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1 March 2005

New South Wales Government Energy Directions Green Paper

The Australian Gas Light Company (AGL) welcomes the opportunity to comment on the New South Wales (NSW) Government Energy Directions Green Paper (Green Paper).

AGL notes that the objectives of the NSW Government are to ensure that new generation capacity is built and funded by the private sector and to reduce risk exposure to the often volatile wholesale electricity market. AGL supports the overarching objectives and direction of the Green Paper.

To deliver on these objectives, the Government needs to implement a policy and commercial framework to encourage private sector involvement. We consider that the Green Paper forms a good basis for resolving or removing current impediments to private sector investment and create a policy framework which balances customer, industry and government interests. Set out below are the issues AGL considers key to delivering on the Government's objective.

1. Industry restructure must deliver management of retailer risk, a level playing field, and the removal of barriers to entry

- In terms of managing retailer risk, integration between generation and retail is both necessary and inevitable.
- It is important to have strong and nationally consistent ring fencing obligations between all networks and retailers. Current electricity ring-fencing arrangements in NSW impact on non-government owned retailers' ability to compete.
- Market distorting mechanisms (such as ETEF) should be removed as soon as possible to encourage effective competition.

2. There should only be regulation where there is market failure and any regulation should be least cost/least intrusive

- Retail price regulation was intended to be a transitional arrangement following the introduction of competition. Governments should focus on ensuring a policy framework exists which enhances competition as well as identifying and addressing causes of any potential or actual market failure (in the period leading up to the end of the current price paths). As competition is expected to be effective at the conclusion of the current price paths, there should be no policy rationale to continue with price regulation, either at a state or national level beyond that time.
- While retail price regulation remains, prices should fully reflect costs (including risks) in order to promote private sector investment in new generation and retail supply, as well

as promoting appropriate demand management and energy efficiency measures. In addition, there should be adequate pass through of any costs associated with government policy framework amendments.

- Effective policies are required to identify and protect customers in genuine need within a policy framework that recognises the shared responsibilities of Government, customers and retailers.
- Consumer protection regulation must be designed against clearly defined objectives and must meet the benchmarks of best practice regulation. General consumer protection law should not be duplicated.
- AGL strongly supports introducing measures to enable energy consumers to respond to more cost-reflective pricing. AGL notes that interval metering is only one option available. Prior to any government or regulator mandating the rollout of a particular metering technology, a trial should be conducted to test customer response over time given various technologies, information and pricing signals.

3. Investors seek policy certainty

It is critical to establish a framework that will lead to reliable and sustainable energy sources in new generation capacity in NSW. Investors seek policy certainty, particularly on carbon constraint policy settings, rate of return, and planning and approval processes. In addition, planning and approval processes must be transparent and timely.

Greenhouse

- A national approach to greenhouse gas abatement will maximise the opportunity to secure environmental outcomes in a least cost manner. AGL supports the Energy Supply Association of Australia's call for a single greenhouse gas emission target for 2050 that applies to the whole economy and with clear milestones along the way. As a first step, AGL believes there is considerable merit in the NSW Government working with the Commonwealth and the other States (and industry), to agree a set of national principles to guide policy settings to achieve greenhouse gas reduction.
- Consideration should only be given to extending the NGAC Scheme beyond 2012 if a national approach has not been or is not likely to be developed.
- Any proposed extension should explicitly evaluate the costs of achieving this. If a more stringent target is chosen, the Government will need to remove any price regulation which prevents retail prices reflecting the additional cost of supply.

Mandatory Emission Performance Standards (MEPS)

- If a MEPS is adopted, AGL supports a two stage approach to implementation.
- There must be provision for pass-through of costs to consumers.
- In setting a MEPS, consideration must be given to delivering certainty about the level of offsets, the different characteristics of generation, and the level of MEPS, (which should not be so onerous as to chill investment in peaking and base-load generation in NSW in preference to other states.)
- The full range of abatement options should be available to meet any MEPS.

Planning reform

- Objectives for greenhouse gas abatement should be set transparently and independently of the planning process in expectation of a national approach being formulated.
- There must be adequate consultation on the details of the SEPP, given the potential breadth of its operation.
- Clarity is required as to how the proposed planning reforms will integrate with the Department of Environment and Conservation's consultation on the Clean Air (Plant and Equipment) Regulations 1997.

Gas Supply

- There will be sufficient supply and pipeline capacity to meet demand for generation purposes in the medium to longer term. Diversity of supply from the Moomba to Sydney Pipeline, Eastern Gas Pipeline, indigenous NSW gas and the potential future Papua New Guinea gas will provide supply security.
- The market is best placed to effectively respond to increases in demand for gas.
- As gas has an important role in a carbon constrained future, government policy settings should not negatively impact gas fired generation.

Low emissions technologies

- There is a need to create certainty about the true cost of carbon through a national approach and by allowing the market to determine and develop technologies.
- As part of the simplification of the planning process, development consents for low emission power generation developments should be timely and effective.

4. Governance arrangements are critical

Governance arrangements established in any industry restructure should provide certainty (and clarity) on the capability of industry participants to operate independently. It will be necessary to ensure arms length and commercial relationships with robust and agreed corporate governance structures between Government and industry participants.

5. Certainty of process in the White Paper

It is important that the White Paper clearly sets out the processes for the next steps. In particular, it is important that the Government clearly defines the criteria and objectives for assessing proposals arising from the White Paper by the private sector.

Attached to this submission are detailed responses to the questions posed (in boxes) in the Green Paper and other matters raised.

If you have any queries, please contact my office on (02) 9921 2585.

Kind regards,

Dr Robert Wiles

General Manager Regulation and Policy

NSW GOVERNMENT ENERGY DIRECTIONS GREEN PAPER

GREENHOUSE POLICY SETTINGS AND NGAC SCHEME EXTENSION

NSW Government view – emissions trading scheme, market forces and NGAC Scheme extension (page 25)

The Government prefers either a National Emissions Trading Scheme or an extension of the NSW Greenhouse Gas Abatement Scheme as these options would provide for a reduction in negative externalities in a least cost manner. The Government indicates that its view is that by allowing the market to determine least cost emissions solutions, the impact on consumer bills could be minimised.

The Government asks whether, in the absence of agreement on a national emissions trading scheme, extending the NSW Greenhouse Gas Abatement Scheme (the NGAC Scheme) to 2020 is the best way to provide potential investors in energy infrastructure with sufficient certainty on greenhouse policy beyond 2012.

AGL Response

AGL is strongly of the view that a national approach to greenhouse gas abatement will maximise the opportunity to secure environmental outcomes in a least cost manner. This is consistent with, and supports, the current work of the Ministerial Council on Energy (MCE) to improve and simplify national energy market regulation.

Critical to improving and simplifying national energy market regulation is the establishment of a national target. AGL supports the Commonwealth's focus on meeting the Kyoto target, but believes that Australia needs to set a longer term target. AGL supports the Energy Supply Association of Australia's (ESAA) call for a single greenhouse gas emission target for 2050 that applies to the whole economy and with clear milestones along the way.

AGL notes that State-based planning and greenhouse schemes may overlap or conflict, creating increased complexity and costs for participants and ultimately for consumers. For example:

- there are effectively three types of abatement certificates in Australia;
- carbon sequestration carried out in NSW is not recognised outside of NSW borders.

Integration of state based policies into a single approach would help reduce costs and complexity.

As a first step, it would be desirable for the States and Commonwealth, in conjunction with industry, to agree a set of national principles to guide policy settings to achieve greenhouse gas reduction. The principles could address the following key issues:

- policy objectives;
- cost;
- cost pass through;
- grandfathering;
- coverage;
- options for offsets;
- administrative simplicity; and
- maintaining property rights/transitional arrangements.

AGL believes there is considerable merit in the NSW Government working with the Commonwealth and the other States (and industry), to agree a set of national principles to guide policy settings to achieve greenhouse gas reduction.

Consideration should only be given to extending the NGAC Scheme beyond 2012 if a national approach has not been or is not likely to be developed. Any proposed extension of the target should explicitly evaluate costs of achieving this. If a more stringent target is chosen, then, as this will have the effect of increasing costs to retailers, it will be important for the

Government to remove any price regulation which prevents retail prices from reflecting additional cost of supply.

Of course, rights acquired under the NGAC scheme should be explicitly recognised as property rights in any national scheme, and proper regard made to the ability of participants to gain **solely** from the transition from a state based scheme to a national scheme. Given these matters will depend upon the nature of any future scheme, and the prevailing carbon price, they will require review in the design phase of national scheme.

Regulatory and legislative changes to the NGAC scheme should be limited to the minimum necessary. AGL notes, for example that there were 5 changes to the Rules for the NGAC Scheme in 2004 and each one either affected the number of certificates AGL could create or the shortfall target we had to comply with. A high level of regulatory change can hamper the secondary market in the trading of the instruments, as the more uncertainty around a market, the greater the propensity for traders to act to limit trading activity. In addition, it raises the level and sense of uncertainty in the investment market.

AGL also believes that the Government should give further thought to the interaction of the NGAC Scheme and proposed intensity limits on new generation facilities and proposed availability of offsets. This is important both from the point of view of simplicity and competitive neutrality. If offsets are incorporated into the MEPS framework, it is AGL's view that NGACs should be acceptable as offsets to meet the separate new generation requirement.

MANDATORY EMISSION PERFORMANCE STANDARDS FOR NEW GENERATORS

NSW Government view – mandatory emissions performance standards (page 31)

The Government's view is that adopting a mandatory emission performance standard (MEPS) for new generators would ensure that greenhouse gas emissions (as a negative externality) are minimised. The Government also considers that such a standard would be simple. The Government however notes that such a standard could increase the cost of energy for consumers and impact on the competitiveness of the NSW economy. Accordingly, the Government considers that by allowing environmental offsets, the goals of efficiency and equity can be further pursued. The Government seeks comment on the adoption of a MEPS two-staged pathway.

AGL Response

AGL considers that generation intensity requirements should be part of a coherent approach to overall greenhouse gas abatement in NSW/Australia. AGL supports a national approach to the management of emissions and the Government's intent to ensure that greenhouse emissions are minimised and to create simplicity. If a MEPS is adopted, it would be preferable if the standard is implemented in a staged approach which allows immediate generation requirements to be built using existing ("best practice") technology. An important principle is that there is provision for pass-through of costs to consumers and that the Government should remove any price barriers which prevent retail prices from reflecting these additional costs of supply.

There are a number of factors that are important in setting a MEPS:

- In determining the financial viability of a project, some degree of certainty is required about the level of offsets, which would be required over the life of the plant. The Government needs to consider whether offsets would be required up-front (i.e. part of the capital cost of a plant) or whether they would need to be surrendered each year in a similar way to the NGAS (i.e. part of the plants variable cost). This is particularly important because two factors could change the economic viability of the plant over time:

- Capacity Factors: Regard should be had to the relationship between intensity and plant production. Generally, as plant production increases, emission intensity falls. As the plant becomes older, it may be run less frequently and possibly at a lower capacity. Therefore, overall emissions and required offsets could change over time.
- Plant Age: As any plant ages its emissions intensity is likely to increase.
- Consideration needs to be given to different characteristics of peak, intermediate and baseload generation if a standard is to be set. A standard would need to allow for both baseload and peak generation. If peak capacity is all that is required in the short-term, it is likely to have lower total emissions.
- The level of a MEPS must not be so onerous as to discourage investment in peaking and base-load generation in NSW in preference to other states. Indeed, stringent greenhouse requirements in NSW may, in practice, result in worsening of greenhouse emission outcomes if differences between state approaches to regulation of new generation facilities continue. Clearly it would be preferable to develop an agreed approach to new generation within the National Electricity Market.
- Retail price regulation should allow for retail prices to reflect the additional costs of supply.

Comments sought on offsets (page 31)

The Government is seeking comments on the types of activities that proponents should be able to use for offsets.

AGL Response

AGL believes that where standards are set in a way which requires the proponent to purchase abatement, a range of market-based mechanisms should be available; including offsets and investment in renewables. Investors in NSW should be able to acquire low cost abatement opportunities internationally, as well as internationally recognised local opportunities. The registration and trading system through MRET and NSW Benchmark scheme provides the platform for this to occur. The development of a set of national principles and guidelines on emissions trading schemes (as outlined above) should facilitate these goals.

PLANNING AND APPROVALS PROCESS FOR NEW PROJECTS

Comments sought on State Environmental Planning Strategy (SEPP) (page 35)

The Government has asked for comment on how it should ensure a precautionary approach to potential environmental impacts is incorporated into the assessment and approval process for NSW energy projects. Comment is also sought on specific environmental performance requirements that should be pursued and what NSW Government environmental and planning requirements should be included in the proposed SEPP.

AGL Response

AGL considers that, to encourage private sector investment in NSW, any planning reform must deliver policy certainty, and timeliness in assessment of new generation facilities. In terms of the SEPP, it is AGL's view that:

- The objective of the SEPP should be to ensure that the assessment of proposals is carried out in a commercially timely manner, with explicit recognition of how environmental requirements will be dealt with;

- There should be no duplication of assessment or other processes.
- The SEPP should allow market participants to use cost effective measures to meet outcomes determined by Government.
- It is important to ensure that requirements placed on major new energy projects are consistent with policies for major industrial developments.
- Standards required as a result of the SEPP should be explicit and provide certainty.
- Finally, there must be adequate consultation on the details of the SEPP, given the potential breadth of its operation.

As for environmental requirements, AGL considers that objectives for greenhouse gas abatement should be set transparently and independently of the planning process itself, in expectation of a national approach being formulated.

AGL supports the Government's intention to deliver sound environmental outcomes and appropriate investment in energy infrastructure and business certainty. In this regard, it is important that the Government considers all imposts and obligations. The Department of Environment and Conservation is currently conducting a consultation on the Clean Air (Plant and Equipment) Regulations 1997 (CAPER). It is unclear how the proposed regulatory amendment will be integrated with the SEPP outlined in the Green Paper. AGL believes that a simple framework is needed which clearly articulates the requirements on new generation proposals. In addition, the proposed retrospective application of standards under CAPER may heighten investment uncertainty.

GAS SUPPLY

Comments sought on new sources of gas (page 38)

The Government has asked for comments about policies that the Government can adopt to ensure that new sources of gas are added to existing supplies.

AGL Response

AGL considers that the market is best placed to effectively respond to increases in the demand for gas, and that new sources of gas supply will be made available by suppliers to meet any significant increase in gas demand. AGL also believes that the current market is capable of delivering, within necessary lead times, both increased production and pipeline capacity to meet significant increases in gas demand. (This could include base load to intermediate gas fired power generation.)

A potential new source of gas is from Papua New Guinea (PNG). The PNG project is under development to bring gas from PNG into Australia. This project has the potential to supply a significant proportion of NSW's growing gas requirements and maintain diversity of supply into NSW. AGL is committed to supporting its introduction as soon as market demand is sufficient to make the investment viable. It is worth noting that, on 24 February, an announcement was made indicating that the AGL-Petronas Consortium (APC) was calling for tenders for the Front End Engineering and Design (FEED) phase of the Australian component of the PNG to Queensland natural gas pipeline. AGL believes that PNG gas can be delivered at a similar cost to existing sources. However the timing of this project is strongly linked to the development of gas fired base load and intermediate electricity generation in NSW, other demand growth, existing supply reserves and availability and parties willing to contract for this gas.

There are also prospects for coal seam methane. NSW has an abundant supply of coal seam methane locked in the black coal seams of the Sydney-Gunnedah Basins. Coal seam methane has the potential to make an important contribution to NSW energy supplies and to provide additional supply security and diversity for NSW.

Gas has an important role in a carbon constrained future. In particular it has been recognised as a transitional fuel in the move to a lower emissions economy. Accordingly, the role the government should play is to set a framework that encourages investment certainty when the appropriate market signals exist. In particular, AGL considers that it is important that government policy settings should not negatively impact gas demand. The focus of such policies should be on reducing greenhouse emissions in a least cost manner.

Comments sought on role of gas (page 39)

The Government has also asked what role gas should play in providing new electricity generation capacity.

AGL Response

No single fuel can offer a complete solution to the State's long term economic and environmental goals. A balanced approach is needed to recognise the relative merits of coal, gas and renewable energy. Within this portfolio approach, it is AGL's view that gas has an important role to play.

AGL is confident that there will be sufficient supply to meet gas demand for generation purposes in the medium to long term. Diversity of supply from the Moomba Sydney Pipeline, the Eastern Gas Pipeline, indigenous NSW gas and the potential future Papua New Guinea gas will provide supply security.

In terms of pipeline capacity, there is sufficient capacity on the Moomba Sydney Pipeline (MSP) and the Eastern Gas Pipeline (EGP) to meet current NSW gas requirements and to meet requirements for gas fired plant in the medium term. If any expansion is required, this can be readily achieved.

As for sources of gas, AGL is confident that additional supply/new gas fields will come on line, as required. AGL refers to the discussion above about the prospects for PNG and coal seam methane. Recent discoveries and developments in the south-eastern supply regions of Victoria, have created further capacity available to be supplied into the NSW markets.

As set out above, AGL believes that gas demand for power generation will be encouraged if appropriate policies on carbon are developed and there is certainty in regulatory frameworks and policies. In this regard, it is important serious consideration must be given to the recently completed Productivity Commission Review of the Gas Access Regime and the implementation of its recommendations.

LOW EMISSION TECHNOLOGIES

Comments sought on developing low emission technologies (page 40)

The Government has asked what policies the Government can adopt to further develop low emission technologies.

AGL Response

As set out above, the Government's focus is to ensure that its policies reduce greenhouse gas emissions in a least cost manner.

Within that context, AGL agrees that barriers to adoption of low emissions technologies should be identified and removed. AGL considers an important factor in the development of low emission technologies is certainty in relation to the true cost of carbon through the implementation of a national approach to carbon constraint policy.

There are also some issues around the need for commercialisation of low emission technologies. The Federal Government White Paper on energy policy, *Securing Australia's*

*Future*¹, contained provision for a Low-emission Technology Fund, which will drive investment in low-emission technologies. AGL supports this initiative and encourages the State and Commonwealth Governments to work jointly with industry and others to bring forward commercialised technologies.

Finally, AGL considers that it is important that, as part of the simplification of the planning process, development consents for low emission power generation developments should be timely and effective.

RETAIL PRICE REGULATION

Comments sought on discontinuing price regulation (page 44)

The Government canvasses the option and seeks comment on discontinuing price regulation for electricity and gas from 1 July 2007.

AGL Response

At the time the decision was made to introduce competition, it was the expressed intent of Governments that price controls would provide a transitional safety net for customers who were not able to, or chose not to participate in, a competitive market following the introduction of competition². The presumption was that competition provided the most effective form of customer protection available. It was expected that retail price controls would therefore only be transitional in nature.

Accordingly, AGL believes that the NSW Government should focus on ensuring a policy framework exists which enhances competition as well as identifying and addressing causes of any potential or actual market failure (in the period leading up to the end of the current price paths). As competition should be effective at the conclusion of the current price paths, there should be no policy rationale to continue with price regulation, either at a state or national level beyond that time.

In that regard, AGL believes that key impediments to effective competition in NSW are the Electricity Tariff Equalisation Fund (EETF), lack of adequate ring fencing of electricity distributors and retailers, and the continued existence of retail price regulation beyond the transitional period. Specifically, AGL strongly believes that the current retail price path does not reflect the true cost of supply and therefore undermines the ability of retailers to compete in the market. In addition to EETF, allowed operating costs and retailer margins are insufficient to manage the risks of the market and therefore do not provide scope for new entrants to compete effectively.

In terms of retail price regulation, multiple year price paths have been agreed in NSW. At the conclusion of the current price paths, the NSW market will have been open to competition for a period of five years, which should provide sufficient opportunity for the government to remove any remaining barriers to competition. At the conclusion of these price paths, AGL expects that the market will be competitive. In a competitive market, price regulation no longer remains a legitimate ongoing mechanism for governments to facilitate consumer protection goals³. Accordingly, there should not be a policy rationale to continue with price regulation. While AGL recognises the need for effective arrangements to protect interests of customers, it is contrary to the interests of the market as a whole to continue to use price regulation for this purpose.

¹ Released in June 2004

² See for example, Ministry of Energy and Utilities, New South Wales Policy Framework to Support Full Retail competition in Gas, 21 December 2000

³ For example, the United Kingdom regulator Ofgem suggests that price controls may inhibit competition and could also remove competitive pressures on prices for those customers who choose to remain with their traditional supplier. In the UK price controls for gas and electricity were removed in April 2002 and replaced with reserve powers existing under UK competition law.

The costs of any social welfare assistance programs should be transparent and funded by government through direct and transparent payments as should any short-term transitional and distributional energy price impacts arising from the removal of price controls.

In considering transitional and distributional impacts, it is also important to take into account existing consumer protection requirements. These impacts are currently being addressed through price controls since the introduction of full retail competition and through transitional price paths. The focus on addressing the transitional impacts entirely through broadly-based retail price regulation has in fact delayed competition and the benefits from it in some jurisdictions, and has led to unintended consequences in relation to infrastructure investment, demand management, and efficiency of energy use. Investors need certainty with respect to retail pricing to ensure prudent investment in new generation, transmission, and distribution infrastructure.

However, AGL recognises that effective policies are required to identify and address customers in genuine hardship. The appropriate model shares responsibility between governments, industry and consumers.

Comments sought on reduction in retail customer threshold (page 44)

The Government asks for comment on gradually reducing the small retail customer definition threshold.

AGL Response

AGL believes that the focus should be on removing retail price regulation as one of the remaining key impediments to effective competition. AGL further notes that as price paths are set until 2007, the issue of reducing the threshold will no longer be a relevant policy consideration as price regulation should no longer be required.

Comments sought on responsibility for retail price regulation (page 44)

The Government also asks for comment on transferring responsibility for retail price regulation to the Australian Energy Regulator.

AGL Response

AGL strongly opposes transfer of retail price regulation to the national regulator.

At the conclusion of the current price paths, competition should be effective in those jurisdictions and accordingly, there will be no policy rationale to continue price regulation. Accordingly, the focus of the governments and the MCE energy market reform program should be on aspects of regulation that will continue and which it is therefore appropriate to transfer to the national regulator.

It is not efficient to transfer retail price regulation to a national regulator as different stages of competition make a common approach at a national level impractical. For example, full retail contestability has not yet been introduced in Queensland.

It is also necessary to consider the effect of the recent establishment of the new Australian Energy Regulator and the ongoing program of energy market reform. In these circumstances, the transfer of retail price regulation would necessitate the new regulator becoming familiar with and understanding the context of NSW retail price regulation. AGL believes that these circumstances mean it would inevitably lead to at least one and possibly two cycles of further regulation. This could mean a further 10 years of price regulation, in circumstances where price regulation should no longer be necessary. This is clearly a sub-optimal outcome and inconsistent with the original policy intention of Government.

RETAIL PRICE SIGNALS

NSW Government view – efficient pricing (page 45)

The Government also considers the issue of efficient pricing and recognises that efficient pricing is necessary to ensure that resources are optimally allocated.

AGL Response

AGL considers that, while retail price regulation remains, prices should at least fully reflect costs (including the costs of managing risk and the returns required by investors) in order to promote investment in generation and retail supply and to promote demand management and energy efficiency.

Cost reflective retail prices result in more optimal outcomes including:

- Incentives for demand management and energy efficiency activity.
- Reduced need for inefficient investment and reduced levels of peak energy demand (eg. current summer demand levels). This should reduce the need for costly investment (that would otherwise be required), resulting in contained costs for customers.
- Increased levels of effective competition because flexible pricing allows greater innovation and increased product offerings;
- Allowing cross subsidies to be unwound;
- Increased penetration of renewable technologies where economic; and
- Providing support for initiatives to reduce greenhouse gas emissions.

Comments sought on roll out of interval meters (page 45)

The Government is interested in comment on mandating the roll out of interval meters for customers above a certain usage threshold.

AGL Response

AGL strongly supports introducing measures to enable energy consumers to respond to more cost-reflective pricing. However, interval metering is only one option available. It is not yet clear that adoption of interval meters will be more effective than other options and interval meters in themselves may not achieve the perceived benefits. For example, the cost of type 5 interval meters along with the cost of developing IT systems to receive and store the significant increase in meter data, will result in a cost burden to the industry. Given that type 5 interval meters are manually read and do not provide for real time price signals, customers may not have sufficient incentives to decrease their demand when most required. AGL believes that technology which provides for real time critical peak pricing signals to be sent to customers and / or the ability to remotely control devices, will elicit a better response from customers at critical peak times, lessening the need for future investment in peak generation and network infrastructure.

AGL is currently trialing type 5 interval metering technology in Victoria, in order to test demand response from customers given peak and off-peak tariffs. The trial is at an early stage and results have not yet been analysed. With government and regulatory support, AGL is also eager to trial two-way communication enabled interval meters to compare demand response when customers receive real time price signals.

AGL encourages governments and regulators, prior to mandating the rollout of a particular metering technology, to conduct a comprehensive trial to test customer response over time given various technologies, information and pricing signals. Until such an industry study is conducted it will be impossible to conclude on the benefits of a rollout or indeed the most efficient technology to be rolled out

In the event that new technology is mandated, AGL considers that it is important that full cost recovery should be allowed.

Comments sought on step price (page 45)

The Government also asks for comments on mandating the use of a step price.

AGL Response

AGL's view is that step pricing should not be mandated. Rather, it is AGL's belief that the market should be left alone to develop its own pricing structures.

ELECTRICITY TARIFF EQUALISATION FUND (ETEF)

NSW Government consideration of ETEF (page 50)

The Government has indicated that it might be feasible and appropriate for the Government to allow the ETEF to expire on 30 June 2007.

AGL Response

AGL has been concerned for some time that ETEF has a distorting effect on both the market and entry signals for new generation capacity, and also represents a barrier to competition. AGL is concerned that such distortions have the potential to adversely effect competitive neutrality. Accordingly, ETEF should be removed as soon as possible to encourage more effective competition in the NSW market.

As a riskless hedge, ETEF represents a significant influence on the risk management practices and wholesale energy costs of government owned retailers. It also has a significant influence on the revenues of government owned generators. The removal of ETEF will clearly require a substantial change in the wholesale energy practices of both the retailers and generators, and has the potential to affect their value. Of perhaps greater potential impact on the value of the retailers and generators is the uncertainty over what conditions they will be operating under post 2007. However, AGL believes that, with a clear timetable and appropriate transitional measures, the removal of ETEF should not have a significant impact on the government owned businesses.

Currently the Independent Pricing and Regulatory Tribunal of NSW (IPART) has responsibility for setting the electricity regulated retail tariffs that standard retail suppliers can charge their small retail customers⁴. One of the benchmarks is wholesale electricity at ETEF prices. Once ETEF is removed, retailers will need to ensure that their hedging arrangements are appropriate.

It is important that prices reflect the true costs of supply (including risks). As set out above under the heading "Retail Price Signals", prices should reflect costs to promote investment in generation and retail supply and to promote demand management and energy efficiency. Accordingly, AGL believes that it is critical to move to the full recovery of costs, including managing risk in the market post ETEF.

AGL believes that the Government needs to give serious consideration to measures necessary to prevent market disruption as a result of removing ETEF. At present, ETEF effectively provides a hedge arrangement for the retailers and generators that are part of the Scheme. If ETEF is removed in 2007, then retailers and generators will need to enter into hedge arrangements to manage risk. In general, a significant proportion of hedging arrangements are entered into several years in advance. Accordingly, if ETEF is to end in 2007, the currently Government owned retailers will need to be entering into hedges in the very near future. In addition, the impact of both retailers and generators of needing to hedge their full tariff market portfolios from 2007 is likely to distort the hedge market and could effect spot market bidding behaviours

Accordingly, AGL believes that there is a need for the Government to develop a program whereby the government owned retailers and generators move to market based hedge

⁴ IPART also has responsibility for setting the non-tariff charges electricity retailers can charge these customers.

portfolios gradually over time. To achieve the Government's objective and avoid risk being taken by the government owned businesses, this means that the reform of government owned businesses is undertaken promptly so that the private sector is responsible for these new hedging arrangements.

AGL also believes that the Government should consider how the funds from ETEF would be used. The Green Paper refers to the Demand Management Fund. AGL suggests that one option is to put the funds towards the NSW Demand Management fund.

CONSUMER PROTECTION

NSW Government consideration of consumer protection (page 45)

The Government considers the issue of consumer protection policies and notes that it is an important objective of the NSW Government to ensure that all residential customers have access to electricity because it is an essential service.

AGL Response

AGL agrees that access to electricity is important. In managing the issue of access to electricity, AGL considers that an effective policy on customers in genuine hardship is required. The appropriate model is one in which responsibility is shared between governments, industry and consumers. The role of governments should be to provide direct funding where needed to meet its social objectives and ensure equity across the community.

In relation to consumer protection arrangements generally, AGL is of the strong view that the complexity of consumer protection arrangements and differences in regulatory requirements across jurisdictions impose significant compliance and operating costs on retailers, which can diminish the benefits that would otherwise flow from energy market reform. AGL notes that the Productivity Commission's draft report on the Review of National Competition Policy Reforms recommends a national review into consumer protection policy and administration in Australia. It is important that such a review occur and that this national review should focus on the effectiveness of existing measures in protecting consumers in the more competitive market environment; mechanisms for coordinating policy development and application across jurisdictions and for avoiding regulatory duplication; the scope for self-regulatory and co-regulatory approaches; and ways to resolve any tensions between the administrative and advocacy roles of consumer affairs bodies.

In considering the appropriate framework for consumer protection, it is important there is a national approach, but that in considering what is necessary, that gaps/deficiencies in existing arrangements are identified, and that the new arrangements do not simply amalgamate or duplicate existing arrangements. The new arrangements must add value, lower the cost of regulation and be effective on a national basis.

REFORM OF GOVERNMENT OWNED BUSINESSES

The Government and this response have discussed the reform of many aspects of the NSW energy market including environment policy settings, planning and approval processes for new generation plant, gas supply, low emissions technologies, retail price regulation, retail price signals, ETEF and consumer protection policies. All of these issues are important inputs to industry restructure, and the Government needs to implement a policy and commercial framework which addresses these issues and encourages private sector investment in the industry.

AGL notes that the objectives of the Green Paper are to ensure the development of necessary new generating capacity funded by the private sector and to reduce risk exposure to the often volatile wholesale electricity market. Reform of government owned businesses is necessary to achieve that outcome. AGL endorses the Governments' objectives. AGL believes that, given the magnitude of the reforms required, it will be important that they occur in a staged fashion.

To achieve the Government's objectives:

- It is important to have clear policy settings that allow investment decisions to be made with certainty;
- Prompt reform is required, as sizeable demands of capital are required and there are long lead times to investigate, install and commission new plant;
- Managing retailer risk will be a key element.

Key issues for retailers are a level playing field (removal of distorting mechanisms such as the ETEF, and strengthening the ring fencing of electricity distribution from retail activities). Comments about ETEF are set out above. In regard to ring fencing, AGL considers that it is important that there are strong and nationally consistent ring fencing obligations between all networks and retailers. Current electricity ring-fencing arrangements in NSW impact on the ability of non-government owned retailers (ie retailers without networks) to compete.

It is also critical that the White Paper clearly sets out the processes for the next steps. In particular, it is important that the Government clearly defines the criteria and objectives for assessing proposals arising from the White Paper by the private sector.

Comments sought on effectiveness of proposals (page 53)

The Government considers that options for structural reform of the Government's electricity businesses would meet the objectives of equity, efficiency, security and simplicity. The Government asks for comment on the effectiveness of these proposals in reducing the Government's risk exposure and providing the private sector with the opportunity and incentives to invest in new generation capacity.

AGL Response

The proposals in the Green Paper relating to industry structure are quite general and accordingly, AGL considers it is difficult to assess how effective they will be in promoting private sector investment in generation capacity.

However, AGL believes that the private sector is well placed to manage retail risk. Based on its experience, AGL believes it can make a valuable contribution in providing comments about matters that are important for the Government should take into account in developing its proposals for industry structure.

AGL accepts that different models and structures may necessary for different government owned businesses but some form of a retail-generation link is inevitable. In addition, models must be customer focussed.

AGL also considers it important that the governance arrangements established in any industry restructure should provide certainty and clarity on the capability of industry participants to operate independently. They should also provide mechanisms to ensure that the sometimes-different objectives of government and private investors are managed effectively in any resultant joint ventures.

Comments sought on involvement of private sector in risk management (page 53)

The Government has also asked for comment on the best ways to involve the private sector in managing the risk of the Government-owned retail businesses.

AGL Response

As set out above, given the general nature of the proposals, AGL does not consider it appropriate to comment specifically on the best ways to involve the private sector. However, AGL believes that the Government should focus on removing impediments to private sector participation in generation. AGL's refers to its earlier comments about the key impediments to private sector participation in generation.

In particular, AGL refers to its comments about ETEF and the need for prompt action now.

Comments sought on joint ventures (page 53)

The Government is interested in comment on joint venture opportunities available for the development of new generation capacity, which would meet the Government's risk objectives.

AGL Response

AGL does not comment on specific joint venture opportunities at this stage. However, AGL has experience with government joint ventures through its 50% ownership of ActewAGL with the ACT Government. As part of this joint venture AGL is the wholesale supplier of gas and electricity to the ActewAGL. This effectively reduces the ACT Government's risk exposure by allocating risk and the commensurate return to the private sector. This model can be readily used in NSW.

Comments sought on avoiding potential supply shortfalls (page 53)

The Government has asked for comment on what options and strategies the Government should consider in order to avoid the risk of potential supply shortfalls while not discouraging private sector investment.

AGL Response

AGL believes that the Government should focus on creating an environment that is conducive to private sector investment. The Government's focus should be on providing regulatory certainty, facilitating movement to a national greenhouse strategy, removing ETEF, and allowing the market to work without heavy handed regulation.