ENVIRONMENT AND NATURAL RESOURCES COMMITTEE

Inquiry into energy services industry

Melbourne — 5 December 2005

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Mr G. Wilson, Chair, Essential Services Commission.
The CHAIR — Welcome, and thanks for your time today, Greg. You have previously presented to a parliamentary committee?

Mr WILSON — Yes, while I was deputy secretary in Water.

The CHAIR — I need to remind you that evidence taken by the committee is protected under the Parliamentary Committees Act from judicial review. However, if you make comments outside the precincts of the hearing, they are not protected by parliamentary privilege. Hansard is recording the evidence taken today, and you will be provided with a proof version of the transcript within the next week or so. I will hand over to you to go through your presentation, and would like you to leave us some time for questions.

Mr WILSON — Shall do. I have not got a PowerPoint presentation, so what I would aim to do is go through the five particular issues that I wish to talk about today: how we facilitate efficiency in industries; how we identify environmental issues; what is happening with the Australian Energy Market Commission and the Australian Energy Regulator; the potential impact on Victoria of the 10 per cent renewable energy target; and the potential impact of the national emissions trading scheme.

Before I go through each of those items I will make some general comments about the Essential Services Commission. We were established out of the Office of the Regulator-General, in 2002 I think it was, and that office was established in the mid-90s with the objective of protecting the interests of customers with respect to price and service. Back then the main area of regulation was of course electricity and the privatisation of the electricity industry and then subsequently gas. Today we have carried forward that objective. It has been amended here and there, but essentially it is the same role: looking after customers’ interests with respect to price and service of the industries we regulate, which include electricity, gas, water, rail and grain handling, and there are also various roles in relation to taxi fares, third-party insurance and WorkCover premiums. So in that sense we are an economic regulator rather than a broader body that takes into account or has primary objectives in relation to environmental issues and other non-economic issues, for want of a better term.

With that in mind I will turn to the first question: facilitating efficiency in energy. I guess the main driver of efficiency is what we call price cap regulation. We fix prices or the rate of change in prices for a five-year period, so for industries that are seeking to make profits, as most of them do in energy, with capped revenues the only way they can do that is to do all the things they have to do more efficiently. If they make gains with their prices fixed, they get to retain those gains.

Price caps themselves are usually set through a 12-month or 2-year process of reviewing all their costs to make sure that what people are actually paying represents good value for money, that they are getting a return on their investments, that all their capital expenditure is efficient — on overheads, operating expenditure and so on — and that people are getting the services they want. The price caps reflect the efficient provision of the services, and the fact that they operate for a five-year period unchanged provides incentives to be efficient to the industries we regulate. We add to that further incentives. If they achieve gains within that five-year period, they get to keep them for five years. People were pointing out that if you work really hard to do things efficiently in year 1, you get the gains until year 5. If you do the same in year 4, you have only got them for one more year. There are arrangements that are quite detailed to allow them to carry over those gains.

With such a big emphasis on efficiency it is important for us to then make sure that does not happen at the expense of service and reliability, so similarly we have things like incentive arrangements where they can outperform assumptions on things like outages or momentary interruptions and guaranteed service level payments if they do not turn up on time or if there are more outages than planned. We do a lot of performance reporting at a disaggregated level, which is particularly important in country Victoria, where the longer lengths of line are harder to fix and they stay out more. We recognise all of that, so we split them up, rather than just having average minutes off supply for a Victorian across the state, so everyone can see how their local distribution business is performing.

We have a range of pricing principles that we make sure also reflect efficiency. Interval meters will be important as well, particularly on the energy side of things as distinct from the infrastructure side of things, with people being able to measure consumption at regular intervals. Rather than having a meter that just accumulates consumption over three months and then you eventually get a bill, this will allow for a lot more innovative pricing arrangements to influence behaviour.
In terms of identifying and assessing environmental issues, I guess most of those we do take into account, but they typically get linked back to this pricing function. Under our act we have that primary objective of looking after customers, and we have a range of facilitating objectives which include allowing regulated entities to recover the cost of social, safety, health and environmental obligations that are imposed on those businesses, but essentially because we do not regulate generators or the retail end, most of those obligations relate to the infrastructure of gas and energy distribution businesses. Things like EPA requirements around oil containment or noise abatement or dealing with asbestos and those sorts of things, and safety considerations from the Office of Gas Safety or the Office of the Chief Electrical Inspector tend to be imposed on these businesses by somebody else, and our job is to make sure that they can recover the costs associated with those things. For example, in the water industry, with things like government water conservation programs or recycling, the water quality requirements of the Department of Human Services, the sewage treatment requirements of the Environment Protection Authority, there are a lot more of those sorts of requirements in comparison with, say, gas and electricity distribution — poles and wires and pipes, basically.

In terms of the Australian Energy Market Commission and the Australian Energy Regulator, essentially these are basically policy matters led through the minister and the Department of Infrastructure through to a ministerial council for energy. My understanding is basically that those roles are looking to be taken up no earlier than mid-2007. That would then mean electricity distribution would go across, then gas distribution, and we would have one more gas review which would take place in 2007. We are keen to make sure that the goalposts are not moving around with a lot of uncertainty, given that that is quite an important review. Essentially the market commission is the rule-making body for the national electricity market and the Australian Energy Regulator is the one that monitors adherence to the rules and also does price reviews similar to what we have just talked about. There is a range of matters that I understand are being dealt with through that ministerial council and the department.

I guess from the distribution point of view there would not be much of an impact on distribution and retail prices from the 10 per cent renewable energy target. There would be potentially some indirect impact to the extent that more of those renewable energy solutions would be more embedded in the networks rather than requiring base load generators that have to deliver energy over a long distance.

Mainly they have to move less volume around the network relative to what they do today, which may then cause some price increases because of the large amount of fixed cost in infrastructure — if there is less volume, prices tend to be higher — but I would have thought that would be rather an indirect impact compared to, say, the retail prices, where, since these alternatives are more expensive in the short run until the market fully develops, you would expect an increased cost of generation. That then progressively flows through to the retailers and retailers then want to progressively pass that on to the customers. How and to what extent, we do not really know. It depends on supply and demand conditions, price elasticities and all sorts of other things. That is a bit difficult to predict without a lot of supporting data and analysis. I guess they are my observations of the likely impacts.

Similarly with a national emission trading scheme, in terms of the impact on retail and distribution they would be quite similar to the extent that you are actually pulling back emissions as well, rather than just allowing trading. That would have a similar effect, because you move from lower emission type solutions, which you would expect in the short run to be a little bit more expensive for them, and they then respond to that.

You also asked what would be the impact on the ESC. Essentially there would not be a lot, unless we were asked to administer that type of scheme, which is a similar role to that the IPART has in New South Wales with the greenhouse gas abatement scheme. As well as monitoring the rules of that scheme it has a registrar-type of role with participants and benchmarking and those sorts of things. There might be some additional cost on our part if we were given an administrative role.

Essentially, to wrap up, I guess we are an economic regulator, not an environmental one, but we do take those things into account to the extent that they impact on distribution businesses. We are always keen to make sure those businesses are looking at new options around planning and augmentation, and they are required to look at things like better generation and so on and not just assume that they will continue to roll out their network and that type of thing. We want them to get onto losses as well as all the other things. We want them to be more efficient, as I mentioned before.

That is it really. I am happy to take questions.
Mr HILTON — What is your understanding of the role of an energy services industry? What do you see, if anything, that the Essential Services Commission can facilitate in the development of that industry?

Mr WILSON — My understanding is that it is essentially a service provider to those that want to save energy, and I am not sure if that is doing it full justice. In a simple sense it is out there in the marketplace helping industry and others find better solutions to their energy needs. In terms of our role, it is a bit difficult when progressively you have moved into being a regulator of infrastructure, the delivery infrastructure, rather than of the product itself, the energy, and where that is produced. It is basically a national energy market now, so it is really the ACCC or the Australian Energy Market Commission.

On the sale of water, we regulate from the dams all the way down to customers and then all the way back out to sewage treatments — the whole cycle — but with the energy market reforms, basically the generators moved into the market and the transmission infrastructure moved to the ACCC. With full retail contestability the retailing is now in the market as well. So our role is pretty much confined to the infrastructure side of it. But as I say, we are always looking to do that in a way that does capture these broader objectives without going beyond the scope of our statutory roles.

Mr DRUM — Whilst you indicate that, effectively, consumer protection is your role there, do you think there is scope in that economic realm to have an increase in the price of electricity so that we could aggregate our electricity costs with some of our more expensive methods? At the moment obviously coal is the cheapest form of electricity. If we are to move down the track, whether it be with wind or solar or PV, do you think there is scope within the pricing structure, if you step slightly to the left of your economic realm, to think about the social and environmental costs? Is there scope?

Mr WILSON — There would not be formally for me. Our powers do not extend to the final price. It is basically retailers negotiating with generators around a spot price in the market. They are telling you, ‘I will supply you with your energy continuously’, yet the market price is bouncing around minute by minute. They then have to take on the risk of saying, ‘I’ve got to supply you with energy at X cents per kilowatt hour. I will contract to pay a premium around that and wear that risk’. But I cannot intervene in that.

I keep going back to water as an analogy, but there are similar things like recycled water. Society wants us to look at different ways of minimising waste and all that sort of thing, and we can take a broader view because we actually regulate those prices. We can say those things you are saying about broader social issues, the long run and that eventually we have got to move to this sort of technology, we have to take into account externalities, environmental impacts and all those things. We have that full scope with powers in relation to water. I suspect that the equivalent would need to be the Australian Energy Market Commission. All governments collectively would need to say that they want to start building in and capturing some of these externalities and so on in the basic cost structure of these businesses, and the market will then pass them through — a bit like, say, building regulations and so on, where the planning people or whoever would impose 5-star ratings where you have got to have solar hot water. The building industry would work out how it is going to do that, how to price it and how to pass it through. At the moment our powers would not extend to doing that.

Mr SEITZ — Does the Essential Services Commission have any role in promoting the efficient use of energy by customers?

Mr WILSON — I am not sure. I would have to take that question on notice formally, but I expect we would have. It is something we certainly do in performance reports and that type of thing. As I say, we do not regulate the market itself, but when we get references from government we are keen to look at how effective competition is and make sure people have more information about choice and things like that. I can confirm that and will get back to you.

Ms DUNCAN — Are you aware of any other body like yours that has responsibility for pricing but also has responsibility for energy savings?

Mr WILSON — No, I am not. Typically you might have bodies like Sustainability Victoria, which has just been established, which would have that role with, say, energy, waste, water and gas, and would be influencing behaviour through things like household information, behaviour change, awareness and that type of thing. My understanding is that if you keep more of that sort of arrangement and keep the regulation of a monopoly and the
Ms DUNCAN — I think that is right, but what comes up again and again is the fact that one of the things that makes energy efficiency difficult is the relatively low cost of energy in Australia. I was wondering if you were aware of any body that tried to do both.

Mr WILSON — I guess price cuts for distribution have been basically because the costs have gone down. Basically on one hand we are saying, in terms of the infrastructure, we want those businesses to be more efficient, we do not want people to pay more than they have to for the infrastructure, but then there are these broader questions of the energy that goes through it and the upstream impacts of the type of generation, what that means in terms of greenhouse, and other impacts are important as well.

The CHAIR — You have answered my question in a sense. The Essential Services Commission does not take into consideration or give any emphasis to the reduction of greenhouse emissions at all? It is a totally separate issue?

Mr WILSON — Yes.

The CHAIR — Thank you very much.

Witness withdrew.