

Energy Reform Implementation Group

Discussion papers – issued November 2006

Joint response by various consumer advocates

December 2006



1 Introduction

This Joint Submission responds to the Energy Reform Implementation Group's (ERIG) discussion papers on market structures, transmission and energy financial markets released on 17 November 2006 (collectively, the **Discussion Papers**). The Joint Submission considers the following issues raised by the Discussion Papers:

1. An efficiency and public interest focus
2. Basis of analysis – productivity, prices and speculation;
3. Public ownership of energy assets;
4. Governance under competition policy;
5. Demand-side participation;
6. Re-aggregation and the effectiveness of the *Trade Practices Act 1974* (Cth) (TPA);
7. Retail price regulation;
8. Greenhouse gas emissions and renewables; and
9. AEMC funding and the role of Federal and State Governments.

The following organisations endorse this submission:

Australian Council of Social Service (ACOSS)

2 An efficiency and *public interest* focus

ERIG states that its Discussion Papers “concentrate on economic efficiency”.¹ Moreover, quoting the Hilmer Report², ERIG posits that competition is the fundamental driver to achieve economic efficiency. While we agree that efficiency and competition are important principles informing future energy market reform options, we are of the view that the public interest must underscore the implementation of these principles. The energy market objective is to maximise efficiency *in the long term interests of consumers*. In our view, the long term interests of consumers are advanced by ensuring continuous access to the affordable, reliable and safe supply of energy, in recognition that energy is an essential service to the community. We are concerned that ERIG has ignored the public interest in favour of a narrowly defined notion of efficiency and that while pure economic efficiency may contribute to the long term interests of consumers, it does not always do so. For this reason we continue to hold the view that competition and efficiency goals need to be balanced by other social policy goals.

In its review of National Competition Policy, the Productivity Commission outlined a number of key benefits of Australia's micro-economic reform program for consumers. These include improved productivity, sustained economic growth and increased consumer choice. The Commission noted, however, that “experience with NCP reinforces the importance of ensuring that the potential adjustment and distributional implications are considered at the outset”.³ The review noted the “mixed impacts” of reforms on regional communities and adverse impacts on the environment (such as increased greenhouse gas emission from the reform-related stimulus to demand for

¹ Energy Reform Implementation Group, *Discussion papers*, November 2006, p 24.

² Hilmer Committee, *Independent Committee of Inquiry into National Competition Policy*, August 1993

³ Productivity Commission, *Review of National Competition Policy Reforms (Report No 33)*, April 2005, p 150.

electricity). In our view, economic growth exists to serve not just the majority of Australians, but all of them. Public policy programs must not place such an emphasis on wealth creation that we pay insufficient attention to how we distribute wealth. Further economic reforms must sit alongside social justice policies that ensure a fair, decent and inclusive Australia. In its final report, ERIG must more clearly address distributional and environmental implications of its recommendations and proposals for reform. The pursuit of economic efficiency, by governments, is pointless unless it contributes to social ends.

In February 2006, Consumer Law Centre Victoria and Monash University's Centre for the Study of Privatisation and Accountability released a comprehensive report analysing the impact of electricity reform in Victoria. The report, *Electricity Reform in Victoria: Outcomes for Consumers*, found that while electricity reforms have produced some significant benefits, these benefits have not accrued equally among consumers.⁴ Benefits have accrued to industry, commercial users and metropolitan consumers while low-income and disadvantaged consumers (including rural and regional consumers) have seen mixed impacts from reforms. ERIG has failed to consider the ways in which unequal distribution of benefits from reform may seriously impinge upon overall consumer benefit. We are concerned that ERIG's proposals, including those related to retail price regulation (see further below), will have significant negative impacts on the most vulnerable sections of the community.

ERIG proposes that the best way to deliver assistance to members of the community disadvantaged by reform is through Community Service Obligations (CSOs). As stated by PIAC in its supplementary submission to the ERIG Issues Paper, we agree that CSOs can have an important and effective role in mitigating negative social outcomes from competition reform. However, we do not see participation in CSO programs as the limit upon service providers' community responsibility. ERIG does not acknowledge or attempt to deal with the complexity involved in targeting and implementing CSOs to ensure they are effective. A number of reports previously provided to ERIG demonstrate the difficulty in this task.⁵ Difficulties include targeting customer groups who do not generally benefit from CSOs, including the "working poor" who, despite being on limited incomes, may not hold concession entitlements. Hiving off social responsibilities to the vague notion of CSOs is an inadequate response to addressing the disadvantage faced by some vulnerable consumers. ERIG's final recommendations must ensure that service providers' responsibilities to disadvantaged and vulnerable consumers are explicit and clear. Victorian reforms relating to hardship and wrongful disconnections are examples of ways in which these responsibilities should be reflected.

3 Basis of Analysis – Productivity, prices and speculation

At the outset of this review process, the ERIG panel made it clear that they were seeking to make recommendations based on hard evidence. The Discussion Papers explain that ERIG's task has been severely constrained by the limited timeframe and commercially sensitive material being sought from electricity businesses. As a

⁴ Consumer Law Centre Victoria and the Centre for the Study of Privatisation and Accountability, *Electricity Reform in Victoria: Outcomes for Consumer*, February 2006.

⁵ Public Interest Advocacy Centre, *Cut off: the impact of utility disconnections*, February 2005; Consumer Law Centre Victoria and Consumer Utilities Advocacy Centre, *Access to Energy and Water in Victoria – A research report*, November 2004.

consequence, the data presented in the report must be understood with such a plethora of caveats as to render it useless as a singular tool of analysis. ERIG has therefore sought to discern broad trends from its data. Our view is that relying on trends extrapolated from unreliable and weak data is a poor outcome for the ERIG process.

Given the substantial public funds that have flowed to this project, we believe the public interest will be better served by delaying the release of the final report to enable accurate and reliable sectoral analysis. In the absence of higher quality data, we make the following comments on how the existing data should be analysed and interpreted.

The data compiled by consultants MMA delivers productivity indicators only for the generation and transmission sectors of the industry. There is no evidence that trends identified in these sectors can be attributed to distribution and retail businesses. Any trends that are identified from this data must therefore be limited to the particular sectors from which it was drawn.

Analysis of the transmission sector has suggested that there are observable differences in productivity trends across jurisdictions. Productivity in the transmission sector must be understood by reference to the regulatory context in which the monopoly is operating. Poor productivity in a monopoly enterprise may be a product of poor regulation. The interpretation of productivity data in the transmission sector should address a broad range of concerns including regulation and ownership.

Productivity in the electricity generation sector requires a somewhat different interpretation. Electricity generation is characterised by large, lumpy investment in capital-intensive operations. The efficiency with which capital is utilised is a more significant measure of the efficiency of the sector by comparison to labour productivity. Capital productivity in the generation sector should therefore take precedence in the analysis of the sector's productivity. The ERIG analysis has failed to consider this issue.

The Discussion Papers consider price outcomes in the spot market. User groups have previously argued that final price outcome for residential customers are determined primarily by hedged contracts and regulatory mechanisms. It is disappointing that the ERIG has not made any efforts to explore the impact of market structures on the final prices paid by consumers. For example, what evidence is there to suggest that higher levels of productivity in the Victorian market have been passed through to consumers in the form of lower prices?

Lastly, we make the observation that the Discussion Papers' reliance on conjecture, assertion and speculation considerably weakens the report's findings and falls short of the standard expected from a CoAG appointed review panel. Again we call on the ERIG to delay its final report to produce a more transparent, independent and robust assessment of the sector.

4 Public Ownership

4.1 State budget pressures

The Discussion Papers raise two contradictory concerns. One, questioning the budget capacity of publicly owned generation assets to expand their growth. But on the other hand, ERIG is seeking to actively cap the expansion of public funds to the

generation sector.. There is currently considerable debate about the future of public ownership of a range of assets, about the capacity of governments to adequately manage these assets, about the real effects of public ownership on industries exposed to competition and market forces, about the pros and cons of public debt. It is

State government budget constraints are proposed as the grounds on which privatisation should proceed. The decision by a government to privatise a public asset must be undertaken on a case-by-case basis and in consultation with its community. The ERIG has chosen to showcase the proposed privatisation of Snowy Hydro. In that case the NSW Government determined a privatisation position unique to that asset. The grounds expressed by Premier Lemura for privatising that asset should not be applied to other energy generation facilities any more than they should be applied to publicly owned NSW hospitals. In the case of Snowy Hydro, the Federal Government effectively blocked the sale with a view to its electoral interests rather than to any notion of efficiency. As demonstrated by the Federal Government, privatisation of public assets will take place on a case-by-case basis and only where citizens confer their approval.

The fiscal impact of privatisation does not necessarily generate the positive budget outcomes identified by ERIG. The gross proceeds from the sale of electricity industry assets need to be offset against foregone earnings. The short run impact of Victoria's privatisation of energy assets on the government's net income has been estimated at almost exactly zero.⁶

Nevertheless, ERIG has identified an important tension in the operation of Government not unique in any way to the electricity industry. That is the allocation of scarce tax dollars, to which citizens hold their Government accountable. In the specific case of NSW, the NSW Government will make those decisions at the behest of NSW citizens. The Discussion Papers comment extensively on the state of the NSW and other state government budgets. We submit that the management of the NSW Government budget, and any other state budget, is outside the terms of reference for the ERIG review.

4.2 Perceptions of bias

ERIG suggests, on the basis of consultation with private sector industry representatives that regulators deal with government-owned businesses in a more limited [generous? or lenient?] way than privately owned businesses. In our view, it is inappropriate for public policy to develop on the basis of perception by the owners of private capital.

In NSW the Independent Pricing and Regulatory Tribunal (**IPART**) operates under its own Act of Parliament. It is clearly not the case that IPART has any legislative or other requirement to treat government owned businesses any differently, except where NSW Government enacts policy decisions applicable to the industry as a whole.

It is unacceptable for ERIG to make such assertions in the absence of clear evidence. Should any evidence of differential treatment come to light, it would be in the public interest to expose that information. However, the legislative framework under which monopoly and other businesses are regulated in NSW does not create a

⁶ Quiggan, J *The fiscal impact of the privatisation of the Victorian electricity industry*, Australian National University, November 2002.

differential system of regulation. Quite to the contrary, we would argue that it is a strong defender of competitive neutrality.

5 Governance under competition policy

5.1 Competitive Neutrality

At page 73, the Discussion Papers list a range of unsubstantiated claims and assertions about the operation of government business enterprises. ERIG has suggested that there are three there solutions to these unsubstantiated claims: greater policy disclosure, privatisation or improvements in competitive neutrality.

The current structure of government business enterprises arises out of the National Competition Policy (**NCP**) reforms of the 1990s. Those reforms saw structural disaggregation, price oversight of public monopolies and competitive neutrality reforms. It was not a precondition of NCP that privatisation occur. Indeed, the National Competition Council points out:

*NCP does not require privatisation, blanket deregulation, free markets, welfare cutbacks, contracting out, reduced social services or a focus on markets, money and materialism. It does not prevent governments from increasing spending on welfare, increasing the level of government funded or subsidised social services, or retaining businesses in public ownership. NCP explicitly recognises a need for government intervention in markets, where this is justified.*⁷

We therefore reject the view that privatisation must flow from competition policy. We do, however, support the view that where government business enterprises have been established, they must operate according to the principles of competitive neutrality.

ERIG has proposed a broad range of measures to improve the competitive neutrality of government business enterprises operating in the electricity sector (see pages 83-85). These recommendations involve either a higher level of regulatory intervention, the erosion of shareholder rights or the application of unnecessary legislation. For example, we do not see how the application of the *Corporations Act 2001* (Cth) to NSW government trading businesses will require directors to act in the best interest of the company to any greater degree than is already required by the *State Owned Corporations Act 1989* (NSW).

We suggest that the issues raised in the Discussion Papers do not reflect solely on the implementation of competitive neutrality in the electricity sector. Rather they reflect the broad agenda of the NCP. Such concerns would more appropriately be taken up with the Productivity Commission as part of a review of national competition policy. Unilaterally changing the application of competitive neutrality in one sector of the economy could undermine the intent of NCP.

⁷ NCC website, <http://www.ncc.gov.au/articleZone.asp?articleZoneID=16>, 29 November 2006.

6 Demand side participation

We appreciate ERIG's efforts to consider the shortcomings of the NEM in terms of demand side participation, and we note that the issue is referred to across the whole set of papers. In theory, the NEM's current design allows for adequate participation for a range of demand side measures, but in practice there has been very little implementation of demand management and mechanisms vary across the jurisdictions. The MCE has said it will investigate demand side issues more closely, but have not yet produced anything substantial.

There is, however, a major flaw in the position taken in the paper, which seems to be that once interval meters are installed and prices are no longer regulated – about which there is no absolute guarantee as jurisdictions will continue to control retail pricing – then demand management solutions will be satisfied. There are limitations to that view.

The use of interval meters allied with real time pricing can allow for consumers to better manage their demand and hence consumption. However, the extent of these benefits depends on the type of meter installed, that is, whether it has remote communication facilities which can give real time information on consumption and costs. To install meters without these facilities severely limits the huge potential of demand savings. Real time pricing additionally offers the potential to avoid inefficient augmentation of the system purely to deal with the rare occurrences of critical congestion. Simple removal of price caps will not lead per se to the development of accurate pricing for the consumer, and thus this is not in itself a solution for better development of demand side participation.

Inefficient augmentation of distribution networks has been inappropriately omitted from consideration within the papers. This is a huge problem to which only piecemeal solutions have been offered in an ad hoc way by the states. NSW and South Australia, for example, have instituted demand management (DM) codes for distribution networks to provide standards for reduction of usage in preference to augmentation of the networks, in recognition of the need to reduce consumption to offset greenhouse gas emissions. NSW has also implemented an incentive arrangement for distribution networks to investigate DM, the "D" factor. While it is open to debate to what extent these approaches have made network augmentation more efficient, it is clear that more needs to be done in this area both to standardise DM incentives across the NEM and improve upon them. If these and additional types of mechanisms were elevated to the national level it would produce a more satisfactory result for consumers – who currently pay for network augmentations that could be avoided through demand management – and the environment, through the greenhouse emission reductions that more efficient networks would deliver.

The Discussion Papers similarly highlight the inefficiencies resulting from unnecessary transmission network augmentation, and identifies the promotion of embedded generation and other non-network solutions as a means of reducing the need for such system expansion. The Paper recognises the additional benefit from appropriate location of generators towards reducing transmission losses and consequent greenhouse gas emissions. It also identifies transmission investment as a competitor to such embedded generation and other non-network strategies.

We welcome these insights on transmission issues and agree that a number of initiatives to improve transmission planning are yet to be implemented. One of these is the situation where networks are required to investigate demand management but

are not obliged to implement it – this position needs to be strengthened so that networks actually do undertake demand management where it is cost effective. To this end, due consideration needs to be given by the AER to such investment in DM and incentive mechanisms for the pass-through of DM costs are needed to balance the supply side and to limit inefficient over-investment in transmission infrastructure. The transparent and thorough investigation of non-network alternatives to augmentation – of both transmission and distribution networks – should be made clear through the Rules to ensure that these investigations are central to the determination of proposed capital expenditure by the AER. A shortfall in predicted DM savings may leave a TNSP at risk of carrying the full capital cost of an alternative (supply-side) means for meeting its reliability requirements. The eligibility of DM-related capital expenditure under this mechanism should be made explicit.

As a complementary measure, in the event that expected DM resources do not materialise as planned, the eligibility of capital expenditure undertaken to implement supply-side solutions where needed should also be made explicit. Network providers have noted that there is a lack of clarity regarding the recovery of DM spending by regulators. Thus there needs to be a proper, considered scheme for treatment of such expenditure when determining acceptable revenue and assessing regulated asset bases.

There are other demand side opportunities which have been inadequately addressed in the Discussion Paper:

- DM aggregation – there are a number of barriers to businesses wishing to develop DM aggregation and this again represents lost investment potential. Demand side bidding needs to be integrated into the NEM; and
- Demand side response – that is, where there is an agreement with a major user to shed, curtail or shift loads at times of peak congestion or price – the paper seems to disregard the untapped potential of this mechanism. NEMMCO has the power to set up these agreements in advance of a perceived constraint, either with a user directly or with a demand management aggregator. There needs to be greater investigation of the possibilities for these agreements within the NEM since this facility is under-utilised, partly due to the problems of inadequate accounting regarding DM investment. In addition, the development of firm short- and long-term prices for demand side response arrangements – as suggested by the paper – would not only make investment more attractive but would also enhance the reliability benefits of DM. With short-term pricing, forward trading would probably be enabled.

7 Re-aggregation and the effectiveness of the Trade Practices Act

We do not have a fixed opinion about the most appropriate industry structure for the delivery of energy services. We submit, however, that there must be continuous and robust oversight of developments in energy market structures to ensure that there are incentives for continued innovation and productivity improvements and consumers are not unfairly disadvantaged. Changes to market structures should not result in poor price and service outcomes for consumers. For the reasons outlined below, we maintain that current governance frameworks, including merger rules in

the *Trade Practices Act 1974* (Cth) (**TPA**) and the processes of the ACCC, need to be further investigated to determine whether they are appropriate to address the complex structures of the Australian energy industry.

7.1 Vertical integration – retail and generation

ERIG concludes that vertical integration between competitive generation and retail sectors is not a problem in the energy industry. We submit that a vertical merger would give rise to competition concerns if the vertical reintegration of an upstream or wholesale electricity supplier (i.e. a generator) and a downstream electricity supplier (i.e. a retailer) increases the horizontal market power of the integrated firm in the upstream market. The vertically integrated firm may exercise its market power to raise the price of its electricity wholesale contract to foreclose the retail market to rivals or potential new entrants. Put another way, the integrated firm may seek to extend its market power from the wholesale market to the retail market.

ERIG posits this problem as essentially a horizontal problem and concludes that section 50 of the TPA is adequate to deal with this issue. In our view, however, there is yet to be clear evidence that the regulator can adequately address such competition concerns. The failure of the ACCC to block AGL's acquisition of part of Loy Yang Power demonstrates the difficulties it has in obtaining the necessary evidence to substantiate assessments of market power.⁸

We do acknowledge that there may be efficiency benefits passed onto consumers from generator-retailer mergers, including improved risk management (it provides retailers with a natural hedge against spot market volatility) and reduced transaction costs. However, efficiency benefits may be outweighed by costs associated with diminished competition. ERIG raises the issue of a loss in the liquidity of hedge markets as integrated retailers hedge internally. Such a loss can result in barriers to new retail entry (as it becomes more difficult for new entrants to secure competitively priced contracts) and risk management problems for smaller retailers. A related vertical market power issue comes about when an integrated generator-retailer withdraws from the wholesale market because of the hedge that is created by the merger. The contract market becomes 'thinner' post-merger simply because there would be two less participants in that market. Generally speaking, the 'thinner' the contract market becomes, the greater are the incentives for remaining market participants to integrate vertically thereby causing further market concentration. Furthermore, the remaining generators may take advantage of a 'thinner' market to raise the price of wholesale electricity. This would have detrimental effects on all consumers given that wholesale price is a component of end-user prices.

ERIG's discussion of this issue is scant, and concludes that contract and hedge markets are not illiquid [is 'illiquid' a proper word?]. In our view, before reaching such a conclusion, ERIG should undertake further research to determine the impact of reduced liquidity in contract and hedge markets.

7.2 Vertical integration – contestable and monopoly sectors

We support the decision by the MCE to legislatively enforce the full structural separation of generation and transmission.⁹ We agree that there is significant potential for owners of transmission assets who also participate in the contestable market to have the ability and economic incentive to restrict levels of competition

⁸ *Australian Gas Light Company v ACCC (No 3)* [2003] FCA 15225 (19 December 2003).

⁹ COAG meeting communiqué, 10 February 2006, Attachment B – Decision 2.4.

and/or to shift costs between the competitive and monopoly arms of its business. We support contention by ACCC/AER that section 50 is ill-equipped to deal with such mergers.

7.3 Horizontal aggregation – generation

We agree that horizontal mergers between generators can give rise to significant competition issues. ERIG argues that competition issues cannot be detected by simply identifying the ability of generators to raise prices above long run marginal cost. This is because the NEM is an “energy only” market that relies on market incentives for investment (energy only markets use price as the signalling device to induce new investment). This argument highlights the difficulty faced by the ACCC when attempting to determine whether market power is being exercised. Assessing the capacity of new entrants to enter the market and the behaviour of incumbents in response to the action of competitors, without relying on scrutiny of prices over the long term, is a difficult process.

ERIG also states that it had limited time and capacity to undertake its own detailed analysis of the economic performance of the electricity market from a market power perspective. It is incumbent on ERIG to undertake such an analysis before making recommendations relating to market structures. Such an analysis is required before a comprehensive assessment of the effectiveness of the TPA can be achieved.

7.4 Horizontal aggregation – retail

We are concerned that ERIG’s analysis about competition at the retail level is based on conjecture rather than evidence. ERIG argues that churn data indicates that the “energy industry is generally highly contestable”. If customer churn rates are to be referenced to indicate levels of competition, they must be an accurate measure of customer awareness and response to market signals. Their reliability as an indicator is compromised when the data does not distinguish between ‘active shopping’ by the customer and ‘passive transfers’. By ‘passive transfers’ we mean consumers that do not demonstrate any awareness of choice (i.e. signs up with the dominant retailer in the area when moving house) or seek to compare offers. We are pleased to see that ERIG acknowledges that churn data currently being reported needs to be further disaggregated between customers moving to market contracts with the same retailer and those changing retailers. Relying on churn data as currently reported, therefore, is an inadequate method to assess levels of competition in the retail sector.

The MCE has established a process by which the effectiveness of retail competition is to be assessed by the AEMC (this is discussed further below under retail price regulation). This process has been supported by the jurisdictions and will comprehensively assess levels of competition in the market. We note that a similar assessment of competition undertaken by the Essential Services Commission Victoria in 2004 found that competition was effective for only 40 per cent of consumers. We find it unreasonable for ERIG to suggest the retail segment is highly contestable in these circumstances.

We also note that the overall number of retailers in the market appear to be decreasing. The latest positioning by the three largest private retailers to purchase Queensland retail businesses will reduce the number of market participants. While this does not necessarily mean that there is any exercise of market power at the retail level, we submit that continuous oversight by the regulator is needed to ensure there are no adverse outcomes from reduced competition.

7.5 Horizontal integration – consolidation of networks

ERIG suggests that there are no competition problems associated with the consolidation of networks as the businesses are natural monopolies. These businesses are stringently regulated in recognition of the fact that network asset owners can exercise market power. This finding ignores the important performance driver that regimes of competition-by-comparison bring to monopoly businesses.

Competition is not just about price outcomes for consumers, but also, especially where monopoly businesses are privately owned, service levels. Public reporting of performance information can stimulate businesses to improve their service outcomes for consumers, as well as provide important information about service levels to consumers. The Victorian Essential Services Commission's annual electricity distribution business comparative performance report is an example of such a report – such information is especially important for regional and rural consumers, who experience generally greater network problems compared with other consumers. We would be concerned about any recommendation relating to the aggregation of network businesses if it resulted in diminished levels of public information about the operations of those businesses and a weakening of performance drivers.

7.6 Merger regulation and process

ERIG has not addressed in detail the process of merger approvals by the ACCC, or the impact of the latest amendments to the TPA, implementing recommendations from the Dawson Review.¹⁰ While these issues are not specific to the energy industry, it is our view that they raise important issues for the industry given the complexities of interrelated energy sector markets. It is our view that electricity-specific merger rules or guidelines are required to ensure these complexities do not inadvertently result in merger approvals which substantially lessen competition.

We maintain that the current processes for merger authorisation and informal merger approvals do not enable the ACCC sufficient power to gather evidence to substantiate assessments of market power and the impacts of mergers on competition. As noted in the Consumer Law Centre Victoria's initial submission to the ERIG Issues Paper, the chief deficiency in section 50 and its application lies with the fact that the ACCC will only conduct a more sophisticated analysis of competition issues where the proposed merger falls outside the so-called "safe harbours". Our concern with an approach that solely considers ownership concentration was supported by the analysis undertaken by Acacia CRE Pty Ltd (**Acacia**) for ERIG on the effectiveness of the TPA to guide mergers in the Australian energy market. Acacia suggests that generator market power arises from intermittent capacity constraints, which can not be addressed by using the current merger guidelines alone. This is because such market power can be exercised by a participant with a relatively small market share. The ACCC's processes for informal merger approvals must enable it to consider the overall impact of merger proposals and not be limited by arbitrary market concentration thresholds.

With the recently legislated *Trade Practices Legislation Amendment Act (No. 1) 2006* (Cth), use of the informal merger clearance process may be significantly reduced. The Act introduces a new formal merger clearance, to operate in parallel with the informal clearance system. The formal procedure imposes certain legislated time limits on the ACCC and a requirement to disclose reasons. In our view, shortened time limits may impinge on the ACCC's ability to investigate merger effects fully and

¹⁰ Dawson Committee, *Review of the Competition Provisions of the Trade Practices Act 1974*, April 2003.

the ability of third parties to intervene. The Act also introduces a new streamlined merger authorisation process, whereby merger authorisation applications can be lodged directly with the Australian Competition Tribunal, bypassing the ACCC. It is our view that this is a major policy change under the Act. We are concerned about the fact that merger authorisation applications can only be considered once, with no merits review of decisions made by the Tribunal. The Tribunal is unlikely to be able to make the same level of inquiries as is currently the case with the ACCC and third parties will have less scope to have their views heard on a proposed merger. Given the dynamic state of energy markets, we believe this is a significant risk to consumers of energy.

ERIG notes that the TPA provides scope for merger parties to provide enforceable undertakings under section 87B of the TPA to allay competition concerns that the ACCC may have. We continue to have concerns with the increasing use of enforceable undertakings to resolve concerns over potentially anticompetitive mergers. In particular, we note that behavioural undertakings (as opposed to structural undertakings) present problems in relation to compliance monitoring and enforcement. In the energy sector, the complex and changing nature of the sector may compound these problems and render behavioural undertakings ineffective in preventing competition. We were pleased to note the ACCC's requiring of structural undertakings (to divest ownership) in addition to behavioural undertakings in its approval of the merger between AGL and Alinta. It is our view that the powers of the ACCC must be adequate to address competition problems and amenable to accommodate industry innovation.

8 Retail price regulation

We are extremely disappointed with seemingly uninformed comments in relation to retail price regulation in the Discussion Papers. To simply assert that retail price regulation forms a barrier to entry into the market ignores the important social protection function performed by retail price regulation. We are also disappointed by the lack of analysis given to the role of consumers in the market. It is clear that residential consumers have the weakest power of any party in the NEM, but can play a role in enhancing or activating competition. As argued in the initial submission to ERIG's Issues Paper by the Consumer Law Centre Victoria, competitive market outcomes can only ensue where there is demand side and supply side participation. In recognition of this fact, consumer protections and retail price regulation ensures that consumers are not disadvantaged by their lack of market power and can participate in the market. For example, consumer protection regulation ensures consumer have access to information needed to exercise choice. It also provides protection from behaviour that may otherwise distort market outcomes such as poor marketing conduct. In the same way, retail price regulation enhances competition, and does not impede it.

State and territory governments have retained power over retail price regulation as they recognise that energy is an essential service, and should not be priced out of reach of domestic consumers. In June 2006, the MCE amended the Australian Energy Market Agreement (**AEMA**) to include a process for providing advice to jurisdictions on the effectiveness of competition in retail markets. The AEMC has been nominated as the body to undertake the assessments into the effectiveness of competition in all States and Territories other than Western Australia, where the Economic Regulation Authority (**ERA**) will undertake such assessments. Where competition is assessed as effective, State Governments are to review the

appropriateness of continued retail price regulation. We support this approach as it is proposed to encompass comprehensive consumer consultation and ensure that consumers and classes of consumers are benefiting from retail competition before price regulation is removed.

ERIG maintains that retail price caps impede competition. Further, it describes the AEMA process as involving a “Catch 22” as it requires the emergence of retail competition as a prerequisite for removal of such price caps. This assessment itself misses the true contradiction in what is proposed by advocates for the removal of retail price regulation – consumers have been sold retail competition on the basis that it will deliver them cheaper prices. Competition ought to be able to deliver on this promise irrespective of price caps given these provide the ceiling not the floor in terms of price. Consumers experiencing higher prices because of competition reforms will be the “Catch 22” should retail price regulation be removed.

We also note that retail price regulation does not necessarily impinge upon market based pricing. For example, within the bounds of the negotiated price path in Victoria, there is significant scope for retailers to offer innovative tariffs that address consumer needs and wants. Retailers offer a range of products with different pricing structures, including peak and off-peak services as well as green products. There also continue to be proposals to introduce time-of-use tariffs in conjunction with interval metering despite the existence of retail price regulation.

9 Greenhouse gas emissions and renewables

We are pleased to see that ERIG has acknowledged that electricity generation is a major contributor to Australia’s overall greenhouse emissions. Australian governments are instituting a range of regulations and schemes to mitigate greenhouse emissions, but it is being approached in a piecemeal fashion. In particular, state governments in the NEM are establishing renewable energy targets (RETs), an area which the ERIG paper singles out as difficult for investors.

There is little argument among electricity consumers and state governments that Federal action has been inadequate. Improved Federal leadership could help solve the piecemeal state approaches, including a Federal Mandatory Renewable Energy Target agreed to by the individual states; this would be one of a suite of programs that could ameliorate the impacts of climate change and reduce greenhouse gas emissions significantly. Carbon pricing is another strategy referred to in the ERIG papers as an area that is producing uncertainty, and again this needs to be adequately addressed at a national level. The recent announcement of the Federal Government’s intention to investigate emissions trading, may be a step in the right direction but is no guarantee of an effective scheme unless there is agreement across the states and territories. Effective action at the national level in these areas has the potential to address not only greenhouse gas emissions but also provide a whole new suite of investment opportunities. By addressing the currently hidden costs of electricity generation the NEM objective would be better met, by ensuring a more efficient system as well as better meeting the long term interests of consumers, who would otherwise suffer from both the environmental effects of climate change and would endure the higher costs of delayed action (as outlined in the Stern Report¹¹ and the Australian Business Roundtable on Climate Change¹²).

¹¹ Stern, N, *Stern Review: The Economics of Climate Change*, Cambridge University Press, November 2006

9.1 Embedded generation and renewable energy generation

In exploring demand side participation the Discussion Papers acknowledges the benefits of reducing consumption at times of peak demand and consequently reducing greenhouse gas emissions. Equally, this is true for embedded generation. Small-scale embedded generation can operate as a form of demand side management by satisfying local demand and therefore avoiding unnecessary network infrastructure. It can also reduce greenhouse emissions through reduced transmissions losses and the installation of renewable generation technologies. Currently, prices for the supply of electricity from small-scale embedded generation are well below [proper?] market prices. This has the effect of dampening the take-up of these technologies. To improve the situation, the provision of cost-reflective tariffs for the feed-in of electricity at peak demand times would stimulate growth in these technologies which are able to supply this capacity.

Embedded generation systems can offer the following additional benefits:

- improved supply reliability through generation diversity;
- generation closer to customers resulting in improved power quality and reduced power losses;
- greater individual and community control over energy sources;
- reduced dependence on a small number of large remotely located generators; and
- improved employment opportunities, with small-scale renewable projects providing more jobs per MWh of electricity produced than conventional energy sources.

An enduring problem is the lack of appropriate feed-in tariffs to promote incentives for small generators and these need to be better developed across the NEM to promote competition and efficiency.

There are further barriers to the installation of embedded generation, particularly small-scale systems, and hence the creation of a truly efficient and competitive market. These barriers include:

- complex technical regulation which discriminates against system owners and potential investors;
- an economic regulatory framework which provides:
 - little incentive for retail or distribution businesses to actively encourage small renewable embedded generation; and
 - minimal protection for system owners;
- a lack of publicly-available information that can assist system owners negotiate and undertake what is often an unnecessarily technically and administratively complex process;
- a meagre return on investment due to a lack of cost-reflective feed-in tariffs for such generation;
- minimal consistency in the treatment of existing and potential system owners negotiating grid connection; and
- distribution businesses demanding gross metering (despite poorly drafted and ambiguous codes which attempt to stipulate otherwise).

A combination of all of these impediments results in a system which is inefficient and obstructive to new investment opportunities. We would encourage ERIG to highlight

¹² Australian Business Roundtable on Climate Change, *The Business Case for Early Action*, April 2006

solutions for overcoming these barriers, to promote the most efficient use of resources.

10 Other matters raised by the Discussion Papers

10.1 States' interim responsibility

The Discussion Papers state that the jurisdictions continue to derogate from national regulation and introduce local regulation. While we are generally supportive of the notion that States should align their activities relating to energy where possible, we are concerned at ERIG's implicit criticism of recent State initiatives relating to consumer protection and greenhouse gas abatement schemes. Industry has made similar criticisms, ignoring the outcome and intent of such regulation, to focus simply on the process.

It is entirely appropriate for States and Territories to act in the interests of citizens to the extent of their authority. Apart from their current, clear and ongoing responsibility, we would also note that the deadline for the implementation of the MCE's commitment to finalise a national regulatory regime has already been extended a number of times, and it would be irresponsible for the jurisdictions, or for jurisdictional regulators, to ignore their responsibilities in what remains an uncertain regulatory environment.

10.2 AEMC funding

ERIG has sought comments from stakeholders on the funding arrangements for the AEMC. We share their concern that the process for resourcing the AEMC is cumbersome and inefficient, and agree that the AEMC must be assured of a level of resources that accurately reflects its role and responsibilities.

This is particularly important in the short to medium term, as the new national regulatory agencies develop and implement rules for retail and distribution, and assessing the effectiveness of competition. Consumers' confidence in the institutional arrangements of the regulatory framework underpins the development of effective competition, and it is therefore crucial that the new national regulators are able to act effectively in accordance with their mandate.

10.3 Role of the Commonwealth

ERIG states that there is a strong case for further Commonwealth participation in decision-making relating to national energy markets. Given that this is an essential service, and its withdrawal produces real detriment to Australian residents and businesses, we believe that decisions with regard to the energy system should be made at the level of government most accessible and responsive to the public.

We would therefore not share ERIG's view that there is a case for allocating the government role exclusively to the Commonwealth, at least in the short to medium term. The NEM remains an immature market, and all governments will – and should – continue to monitor closely its development and be able to intervene if necessary, including in the interests of classes of consumers who may be peculiarly disadvantaged (e.g remote rural communities).