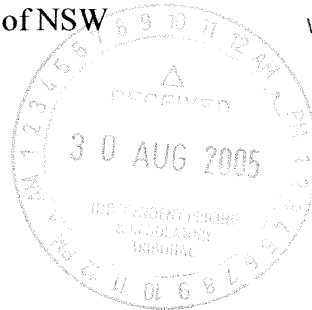


25 August 2005

URF Pricing Principles Discussion Paper  
C/O Independent Pricing and Regulatory Tribunal of NSW  
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Dear Sir/Madam

**Re: EUAA Submission to the Utility Regulators Forum Pricing Principles Discussion Paper**

The Energy Users Association of Australia (EUAA) appreciates the opportunity to provide comments on the Utility Regulators Forum (URF) Pricing Principles Discussion Paper.

The EUAA is a non-profit organisation focused entirely on energy issues on behalf of end users. The EUAA represents the views of approximately 80 members, including many large business end users of electricity and/or gas. Membership ranges across a number of sectors, including mining, manufacturing, construction, commercial property and service sector. Many of the EUAA's members operate across States.

The EUAA is particularly interested in the Discussion Paper as network charges for large business users represent approximately 40 to 60 percent of their final energy bill. Importantly, the Australian Competition and Consumer Commission (ACCC) and State based energy regulators have, or are in the process of, approving some \$20b of capital expenditure over the next five years for Australia's electricity network. How network owners translate these costs to end users as final tariffs plays an important role in ensuring that Australian industries maintain a competitive advantage in energy input costs.

As is clearly documented in Appendix A of the Discussion Paper, to date there are significant differences between the ACCC and State based energy regulators in applying pricing principles on how network owners can recoup large regulated approved expenditures. The variations across jurisdictions in pricing principles are a significant cost impost on large Australian electricity users, especially those that operate across State boundaries. We believe that these costs are unnecessary and can mostly be removed with an appropriate National Consistent approach to Pricing Principles. We see only a limited need for different pricing principles from one jurisdiction to another based on our experience in over 20 network pricing reviews.

## High Level Principles

The EUAA supports the basic principle of “light handed” regulation through the use of high-level principles as outlined in the Discussion paper, namely:

1. That prices should lie on or between the upper and lower bounds of avoidable cost and stand alone cost for economically efficient prices; and
2. That prices should signal efficient economic costs of service provisions by:
  - Having regard to the level of available network capacity; and
  - Signaling the impact of additional usage on future investment costs.

However, we have concerns that the high level principles outlined in the Discussion Paper provide network owners with significant scope to implement network tariffs that lead to monopoly pricing abuse and inefficient outcomes. The next sub-sections outlined our concerns.

We also have a concern that network regulation and pricing needs to be “effective”. There is little point in having “light handed” regulation if the outcomes in terms of benefits to end users, as specified in the Single Market Objective of the new National Electricity Law, does not provide regulation that is “effective”.

### *1.1 Upper and lower bounds*

The first principle provides network owners with a significant amount of latitude to do whatever they want with their tariffs – for example, they can practice monopoly price abuse of various forms, inefficient forms of price discrimination, political pricing (such as levy higher tariffs on large users to cross subsidise lower tariffs for voters), lazy tariff restructuring which merely perpetuates the ills of the past, etc. Through member feedback the EUAA has seen some graphic evidence of such pricing behaviour within the parameters of the first high-level principle. We would be happy to share our members’ experiences with the URF if requested.

Further, this high-level principle provides very little protection for large users through the regulatory process and regulators tend to ‘wash their hands’ of any complaints in the name of light-handed regulation.

Regulators are meant to protect consumers from monopoly prices through their charters but tend to interpret this to mean they can merely applying "side constraints". These only offer limited protection and they tend to be inefficient as they also prevent network owners from developing and moving to more efficient tariffs.

This is further exacerbated as there is also limited involvement of customers in the annual tariff setting process. Tariffs are what really matter to customers, yet they have no real chance to get involved.

In NSW, IPART introduced a set of pricing principles (at their last revenue reset), which at least offer some comfort to customers by specifying how distribution businesses are to notify customers of tariff changes, what notice they are required to give, what information they must provide and how they must include the regulator in tariff setting. They also include some principles that the Distribution Businesses must apply in setting tariffs. The ESCV is now also formulating such principles as part of its current price review. We welcome these efforts as providing a degree of greater accountability, transparency and information than was the case in the past. They are also a step down the road of improved regulatory practice, albeit still quite a limited one.

The latitude afforded to network owners from this principle also has led to a complicated basket of network charges. The variety of charges not only varies within a network but also between network owners. Network owners can and do develop charges that are:

- Customer related;
- Capacity / demand related;
- Consumption / unit related;
- Based either on a charge per megawatt, per megawatt hour or on kVA; and
- Levied differently for distribution and transmission services.

Hence, large users that have operations across a number of distribution regions face different and complex network price signals. This has the potential of making users less responsive to price signals. It also creates additional complexity even for large users and leads to network charges that they find difficult to understand and reconcile with their invoices. This complexity can disguise many aspects of network pricing from end users. This is very different to the energy market, where prices are expressed as a simple per megawatt hour rate. Over the years, the EUAA has received many expressions of concern from its members about the complexity of network charges faced by its members. Further, the complexity and variety of network charges can also work as a dis-incentive for new retail entrants due to complexity and costs associated with billing and network settlement systems that they are required to develop.

There would be great merit in establishing a process that lead to significant simplification of network charges.

We stress that we are not seeking micro management of network owners by Regulators, just a fairer and more efficient pricing outcome that recognises the monopoly position of the network owners. Hence, we recommend that the pricing principles be broadened to include:

- The development of simple, uniform and understandable tariffs;
- Minimum disclosure of useful information for end users, including tariff categories and rates, anticipated direction and size of change, forecasts or future rates, examples of the cost impact of tariffs on end users, etc;
- Notice of price changes and specification of networks requirements for doing this;

- The opportunity for end users or groups like EUAA to be consulted in changes; and
- A complaints mechanism whereby customers who feel aggrieved can go to the regulator to make a ruling on tariffs (based on some pricing principles that prevent monopoly abuse and inefficient outcomes) rather than just whether something is consistent with a price or revenue cap or sits between something as wide and nebulous as stand alone and avoidable costs.

### *1.2 Efficient Economic Costs*

This principle aims to ensure that pricing outcomes signal and provide revenue to network owners to continue to efficiently invest in the up-keep and/or up-grade of the network.

The EUAA supports the general thrust of this principle and the need for network tariffs being cost reflective. However, network owners can also rely on so-called cost reflective pricing to disguise monopoly-pricing practices and to impede the successful implementation of distributed generation.

A distributed generation option can reduce a network constraint as well as decrease the use of the network system at peak times (the basis for much of the increased investment in networks). Many large users have capacity to provide distributed generation and/or co-generation capacity but the ability to do so is often thwarted by distribution and transmission companies who favour investment in their networks.

There needs to be a nationally legislated, regulated or Rule requirement for network owners to explicitly inform potential distributed generators of their individual value to the network. This includes the value of avoided TUOS costs to the distributor, network augmentation and greater network stability (including, transmission loss factor improvements). Without such information, it is difficult for distributed generators to 'capture' a fair proportion of the benefit they bring to the network, which can have a significant impact of the economics of such projects. This is exacerbated as distributed generators deal with monopoly network owners. This provides network owners with a very advantageous bargaining position.

These matters were addressed several years ago as part of the NECA Transmission and Distribution Pricing Review and also by jurisdictional regulators such as IPART. This resulted in the acceptance of a need for avoided TUOS to be a recognized element of distribution pricing and also in the application of a beneficiary pays principle in relation to investment and transmission pricing for new generation. The questionable principle of avoiding so-called 'uneconomic by-pass' of networks was central in this debate (query whether it should have been a principle of avoiding 'uneconomic network investment' instead?).

However, these two principles have never been fully implemented, implemented in the way intended or had much practical impact. A body such as the AEMC should now further review the reasons for this and outcomes.

Secondly, this principle relies solely on a 'stick' approach to obtain the appropriate long-term level of investment in the network. The EUAA believes that network

pricing is only one tool available to Regulators and network owners to manage demand. Moreover, prices can also be used to provide ‘carrots’ as well as ‘sticks’ to customers who are prepared to avoid using the network during peaks in demand, for example. The EUAA is aware that such pricing has been used to good effect in both the south island of New Zealand and also in California. In Australia, it has been more common for those networks that have moved down this path to seek to use prices to ‘punish’ customers who make use of the networks during peaks. Whilst we do not oppose this method of pricing, evidence shows that pricing ‘carrots’ can have a more beneficial impact. We are in no doubt that networks in Australia have relied on pricing ‘sticks’ as they know that the low elasticity of demand of their customers (combined with the muted signals provided by network tariffs due to their delayed impact and share of the total energy bill) will ensure that they can use such prices to increase their revenue rather than moderate demand. Regulators seem to still be blissfully unaware of this.

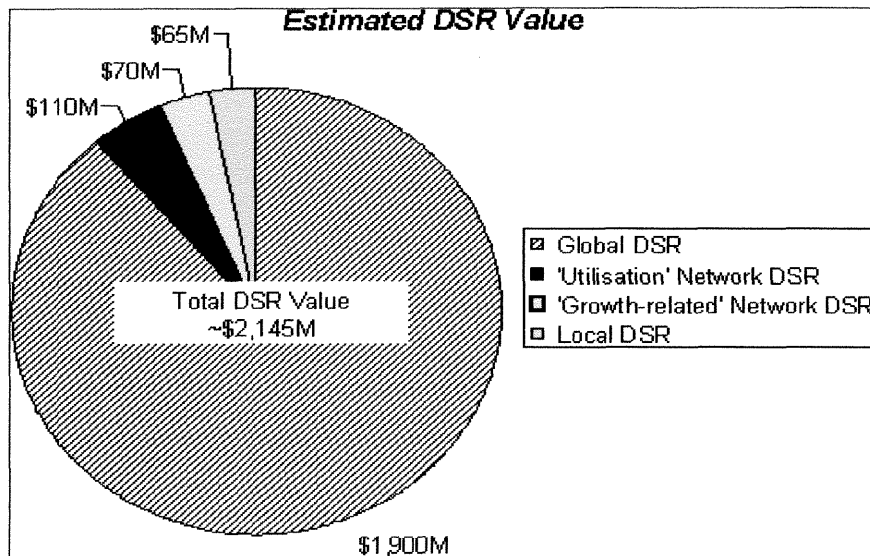
The EUAA believes that the second high-level principle should be broadened to make it clear that the URF supports the inclusion of Demand Management incentives into prices and incentive regulation. .

The EUAA has undertaken a Demand Side Response (DSR) aggregation trial that enabled customers to participate in the market by responding to high pool prices and system stress by bidding to shed load during such periods. It found that the system would stand to gain significantly if customers are empowered to participate in the electricity market. Trial results suggest that demand management could release up to \$2 billion a year in value – or around 10% of retail turnover in the NEM. Regulatory impediments, including existing tariffs and incentive structures, were among the main factors making network DSR problematic. This is shown in Diagram 1.

Although the trial estimated around \$180m worth of network DSR, it is felt that the continuing growth in peak demand and the growing stresses this has placed on networks would mean that this amount has grown in the intervening period. As mentioned above, regulators have approved large amounts of network capex in recent decisions (a large part of which is driven by peak load growth) and the use of network DSR would have a useful impact in lessening or delaying the need for such expenditure.

Whilst the trial only included distribution network support scenarios, it was recognised that there was also a role for DSR in providing transmission support.

**Diagram 1: Estimated Value of Demand Side Management**



The value to networks (both distribution and transmission) comes from savings of:

- \$60-80 million/year from the deferral of 'growth-related' capital investment; and
- \$110 million/year from improving utilisation of 'sunk assets' that are currently rolled into regulatory asset bases.

As a result of our trial, over 100 MW of demand side response have been signed up through a demand side aggregating company, Energy Response. This provides a concrete demonstration that demand management can be activated in the NEM, including for network support. However, this needs a policy and/or regulatory response from bodies such as the URF.

We urge the URF, at the very least, to recommend a broadening of the second high-level principle to require network owners to prove that they have in place arrangements to support demand side management by implementing a range of tariff changes that provide both 'carrots and sticks' and linking DM to the incentive regulation regime.

In the most recent NSW Electricity Distribution Price re-set, IPART recognised the role of demand management in relieving network congestion and improving the utilisation of network assets, both of which would reduce upward pressure on costs. It has taken a pro-active stance on demand management in its latest Determination and introduced a number of incentives to promote network demand management.<sup>1</sup> These include the introduction of a 'D-factor' to the weighted average price cap formula, to recover costs and revenue foregone arising from demand management programs, up to a maximum value equal to the avoided distribution costs.

<sup>1</sup> *Determination of NSW Network Prices for the 2004/05 to 2008/09 Period*, IPART, June 2004.

IPART also set up a Network DM Consultation Working Group, comprising members from distributors, Government, industry and user/consumer groups to develop guidelines for distributors on various aspects DM.<sup>2</sup> The group has now completed this role and IPART has recently published its final guidelines.

A document entitled “*DM for Electricity Distributors Code of Practice*” (“the NSW DM Code”) has also been prepared and published for use by the NSW distributors. The DM Code provides additional requirements on networks for DM at the distribution level and has recently been reviewed and improved.

Finally, in its final determination for ETSA Utilities distribution network in South Australia, ESCoSA has provided some incentives for DM in the form of adopting a DM Code that is similar to that adopted by IPART and allowed specific provision for ETSA Utilities to commit approximately \$20 million over the five year regulatory period to trial a number of demand management initiatives which may result in less need for peak-driven network expansion.

The range of initiatives to be trialled by ETSA Utilities include:

- “power factor” improvements in business and manufacturing premises;
- trials of Voluntary Load Curtailment (VLC) programmes for large customers;
- Direct Load Control (DLC) of domestic equipment such as air-conditioners and pool pumps;
- use of standby generation, and
- the use of incentives for customers to reduce demand at times of peak demand.<sup>3</sup>

In contrast, the Essential Services Commission of Victoria (ESC) has relied predominately on developing punitive price signals implemented by the Victorian Distribution Businesses (as part of a Victorian Government mandate to rollout of interval meters) for demand management by end users. It is not even certain that tariffs will be restructured to allow this to happen (notwithstanding the large investment involved in the rollout), let alone whether they will have any impact among smaller customers (given the retail tariffs remain regulated, customers do not see the price impact of their consumption until well after it actually takes place) and that distribution tariffs are only a proportion of the cost of power). The ESC has also proposed a nominal \$120,000 per year (or approximately 0.05% of total revenue) for each Distribution Business to provide additional revenue for the trial of demand management initiatives during the up-coming regulatory period.

The actions by IPART, ESCoSA and to a more limited extent the ESC, show that there is a growing recognition by regulators of the need to provide some additional ‘positive’ incentives for demand management as part of the pricing principles.

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<sup>2</sup> The Energy Action Group and EUAA were members of the IPART DM Group.

<sup>3</sup> See p (v) and pp 54-60, *2005 - 2010 Electricity Distribution Price Determination, Part A - Statement Of Reasons*, Essential Services Commission of South Australia, April 2005.



The EUAA believes that a combination of tariffs and demand management incentives is a more effective response in meeting the challenge of growing peak demand and therefore the longer-term investment needs of network owners.

If you have any queries regarding our comments, please do not hesitate to contact EUAA's Director Policy and Regulation, Con Hristodoulidis, on telephone number (03) 9898 3900 or e-mail [con.hristodoulidis@euaa.com.au](mailto:con.hristodoulidis@euaa.com.au).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Roman Domanski'.

Roman Domanski  
**Executive Director**