

Address by
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“AUSTRALIAN ENERGY MARKET ISSUES”
(Check against delivery)

Good afternoon energy consumers. Enjoying the air conditioning? Did you have a nice hot cup of coffee or tea when you arrived at the office this morning? Was your lunch nicely cooked?

One way or another our lives are bound to energy aren't they?

Every one of us uses energy in our personal life and our business life and I'll bet that most of you don't think much about it ... except perhaps when you get the bill. You expect to flick the switch or turn the knob and find energy at your fingertips. And fortunately, you usually do. Right?

Well, today I said I'd talk about the energy market in the future. But before we do that let's look back at how and why the energy industry has changed over the last 10 years. There are many lessons in the journey made.

Energy Industry Reform in the 1990's

In the early 1990's the National and State Governments embarked on a process of major change to the industry.

It would be a fair observation to make that at that time:

- energy consumers dealt with vertically integrated gas and electricity companies; and
- there were separate as well as regional markets for gas and electricity.

And what were the objectives of the industry and competition policy reforms embarked on by governments at that time?

Clearly, it was to move towards a national energy market, and I'll quote from the Industry Commission Report of 1991, “with the oversight by a general body at the national level, rather than by a number of state/territory bodies”. In addition, it was to ensure the efficient investment in essential infrastructure.

The energy industry as we know it today had not yet been formed – with segmented regional markets as opposed to a national market. Nor had the multi layered and complex suite of regulatory instruments we have today been introduced. Nor indeed, had the number of state based regulators we, as the industry work with, been tasked.

Through the 1990's the commitment to a national energy market saw:

- The unbundling of generation, transmission, distribution and eventually retail services;
- Victorian and South Australian governments privatising the unbundled parts of the gas and electricity industry supply chains;
- Entry of new players into parts of the unbundled industry including from Asia and the United States; and
- Creation of a number of national and state based independent regulators to ensure market reform benefits were realised by energy customers.

If you were an economist you might sit back and think it all sounds like textbook stuff. And many parts of the industry reforms were significant – without these companies such as AGL would not be in the position we are today.

But it's not that easy. Let me say that in my view the central objectives of the Industry Commission reforms of the energy industry have still not been delivered – although there has been clear progress. Let's explore this theme a little further.

Light Handed Regulation

First, we don't have the promised light handed approach to regulation. In fact far from it!! How many in the audience could say the same of their own industries? The energy industry is regulated by around 13 different regulators with different rules.

Those from the United States or the United Kingdom must wonder about this when at home, markets larger than Australia, have fewer regulators and rules. And even then, as we have seen so graphically in recent times, in places like California they don't always get it right!

But don't get me wrong. AGL is a strong supporter and advocate of national energy market competition. We've been doing business for 165 years already and continue to successfully grow our business.

The concern arises when the benefits of competition are obscured by complex regulatory arrangements which in the view of many are having a perverse effect on investment decisions.

National Energy Market

Secondly, we don't have a genuine national energy market. Well, what's the significance of this, you might well ask.

The issue is that all of us in the energy industry in the 1990's, whether we were existing or new players, developed our commercial strategies on the basis that there would be a national market.

Instead what we still have is a set of regional markets with often different rules which increases uncertainty and impacts on investment decisions. And that's not in the interests of us in the industry or our customers who are interested in reasonably priced, safe and reliable energy products and services.

On the other hand, it is true that the Australian energy industry has been transformed in terms of players. It now has a range of players (some of whom are here today) such as:

- In Generation – there's TXU, China Light and Power as well as governments in Queensland and NSW
- In Transmission – Duke Energy, APT and EPIC Energy
- In Distribution – AGL, CKI, TXU, and Envestra
- And in Retail – AGL, Origin, TXU and government owned retailers such as Energy Australia, Integral Energy, Country Energy, Energex and Ergon.

And it's true that there will continue to be more change, particularly as companies assess business opportunities and decide where to invest in the downstream sector of the industry.

So what's AGL doing given all these developments?

Well the simple answer is, "Heaps"!

Retail Energy Sector

But let me confine my remarks this afternoon to the retail energy sector.

In my view the decisions of retail energy companies to grow and invest today are on the basis of two drivers which underpin shareholder value. First, is economies of scale in operation. And second, is the ability to control wholesale energy purchase costs.

In comparative terms the entire Australian downstream energy market is not large – smaller in numbers than the entire market in some American states.

As such, it is a market unable to sustain companies operating at a small scale in markets where margins are small and capital requirements for IT and related systems are intensive. Inefficient scale means high operating costs and difficulties in being able to effectively control wholesale energy purchase costs.

In fact, I have been saying for some time now – along with a number of others in the industry including, most recently, the CEO of Integral Energy – that the Australian retail market is only large enough to support perhaps 4 or 5 national energy retailers in the future, not the dozen or so we now have.

Simultaneously, the energy industry has become characterised by strategic alliances along the energy chain. These are occurring between retail and generation

segments, often backed by predictable earnings and cash flows from distribution assets.

This is AGL's approach – to build a balanced downstream energy business with a mix of regulated and market based energy businesses. With the heady days of the initial round of privatisation of government assets in some states now over, the industry is again experiencing change. Companies are reassessing their strategic priorities and opportunities for growth in a relatively small energy market that has yet to live up to the promise of being a truly national market.

AGL

Having reflected on the changes during the 1990's, I'd like to specifically talk for a moment about AGL as an example of how economic reform has impacted our thinking on the strategic direction in which we are taking the company.

Let me give you a context. The AGL Group sells around \$4 billion of natural gas and electricity every year across Australia and New Zealand to well over 3 million separate energy accounts. In addition we operate over 40,000 kilometres of transport infrastructure, delivering both gas and electricity.

Pulse

A month ago AGL announced the acquisition of Pulse Energy, Utilimode and EdgeCap which collectively constitute a Victorian gas and electricity retail business.

AGL's **strategy is simple**. We want to build on our position of market leadership by:

- Moving from a separate gas and electricity focus to a balanced energy portfolio;
- Redefining our portfolio of assets in the context of a national business footprint; and
- Delivering maximum returns to our shareholders through enabling change with a focus on economies of scale.

The acquisition of Pulse significantly enhances our competitive position.

It provides an additional 1.1 million customers in Melbourne and takes us to a position of market leadership in that state as well as nationally.

It provides much greater geographical balance and affords us critical mass in each of the major South East Australian markets in which we compete.

It also enhances our national energy footprint.

And, it gives us a premium Victorian customer demographic.

At the same time it establishes the largest dual fuel customer base in Australia and provides a new gas supplement to the AGL's current Cooper Basin natural gas contract.

So the purchase of Pulse has clearly provided AGL with both further economies of scale and an improved ability to manage wholesale energy costs – the twin sisters to successful energy retailing.

However, while the purchase of Pulse has clearly filled an important gap in a populous and important state market, there still exists enormous discontinuities from the failure to develop the truly national energy market promised so long ago.

National Leadership

You could fairly ask then, “Has the way to a national market with a single set of rules and a single energy regulator been lost?”

As I speak, Governments are showing signs of reasserting a national leadership role at a time when the debate over the appropriate nature of regulation has hit a crescendo. Coupled with this, the need for certainty of future energy supplies and new energy infrastructure has led us to a crossroad in policy making.

In this regard recent initiatives arising from the Council of Australian Governments are most welcome and very encouraging.

In particular, the Energy Markets Review being chaired by the former Federal Minister for Resources, Warwick Parer, [assuming it addresses all its terms of reference] is an opportunity to complete some of the unfinished business first raised in the Industry Commission Report of 1991.

It is important that the Energy Markets Review comprehensively addresses regulation and energy market challenges. The Electricity Supply Association of Australia has predicted that over \$20 billion of new capital expenditure will be required to meet forecast national energy demand. This means that we must have clarity for investors and market players about the environment in which those investment decisions will be made.

In addition, the Review must also consider the adequacy of future gas supplies and environmental impacts of the projected fuel mix of the future. Future fuel supplies must be reasonably priced for all customers, and particularly so for the politically sensitive mass market of “mum and dad” energy consumers. And these supplies must be augmented from alternative gas supplies - if that’s what it takes to keep energy prices at competitive levels.

AGL, along with others in the industry, welcomes the formation of the National Electricity Market Ministers Forum. It’s important that governments reassert their policy making role.

This, however, must be in the context of a commitment to a national energy market, recognising that players in the industry have developed their business plans and made investment decisions on that basis. A truly open and competitive national energy market is the surest way of delivering for our customers.

The Premier of this State, along with the Victorian Energy Minister and the Queensland Treasurer, all recognise this to be true. What is needed now is the political courage and determination to make it happen.

It is incumbent on governments to work with the industry to ensure we get one even handed set of harmonised rules for all participants, regardless of ownership, covering the market from production through transmission, distribution, wholesaling and retailing, leaving no untidy loopholes along the way.

In many respects the rules themselves are more important than the numbers of energy regulators. If we don't establish clear unambiguous rules to guide investors and users of monopoly infrastructure, then we are unlikely to achieve the important objective of efficient investment in essential infrastructure.

For, without that, I fear we will not see the right level of investment in transportation infrastructure; and without adequate transportation infrastructure we will not see the investment in peaking power plants; and we will not see the most competitive well head gas prices, essential to our energy intensive industries ability to compete in international markets.

We will not see the best done for our environment, as other less benign fuels will be not be preferred resulting in sub-optimal environmental outcomes.

Conclusion

Now I know we can't do it all overnight and that the task still at hand is large. Breaking it down into stages such as harmonising regulatory arrangements for both access and energy retailing, before a move to a single national energy regulator, would be a huge step forward.

When you think about it, it is vital to the Australian economy that we get energy policy right. And as I have indicated, there are now real opportunities to do so.

The Energy Markets Review is due to report by the end of this year, an important report from the Productivity Commission is now on the Federal Treasurer's desk, (I am advised), which should be released after Commonwealth Cabinet consideration shortly, the NEM Minister's Forum has recently agreed to amend the National Electricity Law to reflect their policy role and the National Gas Access Code is about to be reviewed.

So there is a lot of promise in all of these initiatives.

My plea though is that rather than reinventing the wheel, let's just focus on the key objectives of the Industry Commission Report that started this journey we, in the energy industry, have been on for well over a decade now.

Competition, a national market, harmonised rules moving to a single set of rules overseen by a national energy regulator, investment in infrastructure with fair returns, viable and imaginative retail businesses and light handed regulation – that's what we and the energy customers of this country deserve.



The Australian Gas Light Company

Thank you and enjoy your hot shower tonight – oh, and by the way, don't forget to turn the lights off when you leave the office tonight.