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Simply smarter energy

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Australian Energy Market Commission
AEMC Submissions
PO Box A2449
Sydney South NSW 1235

RE: Review of Energy Market Frameworks in light of Climate Change Policies

Australian Power & Gas (APG) welcomes the opportunity to provide comment on the Australian Energy Market Commission (AEMC) scoping paper on the Review of Energy Market Frameworks in light of Climate Change Policies.

Being a second tier energy retailer, retailing both Electricity and Gas in a number of jurisdictions our key responses to the AEMC Scoping paper are focused on the retail issues highlighted in the paper.

While APG supports and understands the need for Climate Change Policies that aim to reduce carbon pollution and protect the environment, we believe any Climate Change Policy must also ensure the longer term viability of energy retailers so as to ensure customers continue to be provided with competitive options for meeting their ongoing energy needs. Any Climate Change Policy must recognise the additional costs it imposes on business and allow appropriate mechanisms for these costs to be recovered.

Our detailed comments are contained in the following attachment. Should you have any questions or wish to discuss any aspect of our submission, I may be contacted on (02) 8908-2714 or via email at sruddy@auspg.com.au.

Yours Sincerely

Shaun Ruddy
Manager Regulatory & Compliance
Australian Power & Gas



Convergence of Gas & Electricity Markets

How capable are the existing gas markets of handling the consequences of a large increase in the number of gas fired power stations and their changing fuel requirements?

The Carbon Pollution Reduction Scheme (CPRS) may result in increased requirements for gas fired generation, increasing the demand for gas. Further increases in gas demand will arise from the planned construction of a number of LNG export facilities. The continued development of LNG export facilities may create a link between domestic and international prices. Where it is more profitable to export it will create a further squeeze on availability and increase costs towards international prices. In addition any large increase in gas fired generation will require significant investment in infrastructure to meet the increased demand, putting further pressure on costs.

In our view the current gas market is not in a position to handle the consequences of a large increase in the number of gas fired power stations and their changing fuel requirements. There are a number of concerns for retailers such as,

- Long term availability of gas given the requirements to underwrite the base load power stations and LNG export facilities;
- Potential for increases in gas prices and availability given the potential link between domestic and international prices; and
- The increased volatile intra-day gas demand profile.

Retailing

How material is the risk of an efficient retailer not being able to recover its costs, and why?

With the exception of Victoria, where price regulation is to be removed from 1 January 2009, the remaining jurisdictions are covered by retail price regulation for small retail customers. Historically price regulation has made it difficult for retailers to pass through cost increases incurred in servicing customers.

In addition there still remains a level of uncertainty as to the potential costs associated with the CPRS.

The uncertainty of the costs of the CPRS and that of a retailer's ability to pass costs on to end customers in the face of ongoing retail price regulation is a significant "material" concern for retailers. Price regulation has a significant influence over retailer's revenues. If retailers are to incur increased "new additional" costs as a result of the CPRS they must be afforded the ability to recover these costs through pass through mechanisms.

Regulatory certainty is a key issue for electricity retailers.

An electricity retailer's ability to manage wholesale electricity costs (and risk) is directly proportional to their ongoing profitability. Management of this risk predominantly occurs through contractual arrangements with generators. Currently the availability of long term contracts (post 2010) is limited and any such contracts contain carbon cost pass through clauses. This is due to the uncertainty around what effect the impending climate change policies will have over future costs and revenues. As a result retailers are exposed to significant risk.

It is clear that the introduction of a CPRS will increase wholesale energy costs, it is also expected that there will be an increase in other retailer costs such as compliance costs and prudential requirements. Retailers must be afforded the ability to recover any such additional costs.



Further there is a plethora of jurisdiction schemes being implemented on the basis of addressing climate change, such as VEET, REES etc. These too will impose significant costs on retailers especially as each of the jurisdictional schemes have particular nuances.

The risk that there is inadequate cost pass through provisions to account for the introduction of these new schemes is viewed as a material issue.

What factors will influence the availability and pricing of contracts in the short and medium term?

As previously stated wholesale contracts post 2010 contain carbon cost pass through clauses. As these costs are unknown, retailers are unable to determine and offer firm prices to customers as there is no ability to manage the risk from the carbon price component. The main reason for these contract provisions is the absence of certainty on the CPRS and Renewable Energy Target (RET) plans from Government. This will remain to be the case until such time as the Government delivers certainty on both the policy and position on these schemes.

The electricity and gas supply and demand balance will also influence the availability and pricing of contracts. The location and availability of future gas sources will also have an impact on the availability of contracts and getting the gas to market. The potential link between domestic and international gas prices and opportunity for export will also play a role in influencing the availability and pricing of contracts.

How material are the risks of unnecessarily disruptive market exit, and why?

There are a number of potential issues that may impact retailers as a result of the introduction of the CPRS, RET and other environmental schemes. These include:

- Inadequate cost pass through mechanisms;
- High pool prices as carbon cost is factored into pricing by generators;
- Increased prudential costs as a result of the increased pool prices;
- Delays in investment may create an incentive for generators to maximise their returns potentially resulting in high pool prices resulting in unsustainable energy costs; and
- Increased bad debt from customers as a result of price increases.

While the eventuality of any of these issues occurring is unknown, they are within the realms of possibility and may result in a retailer defaulting on their market obligations. This may trigger a Retailer of Last Resort (RoLR) event.

If a RoLR event were to occur the potential for a cascading effect would be linked to the size of the retail failure. Suffice to say if it were a retailer with significant customer numbers there would be a greater chance of a cascading effect.

An issue with the RoLR scheme is the continued delivery of gas to customers, there is a risk that the RoLR will not have sufficient contracted capacity to meet the requirements of the additional customers. RoLR arrangements remain largely untested.

APG agrees with the statement in the scoping paper that RoLR arrangements are seen as a potential weakness in the market.