian market, intermittent renewables are being squeezed in and nuclear generation is not being considered.'* EPIA briefing to members, Sydney, December 2012.



The 2012 reform measures plainly failed to achieve their intended purpose. Much of the failure may be explained by the forcing of renewable energy into the NEM occasioned by the Renewable Energy Target (RET), a concern highlighted by EPIA at the time and more recently elaborated.<sup>7</sup>

It may not be unfair to conclude that the Australia energy industry has been chained up by the AEMA for the last 13 years. During this period, investors have been troubled by greater policy uncertainty, excessive regulation, higher costs and highly damaging market interventions. Policymakers seem to have placed too high a store on aspirational solutions in the expectation that the market would somehow recalibrate itself.

### **Possible Gas Shortages**

In March 2017, AEMO reported that a projected decline in gas production could result in a shortfall of gas-powered electricity generation impacting New South Wales, Victoria and South Australia from the summer of 2018-19.<sup>8</sup> Factors that could mitigate any shortfall included an increase in coal-fired generation, renewable energy, battery storage and the possibility of LNG exporters redirecting a small proportion of their gas production to the domestic market. AEMO suggested this would require *'holistic planning across the entire supply chain to enable investment decisions to be made in the long-term interests of consumers.'*

### **The SA Energy Plan**

In March 2017, the SA government announced an energy plan under which it would *'take charge to source, generate and control more of its power right here in South Australia.'* The government said it would establish a \$150 million fund to invest in battery storage and renewable technology and invest \$360 million in a new gas generator.<sup>9</sup>

The SA government also said it would seek greater local power over the national market for emergency situations or when market forces fail.<sup>10</sup>

### **Rising Electricity Prices**

Retail electricity prices remain a concern. Most recently, in March 2017, the Commonwealth

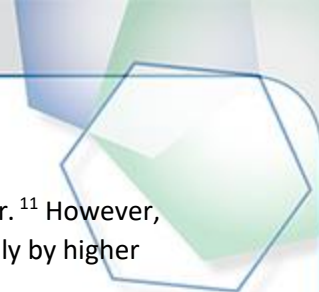
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<sup>7</sup> The Energy Policy Institute of Australia (EPIA) has published three public policy papers addressing the ramifications: see Simon Bartlett, *'The "Pressure Cooker" effect of intermittent renewable generation in power systems,'* September 2016; Robert Pritchard, *Investing in electricity infrastructure in a low-carbon era,'* December 2016; and Stephen Wilson, *How to reform the electricity market before we reach the top of a cliff,'* February 2017. All are downloadable from [www.energypolicyinstitute.com.au](http://www.energypolicyinstitute.com.au).

<sup>8</sup> AEMO, Media Statement – Gas Development Required to Meet Future Energy Demand, 9 March 2017.

<sup>9</sup> *'The State Government will build its own gas-fired electricity generator. Due to the lack of clear national policy settings, investment in new thermal generation has stalled. The generator will provide up to 250 megawatts of generation, which can be switched on in times of emergency. At all times, the generator will make South Australia's electricity supplies more secure by offering the inertia that is needed to stabilise local supplies. This generator is a strategic future asset to unlock economic growth once the appropriate national energy policy settings are implemented.'*

<sup>10</sup> *'The State Government will legislate to ensure that South Australian energy users are not held hostage to unwarranted market behaviour. The Minister for Energy will be given strong new powers to direct the national market in the case of an electricity supply shortfall. Ministerial direction includes the ability to direct generators to operate and direct the Australian Energy Market Operator to control flow on the interconnector. This will ensure every available option is activated to maintain the state's electricity supply in an emergency situation or when market forces fail.'*



government directed the ACCC to thoroughly investigate electricity retailer behaviour.<sup>11</sup> However, as the ACCC reported in December 2016, retail price rises are likely to be driven mainly by higher wholesale prices in the NEM.

### **Climate Policy**

Climate policy remains to be factored into electricity market design. The Commonwealth is presently conducting a review of climate policies that it aims to complete before the end of 2017.<sup>12</sup>

### **Technology**

The energy crisis has also prompted an avalanche of technological solutions. Elon Musk of Tesla reportedly offered SA a utility-scale battery solution. By far the most stirring solution was a 2000 MW pumped-hydro expansion of the iconic Snowy Mountains Hydroelectric Scheme, announced by the Prime Minister himself.

Several States announced they would accelerate the introduction of more renewables into the system. The Finkel Review has received 360 submissions that are presently being evaluated.

All technological solutions to energy security concerns differ in scale, cost and speed of response. No attempt is made in this paper to predict the way ahead.<sup>13</sup>

## ***Is Australia's Energy Governance Framework Still Fit for Purpose?***

How could anyone say with confidence at this time that Australia's 'cooperative' energy governance framework remains fit for purpose? Australia has failed all three of its energy industry aspirations: the price of its energy is for many customers unaffordable, it has been unable to satisfactorily integrate energy and climate policy and, most recently, its energy security is now under a heavy cloud.

The central question that arises is what would be a more efficient and effective governance framework. In this regard, the COAG Energy Council Governance Review Panel reported in October 2015 that:

*'... the [COAG Energy] Council and [the Standing Committee of Officials] SCO appear to lack a focus on strategic direction and are therefore not providing effective and active policy leadership to the energy sector. Whilst the inherent structure of the Council cannot be altered, the Council can improve the visibility, transparency and accountability of its processes and operations ...'*

In the opinion of this author, this assessment is nowhere near good enough. 'Cooperative' energy

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<sup>11</sup> Prime Minister Malcolm Turnbull, Treasurer Scott Morrison and Minister for the Environment and Energy Josh Frydenberg, Joint Press Conference, Parliament House, Canberra, 27 March 2017.

<sup>12</sup> Department of the Environment and Energy, 'Review of Climate Policies: Discussion Paper,' Australian Government, Canberra, March 2017

<sup>13</sup> For a discussion of the principles involved, see Chris Greig and Robert Pritchard, 'Accelerating Low-Emissions Energy Innovation – An Australian Perspective,' Public Policy Paper 2/2016, EPIA, Sydney, March 2016.

governance in Australia has gone as far as it can go.

There can now be little argument that the COAG Energy Council and its SCO is a cumbersome, sub-optimal and outdated model that is no longer fit for purpose: it is too slow, it has too many part-time masters, it has too many part-time servants and its structure and *modus operandi* both need streamlining.

More specifically, it can be said of the COAG Energy Council and its SCO that it has no accountability to anyone except itself, its decision-making is excessively political (hard of course to eliminate where its representatives change every time one of the constituent governments change) and it has no permanent secretariat or dedicated resources of its own.

In short, it is time to throw off the chains of 'cooperative' energy governance that is dragging the entire energy industry down.

### ***A National Energy Commission***

The process that drove the successful reform of the NEM in the 1990s may have achieved its original purpose but the COAG Energy Council now needs to be replaced by a permanent body with appropriate resources and predictable practices, reporting to all stakeholders.

Australia should establish a National Energy Commission that functions independently and transparently, consults with stakeholders and publishes an annual report to the nine Parliaments.<sup>14</sup> Such a Commission could still report to the COAG Energy Council but should never be bound by political directives except in cases of national emergency.

A top priority of the Commission would be to undertake the system planning role that was suggested by EPIA in its submission to the Finkel review.<sup>15</sup>

The Commission's charter could also include replacing the AER.<sup>16</sup>

A National Energy Commission, established by a single Commonwealth law, would do away with the costs, red tape and inefficiencies of mirror legislation in all jurisdictions.<sup>17</sup>

The overriding purpose of an independent National Energy Commission would be to nurture an energy investment climate in Australia in which capital can be safely invested and where the

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<sup>14</sup> *The National Energy Board of Canada is an example of a similar institution.*

<sup>15</sup> EPIA, 'Pursuit of Energy Security by a National Energy Vision and a Long-Term Plan, Submission by EPIA to the Independent Review into the Future Security of the National Electricity Market (NEM),' Sydney, 3 March 2017.

<sup>16</sup> The AER was established under Commonwealth law, specifically Part IIIAA of the *Competition and Consumer Act 2010* (Commonwealth). The AER is a constituent part of the ACCC although it operates as a separate entity. It is responsible for the economic regulation of the NEM, including the transmission and distribution networks and gas pipelines and for compliance with the rules that govern the electricity and gas markets.

<sup>17</sup> In 2006, the High Court of Australia held that the Commonwealth has much wider power under the Constitution to enact laws relating to the business activities of corporations than had previously been thought. Commonwealth power extends to governing the activities of corporations operating in the national energy market. This is elaborated in the Appendix.





interests of all stakeholders, including energy consumers and the environment, are taken into account.

The advantages, to all jurisdictions and energy industry stakeholders, would be to provide on an ongoing basis:

- a greater unity of national purpose
- a 'whole-of-system' perspective
- a greater degree of policy predictability
- a greater level of transparency
- best practice and greater efficiency
- reduced risk of market intervention
- reduced regulatory risk and
- a much greater level of accountability.

It is surely now time for Australia to throw off the chains of 'cooperative' energy governance. A full study should be made of the policy, legal, economic, technical, environmental and social feasibility of the proposal.

## APPENDIX

### *Commonwealth Constitutional Power over the Energy Industry*

#### **Background**

The energy industry in Australia is more than ever a national, not a state-based, industry and is arguably the single most important industry in the overall economy. With global developments, new technological developments and the emergence of coal seam gas and shale gas as major new sources of supply, the energy landscape will continue to be more and more national in its scope and operation.

The way the NEM has actually evolved indicates that intra-state electricity trade has been subsumed by what is now a truly national energy market that is well within the scope of Commonwealth constitutional power.

The scope of Commonwealth constitutional power to regulate the trade and transport of natural gas throughout Australia also seems clear since so much of natural gas is destined either for interstate consumers or for export in the form of LNG.

#### **The Trade and Commerce Power**

The trade and commerce power under s 51 (i) of the Constitution enables the Commonwealth to make laws relating to interstate trade, although it does not extend to the regulation of trade occurring only within state borders.

The incidental scope of s 51(i) may nonetheless authorise Commonwealth regulation of intra-state energy trade if there is a sufficient connection with interstate trade and commerce.

#### **The Corporations Power**

The corporations power under s 51 (xx) of the Constitution potentially much wider application to energy market regulation than the trade and commerce power.

The corporations power grants authority to the Commonwealth to make laws with respect to '*foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth*' (known collectively as 'constitutional corporations'). This would enable the Commonwealth to regulate energy trade in so far as it interacts with all such corporations.

The scope of the corporations power was tested In the *Work Choices* case in 2006.<sup>18</sup> In the Work Choices Case, the High Court endorsed the view that the corporations power extends to:

*"... the regulation of the activities, functions, relationships and the business of a corporation described in that sub-section, the creation of rights, and privileges belonging to such a corporation, the imposition of obligations on it and, in respect of those matters, to the*

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<sup>18</sup> New South Wales v Commonwealth (Work Choices Case) (2006) 229 CLR 1.

*regulation of the conduct of those through whom it acts, its employees and shareholders and, also, the regulation of those whose conduct is or is capable of affecting its activities, functions, relationships or business.*" (underlining provided)

Nearly all State-owned utilities have been corporatised and operate at arm's length from the States, falling within the definition of constitutional corporations and subject to the reach of Commonwealth legislation. Many of these utilities have also been privatised. In any case, the Commonwealth may be able to regulate state government authorities on the basis that are trading corporations under the Constitution (the Tasmanian Hydro-Electric Commission was classified as a trading corporation in the *Tasmanian Dam* case).

### ***State Rights and Constraints on Commonwealth Power***

There are three constraints on the exercise of Commonwealth power under the Constitution:

- i. No Commonwealth law - of trade or commerce or otherwise - may interfere with the directive in s 92 that *'trade, commerce, and intercourse among the States ... shall be absolutely free'*.<sup>19</sup>
- ii. The Commonwealth may not under s 99 pass a law relating to trade or commerce that gives preference to one State over another.
- iii. The Commonwealth may not under s 114 pass a law that has the effect of utilising or attacking State property.

Commonwealth legislation to regulate national energy markets could and would need to be framed so as not to override State rights.<sup>20</sup>

30 March 2017

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### ***About the Author***

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*This paper represents the views of the author and does not necessarily represent the views of EPIA or any of its members.*

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<sup>19</sup> This has been interpreted so as to strike down laws that are discriminatory in a protectionist sense, such as by imposing levies on the States.

<sup>20</sup> A draft of such a law entitled the *National Electricity Bill 2012* was prepared at the request of Robert Oakeshott, a former independent Member of the Australian Parliament, in 2012.