ATCO
AUSTRALIA

Ref:

23 November 2017

Mr Baethan Mullen
General Manager, Retail Electricity Pricing Inquiry
Australian Competition and Consumer Commission

via email: retailelectricityinquiry@accc.gov.au

Dear Mr Mullen

RE: Preliminary Report: ACCC Retail Electricity Pricing Inquiry

As an energy infrastructure and related services company active in Australian gas and energy markets, ATCO Australia has a keen interest in policy and regulatory measures to address energy affordability. This letter outlines a submission from ATCO Australia in response to the preliminary report of the Australian Competition and Consumer Commission's (ACCC) Retail Electricity Pricing Inquiry published on 16 October 2017. ATCO Australia appreciates the ACCC's flexibility in allowing additional time to finalise our submission.

Background

ATCO Australia is a customer focussed company that develops, builds, owns and operates a range of energy infrastructure assets, supporting residential, business and commercial consumers across Australia. The Australian business includes:

- ATCO Gas Australia, which owns and maintains the largest gas distribution network in Western Australia, connecting over 750,000 customers through more than 14,000 km of natural gas pipelines and associated infrastructure. ATCO Gas Australia is subject to economic regulation by the Economic Regulation Authority under the National Gas Law (NGL) and National Gas Rules (NGR) as applied in Western Australia;

- ATCO Power Australia, which owns and operates two power generation facilities in Australia (a joint-owned facility in Adelaide and a wholly-owned facility in Karratha) with a combined capacity of 266 MW; and

- ATCO Structures and Logistics, which has been operating in the Australian marketplace since 1961. Today, ATCO Structures & Logistics has two manufacturing facilities and eight offices across the country delivering modular solutions to a diverse group of customers.

The ATCO Australia Group is part of the worldwide ATCO Group of companies with approximately 7,000 employees and assets of $21 billion. ATCO is engaged in pipelines and liquids (natural gas transmission, distribution and infrastructure development, energy storage, and industrial water solutions); electricity (electricity generation, transmission, and distribution); retail energy; and structures and logistics.

Preliminary report

ATCO Australia broadly agrees with many of the findings in the preliminary report and welcomes the report's emphasis on effective competition as an essential ingredient in measures to improve affordability.

In this regard, ATCO Australia believes that effective competition is a fundamental and powerful means of addressing affordability challenges in the energy sector. Furthermore, ATCO Australia considers the ability of competition to improve consumer welfare remains undiminished despite the concerns highlighted by the ACCC in the preliminary report about the way competition actually appears to operate in some wholesale and retail electricity markets.

In ATCO Australia's view, these concerns seem to arise mostly in areas where the rules that underpin competition have not kept pace with market developments, or where insufficient attention has been given to the potential for unintended consequences of policy or regulatory decisions.

Boosting competition in generation and retail markets

ATCO Australia broadly agrees with the ACCC's assessment that large vertically-integrated businesses are prevalent in wholesale and retail electricity markets in the National Electricity Market. The challenge for the ACCC is to determine how this dominance affects electricity consumers and then consider whether there is a strong market failure rationale for policy or regulatory measures to tackle market concentration.

ATCO Australia has reservations about the overall benefits of policy or regulatory interventions to unwind earlier consolidations of generation assets and retail operations, perhaps by structurally separating these businesses into smaller independent units. In theory, the potential gains from structural separation would be reduced market power and improved allocative efficiency, leading to lower generation costs. However, such gains would be difficult to achieve in practice given the certainty of drawn out resistance by the affected businesses and the likely negative effect of intervention on investment and business confidence.

Furthermore, the *Competition and Consumer Act 2010* already provides the ACCC with powers to investigate and enforce anti-competitive conduct, either independently or in response to specific complaints. The existing framework also provides powers that could be used by the ACCC to constrain further consolidation of existing generation assets and retail operations, for example through heightened scrutiny of proposed mergers and acquisitions in the energy industry.

On the retail side of the market, ATCO Australia strongly believes that competitive retail markets deliver real benefits for consumers and the broader economy. The introduction of competition in the retail gas market in Western Australia has delivered substantially lower gas prices for consumers, with some retailers offering discounts as high as 35 per cent off regulated gas usage charges (retail gas prices are subject to a regulated price cap in Western Australia).

However, even with these discounts, retail margins in Western Australia are still double the national average (Figure 1, Attachment 1). Margins of this magnitude are usually competed away as new retailers enter the market, which suggests there is a role for complementary policy and regulatory reforms to support effective competition. These reforms could include recalibrating the retail price cap to better reflect efficient costs, or even fully deregulating retail prices.

ATCO AUSTRALIA

Lowering network costs

ATCO Australia considers the current regulatory framework for network businesses generally strikes the right balance between allowing asset owners to earn an appropriate financial return and incentivising them to operate and invest in a manner consistent with the long term interests of consumers.

However, in thinking about measures to lower network costs, it is important for the ACCC to recognise that not all energy network businesses are the same. This is particularly true in the case of gas distribution businesses, which although regarded as natural monopolies, operate in an increasingly diverse, contestable and competitive energy services market.

As a consequence, gas distribution businesses need to focus on facilitating upstream and downstream competition by offering services that are valued by gas producers, consumers and retailers. They also need to focus on efficient service delivery for customers consistent with the National Gas Objective set out in the NGL. ATCO Gas Australia, a privatised gas distribution business that is part of the broader ATCO Australia Group, is already operating more efficiently than similar sized distribution networks active in East Coast gas markets, notably in Victoria and South Australia (Figure 2, Attachment 1).

Energy network businesses, like ATCO Gas Australia, that are-operating efficiently, would benefit from stronger incentives to take risk and innovate. The NGR already allow for an access arrangement to include one or more incentive mechanisms to encourage efficiency in the provision of services. These schemes are available in addition to those that are embedded in the regulatory framework, including the price cap tariff variation mechanism.

However, the available mechanisms are unlikely to encourage regulated network businesses to invest in innovative technologies because the returns provided under the current framework do not provide headroom for research and development risk. In addition, the incentives for a regulated energy business to invest in innovation are different to that of an unregulated business. Under traditional expenditure tests, regulated businesses are generally incentivised to focus on short-term projects aimed at containing costs and deriving operational efficiencies within a particular access arrangement period, rather than innovation that could deliver benefits over multiple access arrangement periods.

The lack of incentive to invest in innovation is a failing of the current regulatory framework and means that otherwise beneficial innovations are not pursued, or only those innovations that are low cost and have a shorter payback period are considered. This is not in the long-term interests of consumers.

In this regard, ATCO Australia encourages the ACCC, in preparing its final report, to consider measures to incentivise network businesses to invest in innovation as a way of lowering network costs. ATCO Australia believes such an approach is preferable to broader and blunter actions that will tighten regulatory settings and further weaken incentives to innovate.

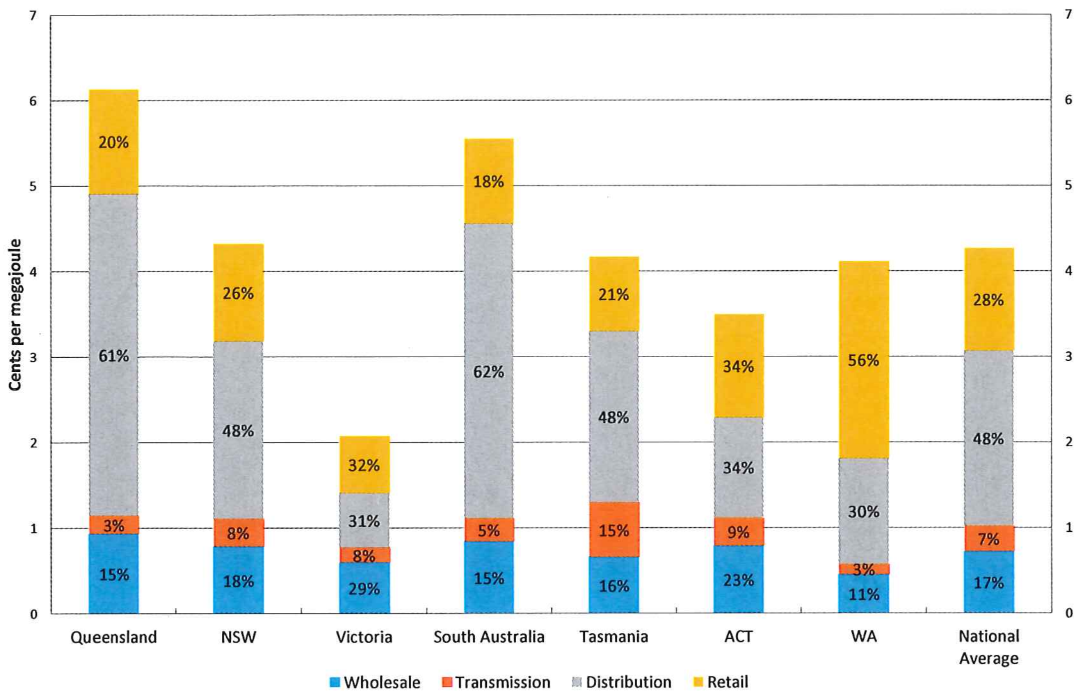
If you have any questions or would like to discuss any of these issues further, please contact me or Matthew Cronin, General Manager Regulation ATCO Gas Australia.

Sincerely,

Pat Creaghan
Managing Director and Chief Operating Officer

ATCO Australia
Level 12, 2 Mill St
Perth WA 6000
T: +61 8 6163 5407

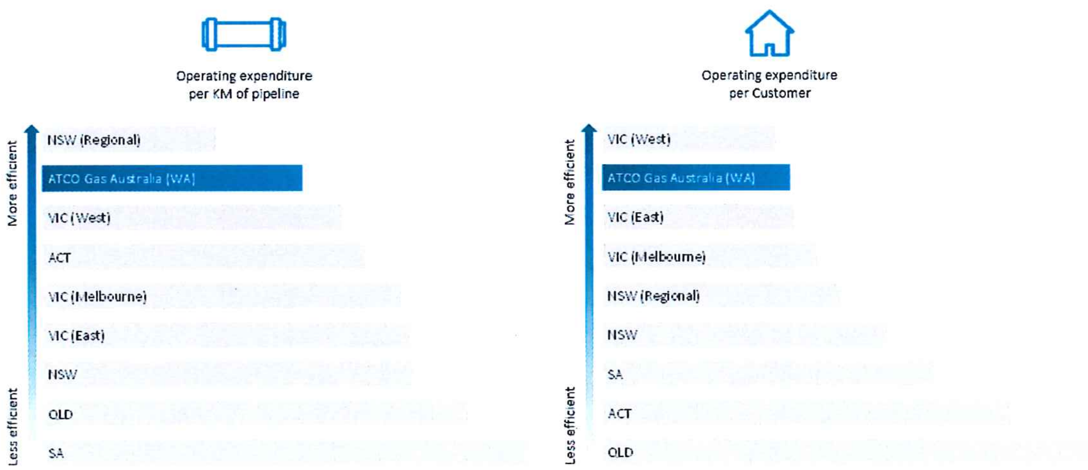
Figure 1: Indicative gas prices across Australia (incorporating July 2017 price rises)



Note: GST included in retail component of cost stack.

Source: ATCO Gas Australia calculations.

Figure 2: Operating efficiency of ATCO Gas Australia



Note: Data is based on average annual operating expenditure over 2007-16.

Source: Synergies Economic Consulting Benchmarking Report (commissioned by ATCO Gas Australia).