

Securing Australia's Energy Future

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Chairman



Pleasure to be here today to speak as the Chairman of Energy Supply Association of Australia

- Newly constituted from 1 January 2004 - representative of CEOs across energy markets
- Industry representation arrangements reflect the need for an overall perspective on energy market issues
- Specialist energy sector industry bodies also
- Elected in November 2003 (followed Ian Nethercote)

Conference is timely:

- Ministerial Council on Energy policy decisions
- Market Competition developing well
- Importance of continuing to develop national energy market including supporting regulatory structures

Today is opportunity to signal ESAA priorities agreed to by CEOs, particularly in light of Ministerial Council deliberations

The Victorian Experience

- Effective structural separation
- Regulation generally restricted to appropriate sectors
- Disappointing to see retail price intervention



Let's step back for a minute and look at the impact of the changes in the energy industry in Victoria in particular

- reform program commenced with structural separation and privatisation
- Broke retail and generation into units where market power could not be exercised
- As competition and the energy market has developed, there has been a large number of players enter and leave the market
- Competition is working - customer churn rates are around 8-10%

ALL IN ALL - RELATIVELY GOOD RESULT

HOWEVER despite competition benefits, continued retail price regulation of the small user sector in the last few years stands out as the most significant obstacle in Victoria from allowing the market to work effectively. Long-term standing price agreement brokered last December is big improvement, but ultimately retail pricing should be left to the competitive market

The Victorian Experience

- Lower energy prices (and returns) than many expected
- Consumer benefit but investor impact
- Energy price outcomes drive subsequent structural change



The competition in the generation sector of the NEM in the early days was more intense than almost anyone expected. Wholesale prices of sub \$20 per MWh were common and unsustainable - well below the long run marginal cost of new generation plant.

In the first few years consumers benefited enormously. This remains a problem with many large users believing prices above \$20 reflect a lack of competition. They don't and policy makers need to understand this.

In fact, policy makers must understand the wholesale market and the inverse relationship between contract prices and spot prices.

These energy price outcomes drive subsequent structural change

Many assets have been or are being sold. There are many reasons for this, but lack of commercial returns is at the heart. This is not sustainable.

Lessons from 6 Years of Competition

- Energy is an essential service – Governments see risk everywhere!
- Outcomes superior to centrally planned state systems
- World-wide, market arrangements have had to be changed



So what are the lessons from six years of competition?

The NEM has been a success, make no mistake. Retail prices are competitive and among the lowest in the OECD. Centrally run, state owned systems never aspired or achieved these outcomes

But the NEM remains shackled by government intervention as the “essential service nature” of energy services means governments don’t want to be blamed for price rises, service failures or a ‘gap’ in new supply.

Industry does recognise these issues but a move back towards central government control will result in inefficiency and higher costs.

Industry is amongst the first to agree that the NEM can be better. But as witnessed around the world early markets have needed attention. By comparison, the NEM needs refinement not replacing.

Lessons from 6 Years of Competition

- Australia's gas and electricity market is not fully developed, regulation is intrusive and governance arrangements are confused.
- Ministers' decisions good step
- Conclusion: market not fully developed, but positive economic contribution nonetheless.



What we see in 2004 is that the NEM is not fully developed. The role of economic regulators remains significant, intrusive and based on state markets - not a national market.

In the ESAA's view they are an expensive imposition in many areas that should be freed to competition instead of price control. The governance arrangements are also confused and uncertain.

The Energy Ministers' December announcement is a first step in the right direction to achieve better governance and hopefully better regulation. But we don't know yet if the detail when developed will be as positive as the decisions appear.

Despite the opportunities for improvement, the NEM is developing and represents the best vehicle for delivering a national market. NEM has made a positive economic contribution.

National Energy Market - **esaa**

- Ministers have brought electricity and gas together in their approach
- The new **esaa** intentionally positioned to contribute similarly
- **esaa** is focussed on strategic, whole-of-sector issues.



The December Energy Ministers decisions are remarkable for their concurrent contemplation of gas and electricity. This is sensible as the market has already moved there. Companies actively manage portfolios of assets, many in both gas and electricity.

As I mentioned in my opening comments, since 1 January the ESAA is also aligned on an energy sector basis. It is the Business Council for Domestic Energy by another name. It's timing is right.

No longer will the ESAA be electricity dominated or sectoral focussed.

It is a strategic, whole-of-industry association that will make positive contributions to the many issues that impact on securing Australia's energy future.

National Energy Market - **esaa**

- **esaa** is a member CEO led organisation. Policies reflect the collective position agreed by member companies
- **esaa** policy positions being developed, but key ones settled already.



The new **esaa** is a member CEO led organisation. That means that the Chief Executives of Australia's domestic energy businesses decide collectively the policy and positions to be pursued.

This is possible by the creation of sectoral industry bodies such as the Energy Networks Assn, Energy Retailers Assn and strengthening of the National Generators Forum as the bodies to deal with the detailed, market facing issues that the individual sectors face.

esaa will not be commenting on such detailed issues. Instead, it will deal with the multi-sectoral, strategically significant issues for the benefit of the sector overall.

Already, the member CEOs have met and decided some key policy positions relevant to current Ministerial considerations on energy policy. I'll outline some of them now. Get ready, there's a few surprises.

Key Reform Decisions 2004

Regulation:

- Lighter handed, lower cost and better quality regulation needed
- Meaningful and efficient appeal processes must be a feature
- Roles for AER and ACCC must be clear and not duplicative



The regulatory environment remains expensive, duplicative and intrusive. We must redress this as the detail is added to the Ministers' proposal for the Australian Energy Regulator (AER).

esaa wants to see an effective and efficient merits-based appeal mechanism for decisions by regulators. This should ensure that the overall quality and consistency of regulator' decisions improves.

We are also very concerned that a statutorily independent AER that is a component part of the ACCC does not provide clarity between the respective roles of the regulators.

In **esaa's** view the roles of the two regulators, the AER and the ACCC, must be very clear and provide for a single step decision. By that I mean that the AER does not make a preliminary decision that could be subsequently reviewed and/or changed by the ACCC. **That would not be progress.**

Key Reform Decisions 2004

Market and Code Development:

- AEMC should be the sole Code approval agency
- Ministers' directions to AEMC must go through consultation processes
- AEMC coverage of all standards and codes for whole of chain



It's time to achieve real efficiency in Code management. The AEMC must have high calibre members who make Code changes with no further approval processes.

The Ministers will have the power to issue binding policy directions to the AEMC. However, what's important is that we make sure the resulting Code change proposals go through the normal consultative process.

We also want the AEMC to be the single body nationally for Code and standards management from generation through to retail, regardless of which regulator (national or state) applies them. No more multiple state based standards please.

Key Reform Decisions 2004

Industry Levy :

- Taxation without representation?
- Industry input on regulator costs and levy
- Levy should be a pass through to consumers
- Industry involvement in appointment of Commissioners to AEMC and AER.



The imposition on the industry of a levy for all Code development and regulatory costs is a big and very expensive change.

So far there are no proposals for the industry to have any input on the regulatory budgets or the structure and size of the levy each year. This is not acceptable.

This a straight tax, a cost transfer from government to industry.

Remember, governments currently pay for the ACCC and all of the state regulators. All up, including NEMMCO, these taxes could total between \$150m and \$200m each year.

These costs should be explicitly passed through to consumers and the industry must have a strong voice on the selection of the members of the AEMC and AER.

Key Reform Decisions 2004

Electricity Transmission:

- **esaa** objective: economically and competitively efficient inter-connected NEM
- TNSP's should be incentivised based on market impact
- Regulatory test - a 'whole-of-chain' approach
- Borrow from gas arrangements to improve electricity network regulation



Electricity transmission is a very big issue.

esaa has a clear view on the objective for transmission - it must provide an economically and competitively efficient inter-connected NEM. Industry seeks a national market not a series of weakly connected regional markets.

The transmission companies should be incentivised to support the market to work. Their impact needs to be appropriately recognised and rewarded or penalised.

We see the need for the regulatory test to properly comprehend the whole of chain impacts, and where the gas code has superior elements, these need to be added to the transmission parts of the electricity Code.

In particular we see the current Productivity Commission review as holding much promise. Depending on the outcomes, it could provide relevant guidance which supports investment in electricity transmission and distribution. Projected growth in demand requires we get the answers right - and quickly.

Key Reform Decisions 2004

Security of Supply :

- Very substantial growth in demand means big investment requirements
- Investment climate must be conducive – action needed
- **esaa** has clear position on achieving this.



We know that over the next decade the growth in demand for electricity and gas is massive – rates of between 50% to 100% over 2000 levels are projected. This equates to billions of dollars in investments

The investment climate is therefore vital to delivering and assuring Australia's energy future.

It isn't all positive currently and could easily worsen. The new **esaa** policy positions that I've spoken about already and the next few aim to address this.

Key Reform Decisions 2004

Security of Supply :

- Constant change in the policy and regulatory climate threatens investment
- MCE to complete all work quickly
- Externalities must be dealt with by government, especially greenhouse



We've had important and necessary reviews of the energy sector, by panels chaired by Warwick Parer, Grant Tambling and by the Productivity Commission. But in the absence of decision making and implementation, these reviews inject uncertainty in business operations and investment decisions.

Probably unwittingly the Ministers have contributed to this by taking a year to make their first set of decisions in response to the Parer Report - the creation of the AER and AEMC.

This means that the other outstanding reviews must be dealt with more quickly by government. However the focus must be on ensuring interdependencies are recognised and implementation is a priority.

The investment climate is suffering considerably due to uncertainty that only Government can address. Greenhouse gas abatement is the key matter needing attention here.

Key Reform Decisions 2004

Security of Supply :

- Understanding and acceptance that wholesale price changes drive investment
- Role for government is to facilitate market decisions on investment, not interfere in price signals



The NEM market mechanism relies on average wholesale price movement to provide the main investment price signal. The Parer review examined this and provides a good explanation of its workings.

Governments are disconnecting retail prices from the wholesale price, yet worry that new plant may not be built.

esaa believes strongly that the wholesale price signal, if allowed to work, **will** deliver timely investment. Some price rises will flow to the retail level but the impacts can be managed and are necessary over time.

Governments should contain their role to ensuring sites for generation are identified, permitted and made available to whoever wants to invest in new facilities. Picking winners, either players or technologies, must be avoided.

Key Reform Decisions 2004

Security of Supply :

- Long lived, very large investments involved
- Sovereign risk growing, especially on greenhouse
- New **esaa** position on greenhouse seeks to address this.



New baseload generation investments are big. Very big. They come at a cost of at least \$1 billion. They then last 35 to 50 years. You don't commit to these numbers without reasonable certainty.

Investors can make their own judgements about pool prices and trading risks. Increasingly however they are unable to adequately factor in premiums to the hurdle rate for sovereign risk considerations. The biggest sovereign risk facing the energy sector is future government policy and measures on greenhouse gas abatement.

esaa has a new position on this important matter that seeks longer term policy commitment from government.

Key Reform Decisions 2004

Greenhouse Position :

- The Commonwealth should decide a single and national GHG emission target for 2050 to apply to the whole economy. No separate State measures
- The Commonwealth should ensure that:
 - The economic impact is manageable; and
 - A predictable investment climate is created



ESAA wants the national government to set a single GHG emission target for 2050 that applies to the whole economy. We want an end to the competing state and federal measures and targets. We want a long term approach with clear milestones on the way.

There are some caveats. Two of the most important of these are:

- The economic impact must be manageable – Australia must remain a competitive economy while addressing the greenhouse issue
- The investment climate must be more certain and predictable so that energy investors can meet the security of supply challenge and the greenhouse objectives concurrently

Key Reform Decisions 2004

Greenhouse Position :

- Measures to achieve the target should minimise market distortions and provide appropriate mechanisms for abatement technology selection by participants
- R&D on new technologies should be effectively coordinated and government funded



The measures to achieve the 2050 target should then be formulated. **esaa** contends strongly that the widest possible set of abatement options should be available to those with the obligation to achieve reductions.

Their selection should be enabled via appropriate mechanisms that minimise the distortion of the energy market.

We are also clear that technological development will be vital to the achievement of GHG emission reductions at least cost.

A more focused and coordinated effort on new technology R&D to achieve emission reductions is needed.

In recognition of the importance to the economy of the energy sector, these activities should be government funded.

Key Reform Decisions 2004

Greenhouse Position :

- Australia must be an active participant in developing global measures to abate greenhouse gas emissions.
- Abatement costs to be a 'pass through' to consumers



esaa recognises that Australia is meshed in the global economy.

To maximise our access to the widest range of abatement measures, Australia must be an active participant in developing global measures to abate GHG emissions.

GHG abatement is a costly business, but to the long term benefit of society.

esaa therefore believes that the additional costs of achieving GHG emission targets should be an explicit pass through cost item to consumers.

This information will inform the community of the costs involved and encourage their efficient use of energy.

SUMMARY

- The NEM has been successful by any standards and comparators
- Improvements are needed and direction being established by Ministers
- BUT big challenges yet to be addressed
- **esaa** brings new strategic positions.



In conclusion

As a nation, Australians are good at running down our achievements. Let me be clear - - by world standards, the NEM is a success. It works, prices are competitive and the economy has benefited enormously.

The need for improvements has been recognised and the Energy Ministers have started down the right road. But the journey has really only just begun and still bigger challenges lie ahead. We must meet them head on and quickly.

The new **esaa** looks forward to working with governments to help them to understand what the CEOs of the companies that will deliver Australia's energy future know are the necessary outcomes

Thank you

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