

To: Jackson, Ryan[jackson.ryan@epa.gov]
From: Fannon, Frank
Sent: Mon 7/17/2017 9:43:16 PM
Subject: FYI
[article on Finkel review and issues.pdf](#)

Ryan –

The article attached might be of interest.

Also, <http://www.financeminister.gov.au/>. Mathias was involved in the G20 deliberations with the PM.

The Ambassador is on vacation this week and next. Recommend we coordinate an introduction after he returns.

Regards,

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Energy poverty and the threat to Frydenberg

Prices are rising and so is the confusion over policy

JUDITH SLOAN

CONTRIBUTING ECONOMICS EDITOR



My guess is that Environment and Energy Minister Josh Frydenberg doesn't know whether to laugh or cry. He is in the middle of trying to sort out a series of energy problems that are not of his making but that are causing substantial pain to businesses and households.

From this week, retail electricity prices for households will rise by between 15 per cent and 20 per cent in most of the eastern states. Retail gas prices also will rise by a slightly lower percentage. We already have seen residential power disconnections rise by 140 per cent in the past six years. We should expect many more disconnections.

For businesses, the situation is worse; they are facing even steeper rises in their power bills. For those operations that use gas directly, their annual gas bills will be two to three times higher than last year. That's if they can secure any deal in the context of a shortage of domestic gas.

In the meantime, the debate about securing the three objects of energy policy — affordability, reliability and sustainability (achieving emissions reductions) — continues to provoke strong and conflicting views, including among politicians, commentators and energy providers.

On one side of the debate is the assertion that rising electricity prices are not related to the increase in the penetration of renewable energy but are the result of rising gas prices. The proponents of this argument point out that electricity price increases have been higher in Queensland, which has very little renewable energy, than in South Australia, which has a lot (close to 50 per cent of its generating capacity).

But the fact electricity

generation is highly concentrated in Queensland in the hands of two very large government-owned corporations is overlooked in this argument. What has been happening is that these two operations have been gaming the system by cashing in on the large price spikes in the system that are the result of there being more non-synchronous power. In this way, the companies are delivering record dividends back to the Queensland government.

Note also that in eastern Australia, at least, there is a national electricity market and across time regional prices converge to the national average. There is nowhere to hide, in other words.

On the other side of the debate, rising electricity prices are seen as the result of too much subsidised renewable energy which, in combination with low demand, has driven cheap, reliable sources of electricity generation out of business. Since electricity prices are set by the marginal provider at a point of time and gas is increasingly that marginal provider, the rising price of gas is feeding into higher wholesale electricity prices.

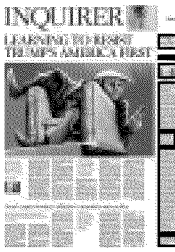
Moreover, domestic gas prices are rising in part because the renewable energy target excludes gas as a source of electricity generation. The gas companies, in effect, have been forced to seek out other markets for their product overseas, a strategy sanctioned by the federal and Queensland governments. While this led to the development of some new fields at the time, the subsequent moratoriums placed on exploration and exploitation of coal-seam gas by several state and territory governments have meant the growth of new supplies of gas has come close to a grinding halt.

To be sure, what happens to retail electricity prices is complicated and note that wholesale prices form only less than half of the total. There are other cost pressures in the system, including in relation to transmission and distribution but also the less-than-competitive retail sector.

So where does this leave Frydenberg who, in all likelihood, wants to avoid a spat with the states about the causes of rising electricity prices? Mind you, he has already picked a fight with Queensland.

His challenges are several fold:

- He wants Victoria and NSW, in particular, to lift their effective moratoriums on the development of onshore gas fields.
- He wants the states and territories to agree to the federal government's decision to abolish limited merits reviews that are used by the transmission and distribution companies to overturn the decisions of the Australian Energy Regulator.



- He wants the states and territories to abandon their own renewable energy targets.
- He wants the states and territories to endorse all the recommendations of the Finkel review on energy security, save the core proposal of a clean energy target.

If you are thinking he's got Buckley's, you

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New supplies of gas have come close to grinding to a halt

Energy poverty poses new threat

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wouldn't be wrong. In fact, the threat to Frydenberg is that the states and territories will decide to go it alone with their own clean energy target and hang what the federal government decides.

Recall that the CET stipulates a benchmark for the emissions intensity of electricity generation below which generators would receive proportional certificates according to their emissions intensity. Wind, hydro and solar photovoltaic would receive a full certificate and other generators with emissions intensity below the benchmark would receive fractions of certificates according to the gap between their emissions intensity and the benchmark.

Given the federal government's commitment to meet our Paris emissions reduction target (26 per cent to 28 per cent by 2030 from the base of 2005) and applying this to the electricity sector, a CET would spin off continuing subsidisation of renewable energy, but with some scope for relatively low-emissions alternatives such as gas or possibly supercritical coal generators to play a role.

If a benchmark of 800kg of

CO₂ equivalent per megawatt hour were chosen, for example, gas would make the grade and possibly some coal. But given the reduction in emissions from the sector needed to meet the target, in practice the adoption of a CET is not very different from the continuation of a higher RET, particularly if gas prices remain high.

In other words, it is the emissions reduction target for the sector and not the chosen benchmark that is critical to the operation of a CET.

Now, some federal Liberal politicians have twigged to this fact and it is one reason there is considerable reluctance on the part of the party room to endorse the CET as recommended in the Finkel review. That renewable energy will make up 42 per cent of the mix (lower if small-scale solar PV is excluded) in 2030 is another reason for their hesitation.

Why has the renewable energy sector, which is known for its skills of political persuasion, otherwise known as rent-seeking, been so quiet in the past several months? (The wind "drought" that affected one of the leading wind farm operators, Infigen, has been another reason to lay low; wind, it would seem, can be even more unreliable than the company assumes.)

Mind you, the renewable energy sector has been quick to endorse the argument that policy paralysis is contributing to a lack of investment in electricity generation (although not in the renewable space, it must be said), which in turn is leading to higher prices.

However, it was only two years ago that then environment minister Greg Hunt told us the renegotiated RET "will not be reviewed until 2020. This will give the renewable energy industry the certainty it needs to grow."

Recall that the RET continues on through the 2020s. Moreover, given the claim that renewable energy sources are now cheaper than fossil-fuel

generators, it is not clear why there should be any need to make more changes to the regulatory framework in respect of the RET to further subsidise renewable energy.

Indeed, as long as renewable energy generators are required to provide stable backup to their offerings, there is a strong case that the regulatory settings should remain steady to achieve the optimal level

and type of least-cost investment in generation — that is, let the RET take its course as was intended.

How should the federal government react if some of the states decide to go it alone by setting up their own CET? Such action would be superimposed on the targets that individual states and territories now have in relation to renewable energy penetration and their aspiration of being "carbon-neutral" by 2050.

It should be noted that the impact of the present suite of go-it-alone policies of the states and territories is already distorting the market, particularly by way of the reverse auctions that provide the winning renewable energy provider with secure cashflows for long periods (most of the present investment projects in renewable energy are being driven by these reverse auctions) and direct taxpayer funding for storage. Examples of the latter include the world's biggest battery in South Australia, cost unknown, and some smaller developments in Victoria.

If this sounds like a mess, you wouldn't be wrong. Whether some of the states could or would run with a CET underpinned by certificates is unclear. While South Australia assisted the development of its renewable energy sector by various interventions — payroll exemptions, easing planning approval processes — the reality is that most of the renewable investment in that state has been driven by the national RET and the attendant encouragement



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provided through renewable energy certificates.

The bottom line is that energy policy in this country has reached the point of catastrophe. Faced with crippling electricity

prices and uncertain system reliability, there is still no agreement about the appropriate direction of policy into the future. If anything, the divergence between the federal government and some state governments is as wide as ever.

And all the talk of demand-side measures is simply code for asking people (and businesses) to desist from using power when it is actually appropriate for them to do so — during a heatwave, for instance. This is not a feature of a First World developed economy.

In the meantime, well-heeled households are subsidised to spend up big to install solar PV with battery backup, meaning that the cost of operating the grid is shared across a smaller number of participants. This drives up prices further for those who can least afford to pay. They call it energy poverty in Europe; expect that term to become common parlance here.

For Frydenberg, his best hope is that domestic gas prices start to fall by virtue of the restrictions on exports and some regulatory changes affecting pipeline operation. But there can be no guarantees.

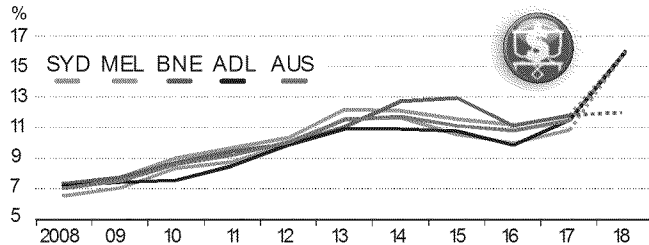
Gas supplies are not something you can simply switch on and off. And unlike hard rock mining, gas requires an ongoing program of drilling to replace expiring wells.

Without strong financial incentives, the Australian government may find that some of the gas companies simply decide that it is easier to pick up their bat and ball and go home.

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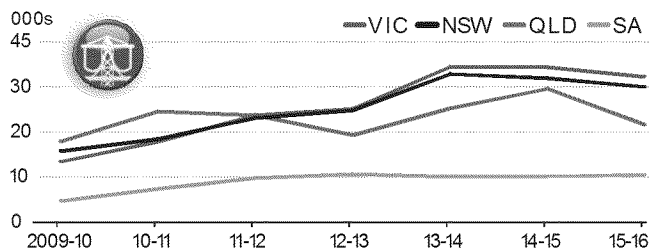
BILL PAIN

Annual retail electricity price increase, adjusted for inflation



POWER DISCONNECTIONS

Number of households cut off



Source: ABS, Australian Energy Regulator, Victorian Essential Services Commission, WA Economic Regulation Authority