



Hon Stephen Robertson MP  
Member for Stretton

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08 DEC 2011

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Minister for Energy and  
Water Utilities

CLLO/CIC/11128

- 2 DEC 2011

Mr John Pierce  
Chairman  
Australian Energy Market Commission  
PO Box A2449  
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

The Queensland Government welcomes the opportunity to provide comment on the rule change proposals currently under consideration by the Australian Energy Market Commission (AEMC) relating to the economic regulation of the energy network businesses.

The following comments relate to changes to the National Electricity Rules (NER) proposed by the Australian Energy Regulator (AER) and the Energy Users Rule Change Committee (EURCC) - your reference ER0134 and ER0135. To the extent they are applicable, the general principles outlined in the following comments also apply to the AEMC's consideration of the AER's proposed changes to the National Gas Rules (NGR) - your reference GR0011.

Transmission and distribution networks are critical elements of Queensland's economic infrastructure. The services provided by these businesses enhance the welfare of the Queensland population, and underpin the competitiveness of state-based industries.

The Queensland Government notes that the NER and the NGR were developed against a background of significant under-investment by network service providers (NSPs) and associated sub-optimal outcomes for reliability and security. At the time, there were also concerns around the ability of infrastructure services to support strong demand growth. The NER in particular was designed to strike a better balance between providing investment certainty for NSPs and the delivery of adequate, secure, reliable and affordable energy services for consumers.

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The AER's rule change proposal raises some important questions in relation to whether the current rules are delivering an appropriate balance between these objectives. The Queensland Government notes that the rule change proposals, particularly the breadth of the proposal from the AER, have important implications for both electricity network revenues and associated electricity price impacts and the ability to maintain investment certainty and a safe and reliable electricity supply. The AEMC is encouraged to consider carefully the issues underlying the rule change.

The Queensland Government recognises the ongoing challenge of striking the right balance between providing certainty for NSPs (to reduce regulatory risk and avoid the potential for under-investment in energy infrastructure), and providing the regulator with sufficient discretion and flexibility (to ensure NSPs make prudent and efficient investment decisions). Going too far toward either extreme is not likely to yield a regulatory framework that performs well over long periods.

In this regard, the Queensland Government believes an efficient and effective regulatory framework will be one that:

- provides appropriate incentives to encourage greater efficiency in expenditure and forecasting by NSPs;
- provides the AER with an increased ability to ensure that only prudent and efficient costs are passed on to consumers;
- provides parameters and/or guidance for regulatory discretion;
- ensures the AER has access to sufficient information to support well informed decision-making;
- does not discourage necessary investment in infrastructure, particularly to deal with unforeseen circumstances;
- does not disadvantage NSPs in jurisdictions such as Queensland where population and economic growth are substantial drivers of capital expenditure and growth rates can be difficult to forecast;
- recognises the different characteristics of the different sectors, such as the 'lumpiness' of transmission investment as compared to distribution investment, and of different service areas;
- has the ability to recognise the regulatory settings which are the responsibility of State governments, such as reliability and security standards – e.g. any benchmarking of expenditure and/or reliability must take into account the frameworks within which individual NSPs operate; and
- remains faithful to the principles of national competition policy.

Further comments on specific issues raised under the rule change proposals are provided below.

### Capital Expenditure Framework

The Queensland Government is concerned that the current regulatory framework allows for automatic roll-over of all actual capital expenditure into the NSPs asset base at the start of the next regulatory period. The Queensland Government agrees with the need to ensure appropriate incentives for the management of capital expenditure by NSPs, but is of the view that NSPs should have flexibility to exceed their forecasts if it is efficient and prudent to do so.

The Queensland Government notes the AER is proposing changes that would see only 60 per cent of capital expenditure in excess of approved forecasts rolled-over into the next period, with the remaining 40 per cent funded by shareholders (that is, with no return on or of capital). The Queensland Government does not support the proposed rule in its current form on the basis that it may discourage necessary investment, particularly where required to respond to unforeseen circumstances.

#### Cost of Capital and Return on Debt

The Queensland Government appreciates the difficulties presented by a prescriptive approach to estimating the cost of debt, particularly in the face of the challenges presented by the Global Financial Crisis. However, the Queensland Government encourages the AEMC to consider a solution that strikes the right balance between the principles of flexibility, and providing sufficient certainty and predictability for NSPs, their financiers and investors, given the long-term nature of investment in energy networks. While the Government notes that the AER intends to provide predictability to market participants through a five-yearly statement on the cost of capital, some definition in the rules may continue to be warranted.

With regard to the return on debt, the EURCC proposal would amend the relevant methodology to require the return on debt for Government-owned NSPs to be determined on a different basis to privately owned NSPs. The Queensland Government is strongly opposed to any proposal which would treat Government and private NSPs on a different basis, which would unravel almost two decades of National Competition Policy reform.


The Queensland Government is a signatory to the *Competition Principles Agreement 1995* (CPA), which included agreement to the principle of competitive neutrality. In accordance with the CPA, Queensland Government owned corporations (GOCs) are required to operate in a commercially-oriented manner, and compete with the private sector on the same basis. In this regard, the Queensland Government ensures that GOCs do not enjoy any net competitive advantage simply by virtue of their Government ownership.

The EURCC's claim that GOCs have substantially lower debt costs than privately owned NSPs is incorrect. In view of the fact that the interest rates at which GOCs are able to borrow funds is likely to reflect the creditworthiness of the State rather than the stand-alone credit of the individual GOC, a competitive neutrality fee is applied to GOCs' cost of debt.

To apply discriminatory arrangements to the cost of debt for Government-owned and privately-owned NSPs would be in breach of the competition principles agreed to under the CPA. More detailed information on the CPA and the principle of competitive neutrality is provided at Attachment 1.

If you have any questions about this submission, Mr Benn Barr, General Manager, Energy Industry Policy of the Department of Employment, Economic Development and Innovation will be pleased to assist you and can be contacted on telephone 07 3225 8305.

Yours sincerely



**STEPHEN ROBERTSON MP**

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### National Competition Policy Reforms

In 1995, all Australian governments agreed to implement a series of initiatives designed to improve the competitiveness of the national economy. This was facilitated by three intergovernmental agreements:

- the Competition Principles Agreement (CPA);
- the Conduct Code Agreement; and
- the Agreement to Implement the National Competition Policy and Related Reforms.

Key reforms addressed under the CPA include:

- the imposition of competitive neutrality between government business activities and their private sector competitors;
- the structural reform of public monopolies; and
- prices oversight of state-based government business enterprises which have monopoly power.

### Competitive Neutrality

Competitive neutrality reform involved the Australian Government and all state and territory governments ensuring that their publicly owned businesses did not enjoy any net competitive advantage simply because they are publicly owned.

For significant government businesses, governments agreed to implement a corporatisation model, and to impose on the business full taxes or tax equivalents and debt guarantee fees to offset advantages from government guarantees, and to apply to the business regulations normally applying to private sector businesses and ensure that the prices charged for goods and services take account of these costs (see extract of CPA below).

In Queensland, competitive neutrality principles for the electricity sector were implemented through corporatisation under the *Government Owned Corporations Act 1993* (GOC Act). Corporatisation of government business activities involves restructuring these business activities in such a way that they operate on a commercial basis, whilst maintaining government ownership.

In relation to the electricity market, the Queensland Electricity Commission was structurally separated and the first tranche of electricity sector corporatisation reforms occurred in 1994. Following the initial reforms, Powerlink and Energex were created on 1 July 1997, and Ergon Energy on 1 July 1999.

The objectives of corporatisation, as defined under the GOC Act, are to improve Queensland's overall economic performance, and the ability of the government to achieve social objectives by improving the efficiency, effectiveness and accountability of GOCs. In order to achieve these objectives, Government owned corporations are required to operate, as far as practicable, on a commercial basis and in a competitive environment, including complying with the principles of competitive neutrality.

As a result, Queensland GOCs are subject to competitive neutrality fees to offset the fact that the interest rate at which GOCs are able to borrow funds is likely to reflect the creditworthiness of the State, rather than the stand-alone credit of the individual GOC.

It is essential that GOCs operate efficiently and in a commercially-oriented manner, and compete with the private sector on the same basis so as to eliminate potential resource allocation distortions. Any community has finite resources, and those resources are optimally allocated when goods and services are consumed in proportion relative to the true cost of their production. For example, if a GOC is not subjected to the requirement to earn a similar rate of return on capital investment, then the GOC may be able to underprice its goods and services, which may lead to overuse of the goods and services.

### **Competitive Neutrality Policy and Principles (extract)**

- 3.(1) The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities.
- (4) Subject to subclause (6), for significant Government business enterprises which are classified as "Public Trading Enterprises" and "Public Financial Enterprises" under the Government Financial Statistics Classification:
- (a) the Parties will, where appropriate, adopt a corporatisation model for these Government business enterprises (noting that a possible approach to corporatisation is the model developed by the inter-governmental committee responsible for GTE National Performance Monitoring); and
  - (b) the Parties will impose on the Government business enterprise:
    - (i) full Commonwealth, State and Territory taxes or tax equivalent systems;
    - (ii) debt guarantee fees directed towards offsetting the competitive advantages provided by government guarantees; and
    - (iii) those regulations to which private sector businesses are normally subject, such as those relating to the protection of the environment, and planning and approval processes, on an equivalent basis to private sector competitors.
- (5) Subject to subclause (6), where an agency (other than an agency covered by subclause (4)) undertakes significant business activities as part of a broader range of functions, the Parties will, in respect of the business activities:
- (a) where appropriate, implement the principles outlined in subclause (4); or
  - (b) ensure that the prices charged for goods and services will take account, where appropriate, of the items listed in paragraph 4(b), and reflect full cost attribution for these activities.
- (6) Subclauses (4) and (5) only require the Parties to implement the principles specified in those subclauses to the extent that the benefits to be realised from implementation outweigh the costs.

### Structural Reform of Public Monopolies

The structural reform commitment under the CPA involved the Australian Government and all state and territory governments agreeing to take certain actions before introducing competition to public monopoly markets, and before privatising a public monopoly.

In particular, governments committed to conducting detailed structural reviews of public monopolies, including the merits of separating any natural monopoly elements from any potentially competitive elements. Further, before introducing competition to a public monopoly market, governments committed to removing from the monopoly any responsibilities for industry regulation.

In early 2007, the Queensland Government finalised the sale of the electricity and gas retailing businesses of Energex, the competitive retail business of Ergon Energy, and Energex's Allgas Energy natural gas distribution network. The decision to sell the assets was made in April 2006, following an independent review of the Government's energy businesses which recommended that the Queensland retail businesses of Energex and Ergon Energy be sold to assist with the introduction of full retail competition for domestic and small business customers in Queensland on 1 July 2007.

Energex and Ergon Energy were retained as public monopolies, with Ergon Energy continuing to provide electricity to rural and regional domestic and business customers who do not enter a market contract with another retailer. These customers continue to receive electricity at the regulated, Government-subsidised electricity prices, with the community service obligation made transparent.

#### Prices Oversight

The prices oversight undertaking involved states and territories agreeing to consider establishing independent sources of prices oversight of their monopolistic business enterprises. For the NSPs, this function originally rested with the Queensland Competition Authority, with this responsibility now having transferred to the AER.

The discussion of monopoly prices oversight in the Hilmer Report 1993 clearly indicated the intent that *'the same process, is applicable to all firms regardless of ownership, although the process takes account of the special considerations that can arise with Government owned businesses...'* (pg 269).

In this regard, the Hilmer Report did not contemplate applying a different pricing arrangement on the basis of Government ownership, beyond that necessary to deal with transitional reform issues.