

Macquarie Bank Investor Clients

Energy market regulation and investment

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A decade of NCP reforms

- Opening up of state controlled infrastructure
 - Gas, Electricity, Rail, Telecommunications
- Coincides with decade of economic growth
 - in “the last decade of the 20th century Australia became a model for other OECD countries”.
 - NCP “the most extensive economic reform program in Australia's history”.

OECD Economic Survey of Australia, Feb 2005



Infrastructure Regulation

The Facts

- No shortfall in investment in ACCC regulated infrastructure
- VERY high levels of investment under ACCC regulation
- Investment problems often due to LACK of regulation in monopoly areas
- Regulation promotes competition



Electricity Investment The Facts

- Over \$4.5 billion under ACCC regulation since 1999
- TransGrid and EnergyAustralia investment decisions.
 - Collectively accommodate over \$1.4 billion in new investment in NSW and ACT over 5 years
 - Total investment decision in NSW and ACT now \$2.6 billion
 - More than doubles replacement cost of assets in 10 years



Gas Investment The Facts

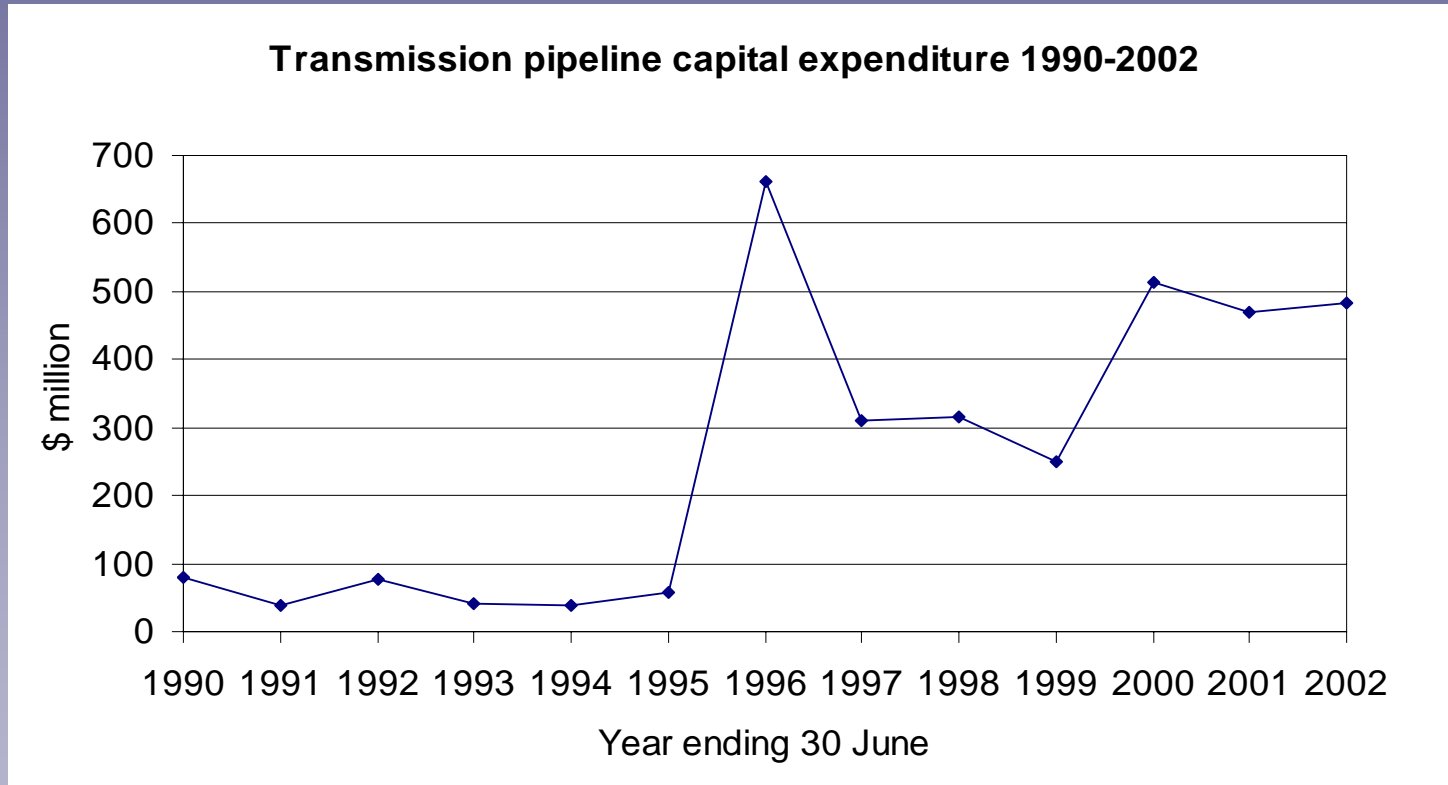
“The current regulatory quagmire is suffocating new pipeline development and requires urgent policy attention by governments.”

Australian Pipeline Industry Association 28 October 2001

- 14,000 klms of new pipeline since 1997
- Doubling of pipeline length in seven years to 28,000 klms



Increased investment under Gas Code



Source: Australian Gas Association, Gas Statistics Australia



Major new pipelines

- Constructed
 - Eastern Gas Pipeline: Longford (Vic) to Sydney
 - Tasmanian Gas Pipeline: Longford (Vic) to Tasmania
 - Roma to Brisbane Pipeline looping
 - SEA Gas Pipeline: Port Campbell (Vic) to Adelaide
 - North Queensland Gas Pipeline: Moranbah to Townsville
 - Telfer Gas Pipeline: Port Hedland to Telfer (WA)
- Under consideration.
 - Central Ranges Pipeline: Dubbo to Tamworth
 - PNG Gas Pipeline: Papua New Guinea to South East Queensland
 - Trans-Territory Pipeline: Darwin to Gove (NT)



Investment in dependent markets

- Electricity generation benefits from gas fired generation
- Substantial exploration and development of traditional gas fields and coal seam methane
- Lower prices stimulate increased gas consumption
 - ACIL Tasman estimates increased market the size of existing NSW and ACT market



ACCC Regulation – Good for Investors

- Utilities Accumulation Index compound return of 17.4% V ASX 200 of 11.1%
- Fitch Ratings “*the current regulatory regime appears relatively supportive for transmission entities*”.
- Allen Consulting Group “*the Australian regulatory framework is providing adequate scope for companies to earn appropriate returns in the energy infrastructure industry*’.



Consequences of relaxing current framework

- Monopoly owners allowed to exercise monopoly power over prices
- ACIL Tasman finding
 - GDP reduction of \$11 billion over 15 years
 - Disastrous outcome for economy
- Even with regulation electricity transmission prices rise an average 15% as investors seek reasonable return on massive investment



Energy regulation and the ACCC

- the next steps

- Ministerial Council on Energy to be Australia's single energy market governance body
- Two new statutory commissions
 - Australian Energy Market Commission (AEMC) with responsibility for rule-making and market development
 - Australian Energy Regulator (AER) with responsibility for market regulation and enforcement



Australian Energy Regulator

- Independent
- Consistent approach to competition law
- Consistency in regulation across national electricity and gas markets
- Part of the ACCC but separate legal entity
- Single national energy regulator delivering consistent, predictable rulings



How the AER will work

- ACCC will continue existing functions
 - Enforcement
 - Authorisation
 - Approval of access codes and undertakings
- AER to assume control of
 - Electricity transmission revenue regulation
 - National Electricity Code compliance monitoring and enforcement
 - From 2006, responsibility for regulation of electricity distribution and retailing



How the AER will work

- AEMC, AER and ACCC empowered to share relevant information
- AER responsible for making regulatory decisions independent of ACCC
- AER required to act in long term interests of national electricity market
 - Promote greater investment, interconnection, efficiency and security of supply



National Electricity Market objective

- Single clear national objective

“To promote efficient investment in, and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply and the safety, reliability and security of the national electricity system.”

- Market must be competitive, open, and without favouritism



AER Enforcement

- Responsible for bringing court proceedings for breaches of National Electricity Law and Rules
- Power to apply directly to magistrate for search warrants
- Maximum penalties of \$100,000 and \$10,000 per day
- Court may order disconnection
- Decisions can be appealed and dispute resolution panel available



Energy Issues

- Retail competition in electricity
 - Need to improve consumer involvement and price signals
- Uncertainty in Gas Code rulings
 - MSP appeal
- Electricity - transmission planning



Importance of Retail Competition

- Consumers only able to contribute if they can act on price signals.
- Parer found impediments:
 - Limited ability of most consumers to respond to price signals
 - Residential consumers (40-50% of load) excluded because of lack of access to meters
 - Lack of price controls restricts ability of retailers to restrict consumption at peak times



Improving consumer involvement in the NEM

- Interval meters for residential customers
 - Consumers must be able to respond as prices vary
- Regulatory frameworks must encourage retailers to give consumers incentives to reduce and shift load
- Urgent review of Retail Price Caps
- Promote new entry in retail and generation markets



MSP Appeal

- Tribunal rejected valuation methodology applied by both ACCC and EAPL
- Inconsistent with WA Supreme Court ruling in Epic energy
- ACCC appealing to Federal Court to clarify key aspects of Gas Code and end uncertainty



Gas Code rulings

- Four appeals from 13 access arrangements
- 22 issues raised in appeals
 - 10 abandoned by provider before reaching Tribunal
 - 3 ACCC conceded
 - 7 found in favour of applicants
 - 2 ACCC decision upheld



Global Competition Review

- ACCC rated one of the world's leading competition agencies
 - US & UK 4 ½ stars
 - EU 4 ¼ stars
 - Australia, Netherlands, Germany 4 stars
- ACCC “is said to understand competition in energy markets particularly well. Several sources identified this as an area in which it ‘leads the international field’.”

