



8<sup>th</sup> December 2006

Ms M. Taylor,  
Director, ERIG Secretariat  
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Canberra City, ACT 2601.  
By email: [erig@industry.gov.au](mailto:erig@industry.gov.au)

Dear Ms Taylor,

I write on behalf of the Energy Intensive Industries Alliance (EIIA) in response to ERIG's draft report to the Council of Australian Governments.

As explained in earlier submissions, EIIA represents the interests of industries where energy is a substantial proportion of production costs and is a significant contributor to their competitiveness. It represents the aluminium industry (through the Australian Aluminium Council), the cement industry (through the Cement Industry Federation), the plastics and chemical industry (through the Plastics & Chemicals Industry Association) and the forest products, pulp and paper industries (through the Australian Plantations Products & Paper Industry Council). The major energy-intensive manufacturing sector accounts for about a quarter of Australia's primary energy consumption and about a third of national electricity consumption.

At the outset, EIIA wishes to compliment ERIG on producing a comprehensive and insightful review of key energy market issues in a very short time. While the deadline provided for comment on such a detailed review is very short, EIIA appreciates that this is dictated by the COAG requirement for a report by the year-end.

This further submission by EIIA is not intended to deal with all issues canvassed by ERIG, but rather to focus on those of most importance to a sector of industry that is heavily trade-exposed to global markets, dependent on competitively-priced energy to maintain a competitive edge and unable to readily pass through domestic cost increases to its customers.

The ERIG draft report rightly observes that the energy market in Australia is in a period of significant uncertainty and EIIA points out that this must flow on to the appetite for investment risk in the energy-intensive manufacturing sector, which, like energy supply, is facing the need to spend many billions of dollars

in the next 15-20 years on expanding existing operations and developing new projects.

EIIA welcomes the strong focus in the draft report on the need for governments to take a new approach to energy issues. The report's finding that the State-by-State approach to energy policy and planning continues to "permeate" the energy system to the detriment of investors and users is correct and needs to be driven home to COAG as a critical element in achieving the more efficient market it claims to be pursuing. In the Alliance's submission, this is the single greatest cause of market uncertainty. A national approach to the major improvements required in energy market efficiency is vital to any progress that COAG can make in addressing the main recommendations emerging in ERIG's report.

While ERIG expresses the hope that there will be a change in approach over time, EIIA wishes to emphasise that governments have now been working on market reform for 16 years and that, because of the impact on energy-intensive industry investment and ultimately on the national economy, these changes are very urgent. The context for driving forward reform needs to be seen by COAG as Australia's place in the global market, not just its domestic situation.

It is an alarming notion in 2006 that a government (see ERIG report page 8) should rely on "snake charming" investment in energy supply rather than having in place a long-term set of policies to encourage efficient development. EIIA wishes to reinforce the views provided to ERIG by market participants and would-be investors on the need for energy policy certainty.

An important part of the draft report, and a key area of interest for EIIA and its member companies, is the examination of the development of a fully national and efficient transmission network.

In brief, EIIA responds to the ERIG commentary by strongly supporting:

- The need for a single national transmission planner.
- The requirement for greater transparency in transmission augmentation proposals.
- The prevention of cross-ownership between generators and transmission service providers.
- The need for incentives for efficient transmission and efficient location of generation capacity in the market.
- The proposal to improve governance in the market by introducing a role for the Australian Government and customer representatives.

EIIA's support for a national planner comes with two caveats: first, it is absolutely essential that the planner's establishment should not create a further layer of bureaucracy in an already overloaded national electricity market; second, the issue of how the planning body is provided with incentives to ensure efficient economic outcomes without jeopardising network reliability needs very careful thought.

The Alliance is pleased that ERIG has come to the conclusion that the present transmission regulatory test is inappropriate and, while reserving its final endorsement of the proposed national transmission network development plan until full details are available, assuming COAG's acceptance of the concept, it broadly endorses ERIG's suggested approach, involving:

- The establishment of a set of overall objectives to guide development of the network to maximise net market benefits while maintaining (at least) customer reliability standards.
- The harmonisation of reliability and planning criteria for network development across the NEM.
- The requirement for genuine consultation about proposed transmission developments with interested market parties and for formal involvement of networks users in the evaluation process.
- The establishment of an independent national planner and co-ordinator for transmission development responsible for making decisions on augmentation projects.

In this context, EIIA welcomes and endorses ERIG's conclusion on the major shortcomings in achieving a mix of efficient generation and transmission investment across the national electricity market and its assertion that efficient regulatory and planning structures must be put in place to attract efficient power supply investment.

The definitions of what will constitute a fully national and efficient transmission system set out on pages 110 and 111 of ERIG's draft report are wholly appropriate and endorsed in their entirety. EIIA considers that COAG's specific endorsement of these definitions will provide vital underpinning to the steps to be taken to address transmission service deficiencies.

In particular, EIIA endorses the ERIG view that the longer-term development of the national transmission network is poorly co-ordinated. The slowness of government in addressing such critical issues needs to be highlighted as another shortcoming. EIIA fears that government processes as they are presently constituted will not allow fast adoption of ERIG's proposals.

In this regard, EIIA sees the self-interest of governments with strong ownership interests in electricity supply assets as a major impediment to efficient implementation of the reforms proposed by ERIG. If, as ERIG apparently accepts, these governments are not budged from their opposition to privatisation, then it is imperative that market structure and governance arrangements counter such self-interest to the maximum extent.

It is also imperative, as ERIG has proposed, that asset-owning governments make clear and unequivocal commitments to encouraging the private sector to undertake new electricity generation investment. EIIA agrees entirely that failure by governments to do this, or subsequent backtracking on the commitment, will affect the hurdle rates of return for such investment and/or delay or prevent such projects from being undertaken when needed.

The Alliance and other representatives of energy-intensive industry have expressed strong concern to ERIG about the exercise of market power in the NEM. While noting that ERIG has taken a conservative approach to this issue and appears to find that there is no evidence that generators are able to induce and sustain higher average pool prices over long periods above the normally efficient, the Alliance focuses on ERIG's acknowledgement that it does not have the time and capacity to undertake detailed analysis of the economic performance of the NEM from a market power perspective. In EIIA's opinion, the research needed to address this issue is extremely important and it urges ERIG to recommend to COAG that an independent study should be carried out as soon as possible.

One of the most important observations of ERIG's draft report relates to the need for government to cease interfering in market planning, rule making, market operation and regulation. EIIA strongly endorses ERIG's view that governments should delegate such functions entirely to statutory bodies operating under charters that require delivery of market outcomes consistent with agreed policy objectives. EIIA urges ERIG to move beyond suggesting that such good governance should be embraced "ideally" to urging that COAG give priority attention to ensuring that these bodies are formally and functionally independent, that they have independently-appointed boards and that they be answerable to governments only in terms of delivering the broad objectives policymakers have set.

ERIG's proposals that this concept be applied to the Australian Energy Market Commission and to the Nationally Electricity Market Management Company are vigorously endorsed.

ERIG has set out on page 114 of its draft report the four key principles -- of accountability, independence, transparency and national focus -- that should apply to the governance structure of major market functions in the NEM. These, too, are endorsed by EIIA. Their formal endorsement by COAG is seen as fundamental to the successful implementation of the recommendations of ERIG's final report.

As well, the suggestion that ERIG has thrown up for an annual stock-take of progress towards removing State-based rules and regulations in favour of national consistency in the NEM (and beyond it to Western Australia and the Northern Territory) deserves encouragement. Governments have demonstrated a willingness in the past to give lip service to the desirability of harmonisation only to drag their feet on implementation. An independent annual stock-take on their performance in this regard has decided merit.

There are a number of areas of the report which EIIA would prefer to study in more detail -- and to consult with its members companies -- before providing a definitive response. It does, however, welcome the manner in which ERIG has opened up for further government focus such issues as:

- Demand-side participation -- EIIA agrees that achieving its potential in the NEM will drive major benefits and it supports ERIG's call for further work to be instigated by COAG and/or the Ministerial Council on Energy to develop a framework whereby customers, market participants and intermediaries can benefit from DSM activity. The Alliance again draws attention to the fact that governments have not moved efficiently or effectively over more than a decade in addressing this important issue.
- The effectiveness of the Trade Practices Act -- EIIA remains unconvinced that the Act requires no change and that there is no case to be made for electricity-specific rules regarding vertical integration of contestable segments of the market.
- Carbon pricing signal -- while noting ERIG's report that energy market investors are "factoring in a carbon pricing signal" to their planning decisions, EIIA believes it is critical to the future competitiveness of Australia's energy-intensive manufacturing sector that no unilateral commitment is made to carbon charges that will put its member companies at a disadvantage with their international competitors. Attempts by the State governments to impose such a scheme through inter-state agreements are a cause for substantial concern. The Australian Government needs to take early action to fully identify the impacts of any such scheme on the trade-exposed sector.

Overall, EIIA is impressed with the breadth of issues that ERIG has addressed in the draft report and with the clarity of its exposure of flaws in the current electricity market. It looks forward to seeing the final report.

Yours sincerely



Miles Prosser

ON BEHALF OF THE **ENERGY INTENSIVE INDUSTRIES ALLIANCE**