

Mr Gary Henry
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

28 January 2003

Dear Gary

Re: Discussion Paper: Review of the Form of Regulation of Electricity Distribution
October 2002.

We understand that “[u]nder the Code, the Authority is responsible for ensuring that the prices ultimately charged to customers for services provided by the electricity distribution networks reflect the efficient costs of providing those services.”¹

As an Australian manufacturer who is fully exposed to international competition, Incitec is focused on controlling total costs. Competitive energy prices (our major inputs are gas, electricity and water) and price certainty are key to meeting this requirement.

The QCA is seeking to determine from this exercise which of the three forms of regulation:

1. A revenue cap
2. Weighted average price cap or
3. A combination

should be used in the next regulatory period. We understand that the specific details re: how this form will be implemented will be decided as part of the 2005 determination process.² We will reserve our comments in respect to the latter until the appropriate time.

The current regulatory regime is “based on a fixed revenue cap, with side constraints on prices.”³ In relation to the Authority’s questions raised throughout the October 2002 Discussion Paper, Incitec has the following comments:

1. Incitec supports the central themes and objectives as outlined in CI 2.2 of the discussion paper.⁴
2. In choosing the current form of regulation, the QCA relied on certain assumptions and information. We are strongly of the view that these should be reviewed and tested against actual results from the current period to determine whether the fixed revenue cap approach has delivered against the original objectives.
3. The QCA has provided “benchmarking” information on other jurisdictions.⁵ It would be more beneficial if real examples were given in relation to whether the criteria assumed by the regulators in these jurisdictions was actually met by the chosen form of regulation. This information would be very useful in distinguishing between the different options.

¹ Queensland Competition Authority, Discussion Paper: Review of the Form of Regulation of Electricity Distribution, October 2002: p1

² *ibid.* p3

³ *ibid.* p3

⁴ *ibid.* p4

⁵ *ibid.* pp 8-10

4. Further, CI 4.5 of the Discussion Paper states that the "ACCC currently uses a fixed revenue cap approach to regulate electricity transmission services".⁶ We would like the QCA to take Incitec's recent experience with the ACCC's revenue price cap for Powerlink into consideration. Powerlink's revenue cap was set by the ACCC in 2001 for a period of 5 years from 2002/03. The pricing mechanism CPI-X was used, but X was found to be a negative number. As a result, Incitec's transmission charges were increased by more than CPI - 31% in 2002/03 in comparison to the previous year. Incitec would have liked to see more of a "glide path" approach for pricing between each determination period and also would expect X to remain positive at all times.
5. CI 5.3 of the Discussion Paper indicates that "it is relatively easy to incorporate new pricing structures within a given regulatory period" under fixed revenue caps.⁷ We would be interested to find out more about the meaning of this statement as often end-users are faced with comments to the contrary i.e. "we are unable to do this *because* of the fixed revenue cap."
6. It is important for the end-user to know that the regulator has sufficient and adequate information from the distributor in order to make informed decisions. The comment that "the Authority's information may be inadequate for the task, or at least inferior to that held by distributors",⁸ does not provide much comfort. There should be no constraints on the QCA's access to and use of information from the distributors. Transparency of information is of vital importance.
7. Reliability of supply is fundamental for Incitec as we are a continuous operation plant i.e. 24/7, 365 days a year. Interruption to supply impacts dramatically on our business, not only production-wise but also damage to plant. Incitec is in support of a regime that has enough flexibility to allow negotiation on service standards at an individual level. Further, if agreement can't be reached then there needs to be the ability for the regulator to intervene and assist with a suitable solution. Currently the distributors have a guaranteed income no matter what the level of service. Based on this fact, there seems to be an underlying assumption that the current service is *acceptable* and that customers will have to pay more for a *higher* level of service. This needs to be challenged as in a competitive market a customer would not only have the opportunity to change suppliers if not satisfied but would also have some leverage based on, amongst other things, size, load profile, predictability.

Overall, Incitec will support any regime that results in a reliable system whereby network charges reflect the true cost of supply. As there is no competition, we place a heavy reliance on the regulator to access all necessary information and to conduct adequate benchmarking studies to make informed decisions in the best interests of all parties.

Mary Goodwin
Energy Development Manager

⁶ *ibid.* p9

⁷ *ibid.* p12

⁸ *ibid.* p12