

Manager – EMR Projects  
National Energy Market Branch  
Department of Industry, Tourism and Resources  
GPO Box 9839  
Canberra ACT 2601

26 October 2004



LEVEL 3  
TOURISM HOUSE  
40 BLACKALL STREET  
BARTON ACT 2600  
AUSTRALIA

T +61 2 6273 8111  
F +61 2 6273 8011  
W [www.a3p.asn.au](http://www.a3p.asn.au)

## **RE: NATIONAL FRAMEWORK FOR ELECTRICITY AND GAS DISTRIBUTION AND RETAIL REGULATION**

A3P – Australian Plantation Products and Paper Industry Council appreciates the opportunity to make a submission on the Issues Paper: *National Framework for Electricity and Gas Distribution and Retail Regulation*. A3P's membership includes significant energy users involved in the manufacture of paper products, reconstituted wood products and sawntimber. The combined energy use of the industry is approximately 2.0% of the total Australian energy consumption of both gas and electricity.

### **Summary**

A3P supports the impetus to streamline the regulation of energy markets through removal of duplication, and an increase in consistency across regions, through the supply chain and across energy types. Specific comments on the Issues Paper include:

- Pricing principles must be explicitly linked to the primary objective of “protecting the long term interest of consumers with regard to the price quality and reliability at which electricity and gas, as essential services, are provided to consumers.
- The pricing principles should include an objective of distributing costs amongst users in a manner that reflects their contribution to the cost of the service. Distribution costs should be linked to the peak loads for each customer or customer group rather than the overall usage.
- Any modifications to existing consumer protection codes and service standards must not result in any dilution of users' rights.
- End-user impact statements should be prepared as part of any process that modifies rules, codes or standards.

The plantation products and paper industry produces and sells more than \$12 billion of product each year. It employs 50 000 people in plantation operations, sawmills and paper manufacturing plants, mainly in rural and regional areas. The industry produces 15 million tonnes of wood annually, and processes this wood into products including 3 million tonnes of paper and 3 million cubic metres of sawn timber.

The industry is heavily trade exposed, depending on competitively priced energy to maintain a commercial edge and is unable to readily pass costs through to customers. Energy supply and pricing is critical in the formula that determines industry growth and investment.

A3P supports the completion of the Council of Australian Governments' program to make energy markets truly efficient, delivering reliable energy supplies at prices that enable energy-intensive industries to remain internationally competitive.

A3P has maintained an active and constructive role in the energy market reform program on behalf of its members. We believe the maximum benefit will be achieved if the policy and regulatory processes effectively integrate end users and facilitate more constructive engagement between energy users and energy suppliers.

## **General Comments**

A3P supports the impetus to streamline the regulation of energy markets through removal of duplication, and an increase in consistency across regions, through the supply chain and across energy types. It is important that streamlining regulation is differentiated from reducing regulation that lowers expectations and requirements on the entities being regulated.

Streamlining the regulation of energy markets benefits both suppliers and users as it reduces the overall cost burden. Reducing regulatory requirements however, though undoubtedly benefiting suppliers, has the potential to come at a cost to users through, for example, lower standards, decreased accountability, reduced transparency and higher prices.

The cost of regulation is a powerful determinant of the cost of energy. The cost of energy is one of the few areas where Australian based production facilities can earn a competitive advantage against overseas facilities in trade-exposed, energy-intensive industries.

In the absence of specific proposals (we note that there will be a second round of consultation on options that are developed) the following comments are fairly general and focus strongly on the need for a competent regulatory framework to adequately take account of the impact on, and implications for, large end-users.

## **Primary Objective – Pricing Principles (Issues 1 and 7)**

The pricing principles outlined in the paper for gas and electricity cover a wide range of issues. Clearly, many of these issues are included to protect the interests of energy users. However there is no explicit link, either in content or structure, between the principles listed and the acknowledged primary objective.

Page 13 identifies the primary objective that underpins the distribution and retail functions as:

*protecting the long term interests of consumers with regard to the price quality and reliability at which electricity and gas, as essential services, are provided to customers.*

A3P strongly supports this primary objective and suggest that it be incorporated explicitly into all relevant legislation, codes, lists of objectives and principles and policy statements.

Specifically, the list of pricing objectives and principles should include this as the first objective. A new set of principles should be developed that are founded in the primary objective outlined above. Many of the same issues may be included but they must be presented and structured in a way that clearly descends from the primary objective. The risk of not doing this is that the primary objective will exist as a vague statement of intent with no demonstrable link to other principles and objectives and no requirement to test subsequent objectives and principles against their ability to deliver on the primary objective.

### **Role of Governments in Electricity Distribution Pricing (Issue 4)**

If the structure and implementation of pricing objectives adequately take account of users' interests and serve the primary objective of the market, there appears little justification for additional Government-imposed rules in electricity distribution pricing.

However, we would like to monitor the further development of the pricing principles (see section above). If the final principles do not adequately protect the interests of users, there may be justification for Government intervention to protect public interest in the pricing of essential monopoly services.

### **Cost Reflective Pricing (Issues 1 and 7)**

The cost of any service should, wherever practical, be paid by the users of that service. In the case of distribution costs, the critical factor driving the investment in, and cost of, distribution networks is the peak load. Distribution charges are currently applied on a usage basis with no relationship to 'capacity'. Consequently, those with stable loads and a consistent demand profile subsidise those with a 'peaky' demand profile. This is inequitable and should be rectified through the pricing principles. The pricing principles should, therefore, include an objective of distributing costs amongst users in a manner that reflects their contribution to the cost of the service. This suggests that distribution costs should be linked to the peak loads for each customer or customer group rather than the overall usage.

An objective of "pricing structures that link prices to the parameters that drive the cost of providing the service" could be included to address this issue.

Pricing should also provide a signal to encourage users to utilise the network assets in a manner that minimises the need to invest in additional capacity and improves the productivity of these assets through increased utilisation of the network during times other than peak.

## **Pricing – Reinvestment and Shareholder Returns**

The pricing principles and methods outlined in the paper rightly allow for suppliers to generate funds for reinvestment in the network and return to their shareholders. However, if the level of assumed reinvestment does not take place, the supplier has excess funds to provide as a larger return to shareholders. Energy users ultimately bear the burden of a lack of reinvestment in the network through a reduction in the quality of supply and increased interruptions to supply.

In the case of privately owned distributors, their commercial interests and the existence of competition in the market should prevent this from occurring. The same constraints, however, do not apply if there are monopoly characteristics in the distribution network and/or high levels of government ownership.

In these instances either the pricing principles and/or the service standards imposed must ensure that appropriate levels of reinvestment in the network are actually occurring and excess returns are not being provided to owners of the network.

Network pricing is regulated and will tend to provide a return to the owner. There is a need to ensure that additional investment in networks is justified on the basis of demonstrable gains to consumers in the system. Regulated pricing may also reduce the incentive for retailers and distributors to facilitate demand management.

## **Regulation of Excluded Distribution Services**

On page 35, the paper notes that the form of regulation to be applied to excluded distribution services is a more “light handed” approach than that which applies to prescribed distribution services. The assessment of the level of competition in a market is not as simple as ‘competitive’ or ‘monopoly’. The principles for regulation of excluded distribution services should be expanded to allow for varying levels of regulation based on the level of competition in the market.

## **Pricing Objectives and Principles: Gas Distribution (Issue 7)**

The factors that must be taken into account by a regulator when assessing proposed access arrangements under the current National Gas Access Code are presented in the Issues Paper, along with the Productivity Commission’s recommended amendments.

Given the primary objective of the market (that is, protecting the long term interests of consumers) it is appropriate for the interests of the public, users and prospective users to be retained in the pricing objectives and principles. Accordingly, factors 5 and 6 from the current code should be retained in any new objectives and principles:

*factor 5: the public interest, including the public interest in having competition in markets (whether or not in Australia);*

*factor 6: the interests of users and prospective users.*

## **Regulatory Instruments (Issue 11)**

The paper discusses the various regulatory instruments available and the need to rationalize how the licence provisions are applied through each instrument. In undertaking this rationalisation, the interests of energy users must be considered.

It is often the detail of regulatory requirements and the level of service standards that are most crucial to energy users. The paper proposes that the detailed, technical requirements should be included in codes, rules and guidelines to allow them to be changed to accommodate industry developments.

If this is to occur, the process for varying them must fully capture users' input. Users should be informed of any proposed change and its justification, they should be provided with the opportunity to participate and comment, and the final decision should consider their views and serve the overall objective of "protecting the long term interests of consumers". A3P strongly supports the requirement that end-user impact statements be prepared as part of any code/rule change making process. While the detailed conditions may be included in the legal instruments, the process for varying those codes should be enshrined in legislation.

There are many parallels with processes currently being developed for the management of rules in electricity markets. There would seem to be a compelling argument for consistency in the process for rule changes in all energy markets.

## **National Consistency or Jurisdiction-specific (Issues 1, 7, 20 and 24)**

The tension between creating a nationally consistent regulatory regime and the need to deal with jurisdictional and historical differences is raised a number of times in the paper (including Issues 1, 7, 20 and 24).

Given that the main objective of the process is to reduce regulatory costs through the creation of a nationally consistent regime, then jurisdiction-specific differences should only be accommodated where they can be demonstrated, to the MCE's satisfaction, as necessary.

The existence of (even slightly) different regulatory regimes between jurisdictions acts as a barrier to new entrants, particularly experienced participants from one jurisdiction expanding into others.

At the very least, there should be a consistent set of national principles that will be applied to all jurisdictions. There also needs to be a process of national oversight of any jurisdiction-specific differences to ensure they only exist where necessary to meet the objective of the market (that is, protecting the long term interests of consumers).

## **Price Forecasting – Service Standards**

A significant issue for large energy users is the predictability of energy prices. This is a crucial input to budgets, pricing and marketing strategies and an essential component of any energy-intensive capital investment proposal.

The quantity of data available on generation capacity, transmission capacity and projected usage suggests that forecasting of future energy prices by retailers could be informative. However, there is a lack of incentives for the retailer to provide accurate price forecasts to users.

It is, therefore, appropriate to include price forecasting, on the basis of best available information, as a component of service standards, particularly for large users.

### **Triangular or Linear Approach – Issue 15**

Two models for the relationship between distributors, retailers and customers are discussed in the paper: the linear approach and the triangular approach. The key objective from the relationship should be service that is responsive to the customer's needs. Given the influence that the distributor has over the quality of supply, the triangular approach, where the user has a direct relationship with both the retailer and the distributor, seems the most appropriate, particularly for large energy users.

However the structure of the relationship is less important than ensuring that the service standards and pricing regime provide incentives for a high quality of supply and timely response to users' needs.

### **Government-controlled or Regulator-controlled Licensing System (Issue 16)**

The paper discusses two broad models for administration and enforcement of the licensing systems: the Government-controlled model and the regulator-controlled model. The regulator-controlled model, with the Australian Energy Regulator (AER) taking on the role, is described in more detail.

Pursuing any other model of administration and enforcement of the licensing system appears contradictory to information already released on the energy market reform program. A3P supports the regulator-controlled model and the proposed role of the Australian Energy Regulator, subject to the comments made in relation to Issue 4 above.

### **Consumer Protection Code and Service Standards (Issue 20 and 26)**

Any modifications to existing consumer protection codes and service standards, including the logical proposal to implement a single consumer protection code, must not result in any dilution of users' rights. A3P looks forward to examining further detail on proposals for a single consumer protection code in this context.

Standards of service are critical to consumers and are the balancing item in the regulatory bargain. The most critical service is the quality and reliability of supply. It is essential that a set of agreed measures is established in order that consumers have an agreed method of measuring quality and reliability at the point where the energy is delivered (i.e. the point where consumers see the impact).

Whilst there may be different set points for each of these measures for different regions (to reflect differences in geography, network design, etc), the set points for measuring quality and

reliability in each region must be publicly available so that consumers understand what they are entitled to. This then gives each consumer the ability to make other arrangements if the set points for the standards are not sufficient for their needs.

These standards should be subject to penalty or reward if there is a variance in order to encourage networks to improve quality and reliability of supply.

## **Concluding Remarks**

Overall, A3P supports the moves toward a more efficient approach to regulation in the Energy Market provided it delivers real and measurable benefits to end users. We have proposed a number of suggestions to ensure these reforms do not unintentionally compromise users' interest.

Once again, thank you for the opportunity to comment on the Issues Paper. If you have any queries please contact me at the address above or e-mail [miles.prosser@a3p.asn.au](mailto:miles.prosser@a3p.asn.au) .

Yours sincerely

MILES PROSSER

**SENIOR POLICY ANALYST**