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Energy Efficiency Inquiry
Productivity Commission
Locked Bag 2
Collins Street EAST MELBOURNE 8003

30 May 2005
Re: Draft Report on Energy Efficiency

Dear Sir or Madam

AGL welcomes the opportunity to provide comments on the Productivity Commission Draft Report on *Energy Efficiency*.

AGL believes that there is significant potential for energy efficiency to deliver two important policy objectives: economic efficiency and reduced greenhouse gas emissions.

Please find enclosed AGL's submission that addresses these issues. Do not hesitate to contact Tim Nelson, Manager Environment Policy and Strategy, on (02) 9921 2516 if you have any queries.

Yours sincerely

Mary Darwell
Manager
Group Environment

AGL SUBMISSION ON THE PRODUCTIVITY COMMISSION DRAFT REPORT ON ENERGY EFFICIENCY

1. Introduction

AGL is Australia's leading energy company, with significant electricity and gas customer bases in South Australia, Victoria and New South Wales. AGL also owns gas and electricity distribution networks and a number of electricity generation assets including Loy Yang Power (minority investment), the Hallet peaking power station in South Australia and the Somerton peaking power station in Victoria.

Given our business experience, the focus of this submission is on efficient electricity and gas usage. AGL broadly supports the Productivity Commission's general assessment criteria for energy efficiency initiatives. Cost reflective retail prices are necessary to improve energy efficiency. Where market failure exists, there may be a case for Government intervention.

Set out below are AGL's views on issues raised by the Productivity Commission in its draft report.

2. Energy Costs and Market Failure

Energy costs represent around 3% of average weekly household expenditure. This relatively small proportion of expenditure limits the incentive for users to consume energy efficiently. AGL agrees with the Productivity Commission's assessment that as energy usage increases as a proportion of total costs, the incentive for energy efficiency increases.

In this context, the Productivity Commission has identified a range of barriers to the uptake of energy efficiency. These include asymmetric information, split incentives, implementation costs, bounded rationality, organisational barriers and capital constraints. AGL believes that there are significant opportunities for making energy use more efficient where barriers such as these occur. Governments, industry and consumers all have a role to play in making energy use more efficient.

Programs aimed at increasing energy efficiency have two main benefits:

- Economic efficiency. If businesses and consumers are using energy inefficiently, there is scope for producing more output using the same amount of energy. Over time, this could contribute to significant additional economic growth.
- Reduced greenhouse gas emissions. Where overall energy consumption is reduced through appliance standards and the like, greenhouse emissions are likely to be reduced.

AGL believes that the focus of energy efficiency policies and programs should be on economic efficiency. However, when energy efficiency policies are being developed, there should be explicit consideration of the likely greenhouse impacts. More broadly, a national approach to greenhouse policy, including the role of energy efficiency, should be developed by the Commonwealth in consultation with the States.

3. Cost Reflectivity and Energy Market Reform

AGL believes that retail energy price regulation limits the development of retail products and services which encourage more efficient behaviour by consumers. The incentive for customers to use energy more efficiently is increased when energy prices reflect the total cost of supply. Accordingly, AGL supports the Productivity Commission's recommendation that retail electricity and gas prices be deregulated.

Streamlined energy regulation is another important element in increasing energy efficiency. In particular, AGL believes that:

- Priority should be given to the finalisation of a national regulatory framework for electricity and gas distribution and retailing. In developing this framework, regulatory settings that impact on energy efficiency should be examined.
- A national approach to energy efficiency policies and programs should be adopted (see section below).
- The Commonwealth and State Governments should develop an agreed set of principles to guide a national approach to greenhouse gas emission reductions.

There is significant potential for more efficient energy use during periods of peak electricity demand. AGL believes that energy market reform, and in particular the removal of retail price controls, has significant potential for reducing these peaks.

4. Metering

AGL supports Productivity Commission's assessment that the mandated roll out of interval meters should be subject to a comprehensive cost-benefit analysis.

That said, AGL believes that there may be potential for metering technology to provide for product differentiation and energy efficiency. AGL is currently conducting trials to compare different metering technologies. These trials should reveal important information about customer demand elasticity in response to different price and technology options. Retailers should be free to introduce new metering technology when it is efficient to do so.

Energy efficiency relies upon appropriate price signals reaching the end consumer. Currently, the widespread use of old metering technology limits the degree to which consumers can respond to price signals. At times of high demand and therefore higher wholesale energy prices, many consumers are paying a flat regulated rate for their energy. New metering technology would allow retailers to offer innovative contracts where consumers would be able to shift their consumption into periods when prices are lower.

Furthermore, advanced metering technology can provide for load control functionality. This allows devices to be controlled externally so that peak loads can be reduced when required. For example, at times of higher prices, advanced metering technology could be used to alter air-conditioner and fridge thermostats.

In addition to metering technology, the current regulatory arrangements for mass-market meters should be considered. If metering competition is introduced or new metering technology is mandated, policy makers should allow the net costs of these meters to be passed through to the end consumer.

5. Minimum Performance Standards for Appliances

Minimum performance standards can provide a useful way for reducing energy inefficiency. Customers sometimes lack information about the long-term cost effectiveness of an appliance. In this context, standards can correct market failure associated with incomplete information.

The benefits from adopting minimum standards are likely to be relatively small for individual customers. However, when aggregated across the economy, there could be significant potential for inefficient energy consumption to be directed towards a more productive use.

There are many appliances available today that exceed minimum standards. These improvements in efficiency demonstrate that the market is delivering more efficient products where consumers demand them. In this context, appropriate labelling is just as important as minimum standards.

AGL understands the concerns raised in the Draft Report about the impact of restricting consumer sovereignty on lower-income households. However, the potential for customer hardship caused by increased energy use over the life of the appliance is also an important

policy consideration. Energy inefficient appliances can be a contributing factor to high energy bills. In some cases, the consumer would not have been aware of the lifetime cost of the appliance. This can contribute to customers experiencing difficulty when paying energy bills.

Therefore, some customers may experience ongoing hardship in the absence of minimum performance standards. Accordingly, AGL believes that policy makers should consider this issue when determining the costs and benefits of minimum performance standards.

6. Standards for the Built Environment

AGL believes that appropriate national cost-effective minimum standards for the built environment can deliver energy efficiency gains. Investments in new dwelling and commercial premises involve significant capital expenditure. As such, customers may choose to reduce the initial outlay by purchasing cheaper, less efficient equipment and fittings. This decision is often made due to a lack of available information. While this is understandable given the complexities of construction, it is uneconomic.

Once installed, many features of a dwelling are expensive to retrofit for energy efficiency purposes. An initial decision to reduce capital outlays is therefore not easily reversed. Consumers can feel 'locked in' once the initial decision is made. They have no choice but to pay higher energy bills for the life of the investment.

7. National Consistency

AGL supports the Productivity Commission's recommendation that refers to the rationalisation of standards. Where possible, national standards should be developed for both voluntary and compulsory schemes. At the very least, this national consistency should apply to labelling schemes and minimum performance standards.

8. National Energy Efficiency Target

AGL agrees with the Productivity Commission's assessment of a national energy efficiency target as a policy instrument. To put in place an energy efficiency target, it would be necessary to calculate an 'optimal' level of energy efficiency. This would be very difficult to calculate and it is very unlikely that agreement on it would be secured.

If the target resulted in reductions in consumption beyond an efficient level, economic growth would be constrained. If the target resulted in smaller reductions than necessary to achieve economic efficiency, the transaction costs of the scheme may end up outweighing the economic benefits realised.

9. Mandatory Energy Efficiency Opportunities Assessments

There are significant gains to be made through energy efficiency audits. AGL has several programs and products tailored towards providing such services. Customers who purchase AGL electricity or gas are purchasing an energy service along with the energy commodity. Optimising customer use of the product is an area of product differentiation.

Many industrial and commercial energy customers already undertake energy efficiency audits. These audits are used to reduce energy costs because energy is often a higher proportion of their total structure. It is unclear why mandatory energy efficiency opportunity assessments are necessary given the commercial benefits from improving energy efficiency and the growing level of activity.

10. Conclusion

In conclusion, AGL believes that the Productivity Commission's Draft Report provides some useful insights into energy efficiency. However, AGL believes that the following points need to be incorporated or emphasised in the final report:

- Price regulation prevents cost-reflective energy pricing. As such, Governments should transition to cost-reflective pricing with a view to removing price regulation at the end of the current price paths. To ensure customers in genuine hardship are adequately protected, Governments should provide direct and transparent payments to customers experiencing genuine hardship.
- Minimum performance standards for appliances and the built environment can provide energy efficiency gains where they are cost effective over the lifetime of the product.
- Energy efficiency audits are often a cost-effective way for large energy users to reduce energy bills. Generally, energy businesses already track and reduce energy usage where possible. As such, the proposed mandatory energy efficiency opportunities assessments program is unnecessary.