Weston Aluminium Pty Ltd

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15 February 2010

Mr Steve Edwell
Chairman
Australian Energy Regulator
360 Elizabeth St
Melbourne VIC 3001
steve.edwell@aer.gov.au

Dear Mr Edwell

AER REVIEW OF ELECTRICITY DISTRIBUTION PRICES IN NSW AND GAS DISTRIBUTION PRICES FOR JEMENA GAS NETWORKS IN NSW

I am writing to you about the above and would like to draw your attention to the adverse impacts that the large price increases being proposed would have on us.

We are a secondary Aluminium Plant. We are located at Kurri Kurri and employ 65 people. We currently use 150,000 MWh of electricity and 120,000 Gj of gas per annum. Energy is a significant operating cost for us and large price increases will have the following adverse impacts on our operations:

We are competing against companies in Asia and these increases are making us uncompetitive. More and more, aluminium scrap and dross is being exported overseas, processed and returned to Australia as finished product (Ingots).

We would like to make you aware that such large price increases come at a time when our business is already under stress due to the tougher economic times and our energy costs are facing significant upward pressure due to the increasing costs of renewable energy and the impending cost of carbon. Additional large increases such as those proposed would be most unwelcome and place undue stress on our business.

We support the provision of costs to these businesses that ensure a continuing reliable supply but these costs should be efficient ones and we urge you to ensure this. It is with alarm that we read stories such as page 63 of AFR on Monday February 15, 2010 (Copy attached). Where electricity distribution costs are substantially more than Britain. In that regard, we are most concerned that the AER apply its statutory role to use benchmarking to help establish an efficient level of costs.

Would you please treat this as a submission to the above.

Yours sincerely,

Garbis Simonian
Managing Director

THE AUSTRALIAN FINANCIAL REVIEW
MON. 15 FEB 2010

NSW missing benefits of reform

Government-owned distributors are charging electricity users too much, writes **Bruce Mountain.**

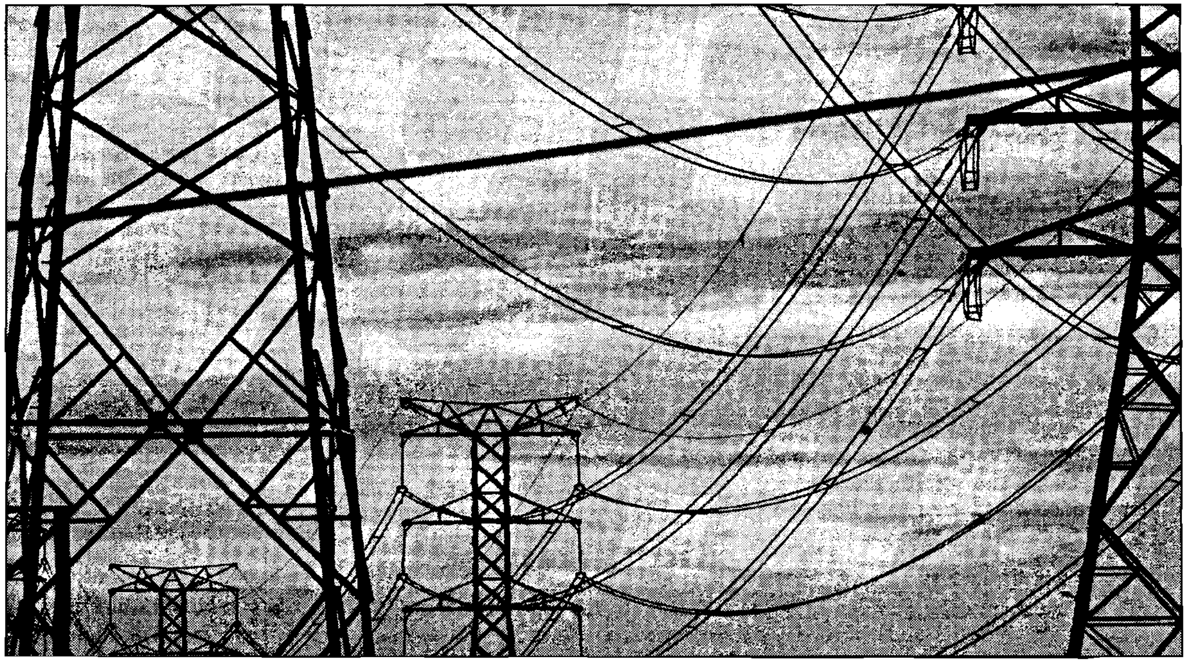
The federal government has drawn attention to the need to raise Australia's productivity. Workforce participation, education, skills and competitive markets are being promoted. Productivity also grows when less is spent to achieve the same or better outcomes.

To improve productivity in Australia's electricity sector, various reforms were implemented in the last decade. Large elements of the reform drew on British experience. What has been achieved in electricity distribution in Australia, by far the biggest element of electricity bills?

The results are discouraging. Following recent price control decisions for distributors in NSW and Britain, NSW distributors will be charging their customers four times as much as distributors in Britain by the end of the current price control period in 2014-15.

During the current regulatory period, per customer, allowed operating costs (opex) are about 3.5 times higher and allowed capital costs (capex) are six times higher in NSW than in Britain. Since reforms were implemented in Britain, electricity distribution costs have more than halved. By contrast, since reforms were implemented in NSW, costs have more than doubled, despite the fact that state government studies concluded, before the reform, that NSW distributors were significantly less efficient than their peers.

In geography and operating environment NSW and British distributors are similar, while in other respects, notably demand growth, they are rather different. But it is not clear how far these differences could be expected to explain per-customer differences in opex or capex of the magnitudes observed. Other factors, including the regulatory framework, the implementation of regulation and ownership seem likely to be more important.



Electricity distribution is by far the biggest element of electricity bills. Photo: JAMES ALCOCK

The regulatory framework places the onus of proof on the Australian Energy Regulator to justify its price control assumptions, unless it uses the values proposed by the regulated businesses. The businesses can choose to appeal any elements of the regulator's price control decision to the Australian Competition Tribunal. That is, they can "cherry-pick" the elements where an appeal is likely to benefit the business. Moreover, the tribunal's decision can relax the proposal but not tighten it. Not surprisingly, all the regulator's distribution price control decisions to date have been subject to appeals by the distributor.

By contrast, if a British distributor disagrees with the regulator's price control proposal, the whole proposal is reviewed, which prevents "cherry-picking". The review can lead to a tougher price control and in practice has done so. In Britain, only one electricity distribution price control proposal has been subject to appeal out of some 56 such proposals to date.

The implementation of regulation by the Australian regulator may also explain higher costs in Australia. In Britain, the regulator uses benchmarks to encourage inefficient distributors to reduce their expenditure to catch up with their more efficient peers, and to protect customers against inefficient distributors that fail to do so. In Australia, the regulator makes no such use of benchmarks. The AER has also allowed higher rates of return on equity and debt than in Britain, so the weighted average cost of capital is around 60 per cent higher here. For a capital-intensive business, this has a significant impact on price to customers.

Government ownership, too, is likely to have had a detrimental impact on efficiency. Privately owned companies can be expected to be more interested in increasing efficiency, and therefore more responsive to regulatory incentives that reward reductions in opex and capex. Indeed, raising efficiency has been a major reason for privatisation in the UK and elsewhere. Government-owned companies can be expected to place greater weight on pressures from employees, politicians, government and the media. This is likely to make them more cautious about cutting costs and more sympathetic to increasing capital expenditure. Experience worldwide is consistent with this. The privately owned distributors in Britain have generally underspent their opex and capex allowances, despite the relatively tough levels at which the allowances are set. In contrast, actual capital expenditure in NSW, and to a lesser extent opex, has exceeded the regulatory allowances despite very significant increases in these allowances. Other government-owned distributors and transmission service providers in Australia have also consistently overspent their regulatory allowances. In contrast, privately-owned distributors and transmission businesses in Australia have consistently spent less than their regulatory allowances.

A comparison of the privatised Victorian distributors with the government-owned distributors in NSW mirrors the comparison with the privatised British distributors. While distributor costs have more than doubled in NSW, they have decreased about 25 per cent per customer served in Victoria since privatisation. This is despite the fact that peak demand and customer numbers have grown significantly faster in Victoria than NSW, and quality of supply as measured by the frequency and duration of outages has consistently been better in Victoria than in NSW.

Electricity consumers served by government-owned distributors appear to be paying more than they need to. Generators and retailers who rely on the distribution network to transport electricity to their customers might be vulnerable. So may the distribution businesses if networks are bypassed.

If further research corroborates the main findings above, then obvious questions arise. Should the regulatory framework within which the AER has to work be reconsidered? Could the regulator do more to encourage efficiency even within its present framework? Is it time to consider privatisation of electricity distributors where this has not yet taken place?

■ *Bruce Mountain is director of Carbon Market Economics.*