13 December 2013

Economic Regulation Authority
Level 4, Albert Facey House,
469 Wellington Street, Perth WA 6000

Inquiry into Microeconomic Reform in Western Australia

Alinta Energy (Alinta) welcomes the opportunity to comment on the discussion paper on the potential reforms to be considered in the Authority's inquiry into Microeconomic Reform in Western Australia.

Alinta is both a generator and retailer of electricity and a retailer of gas in Western Australia and the Eastern States energy markets. It has over 2500MW of generation facilities and about 750,000 retail customers.

Alinta is strongly of the view that well-functioning competitive markets provide the greatest protection and long term benefits to consumers and the economy generally. Any micro-economic reform should be directed at achieving this market outcome. We therefore welcome the Authority's current inquiry which will focus on:

- Reviewing Government ownership of assets
- Improving the State infrastructure spending, planning and utilisation
- Reviewing the efficiency of State Government taxes and charges
- Reducing the cost of complying with "red tape"
- Examining current restrictions on product markets in Western Australia (in particular, liquor licensing, licensing and registration of tradespeople, taxi regulation, retail trading hours, potato marking regulation, and domestic gas policy).

However, given the importance of the energy industry to WA's economic growth, Alinta has limited its comments to those matters impacting the efficiency of the WA energy market.

1. Government Ownership

The WA Government is a significant owner of assets in the WA electricity market[1]. It owns some of the most important and most expensive assets in the energy market. These are:

- Verve and Synergy[2] which own the majority of both power generation in the South West and electricity customers;
- Western Power which owns the transmission and distribution electricity networks in the South West and

[1] Alinta notes the WA Government does not own any gas assets since these assets were sold to the private sector in 2000.
[2] Verve and Synergy will merge on 1 January 2014 leading to the new entity having significant shares of both the electricity and gas markets.

- Horizon Power which owns regional electricity assets (generation, transmission, distribution and retail).

For example the property, plant and equipment assets for Western Power alone are worth about $7.6 billion thereby significantly contributing to state debt. Further to be commercially viable Synergy requires an additional operating subsidy allocation of $634.7 million over 2012-13 to 2016-17 to compensate between the cost of electricity provision and the prices paid by end use customers[3].

Alinta strongly supports the principle put forward by the Authority in its discussion paper that: "*The government should only enable the delivery of goods and services (including infrastructure) that the private sector is unable to commercially provide*."

Recent market experience suggests that the private sector is well placed to provide electricity generation and retail services in WA, as illustrated by entrance of a number of independent generators and retailers since the formal disaggregation of Western Power. Further, Government ownership of electricity assets is no longer necessary from a "public good" perspective given the regulatory instruments that are in place to:

- set electricity prices for non-contestable customers for a pre-determined period;
- maintain service standards, availability and environmental standards; and
- ensure customer protection.

To the extent that the government wishes to provide safeguards to consumers Alinta considers that this is best done through direct and transparent means rather than through the government's position of owner.

Divesting government owned electricity assets to the private sector would not only remove a significant amount of risk from the state but will also result in broader benefits associated with improved productive and allocative efficiency. For example the Queensland Commission of Audit recently noted in its Final Report (April 2013) that there is substantial international evidence that privatised government enterprises operate more cost effectively when they are allowed to operate without government interference in commercial decision-making processes[4].

Consistent with the principle put forward by the Authority, Alinta supports the inquiry considering whether the electricity market would be best served through the Government exiting the market over time. If the inquiry finds this to be the case then a plan for achieving this should be developed and communicated to industry.

To assist the inquiry in considering whether an asset in the SWIS or NWIS should be privatised the following potential benefits should be assessed against the continued costs of state ownership. Alinta notes that this list is not exhaustive and there are likely to be additional benefits on top of these.

The WA Economy

- Removal of unnecessary risks which tax payers are currently exposed to due to government ownership. For example the state is largely exposed to the risks associated with underwriting investment in new generation assets currently.
- Reduction in State debt and improvement to budget expenditure likely to lead to an improved credit rating for the State;

[3] 2013-14 Budget: Economic and Fiscal Outlook, Budget Paper No. 3, page 162
[4] Refer to: http://www.commissionofaudit.qld.gov.au/reports/final-report.php

- Better use of the State's capital, i.e. funds can be redirected towards investment in core services such as health and education;

- Improved competitive economy driven by a more efficient energy market; and

- Boost to capital markets if private sector financing for purchase of generation or retail assets is sourced within Australia.

The Assets

- Greater access to finance for investment, with no impact on state budget;

- Commercial focus to extract maximum value through pricing, investment and operation of the electricity business. For example in the case of generation assets a strong commercial focus will likely improve reliability as the owners will have a greater ability to fund O&M expenditure. That is Government expenditure on O&M may be assessed against other budget requirements which may impact on-going investment into existing generation assets;

- Improved efficiencies as consequence of more flexible work practices. In a competitive market these benefits will be shared between the owners and customers[5];

- Removal of conflicts of interest associated with the State acting as both a regulator and commercial producer and/or supplier of electricity; and

- Removal of political interference (perceived and actual) with respect to business operating decisions.

Other stakeholders

- Removal of potential deterrents for other private sector investment. In particular privatisation of generation assets and/or retail assets is likely to encourage interstate competitors into the electricity retail market in WA

- Improved quality of service and reliability; and

- Lower prices driven by increased efficiency and competition.

2. Domestic Gas Reservation Policy

Domestic gas reservation policy in Western Australia has arguably been necessary given the unique nature of the WA gas market and the historically limited upstream and downstream gas competition.

Competition in upstream gas is vital for keeping electricity and gas costs down for residential and business customers. This is a particularly an issue in Western Australia given:

- Until recently, there has been little competition in upstream gas. Traditionally WA has had one major gas field (North West Shelf) which was originally developed primarily for export purposes and has joint venture marketing in place.

- There is limited on-shore gas. Currently only 2-3% of gas used in WA is supplied from on-shore sources.

[5] Refer to: Privatisation of Public Utilities: The OECD Experience, Nestor and MahBoobi (1999): http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/1929700.pdf

- The downstream gas market is concentrated with Government ownership of the major energy companies making it difficult for other gas users to negotiate relatively favourable contract terms without a highly competitive upstream market.

The benefits of the policy are very difficult to quantify however Western Australia now has a reasonable level of upstream and downstream gas competition which could in part be attributed to the policy.

Given the Western Australian gas market has evolved to the point it is at, and that gas users have made investment decisions with the domestic gas reservation policy in mind, Alinta considers that there is no reason to remove the policy at this time.

Alinta notes that in Western Australia the domestic gas reservation policy was a policy only implemented to ensure supply to the domestic market not as a policy to deliver supply at below market cost by regulating the supply-side.

4 Reducing Cost of Complying with Red Tape

Participants in the state's energy markets are subject to numerous regulatory approvals and requirements, i.e. licensing, compliance audits, environmental approvals, reporting obligations etc. While it's recognised that a robust regulatory and compliance environment must exist, Alinta supports the inquiry in considering opportunities to cut red tape in this sector with a view to reducing the significant costs that are imposed on energy market participants to ensure compliance. Areas for particular consideration include:

- Frequency and scope of gas and electricity licence audits and performance reviews;
- Rigour of licence application and regulatory approvals processes;
- Review of standard form contracts – this particularly relates to the opening up of the entire contract when a minor change is requested by the licensee.

If you would like to discuss this submission, please contact me on 9486 3762.

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