

The Australian Gas Light Company
ABN 95 052 167 405

North Sydney
AGL Centre, 111 Pacific Highway
North Sydney NSW 2060
Locked Bag 944
North Sydney NSW 2059

Telephone 02 9922 2585
Facsimile 02 9957 3871

18 June 2004

NCP Inquiry
Productivity Commission
PO Box 80
Belconnen ACT 2616

Dear Sirs

Review of National Competition Policy Arrangements

The Australian Gas Light Company (AGL) welcomes the opportunity to comment on the Productivity Commission's (the Commission) Issues Paper.

AGL has substantial interests across the Australian energy sector, including gas and electricity retailing, gas and electricity wholesaling, the ownership and operation of gas and electricity networks and interests in power generation.

AGL's comments on the Issues Paper are limited to energy matters.

Work undertaken to date in relation to energy

AGL notes that the terms of reference require that the Commission take into account but not replicate the significant current and recent review activity in areas such as the CoAG work on energy and water and the review of the competition provisions of the Trade Practices Act.

Gas access

AGL has actively participated in the Commission's current review of the Gas Access Regime and looks forward to the Commission's Final Report. As is clear from AGL's participation in the review of the Gas Access Regime, AGL considers that, while there has been significant work involved in the reforms to the energy market over the last 10 years and benefit arising from those reforms, AGL remains of the view that the current Gas Access Regime is flawed and requires a number of changes. However, as there has already been extensive consideration of gas access regime issues, AGL does not intend to further discuss those issues in this submission.

Electricity

AGL notes the comments in the Issues Paper that:

[a]lthough significant progress has been made in electricity reform, a fully competitive national market has not been realised. According to CoAG (2003), contributing factors include inefficient institutional arrangements (due to multiple regulators) and the lack of grid interconnection (arising from poor incentives for transmission investment and inappropriate pricing structures). Insufficient competition in generation, inflexible price signals for residential customers and regulatory and market features limiting use of long-term contracts have also been identified as detracting from reform objectives.

The Issues Paper also refers to the considerations by CoAG of options to build on NCP initiatives in energy market reform and asks whether the current CoAG energy initiatives are appropriate ways of extending reform in this area, whether there are other reform opportunities in these areas which need to be explored, the benefits and costs they would involve and what procedural arrangements would be required to implement them. The Issues Paper also asks what impediments there are to the timely implementation of additional reforms in the energy sector.

AGL agrees that significant progress has been made in electricity reform.

AGL agrees, however, with the view of CoAG that there are major concerns with the transmission sector of the NEM. These concerns are with the operation, augmentation and pricing of transmission.

AGL welcomes the significant work currently being undertaken under the auspices of the Ministerial Council on Energy (MCE) energy market reform program arising from the recognition by Australian Governments that effective operation of an open and competitive national energy market contributes to improved economic and environmental performance, and delivers benefits to households, small business and industry, including in regional areas.

AGL notes that the MCE energy market reform program constitutes a substantial response to the CoAG review and is intended to provide the basis for the development of a truly national and efficient energy market.

AGL is hopeful that the current MCE energy market reform program will address many of the outstanding issues/areas of concern in relation to electricity/energy market reform. In particular, AGL hopes that the program will result in the removal of remaining barriers to achieving an open and competitive energy market and that the program will result in reduced regulatory costs and streamlined approaches that encourage investment and deliver an effective regulatory culture in the new agencies. In AGL's view, the current CoAG/MCE initiatives are an appropriate way of addressing energy reform.

AGL appreciates that there is still considerable work to be undertaken in relation to the current MCE energy market reform program. However, AGL has concerns that there are some areas which are part of the reform program where the process may be poorly directed or where the process is unclear. AGL also considers that there are areas where further reform should be included in the MCE energy market reform program.

Areas which are part of the current MCE energy market reform program where AGL would like to see better focus or an improved process:

(i) *Consistent and efficient national regulation*

AGL welcomes the commitment to harmonise jurisdiction regulation expressed by CoAG. In AGL's view, jurisdictional regulation should be such that a national participant in the energy industry faces the same obligations and requirements in each jurisdiction. Consistency between jurisdictions would improve customer service and reduce costs.

For example, AGL is firmly of the view that national consistency of the *retail* licensing system will reduce compliance and operational costs. At present, the divergence between regulatory codes and licences in each state means that a national participant has to employ additional staff and meet different requirements increasing the risk and costs of participants, resulting in increased costs to customers. Uniformity will reduce costs.

However, AGL cautions that moves to national consistency must be based on principles of efficiency. Competition is to be preferred over regulation. Regulation must be at a minimum level; that is, it should only be applied where competition is not effective and having regard to other legislation and regulations that cover the area.

Further, energy market regulation should not duplicate customer protection frameworks already in place, such as under the Trade Practices Act and under jurisdictional laws such as the Fair Trading Acts etc. Any additional regulation, or jurisdictional specific regulation should be based on robust justification process to ensure that it achieves the objectives it is designed for in a transparent manner and does not distort the operation of a competitive market or add unnecessary costs.

The MCE has proposed a single national regulator for gas and electricity. AGL has concerns, however, that, notwithstanding the commitment to consider moving most aspects of jurisdictional regulation to the national regulator and to increase harmonisation in the interim, there is as yet, no firm process for achieving harmonisation and no firm agreement to reduce jurisdictional regulation. AGL considers that it is important that there be a clear process, beginning immediately, to harmonise regulation between jurisdictions and which is understood by all participants. AGL believes that the main benefits of the Australian Energy Regulator will be achieved by this harmonisation.

(ii) *Electricity access*

It has been made clear as recently as 20 May 2004 in the MCE's Bulletin 12 that the Productivity Commission report on the National Gas Access Regime and MCE's response, will form part of the MCE's in principle commitment to develop a national approach to energy access under the Trade Practices Act 1974, covering electricity and gas transmission and distribution. As a result of a comprehensive review by the Commission and subject to its recommendations and their adoption by Government, there is a real prospect of significant improvement to the Gas Access Regime.

However, AGL is concerned that there is no clarity around reform to the electricity access regime. It is critical that reforms to the electricity access regime occur in a methodical and considered fashion and that there is appropriate consultation.

(iii) *Full retail contestability;*

AGL has concerns that jurisdictional distortions in some areas are having an adverse effect on competitive neutrality. AGL believes that full retail contestability should be introduced into all jurisdictions. At present, competition has not been introduced into Tasmania and Queensland. Queensland has recently indicated that it will not introduce full retail contestability in electricity. While full retail contestability commences on 28 June 2004 in Western Australia, full retail contestability in electricity is some time away.

Another issue is that in NSW and Queensland, private companies compete with State owned entities but there is not a level playing field. For example, the Electricity Tariff Equalisation Fund (ETEF) protects government owned retailers from risk.

The recent decision on regulated retail electricity prices in NSW by the Independent Pricing and Regulatory Tribunal (the Tribunal) is based entirely on its assessment of the risk profile under the Electricity Tariff Equalisation Fund (ETEF) that is only available only to incumbent retailers. The decision as a result does not fully reflect the market risks faced by second-tier retailers and underestimates the true cost of wholesale electricity. The impacts of this decision are likely to include:

- Risk that the wholesale electricity price provided for in the regulators decision will not support investment in intermediate and peaking plant affecting the reliability and security of supply in the NSW electricity market;
- Limitations on the ability of the non-incumbent retailers to participate fully in the market, impacting on competition in the electricity market; and
- An artificial wholesale price that does not reflect real costs of supply and thus distort signals for demand management and energy efficiency.

AGL believes that cost benchmarks should be fully cost reflective to promote investment generation and retail supply, and for demand management and energy efficiency. The arrangements should also be competitively neutral for effective competition to be achieved.

AGL urges the Commission to acknowledge that jurisdictional distortions are creating competitive neutrality issues and urge the removal of these jurisdictional distortions. At present, there is no clear process or mechanism to ensure that this issue is addressed by the MCE energy market reform program.

(iv) Retail price regulation

AGL notes that there is a move towards a light handed form of regulation of retail prices for residential and small business customers in the majority of jurisdictions where full retail contestability has been introduced. AGL welcomes these moves.

AGL notes that, the consultation paper issued by the Ministerial Council on Energy SCO "Improving User Participation in the Australian Energy Market" appears to be based on a premise that in the transition to effective competition, price regulation remains a legitimate and ongoing role for governments to facilitate consumer protection goals. AGL disagrees. Effective competition is to be preferred over regulation as a means of ensuring customer protection. Multiple year price paths have been agreed in Victoria and are being discussed in South Australia. At the conclusion of these price paths, AGL expects that competition will be effective in all markets and considers that jurisdictions should not continue with price regulation.

It is essential that appropriate incentives are in place to encourage investment in intermediate and peaking generation plant that will be required in the medium term. The

risks arising from the volatility in the wholesale market needs to be reflected in the retail prices to encourage such investment. The failure to reflect the true wholesale electricity cost in retail prices was one of the contributing factors to the issues in the Californian market.

At this stage, there does not appear to be a process or forum (other than by way of responses to the consultation paper) for considering the issue of price regulation and its appropriateness in the current competitive market environment.

Further, the proposals issued by the MCE SCO fails to address a number of important issues relating to non price characteristics, such as incorporating environmental and demand side objectives into the competitive energy market framework. Again, there does not appear to be a process or forum (other than by way of response to the consultation paper) for addressing these important issues

Areas which are not part of current reform program, but which should be included

(i) B2B issues in electricity

At present, B2B frameworks are jurisdictionally driven. AGL considers that the CoAG/MCE reform program should be expanded to consider B2B issues in electricity.

Concerns with particular principles of the MCE reform program

Transparency, appropriate consultation, appropriate governance and institutional arrangements (including clear and well defined objectives, separation between the bodies responsible for rule making and administering regulation), strong appeal rights and accountability for market funded institutions are all principles which are critical to creating an effective Australian energy market. AGL has concerns that these principles are not clearly incorporated into the elements of the MCE reform program.

AGL considers that it would be helpful for the Commission to make a finding acknowledging the importance of these principles in taking the MCE energy market reform program forward.

Environmental goals

AGL considers it necessary to have a national approach to achieve reduced emissions of greenhouse gases. Multiple programs in different jurisdictions create complexity, increase compliance costs and investment risks and dissipate resources. An emissions trading scheme, depending on its detail, could be expected to deliver lowest cost outcomes provided it applies across all sectors of the economy and not just the energy industry or a part of it.

If greenhouse gas policies are to achieve appropriate changes in behaviour, especially in energy efficiency, then price signals should be encouraged to flow through to consumers through specific pass through mechanisms.

Investment certainty for business requires a scheme that allows carbon constraint costs to be factored in for the long term.

AGL urges the Commission to make a recommendation that there should be a co-ordinated and systematic national approach to the achievement of environmental goals.

Action required

As set out above, AGL has concerns that there are some areas which are part of the reform program where the process may be poorly directed or where the process is unclear. AGL also considers that there are areas where further reform should be included in the MCE energy market reform program.

Accordingly, AGL urges the Commission to provide a recommendation in relation to the process that should be followed in order to ensure that these issues are addressed satisfactorily.

It would be helpful for the Commission to make a finding acknowledging the importance of transparency, appropriate consultation, separation between the rule maker and enforcer, strong appeal rights and accountability for market funded institutions.

AGL urges the Commission to make a recommendation that there be a coordinated national approach to the achievement of environmental goals.

Please do not hesitate to contact me if you have any queries in relation to this submission. AGL is happy for this submission to be placed on the Commission's website.

Yours sincerely

Dr Robert Wiles
General Manager
Regulation and Policy