



4th August 2006

The Director
ERIG Secretariat
Level 4, 33 Allara Street
GPO Box 9839,
Canberra City, ACT 2601
By email: erig@industry.gov.au

Dear Ms Taylor

For attention of Market Structures Reference Group

I write on behalf of the Energy Intensive Industries Alliance (EIIA) in response to ERIG's investigation for the Council of Australian Governments of measures that may be necessary to address structural issues affecting the ongoing competitiveness and efficiency of the electricity sector.

EIIA represents the interests of industries where energy is a substantial proportion of production costs and is a significant contributor to their competitiveness. It represents the aluminium industry (through the Australian Aluminium Council), the cement industry (through the Cement Industry Federation), the plastics and chemicals industry (through the Plastics & Chemicals Industry Association) and the forest products, pulp and paper industries (through the Australian Plantation Products & Paper Industry Council).

Many member companies within the EIIA are also members of the Energy Users Association of Australia (EUAA). They have been involved in, and are supportive of, the EUAA submission on these issues which more comprehensively deals with some of the technical issues.

This submission has been prepared using assistance provided by the National Consumer Advocacy Panel and engaging the services of Coolibah Pty Ltd.

The major energy-intensive manufacturing sector contributes:

- 12 per cent of Australian gross domestic product,
- 12 per cent of full-time employment and
- 20 per cent of capital investment.

The sector accounts for about a quarter of Australia's primary energy consumption and about a third of national electricity consumption. Energy accounts for about 25 per cent of the sector's cost of production. Reliability and low cost of energy supply underpin this industrial base of the Australian economy.

The sector's companies are heavily trade-exposed to the global markets, dependent on competitively-priced energy to maintain a competitive edge and unable to readily pass through domestic cost increases to their customers.

They also provide the loads that stimulate the energy investment necessary to get power and gas in to Australian homes and smaller businesses and pay for a substantial portion of infrastructure development.

A significant issue for large energy users is the predictability of energy prices. This is a crucial input to budgets, pricing and market strategies and also capital investment programs.

In the Alliance's perspective, the key challenge of NEM reform is to ensure that the market is driven by the genuine needs of consumers and not the needs of consumers as interpreted by parties wishing to invest in supply infrastructure.

While the EIIA's principle focus in ERIG's activities is the urgent need to give importance and priority to policies that will develop the national (ie NEM) transmission network to provide users with a more efficient supply of electricity, the commitment by CoAG in February to implement national energy market structures to foster competition is also strongly welcomed.

The comments provided here deal with the structure of the NEM, as this is the main area where the EIIA's member companies are active.

At present, there are three core issues of concern with the NEM structure for energy-intensive manufacturers:

- the continuing dominance of government-owned energy businesses in most areas of the NEM;
- the heightened levels of ownership concentration in both the electricity and natural gas sectors and
- the way in which the exercise of market power lifts generator revenue above long-run marginal cost so that end-users pay more than necessary for wholesale electricity.

Governments and regulators have not undertaken a full study of market power in the NEM in the past 10 years and, in EIIA's submission, such a review is overdue. The Alliance has addressed the critical problems of weak inter-state inter-connection in its first submission to ERIG. It wishes to point out here that other factors impacting on market effectiveness, and hence on the capacity of EIIA member companies to maintain their competitive edge, include:

- ❑ a less than optimum number of independently-owned market participants;
- ❑ the current and increasing move to mergers and acquisitions in both electricity and gas supply;
- ❑ the way generators behave in bidding, especially when price spikes occur; and
- ❑ the ability of incumbent generators to create pool circumstances that deter new entry to the market.

EIIA is aware of a view that some degree of market power needs to be exercised by generators because, unless they can push their wholesale market revenues above long-run marginal costs, they will not be able to recover fixed costs. The Alliance disagrees that market manipulation is desirable under any circumstances and argues strongly that, in a well-designed market, generators should be able to recover fixed costs from a number of sources, including for example capacity markets to meet resource adequacy requirements.

EIIA believes that vigorous competition at the wholesale level in the NEM is the key to reducing the exercise of market power and that the concentration of more than 50 per cent of generation ownership in the government sectors in New South Wales, Queensland and Tasmania is a particular problem that ERIG must address as part of this inquiry.

While the strengthening of inter-connections will undoubtedly help to address market power issues, EIIA is concerned that these other structural issues may be perceived by policymakers as too hard for resolution and that, therefore, reform efforts will focus on transmission improvements at the expense of structural change to the long-term detriment of achieving a genuinely efficient market.

In EIIA's view, realisation of this goal, in addition to adequate transmission augmentation, necessitates mitigation of market power through:

- ❑ prevention of further supplier concentration in the NEM;
- ❑ the greatest possible disaggregation of government-owned generation portfolios; and
- ❑ an independent process to monitor pool price volatility, generator bidding and rebidding practices and wholesale price trends in the NEM to ensure that governments are fully informed on market performance.

In answer to ERIG's questions on market structure (at page 14 in the issues paper), EIIA provides the following answers:

1. *To what extent do existing market structures in the energy sector facilitate or impede competition and hence economic efficiency? What changes, if any, would achieve materially greater efficiency?* Answers: As set out above, existing NEM structures impede market efficiency. EIIA has provided suggestions above as to how these problem should be addressed.
2. *How are competition and efficiency affected now and in to the future by integration between monopoly and contestable sectors, vertical integration*

between contestable sectors and horizontal aggregation? Answer: As EIIA has explained above, all these factors contribute to higher costs for end-users and, in the case of energy-intensive manufacturers, erode their capacity to compete in the global marketplace.

3. *Does transmission capacity between regions and within regions effectively support competitive and efficient electricity market outcomes?* Answer: Not in the NEM at this time -- this issue has been dealt with in depth in EIIA's first submission to ERIG.
4. *Is competitive neutrality between government and private businesses a significant issue influencing competitive and efficient outcomes?* Answer: Yes. In a relatively small marketplace, common government ownership of supply companies in NSW, Queensland and Tasmania is a substantial issue. Breaking up these generation portfolios is highly desirable and State government agreement that these generators be allowed to act fully independently is an essential factor in pursuit of market efficiency. In addition, all State-based schemes for "equalising" end-use tariffs (such as the New South Wales Government's ETEF scheme) need to be recognised for their anti-competitive and market-distorting character and banned. It is worth noting that one of the objectives of the original National Grid Protocol agreed by the Heads of Government Meeting (the precursor to CoAG) was "to enable private generation and publicly owned generation to compete on equal terms."
5. *ERIG poses a series of questions relating to mergers and whether special limitations are necessary for the energy sector?* Answer: Governments need to come to a clear landing on (a) whether market power is being used in the NEM to the detriment of end-users and (b) if so, what rules or structural changes and market oversight activities are needed to eliminate this problem. The "horse" of examining market power in the NEM must be put before the "cart" of the ACCC seeking to extend its powers under s50 of the Trade Practices Act. The important underlying issue includes both merger and acquisition activity and the issue of governments owning more than 50 per cent of NEM generation plant. If the conclusion of this review is that there is a market power issue and the TPA is inadequate to manage the aspects relating to energy market mergers without extended ACCC powers impacting adversely on other areas of the national economy, then it is incumbent on governments to strengthen energy market controls to prevent competition-weakening ownership arrangements. The starting premise here, for EIIA, is that the NEM is already highly concentrated by global energy market concentration standards.

An issue that needs to be raised in the context of these matters is the disparity between service performance standards across Australia. Pursuit of national technical standards to the maximum extent possible is not only necessary to ensure common quality delivery for end-users but also to eliminate unnecessary cost burdens. This is an issue of regulatory structure that should not be ignored in pursuit of market efficiency.

In conclusion, the Alliance is a strong supporter of a competitive NEM, and more generally of the national energy market, because this will enhance its

member companies' competitiveness, encourage further investment in energy-intensive manufacture and promote employment opportunities for the Australian community.

Governments had the objective of true competition in electricity supply to promote efficient supply and use of power when they agreed to the 1990s disaggregation arrangements. As evidenced by CoAG's decision to establish the ERIG process, this goal has been eroded by government actions and inactions, by marketplace behaviour and by re-aggregation in the private sector.

The cost burden of this erosion falls on end-users and to a substantial extent on the manufacturing sector to the detriment of the national economy and ultimately the community overall.

The priority focus of policymakers for the NEM, and of the national energy market in general, must be to ensure a competitive market structure for both power generation and gas supply.

EIIA looks forward to seeing ERIG's draft report and will welcome further opportunities to make input to the inquiry.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Miles Prosser', is written over a vertical line.

Miles Prosser

ON BEHALF OF THE **ENERGY INTENSIVE INDUSTRIES ALLIANCE**