

**ENERGY MARKETS REFORM FORUM,  
ELECTRICITY CONSUMERS COALITION OF SA,**

**and**

**ENERGY USERS COALITION OF VICTORIA**

**COMMENTS**

**ON THE ISSUES PAPER**

**DEVELOPING A NATIONAL  
FRAMEWORK for  
DISTRIBUTION and RETAILING**

**A SUBMISSION TO**

**MINISTERIAL COUNCIL ON ENERGY**

**STANDING COMMITTEE OF OFFICIALS**

**October 2004**

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The views expressed herein are those of the Energy Markets Reform Forum, the Electricity Consumers Coalition of South Australia and the Energy Users Coalition of Victoria.

## INTRODUCTION

This response to the MCE review of Distribution and Retailing of gas and electricity is by the Energy Markets Reform Forum (a group comprising large electricity and gas users in NSW), the Electricity Consumers Coalition of South Australia (a group comprising large electricity and gas users in South Australia) and the Energy Users Coalition of Victoria (a group comprising large electricity and gas consumers in Victoria). The member companies include OneSteel, BlueScope Steel, Holden, Mitsubishi, Toyota, Ford, Air International, Unidrive, Seeley International, Amcor, Kimberly Clark, Visy, Adelaide Brighton Cement, Boral, Orica, BHP Billiton, Tomago and Hydro Aluminium Kurri Kurri.

Each and every one of these companies is exposed to the rigors of international competition and sees the need for each of their key suppliers to be likewise exposed to competitive pressures to ensure that Australian industry is as competitive as possible. Thus, these groups are vitally interested in ensuring that the changes made by the MCE reform process maximize the efficiency and security of the electricity and gas supply industries.

The energy reforms undertaken over the last decade were intended to expose the state owned (or state protected) vertically integrated energy supply monopolies to direct competition or to competition by comparison, in order to eliminate economically inefficient practices. Additionally the reforms were to eliminate the inter-jurisdictional constraints which prevented cross-jurisdictional competition. The reforms should lead to the energy supply chain elements operating at international best practice.

**Therefore an overriding principle which should underpin the review of the structure and regulations governing the energy supply industries, is that the legislation, codes and rules must ensure that their effect is to institute and/or replicate competitive market pressures across the entire energy supply chains.**

There appear to be a number of misconceptions embedded in the Issues Paper.

### 1. Gas and electricity are not really in serious competition

Gas and electricity do not compete in any realistic way, and therefore the convergence referred to in the document has more form than substance. Electricity is primarily used for providing motive energy (fans, reverse cycle air conditioning, motors), for data processing (computers, telephones) and lighting, for which it has no competitor. Its use for thermal energy purposes is limited to small appliances (kettles, cooking, small space heating), and some hot water heating for domestic purposes. Thus,

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except in a small sector of electricity usage, electricity has no competition and to assume that gas and electricity will converge as competing energy sources is quite incorrect.

Conversely, gas is primarily used for providing thermal energy – to domestic users and to industry – which implies that gas competes with coal, wood and electricity for this purpose. Another small but significant use of gas is to generate electricity, implying that it competes with coal, LPG and oil as a fuel. Prima facie, this implies that gas has a number of competitors. However, an analysis of the differential cost structure and other factors would indicate that gas has a unique position in the energy market.

Gas is one of a number of fuels used to generate electricity. The relative shares of electricity generated in Australia by the different fuel types are<sup>1</sup>:-

➤ Black coal	58.5%
➤ Brown coal	25.9%
➤ Natural gas	7.7%
➤ Hydro	7.6%
➤ Oil products	0.3%

This would indicate that rather than the views suggesting there should be a convergence between gas and electricity, there is a more compelling argument for the view there should be a convergence between coal and electricity, or even just between black coal and electricity. In support of this view, there is a more in-depth comparison is provided in Appendix 1 to this submission, which examines the extent of gas usage for electricity generation in the SA region (the smallest in the NEM) and in NSW region (the largest in the NEM).

The cost of gas per gigajoule of energy delivered to a power station is many times the cost of brown or black coal. Whilst the infrastructure needs of a coal fired power station are much greater than for a gas fired power station, these do not offset the higher cost of gas as a fuel source. Even when using the most efficient form of gas firing for power generation (using combined cycle technology), the long run marginal cost of electricity from gas firing is about 35% more expensive than the long run marginal cost of electricity from coal fired power stations<sup>2</sup>.

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<sup>1</sup> Source: AFR 8 October 2004, data attributed to NEMMCo

<sup>2</sup> See for example the report from ACIL Tasman: SRMC and LRMC of Generators in the NEM - A Report to the IRPC and NEMMCO, 21 March 2003

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The facts relating to the use of electricity by industry as a source of thermal energy when compared to gas are even more stark – the supply of electricity might cost industry between \$60-70/MWh (equivalent to \$17-20/Gj) when delivered, compared to the cost of gas (\$4-5/Gj) delivered – highlighting that **the cost of electricity is a factor of over four times the cost of gas per gigajoule when used for thermal uses.**

A further issue is that the electricity market pricing is extremely volatile. The implication of convergence is an expectation that the gas market pricing would also become extremely volatile. There is no justification for this.

As an example, the Victorian gas market (as managed by VENCORP) operates a daily spot market for gas supply adjustments, supplying gas for industry, domestic use and for power generation. A quick review of this spot market does not indicate there is a convergence of electricity and gas prices in the Victorian region. In fact the spot gas price shows a high degree of consistency and stability, with low volatility compared to the highly volatile electricity spot price.

In South Australia, where the bulk of regional power generation is from gas supplies, the only concerns regarding electricity supply occur when there is a peak power demand which continues over a number of days (such as during a heat wave). In the past this caused a loss of line pack in the gas supply chain and the constraining off of gas supplies to industry. This gas supply constraint was an outcome of three major issues – insufficient interconnection of electricity supplies, too high a dependence on gas as a fuel for power generation, and the need for a larger gas supply for these few occasions. The augmentation of the electrical interconnection between Victoria and SA and the building of the SEAGas pipeline and gas interconnection with Victoria has eased significantly the potential for constraining off industrial gas users during times of high electricity demand.

Already, the high volatility of the electricity market creates major concerns for electricity users, with the price signals (often influenced by economic withdrawal of capacity) being available to consumers from the electricity spot market often occurring after the price adjustment event. To expose gas consumers to a similar volatility is not warranted. The current gas market supply arrangements already provide for sufficient pricing signals for gas supplies. Any moves to engender artificial convergence between gas and electricity will result in a higher volatility of gas pricing – a move which is neither necessary or, indeed, desirable.

## **2. Distribution is a monopoly.**

Both gas and electricity distribution networks are essentially monopolies, and even at the boundaries between different networks, competition is very limited. As a result, there must be consistency of regulations overseeing the operations of distribution networks.

Even though there are rights for third parties to build inset networks within the boundaries of distribution networks, the practice is that very little third party augmentation is undertaken. The reason for this is the high entrance costs pertaining to building networks, the relatively high cost to provide the necessary infrastructure to accommodate the operations of the inset relative to the extent of the inset network, and the high risk applying to a small augmentation without the benefit of being able to spread risks over a large network.

Consumers have endeavored to get augmentations carried out on a competitive basis. Whilst the capital costs for building an augmentation can be assessed on a competitive basis, it is the long term risks and operation of a third party owned inset which limits the options available to consumers. It should be remembered that energy supply is not the core business of industry and for industry to become owner and/or operator of a network augmentation exposes it to activities for which it has little experience. This then provides a further barrier to entry – perhaps one which is appropriate. However, to get existing distribution business to compete for work in another distributor's area has proven to be extremely difficult, if at all possible

## **3. Retailing energy increases competition only marginally.**

Electricity and gas are each of themselves indistinguishable commodities. Thus, the creation of many participants in the retailing function may not have sustained impacts on competition benefits. Retail margins are very modest, and the only way a retailer can even marginally differentiate its pricing is by varying its risk profile through varying of its sources of the energy commodity make-up. In particular, the very limited sources of gas and the ability to store it, provides a limited ability to differentiate in the retailing of gas.

It is therefore recommended that the MCE should examine the options for increasing the competitiveness of, or establishing the regulation for the distribution and retailing functions of gas and electricity bearing the above points

in mind. For example, apart from ensuring that the (pro competitive) principles of the electricity and gas codes be harmonized (and thereby ensuring consistency) it may not be necessary (or indeed desirable) to fully harmonies all aspects of the two codes, just for the sake of harmonization.

## **LIST OF ISSUES RELATING TO NATIONAL FRAMEWORK FOR ELECTRICITY AND GAS RETAILING AND DISTRIBUTION**

### **DISTRIBUTION PRICING - ELECTRICITY**

#### **Issue 1 – Regulatory Objectives and Principles: Electricity Distribution Pricing**

*Is the set of regulatory objectives and principles relating to electricity distribution pricing and described in the annexure to Section 3 appropriate for all jurisdictions?*

The listing of the regulatory objectives and principles should be common to all jurisdictions. There is no basis for one jurisdiction to permit lower standards of performance or to have a larger reward than another jurisdiction, accepting only that geographical and system design differences may lead to an enhanced network performance or reliability.

The essential premise applying to all distribution networks must be that there will be incentives for performance improvement by all distributions companies to improve service standards, security, and to reduce costs.

*What other regulatory objectives and principles (if any) should the Australian Energy Regulator be required to apply in regulating prescribed electricity distribution service charges and excluded electricity distribution service charges?*

Whilst the listing of regulatory objectives and principles is supported as far as they go, there are two glaring omissions from the listing. These are:-

1. There is a need for all of the regulatory decisions to be benchmarked against international performance. As electricity consumers are subject to international competition, so must the regulated entities be subjected to similar competition. Such benchmarking should not only relate to technical and standards of service, but also to the cost allowances and financial rewards that are granted as part of the regulatory bargain.  
**An additional principle must be added – that regulation will require benchmarking to international performance standards. It is in this way that all network performance and costs will be driven to match international best practice.**
2. The listing excludes any reference to service standards. Currently, there is no consistent set of service standards across all jurisdictions and the performance benchmarks vary between jurisdictions. Whilst there may be the need to modify service standards between different networks (for example due to geographical or design considerations) there is no basis

for having different jurisdictional performance benchmarks for networks of a similar nature, regardless of which jurisdiction they are in.

**An additional principle must be added – that comparisons of like with like must drive performance to be similar for similar networks regardless of the jurisdiction.**

*Are there any particular jurisdiction-specific characteristics that need to be accommodated in the regulation of electricity distribution pricing? If so, can they be accommodated as part of a national set of electricity distribution pricing principles or only as specific jurisdictional deviations?*

There is no reason for different jurisdictions to have different standards or to be treated differently. All electricity networks have common characteristics and the only differences that should be considered are those that relate to geography or network design. Such differences may apply equally to networks located in different jurisdictions. Thus the regulatory approach should reflect the network and not the jurisdiction or its ownership.

We consider there is no basis to invoke jurisdictional reasons for having any variations to regulation.

### **Issue 2 – Consistency with Gas Distribution Price Regulation**

*To what extent should the principles relating to electricity distribution pricing be the same as those that relate to gas distribution pricing?*

The only difference between regulation of gas assets and those for electricity transport is that gas can be compressed and so provide a degree of storage of energy. Electricity cannot be stored.

Therefore the comments made regarding electricity regulation above under issue #1 apply equally to gas distribution except that in the regulation of technical aspects, issues relating to customer impacts such as on supply quality (eg power factor, harmonics) and short term demand (eg MDQ compared to half hour demand) might be a little less stringent.

### **Issue 3 – Principles for Electricity Distribution Pricing Methodologies**

*What are the principles that should be included in any electricity distribution pricing methodology that may be applied in all jurisdictions?*

As mentioned above in issue #1, whilst there may be differences between networks relating to geography and network design, there are fundamentally no differences between similar networks in different jurisdictions. On this basis there should be not be a different set of principles for regulation between jurisdictions.

Where there is some flexibility permitted in the regulatory approach, each network owner should have the ability to select the regulatory approach which they would want to be applied to their assets. In granting the different regulatory



approach, the regulator should ensure that the approach used does not disadvantage nor discriminate between consumers.

In development of the various codes of practice that the regulator establishes as part of the regulatory bargain (eg Distribution Code and minimum service standards) it is essential that the regulator establishes a fair and equitable balance between the relationships of network and the consumer. There is a major concern that in establishing the codes of practice, there will be a drive to the “lowest common view” which consumers see as likely to be to their detriment.

#### **Issue 4 – Role of Governments in Electricity Distribution Pricing**

*Should Governments be able to impose requirements in relation to the regulation of electricity distribution pricing, eg. by way of rules made with the agreement of all the Governments or by way of jurisdiction-specific rules made by the Government of that jurisdiction?*

The decision to move to a national approach to electricity regulation is based on the expectation that there will be a national benefit by the standardization between all of the rules applying to electricity distribution regulation. To allow one jurisdiction to arbitrarily modify those rules detracts from the normalization of all of the rules across all jurisdictions. Thus there should not be the ability for one jurisdiction to act unilaterally.

Notwithstanding this, to eliminate the ability of governments to act in unison to correct a flaw or failure in the pricing rules will prevent governments from exercising their proper role acting as the trustee for the nation and its people. There must be the right for all jurisdictions to act in unison to effect changes which are seen as needed to benefit the nation and which are in the long term interests of the public. But no single jurisdiction, acting on its own, should be empowered to improve requirements that undermine the competitive principles or the level playing field. For example, governments should no longer be permitted to impose levies in their own jurisdictions, or impose arrangements (e.g. the NSW ETEF) which impede inter-state competition.

*Should existing Government-imposed rules relating to electricity distribution pricing, as set out in any Government-imposed tariff or pricing order or in any Government direction, be retained? If so, how should the responsibility for their administration be transferred to the Australian Energy Regulator?*

The aim of the changes to have a national approach to distribution regulation is to bring consistency across all jurisdictions. For jurisdictions to retain different controls on the regulation of electricity distribution assets in different jurisdictions defeats the purpose of the proposed changes. Thus the derogations of, and different rules extant in, each jurisdiction need to be terminated and for a common set of rules to apply across all jurisdictions.

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*Should additional rules relating to electricity distribution pricing, eg. under a tariff or pricing order or in a direction, be able to be made by Governments in the future?*

As mentioned above, the purpose for establishing a national market is that there is consistency across all jurisdictions. To permit derogations (whether carried over from the move to a national approach or for any jurisdiction to be able to unilaterally implement changes at a later time) from the national standard set of market rules, defeats the purpose of the national market. The drive for national consistency has at its roots, four formal drivers:-

1. To reduce costs to consumers which have multi-jurisdictional activities by having consistency of regulation and structure
2. To reduce costs to retailers which have multi-jurisdictional activities by eliminating the inefficient need to respond to different rules and structures in each of the jurisdictions they operate in
3. To reduce costs by eliminating the costs associated at managing different rules at interfaces between
4. By standardizing regulation across all jurisdictions, this will reduce the cost of regulation itself by reducing the number of regulators

The addition of any jurisdictional differences must have a cost impact. Therefore the principle of there being no exceptions between jurisdictions must result in the lowest cost to consumers.

Once a decision is made to move from this principle, there is no limit to the potential for introducing subsequent changes. Where a change is seen as being appropriate for a single jurisdiction, the approach must be that it be examined to identify the benefit to every jurisdiction. If it is identified there is a benefit across all jurisdictions then by all jurisdictions mandating the change, the principle of a national market is maintained.

### **Issue 5 – Impact of Existing Electricity Distribution Price Determinations**

*In making a future electricity distribution price determination, should the Australian Energy Regulator be required to conform with the statements of intention made by a jurisdictional economic regulator in the context of an existing pricing determination, or should the Australian Energy Regulator merely be required to consider whether to apply them?*

There is no doubt that certainty of outlook must underpin the efficient operation of the electricity market. Decisions have been made by all parties involved in the NEM (consumers, retailers and distribution network owners) based on the determinations of the jurisdictional regulators. For the AER to be permitted to ignore such determinations creates uncertainty in the regulatory process.

Equally, for the AER to be bound by such statements of intention into the future (especially if they apply over long periods of time) without having the ability to move to consistent regulation within a reasonable time, defeats the purpose of

the changes which have as a goal, the elimination of differences and the attainment of a national approach. If the national regulator is bound by statements of intention made by a regional regulator, then the goal of achieving a national approach is severely curtailed.

There are many examples of changes to Australian laws where, in the interests of the national good, decisions made on the basis of earlier laws have been negatively impacted by the introduction of new laws. The ability to make such changes creates a risk for all business and is seen as “Sovereign Risk”. An example of such a risk was the virtual elimination of import tariffs, exposing Australian industry to international competition. Prior to the introduction of the tariff reductions, Australian manufacturers were making decisions on investment based on the market as it was.

Following on from this, the AER should examine the specific reasons behind a statement of intention by a regional regulator. If such a statement of intention is seen a beneficial then the AER can introduce the specific statement across all jurisdictions. If the AER is not convinced that the regionally stated intention is beneficial then the national approach should be seen as having priority, and the regional statement of intention be eliminated. The AER should have the power to be able to phase out the earlier statement of intention over time to limit the impact on the parties negatively affected.

Thus the AER should be provided with the power to assess the benefits of the intentions made by regional regulators, but it should be able to decide not to continue with any such statement of intention.

However, the AER should be required to honour the current price determinations. Such an approach has been used by the ACCC in its regulation of the transmission assets. In this case the ACCC applied the decisions of the earlier regulator, but when the ACCC made its determination, it applied its own regulatory approach to the new price determination.

*If the Australian Energy Regulator is to be bound by statements of intention by a jurisdictional regulator in an existing price determination:*

- *what is the nature of these statements of intention; and*
- *should these statements of intention be incorporated in any national set of electricity distribution pricing principles, either as a nationally applicable pricing principle or as a specific jurisdictional deviation?*

As noted above the AER should not be bound by the statements of intention made by regional regulators. It should have the ability to assess the benefits and detriments of such statements, and as a result either have the power to phase out the impact of statements over a reasonable time, or to introduce such statements on a national basis.

## **Issue 6 – Interaction of Australian Energy Regulator with Other Bodies**

*What consultation requirements should be put in place between the Australian Energy Regulator, on the one hand, and other regulators and Government departments and agencies, on the other hand, on matters that may impact on the Australian Energy Regulator's price regulation function, eg. should the Australian Energy Regulator be required to enter into memoranda of understanding with such other bodies in relation to such matters and for the purpose of obtaining information that is necessary for the performance by the Australian Energy Regulator of its functions?*

It is agreed that the AER will have an economic regulatory role, and not one which encompasses environmental, and occupational health and safety matters. These are rightly the province of the jurisdictional government to both implement and enforce. Equally it is recognized that there is a financial cost which any business incurs by complying with such directions. Particularly, the costs associated with the regulation of gas and electricity safety requirements and enforcement may well need to be included in the operation of some of the businesses involved with the supply of gas and electricity to consumers.

It is therefore sensible and supported that the AER be required to consult with those jurisdictional regulators and government departments which are involved with those activities which will impact on the pricing and performance of regulated businesses.

In addition, the AER should be required to consult with those jurisdictional regulators and government departments where their activities may impact on the issue (and retention) of licences to businesses which desire to become involved in the supply of gas and electricity. Such matters might include the desire of a jurisdictional government to provide certain services or support to specific consumers, or a class of consumer, of the provision of money or support to cover certain social obligations which have been legislated, and are most optimally provided through a business which requires a licence from the AER. This will require the AER to be involved with ensuring that the licensee does comply with the obligations impressed on it by the requirements of such legislation.

**Providing that there is a requirement for the AER to be aware of and provide the necessary controls for the implementation of the jurisdictional government requirements, the actual method for ensuring this awareness can be achieved in a number of ways. Equally there must be a balancing responsibility on the jurisdictional regulator or government department to ensure that they have an identical responsibility to consult with the AER.**

## **DISTRIBUTION PRICING - GAS**

### **Issue 7 – Pricing Objectives and Principles: Gas Distribution**

*Should the pricing objectives and principles set out in the National Gas Access Code continue to apply under any national framework for the regulation of gas distribution pricing? Should any of*

*the existing objectives or principles (including as recommended to be amended by the Productivity Commission) be modified or removed, or should any new objectives or principles be added?*

The pricing objectives and principles set out in the current gas code should continue to apply under the national framework for the regulation of gas distribution pricing. Whilst major gas users had supported the utility of an overarching objective along the lines recommended by the Productivity Commission, there is considerable disquiet that the Commission failed to address significant concerns that the objectives of preventing the abuse of monopoly power and of providing fair and reasonable access conditions must be retained to provide comfort to gas users. This concern is amplified, as such theoretical economic concepts can be vague and ultimately offer a wide range of price levels which can all be “economically efficient“. Nowhere in its Review Report does the Productivity Commission define what it means by “economically efficient.“ Is it replacement cost pricing based on inflated notional costs (such as pricing using the depreciated optimized replacement cost methodology)? Is it short run marginal cost or long run marginal cost pricing? Does “economically efficient“ pricing extend to non-price factors, noting that price and non-price factors affect access and other conditions?

“Promoting effective competition in upstream and downstream markets “should not necessarily be an end in itself. The outcomes desired are price, security of supply and service quality levels. But two competing pipelines do not necessarily mean “effective competition “. In this regard the Productivity Commission has failed also to define what is meant by “effective competition.“ There can be competition at the margin, or even parallel pricing.

Overall, major gas users consider that the Productivity Commission’s recommendations with respect to the pricing objective is theoretical; and incomplete, in that it fails to define or explain key outcomes and terms; and lacks an adequate understanding of the realities of the gas pipeline industry and the legitimate concerns of gas users.

The Productivity Commission’s recommendation that only factors 2 and 3 be retained in respect of the factors that regulators need to take into account in setting the terms and conditions of access, is undesirably narrow. Major gas users consider that the current 7 factors should be retained, particularly factors 1, 5 and 6. Factor 5 ( the public interest ) is the reason why Parliament agreed that strategic bottleneck ( pipeline ) infrastructure be regulated in the first place!

The Productivity Commission’s assertion and conceptual approach that the Gas Access Regime was “ intrusive “ and “ costly “ is difficult to accept as it is not based on cost benefit analysis and empirical evidence.

*Are there any particular jurisdiction-specific characteristics that need to be accommodated in the regulation of gas distribution pricing?*

Caution is urged in respect of concerns with “regulatory inconsistency or jurisdictional deviations”, especially as there are major differences in the nature of regulated distribution networks and hence the differences in the business risks they face. For example, in NSW, the dominant gas retailer is part of a vertically-integrated business with transmission and distribution network interests. In this case, particular jurisdiction-specific characteristics need to be accommodated in the regulation of gas distribution price- e.g. information disclosure powers especially in relation to related party transactions such as those involving Trust vehicles and arrangements. These information disclosure powers are already included in the NSW Licensing Legislation.

### **Issue 8 – Consistency with Electricity Distribution Price Regulation**

*To what extent should the principles relating to gas distribution pricing be the same as those that relate to electricity distribution pricing?*

In general, principles relating to gas distribution pricing should be the same as those that relate to electricity distribution pricing. However, a key feature of the Gas Access Code is a provision whereby the value of the initial capital base cannot be revisited by the regulator at subsequent regulatory assets. It is highly desirable that this feature be retained and for the principle to apply equally to electricity distribution pricing regulation.

### **Issue 9 – Impact of Existing Gas Distribution Pricing Arrangements**

*Should any of the existing fixed principles, or any existing requirements of any Government-imposed tariff or pricing order, be incorporated into the pricing objectives and principles contained in the National Gas Access Code?*

The arrangements relating to certain “fixed principles” whereby they cannot be changed without the service provider’s agreement should be retained. These have sun-set provisions, which are limited and need not have major implications.

## **LICENSING**

### **Issue 10 – Activities to be Licensed**

*What activities should be licensed under a national licensing scheme for the electricity and gas industries?*

The supply of both electricity and natural gas to consumers is accepted as being an essential service. Thus, all participants in the supply chain must be seen as providing an essential service.

In addition to this there are elements of the supply process which:-

- permit participants authorized access to both public and private land (eg the right to secure easements)

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- require the participants to meet certain technical requirements (eg generators to match the system quality, gas producers to meet gas quality, energy transport to meet certain safety and quality requirements such as are laid out in distribution codes of practice)
- require participants to meet certain performance requirements related to their involvement in providing an essential service (eg minimum contractual relationships such as laid out in retail codes of practice, agreement to apply certain dispute resolution practices)

Unless there is a requirement on each of the parties involved in the supply chain to meet such minimum standards (technical and commercial) then there will be confusion, and consumers could be exposed to less than reasonable practices that are associated with the provision of an essential service.

It is accepted that there are other government bodies which can be used to apply the requisite controls (eg legislated land acquisition requirements and safety standards), but it is essential that the regulator of the supply chain be not only aware that the parties in the supply chain have to comply with the standards set by other governmental bodies but also that they have complied with these requirements. This is best achieved by requiring all participants in the supply chain to be licensed and to have their licence subject to compliance with these other governmental requirements.

The implementation of a licence for all participants in the energy supply chain has been proven to have provided a degree of protection for all consumers. The requirement of a licence can provide the regulator (and the MCE) the ability of sanctioning appropriate behaviour within the energy supply chain. In this regard it should be noted that with the single exception of the retailing function there is limited competition within each of the elements of the energy supply chain. This is clearly the case with regard to energy transport, but it equally applies with regard to the generation of electricity (in most regions there are insufficient independent generators of electricity that prevent the exercise of market power) and gas production where even in the most competitive of gas market regions in Australia, there is still the ability of a producer to create shortages and therefore exercise market power.

With regard to retailing there is a need to ensure that retailers comply with minimum standards of commercial behaviour. In particular, electricity retailers must be able to provide adequate demonstration of their financial standing in order to meet their financial commitments, as these are debts due to the central clearing house (NEMMCo) rather than to other electricity market participants. Further, as providers of an essential service retailers must meet a minimum standard with regard to end use consumers. These obligations can be best managed through a requirement of licensing with the regulator having the ability to revoke a licence for misbehavior.

**Licensing of all participants in the energy supply chain is considered essential and the requirement of a licence in order to participate in the gas and electricity supply chain must be mandatory**

**Issue 11 – Suggested Licence Conditions**

*Is the allocation and coverage of existing licence provisions between the various regulatory instruments, as suggested in Appendix 1 to this Issues Paper, satisfactory?*

*Are the suggested licence conditions for electricity and gas retail licences and electricity and gas distribution licences, as described in Appendix 2 to this Issues Paper, satisfactory?*

The process of standardizing the conditions of the licences is supported.

However the exclusion of the following licence provisions is not supported.

- There must be a licence requirement for the participant to conform to a series of technical performance requirements and to a series of commercial performance requirements. The details of these would be included in the Distribution Code and the Retail (or consumer protection) Code. A specific reference to such performance requirements should be included in the sections relating to “Compliance with all applicable laws”.

It is noted that where existing licence provisions note these are to be included, the commentary in appendix 1 notes these are to be deleted from the licence and for them to be covered in legislation, codes and rules. Whilst there is reference to performance measures as being included as part of any economic review by the AER, the AER decision will include only for a financial incentive program to meet performance standards, with a penalty for underperformance and a bonus to out performance

**The form of the licence must explicitly state that there is a requirement for the business to meet performance standards with regard to technical and commercial obligations. These obligations are to be detailed in the Distribution Code, the Retail (consumer protection) Code and in the regulatory pricing determinations**

- There should be a review process for the terms of the licence so that aspects where there are concerns can be identified, examined and resolved.
- The requirement for there to be dispute resolution as part of the standard form of licence is supported. However such dispute resolution must be fully independent and fully funded. An extension to a national independent dispute resolution (IDR) scheme comprising the best elements of the various ombudsman schemes currently in operation in most jurisdictions is seen as the most appropriate form of IDR.

**The form of the licence should require the dispute resolution process to be fully independent.**



## **Issue 12 – Mandatory Licence Conditions**

*Are there any existing or suggested licence conditions which, as a matter of Government policy, should be included in electricity or gas retail licences or electricity or gas distribution licences and therefore should be specified in legislation as mandatory licence conditions?*

Electricity and gas supply are essential services. It should not be in the province of the regulator or the supply chain business to be able to refuse supply to any consumer. Thus there must be a retailer of last resort to ensure that consumers can access electricity and gas supplies. The regulator can establish the terms under which the retailer of last resort provides the service.

Where a jurisdiction determines that a community service obligation is required to be provided, it should not be at the discretion of the regulator or the supply chain business to refuse to implement the jurisdictional decision.

The establishment of competition lies within the purview of government. It should not lie with the regulator or the supply chain business that a customer cannot be refused the right to transfer between suppliers, unless the customer is served by the retailer of last resort.

As it is the jurisdictions that have removed themselves from being directly involved in the supply of these essential services, there must be a reliable and independent method of resolving disputes between supply chain businesses and consumers. The decisions of this dispute resolution process must be enforceable.

## **Issue 13 – Form and Variation of Licence Conditions**

*Should the Australian Energy Regulator be required to issue licences in an agreed form containing specified conditions?*

Consistency and lack of jurisdictional variation is one of the basic reasons for underlying the decision to move towards a single regulator. On this basis alone the regulator should develop a standard form of licence, which would only vary between the types of businesses being regulated.

However, the regulator must be permitted to include special conditions to a licence being granted to a specific business. Such special conditions would relate to concerns the regulator might have with regard to that specific business and the scope of its proposed activities.

For example a generator may wish to take out a retail licence purely for the purposes of limited supply to a single consumer, or a small group of consumers involved in an energy park. To require the licensee to comply with a range of requirements more related to a large customer base and large volumes of energy being traded, might be seen as unnecessary. Accordingly the regulator might desire to issue a less prescriptive licence where the customer base is confined to a small geographical area.

It is noted in the text of the issues paper that there should be the need for specific jurisdictional requirements to be included in the form of a licence. The case of bushfire is cited as a case in point where South Australia believes there should be a requirement to insure appropriately against bush fire damage. It should be seen that such a risk is common to all distribution businesses, (with the only exception being perhaps CitiPower which operates only in suburban Melbourne) and so the SA requirement should become part of the national approach rather than being seen as an exception.

**Thus a standard form of licence is seen as desirable as the regulator must have the right to vary the standard form based on business differences, but not on grounds of jurisdictional differences.**

*Under what circumstances (if any) should the Australian Energy Regulator be able to vary a licence condition that is included in any agreed form of licence, eg. only with the approval of the Government of the relevant jurisdiction(s) or of all of the Governments?*

As discussed above the regulator must have the right to vary the conditions of a licence from the standard form. The ability to respond to jurisdictional direction defeats the purpose of national regulation, but the power for all governments acting in unison (eg through the MCE process) should be retained and the regulator must respond to these requirements. For the regulator to be permitted to ignore the directions of the governments acting in unison, passes power to the regulator and away from the nation.

*Under what circumstances (if any) should the Australian Energy Regulator be able to include licence conditions that are in addition to those included in any agreed form of licence?*

As discussed above the regulator must have the power to vary the form of the licence by inserting additional licence conditions that modify the form of the licence. However to balance that power there must be an appeal mechanism provided should the decision of the regulator be challenged by the business requesting the licence. As it is the jurisdictions acting in unison that grants the powers to the regulator, then the appeal process should permit the appellant access to the MCE should it consider the decision of the regulator is too onerous.

#### **Issue 14 – Ability of Governments to Vary Licence Conditions**

*Under what circumstances (if any) should the Governments be able to require that issued licences be varied to include additional specified conditions?*

As discussed above, to ensure there is national consistency there should be no jurisdictional differences in the form of the licence. The regulator should have the power to vary the form of the licence through the use of special conditions. The governments acting in unison (eg through the MCE) must retain the power to vary the form of licence as it is their power that has required the licence to be structured in the form it is.

Jurisdictional governments have decided to move to a national market. They have agreed to appoint bodies (MCE, AER, and AEMC) to manage the operation of the energy markets. Jurisdictional governments should not have the power to act unilaterally with regard to the national energy market, as to do so creates uncertainty and a reduction of cohesion.

The issues paper suggests that there are jurisdictional differences that might need to be the province of a specific jurisdiction. It cites dispute resolution, customer transfer, business to business information exchange and retailer of last resort. It is essential that each of these issues is addressed in a national scheme, and that a national approach is not only possible, but preferable for them to be included in the national approach with a consistent requirement and standard. As mentioned above in the section under issue 13, the requirement that a specific jurisdiction sees as important is probably important for all jurisdictions.

In developing the set of standard documentation, it is imperative that notice be taken of these supposed differences in order that the best set of rules is achieved. Once the best set of rules has been developed, jurisdictional differences can be eliminated.

**Other than the regulator, only the MCE (governments acting in unison) should be able to vary the form of the licence. Jurisdictions acting in isolation must not have the power to vary licences.**

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

*Should a triangular or linear approach be adopted, on a national basis, to the relationship between retailers, distributors and end-use customers? Should the customer be able to decide which form this relationship is to take or should the form of the relationship be mandated under the regulatory regime?*

The provision of energy transport to end use customers is a monopoly business. There is a physical connection between the end user and the distribution business. The quality of supply to an end use customer is directly related to the activities of the distribution business, as is the supply itself. To formally break the relationship between the distribution business and the end user eliminates the ability of the end user to act in its own interests.

The relationship between the retailer and the end user is purely one of “paper”. It is a contractual relationship only, and although the reliability and stability of supply is paramount to the end user, the retailer has no control over these aspects at all. Equally, it is the end user which creates the challenges to the distribution business with issues such as excessive demand, power factor, harmonics, pressure fluctuations, etc.

Augmentation of supply to suit the needs of the end user, compounded with the need of the network to ensure there is adequate capacity in the network for the augmentation is best left to negotiations between the distributor and the end

user. To insert a third party between the two directly involved protagonists creates confusion, delay and unnecessary costs to all involved.

To mandate the initial responsibility for reliability and stability of supply and impacts on the system from incorrect use, all of which are in the province of the distributor and the end user, onto a party which has no control over any of these matters at all is patently absurd.

If the end user desires to give responsibility to a retailer for acting on its behalf in discussions with the distribution business, then this is the election of the end user. Mandating this responsibility (through deeming or another provision) removes all power from the end user to negotiate with the party best able to manage reliability and stability of supply, just as it removes all direct contact by the distributor with the end user which is best able to address the issues of concern for the distributor.

The Issues paper cites that the benefit of the linear approach is that the end user has only one party to contact in the event of a problem. Whether there is linear or triangular relationship, it is probable that the end user would still need to discuss its issues with different people, and if the issue was with the distribution business, then the matter is best resolved by direct dialogue between the parties involved, without the need for a third party who can add little to the issue.

**A triangular approach to the relationships between end user, retailer and distributor represents the actuality of the physical relationships and this is strongly supported.**

**To mandate a linear approach removes the ability of two of the three parties to negotiate on issues directly affecting them, such as security and quality of supply and reliability, augmentation and of the impact the end user has on the networks.**

#### **Issue 16 – Suggested Licence Administration and Enforcement Arrangements**

*Is the suggested licence administration and enforcement regime described in Section 5 suitable for application as a national regime? If not, in what respects should it be modified?*

Licensing permits businesses to be a participant to be involved in the national energy markets and the supply chains. Licensing should be made possible for the minimum administrative cost to the licensee and to the licensor. Separation of issuing of licences and overview of licensing requirements is best managed by one party, eliminating the potential for “gaming” by licensees.

The issuing of licences should be controlled centrally and permit a licensee to operate in those jurisdictions stipulated in the licence. A licence to operate nationally should be available if that is the desire of the applicant.

This provides the lowest cost administration and control of licensing.

As the AER is responsible for ensuring the market operates satisfactorily, it is therefore appropriate that the AER should establish the licensing provisions, issue the licences and enforce the requirements of the licence.

**There is no reason not to apply the licensing regime on a national basis, and the AER is best suited to have this responsibility.**

*What role (if any) should the Governments play in the administration or enforcement of the licensing regime?*

Governments have decided to implement a national energy market. Thus, jurisdictional governments should permit a national body to be involved in managing the energy markets. If the decision is to retain the issuing of licences by Government, this should be by the MCE or the federal government, and not individually by each jurisdiction.

If it is decided that jurisdictions should hold this power, it will require each licence applicant to access each jurisdictional government to operate within each jurisdiction. This eliminates the very sensible approach to minimize duplication by each licence applicant. Such an approach will increase costs unnecessarily for little purpose.

Governments have agreed to devolve their power to ensure the energy markets operate nationally for the benefit of all Australians. Licensing should be controlled by the central body to which this power has been given.

**Jurisdictional governments should not be involved in licensing or its control**

*What role should the Australian Energy Market Commission (in its rule making and market development capacity) have in any licensing arrangements?*

The functions of the AEMC are broadly to monitor the performance of the energy markets and to address changes which might improve the overall performance of the energy market. If the AEMC is to become involved in the operation of the energy markets (eg by the issuing of licences), this decreases the separation of the very clearly defined activities of the AER and the AEMC. This is not supported.

**The AEMC should not become involved in the operation of the energy markets by becoming the licensor.**

### **Issue 17 – Suggested National Exemption Regime**

*Is there benefit in adopting a national system of exemptions from licensing requirements? Is the suggested national exemption regime described in Section 5 acceptable?*

The purpose of a national approach to the energy markets is to eliminate inter-jurisdictional differences. Therefore it is not supported for there to be the power for jurisdictional governments to unilaterally grant exemptions.

In the event that a specific applicant requires an exemption of a licence or a licence condition, this should be assessed by the national energy regulator which should have the power to permit the exemption from having to hold a licence or to exclude a specific condition of the national form of licence. Guidance should be provided to the AER as on what basis exemptions can be granted. This advice should be provided from the MCE from time to time, to ensure that there is national consistency as to how the regulator can exercise its powers.

If the MCE is concerned that the regulator might not use its powers sensibly in this regard, then the MCE should hold to itself the power to grant the exemption, but it should only exercise this power on the advice of the AER.

Either of these two approaches will maximize the benefit of a national energy market, and create the least number of exceptions.

**The MCE should provide guidance to the AER as to what basis exemptions should be granted.**

**The AER should have the power to grant exemptions.**

**If the AER is not given this power, the power should reside with the MCE, but only on the advice of the regulator.**

*If not, in what respects should it be modified? In particular, should only the Governments be able to grant or authorise the granting of such exemptions?*

The purpose of the new market rules is to ensure the highest level of consistency across the national energy market. To permit jurisdictional governments to act unilaterally will detract from this goal.

**No jurisdictional government should have the power to grant exemptions unilaterally.**

### **Issue 18 – Process for Introducing New Licences and Exemptions**

*Should the replacement of existing licences and exemptions with the new agreed forms of licences and exemptions (if any) be effected through legislation or by way of a voluntary surrender and replacement, in either case with a transitional period?*

There must be a point in time when the move to a national energy market is determined. Whilst it is expected that most, if not all, existing licensees in each jurisdiction will cooperate in the changeover process, to rely on voluntary relinquishment of licences might not result in all licensees relinquishing their jurisdictional licence.

It is essential that the new regime be applied consistently and concurrently across all jurisdictions following an agreed time frame. If this does not occur, then the result will be that much of the benefit of consistency which is a feature of the new regime will be lost.

**The only sure way to ensure a smooth transition to the new regime is for all jurisdictions to legislate to terminate all jurisdictional licences at an agreed but common point in time.**

### **Issue 19 – Alternatives to Licensing**

*Is there any alternative form of regulation (eg. registration) that it would be preferable to adopt instead of the licensing of electricity and gas retailers and distributors?*

The issuing of a licence is common practice and can have the force of law behind it. The withdrawal of a licence to operate is a powerful sanction to comply with appropriate and acceptable business practices. Licensing is accepted practice in the gas and electricity market, and no real detriment to this mode of control has been identified.

Registration is identified more with a process which implies a voluntary involvement. This was necessary in the national electricity code as the NEC is a voluntary code of practice. Registration does not provide the regulator with the same ability to manage the performances of the businesses.

**Licensing of participants in the new gas and electricity markets is a preferred approach over other alternatives.**

## **INDUSTRY CODES AND RULES**

### **Issue 20 – Single Consumer Protection Code**

*Is there benefit in adopting a single consumer protection code that applies in respect of electricity and gas retail and distribution in each jurisdiction?*

There is value in a common consumer protection code across all jurisdictions. The key benefit of common regulation with no (or minimum) variances across all jurisdictions eliminate (or reduces) the costs where a consumer has activities in multiple jurisdictional locations and where a retailer and distributor operate in multiple jurisdictions. The greater there is variation between jurisdictions, there is a lesser value in common regulation.

**A common single consumer protection code is preferred and supported.**

*If so, are all the relevant matters for inclusion in such a code listed in Table 9?*

A single consumer protection code is preferred as to require consumers to be aware that their obligations and rights are detailed in a number of different documents provides the supplier with an advantage in any negotiations. The headings provided in table 9 cover the range of the required elements necessary in a consumer protection code.

Notwithstanding this support of the elements of table 9, it is necessary to highlight it will be the detail of the wording of the actual code which determines its

balance and usefulness. Issues such as timing payment periods to welfare payments, security of deposit monies, interest payable by the holder of deposit moneys, disconnection policies, detail of standard form contracts, penalties for non-performance by both parties, dispute resolution requirements, etc,

*What are the areas in respect of which justifiable jurisdictional differences are likely to arise?*

There does not need to be variation of the consumer protection code between jurisdictions. What is of concern is that in attempting to establish such a code, jurisdictions and suppliers may resort to a “lowest common denominator” approach.

**The consumer protection code must be consistent across all jurisdictions and provide a fair and balanced approach to setting terms, obligations and rights of the parties involved, and recognize the constraints each party is exposed to.**

#### **Issue 21 – Responsibility for Making Industry Codes and Rules**

*Should industry codes or rules (such as a consumer protection code) be developed by, or be subject to the approval of, the Australian Energy Regulator or the Governments, or should the Australian Energy Market Commission be responsible for making such industry codes or rules?*

The development of the various codes of practice (distribution code, consumer protection code, metering code, etc) must be carried out as a joint exercise between the regulator, the affected supply side businesses and end use consumers. Not to involve each of the parties will result in a less than optimal outcome.

There are many elements of these codes of practice which have financial implications for both supplier and consumer. Thus the regulator responsible for regulating the regulated activities of the supply businesses (the AER) needs to be aware of the costs that might accrue to either the business or to consumers as a result of the code application, and so be able to balance the financial implications of setting code requirements with the ability to absorb those costs. This tends to lead to the conclusion that the economic regulator should develop at least some of the codes of practice.

If such codes of practice are developed under the auspices of one regulator (eg the AEMC) then it is incumbent on the code developer to ensure that the regulator charged with enforcing the code requirements, has involvement in the process to ensure that the terms of the code are in fact enforceable. Thus to give responsibility of the development of a code of practice to the AEMC will require the AEMC to seek agreement from the AER that the code can be applied and that it can be enforced.

An alternative approach might be to have the AER develop the code of practice and seek formal approval of the code from the AEMC to ensure that there is balance between the obligations of supplier and consumer, and that the code of



practice does not conflict with the market requirements and legislation. This then removes the need for jurisdictional review of the codes of practice, and this will lead to a more consistent set of codes across all jurisdictions.

**The code of practice is probably best developed by the regulator responsible for enforcement (the AER), and the agency responsible for ensuring the optimum operation of the markets (the AEMC) can review and approve the codes of practice developed.**

## **Issue 22 – Variation of, and Exemptions from, Industry Codes**

*If the Australian Energy Regulator is to have responsibility for making an industry code (such as a consumer protection code), under what circumstances (if any) should it be able to vary or add to the terms of that code, eg. only after a process of public consultation?*

No codes of practice should be developed in isolation. The development process must include the active involvement of the supply side businesses affected by the code, and with the active involvement of consumers. Accepting this premise it then follows that any change to a code of practice must involve the active participation of the parties involved with the initial development.

**Codes of practice should only be changed with the active involvement of the affected supply side businesses and consumers.**

*Are there any consumer protection measures, that could be included in a consumer protection code, which should not be able to be varied without the approval of the Governments (eg. because they implement a particular policy or are of particular significance to one or more jurisdictions) and so should be enshrined in legislation?*

Each jurisdiction has its legislation designed to provide protection of consumers from unconscionable terms of trading, and from terms which do not provide a reasonable balance between the obligations between supplier and consumer. The development of codes of practice for the energy markets must not obviate any of these jurisdictional requirements for fair trading, and so there must not be the ability for the codes to be developed or varied to exclude the basic jurisdictional requirements for fair trading.

**As jurisdictional changes to fair trading acts occur, then the energy markets codes of practice should be varied to ensure the energy market codes reflect these changes in community attitudes.**

*Under what circumstances (if any) should the Australian Energy Regulator be able to exempt an electricity or gas retailer or distributor from complying with a provision of a consumer protection code?*

Whilst the development of a code of practice with involvement of regulator, supply side business and consumers, should result in there not being the need for many circumstances where an exemption from the code or a term of the code might be appropriate, it is inevitable that such will occur from time to time. Rather

than stipulate specific circumstances where an exemption might be appropriate, it would be of greater use to the regulator to define what outcomes from the exercise of exemption should result.

The implementation of a series of principles would provide guidance to the regulator for the exercise of its right to vary the requirement of a code of practice, or a term in the code, such as the exercise of exemption but it must

- Be only at the request of a supply side business or a consumer
- Not result in additional costs or obligations unless there is a compensating benefit which is acceptable to the non requesting party or parties
- Not result in a reduction of rights unless there is a compensating benefit which is acceptable to the non requesting party or parties
- Have the agreement of all parties directly affected by the grant of exemption.

**The regulator should have the power to exempt a party from the obligations of a code or term therein, but the exercise of the power must comply with a series of principles which should be explicitly identified.**

### **Issue 23 – Minimum Terms and Conditions for Distribution and Retail of Electricity and Gas**

*Should there be a form of nationally uniform regulation that applies to the minimum terms and conditions that must apply in relation to the distribution and retail of electricity and gas to (small) consumers?*

The principle behind the move to national regulation is that there should be consistency between all jurisdictions. As such there should be a national code of practice which sets a balanced arrangement for the dealings between suppliers and consumers of energy.

The principle behind the regulating of a standard set of terms and conditions to manage the dealings between supplier and consumer is that it is recognized that the asymmetry of information and knowledge of the energy markets provides the supplier with an advantage over the consumer, regardless as to the size and experience of the consumer. Whether the consumer is “contestable”, “franchised” or “small”, there always remains this information asymmetry which benefits the supplier. With the move to having more consumers becoming “contestable” under full retail competition, to differentiate between consumers based on contestability becomes meaningless.

Thus in one way a code should not be considered as a “minimum” set of terms and conditions, but must represent a fair and equitable set of rules for dealings between the supplier and consumer in the supply and receiving of gas and electricity. This is necessary as the code becomes the default contract in the

event that the supplier and consumer do not reach agreement for a formal contract.

However, if a supplier desires to enhance the terms for trading in gas and electricity, then it should be possible for the terms to be enhanced in the favour of the consumer, and in this instance the code provides the minimum form of contract for the dealings between the parties. There should not be ability for the consumer to agree to any lesser standards than in the code, as the information asymmetry favoring the supplier can lead to undue pressure on the consumer to accept a less than equitable supply contract.

**The code of practice should be crafted to represent an equitable contract between supplier and consumer. Under the code of practice it should not be possible for a contract of supply to decrease rights or increase obligations for the consumer which are incorporated in the code, but it should be possible for the code to allow the contract of supply to provide greater rights and benefits to the consumer.**

*Should there be less prescription of such terms and conditions in relation to contestable customers as opposed to distribution customers and franchise customers?*

As noted above, the move to full retail competition eliminates the differentiation between “contestable” and “franchise” consumers. The information and knowledge asymmetry always provides the supplier with an advantage in any negotiations, so the code of practice should provide the basis of a default contract of supply regardless of the standing of the consumer.

**There should be no differentiation of the default provisions for the contract of supply of gas and/or electricity between different classes of consumer.**

## **ASSOCIATED ELECTRICITY AND GAS SCHEMES**

### **Issue 24 – Uniformity or Consistency in Associated Electricity and Gas Schemes**

*Should there be a single national approach to or consistency in the terms of:*

- *the dispute resolution schemes;*
- *the retailer of last resort schemes;*
- *the customer transfer schemes; and/or*
- *the business to business information exchange schemes,*

*that apply in each of the States and Territories?*

Each of these schemes provides an enhancement of the regulated energy markets and assists in ensuring that there is adequate protection for consumers from inappropriate and monopolistic behaviour by retailers and distributors. Their retention in a national market is essential and every endeavor must be made to

ensure that the protections these schemes provide are available to all consumers.

The principle behind the move to national regulation is to develop a high degree of consistency between the jurisdictions. It is by achieving this consistency that costs are driven down for regulation, for the supply businesses and for consumers. It should be remembered that not only do consumers have their own costs associated with varying regulations between jurisdictions, but ultimately they pay for the cost premiums incurred by regulators and the supply side businesses where consistency is not achieved.

Thus the goal that these changes for moving to national regulation must be that a national approach is preferred over any degree of jurisdictional differences. There are a number of principles that should form the basis of the changes needed to achieve national consistency. These are:-

- There needs to be consistency of the various codes of practice (eg distribution code, customer protection or retail code, metering code, etc). The greater any jurisdictional difference between these codes the less effective each of the national schemes will become.
- There must be an avoidance of the trend to settle for the “lowest common denominator” when establishing the national basis for each of the schemes. In developing the principles and rules for developing each scheme there must be a striving for the maximum effectiveness and the requirements for each must reflect best practice rather than the minimum to get agreement from the jurisdictions. Rather than accepting the lowest common denominator, there must be a striving to incorporate the best of each of the different models for each scheme for incorporation into the national approach.
- Contact with all of the current schemes should be undertaken to identify the unique elements which must be incorporated to ensure that the rules and principles underpinning the effectiveness of each scheme so that the best option is identified for the development of an effective national approach is achieved.

*What impediments are there to achieving such a national approach or such consistency in respect of any of these kinds of schemes?*

The main impediment to achieving national consistency will occur if there jurisdictional differences in the mechanisms (eg codes of practice) which each of the schemes is required to operate with.

For example, if there are differences in the consumer protection code between jurisdictions, then the scheme (eg the dispute resolution scheme) is required to train its staff to recognize that there are differences between the jurisdictions and the assess the impact of the differences. Any differences can directly increases costs (eg for staff training to be aware of the differences), increases indirect costs

(eg from an inappropriate or delayed outcome) and increases the potential for errors.

### **Issue 25 – Community Service Obligations**

*How are electricity and gas retailers and distributors to be obliged to perform community service obligations under a national regime, eg. through a licence condition or Ministerial direction?*

There must be retained the right of jurisdictions to provide support to their constituents and the provision of community service obligations is one way that this jurisdictional feature can be achieved.

As noted above the AER on one hand and jurisdictional regulators and government departments on the other must have a responsibility to keep each other informed. A community service obligation (CSO) is one such example. Providing the AER is aware of the impost of the CSO in any particular jurisdiction, the AER is placed to ensure that the CSO is being accommodated, and that if there is doubt as to whether the obligation is being managed appropriately, for the AER to withdraw the licence of the offending party.

The AER has both the authority and the power to identify whether any obligation imposed under a licence has been appropriately fulfilled.

The alternative to this is to have the jurisdiction attempt to control the CSO directly with each licensed business; yet under a national regime, no jurisdiction has a relationship with a licensee. As there is to be no barrier to interstate trade under the national regime, for each jurisdiction to establish a relationship with each supply side business proposing to carryout business in that jurisdiction, purely for the purpose of administering a CSO, will detract from the principle of the national regime and add to the cost of operating in that jurisdiction.

**The obligation to fulfill a CSO declared and funded by a jurisdictional government should be a licence provision and the AER is best able to ensure the licensee fulfills the CSO.**

## **SERVICE STANDARDS**

### **Issue 26 – Uniformly Defined Service Measures**

*Are there advantages in employing a set of uniformly defined service measures to measure the standards of reliability and customer service provided by electricity and gas retailers and distributors in each of the jurisdictions?*

Reliability of supply is an essential element of service which affects all consumers, although to varying extents. For example, the loss of supply for one second might not have an impact on one consumer yet have a catastrophic impact on another. At one extreme loss of supply for one second might mean a break in a production run resulting in the loss of raw materials and an extended downtime to re-establish the production run, whereas a mundane level, loss of

supply for one second might require a domestic consumer to have to reset electric clocks. In a similar vein, variation in quality of supply can have either major or minor impacts on consumers.

At the same time there is a cost to the consumer involved in identifying how and when the business will carryout steps to assist the consumer – whether this is to provide the time to re-establish supply after an outage, or the time to appear for an appointment to discuss issues affecting the consumer. Such performance standards have a key role to play in the provision of essential services such as providing gas and electricity.

Regardless of the size of the impact on the consumer, there is a need for supply businesses to be able to give each consumer an indication of the reliability and quality of the supply so that appropriate actions can be instituted by consumers. This can only be achieved if the reliability and quality is measured and there is consistency across all jurisdictions as the form of the measurement. If then a particular business fails to meet the standard of supply which is expected there needs to be some penalty to incentivise the business to perform better.

Equally consumers' time and inconvenience has a cost to the consumer, and the ability of a monopoly business to recognize the impact of their performance on consumers needs to be measured.

Consumers do move between jurisdictions. If there is the ability of one supply side business to be able to measure its performance differently to another creates confusion and has a cost impact. One of the key factors underpinning the move to national regulation is for there to be a consistent method of measuring performance of regulated businesses, regardless whether this relates to the service they sell or the way they manage their affairs with consumers. Already jurisdictional regulators have instituted a range of standards across a number of different businesses, all of which have a common method of measurement so the principle of a national approach need only be an extension of the current jurisdictional approach.

**The principle of having a national set of defined service measures for business performance, reliability and quality of supply is supported.**

*If so, what are the appropriate measures and are there any issues specific to a particular jurisdiction that might preclude the adoption of these measures? [Note: This is not to be taken as suggesting that the same empirical service standards should be imposed on each retailer or distributor.]*

By its very nature, a regulated business is not subjected to the usual pressures of competition. The only way to ensure that the business responds to the needs of the consumer is for its performance to be compared to its equivalents. The importance of setting performance standards cannot be over stated as this is the only way any pressure can be placed on a regulated business for it to act as if it has competition for its services. It is competition which drives the cost of the

service provision down, and the quality of the service provision up. Competition by comparison is essential.

There are many measures used by both regional and national regulators for measuring and monitoring performance of regulated and licensed businesses. These were developed in each jurisdiction, often by the active involvement of suppliers and consumers. Of major concern is that the actual performance of a business might not be measured in the way that meets the needs of consumers, and therefore the business might need to record its performance in more detail or install additional equipment. As this has a financial impact there needs to be a balance between cost and the extent of the performance measures. This can only be developed in an environment where businesses and consumers can contribute to the development of such measures.

In many cases the performance of one business in the supply chain have a major impact on another business in the supply chain, and thus the performance measures also are of vital interest to others in the supply chain; such issues also need to be examined.

**It is recommended that the AER be required to convene a working group of regulators, suppliers and consumers.**

The supply of both gas and electricity are now considered essential services, and there is an expectation of consumers that both will be provided to suit the needs of the consumer at all times. As the consumer has little understanding of the issues affecting the supply chain, the most useful performance measures are those which reflect the supply at the point of consumption. If a consumer is regularly losing supply it is of little comfort to know that across the system, the supply standard might be high.

Thus as a starting point the type of performance measures that consumers need to see are:-

- The time the supply is within a usable range (ie no outages, dips or spikes)
- Frequency of outages, dips and spikes
- Duration of outages
- Time to re-establish supply
- Time to return requests for information, costings and estimates
- Promptness of attending to concerns

### **Issue 27 – Determination of Service Measures and Targets**

*Should the service measures used, and any related targets, be determined by the Australian Energy Regulator, the Governments or the Australian Energy Market Commission?*

The quality of service arises essentially from the regulatory bargain. If more funds are provided to a regulated business, the better the business can respond to the

needs of the consumer and others in the supply chain. Equally there comes a point where additional funding provides little additional quality of service – there is a trade off between increasing service quality and increasing costs.

Thus the most appropriate point where the balance between costs and service can be managed is during the determination of the funding for regulated business where its performance against agreed standards can be valued. This is carried out by the economic regulator – in this case the AER.

**The setting of performance measures, monitoring performance and setting targets is best managed by the economic regulator – the AER.**

### **Issue 28 – Use of Service Measures**

*Should the performance of electricity and gas retailers and distributors against any target levels for the relevant service measures:*

- *be published?*
- *constitute the basis for an incentive/penalty scheme?*

Competition by comparison requires two basic elements – a range of comparable businesses, and a method for measuring performance. If a business's performance is to be compared, then it requires the performance measures to be agreed and for the outcomes of the measurement to be available so that consumers can see that they are being provided with what they are paying for.

With such performance measures being made public, consumers are then able to make decisions regarding alternative solutions if they are concerned with the quality of service they are receiving. Such decisions might include moving to another location, providing their own standby supply or installing equipment to provide stability of supply.

Incentive regulation is the basis for the Australian regulatory regime. Unless there is an incentive for the business to make changes to improve its quality of service, it is less likely that any improvements will eventuate. In a competitive environment a business will enhance its service levels to either increase its market share or to prevent the loss of customers. Either way the competitive environment rewards the improvement of service and punishes the reduction of service.

Competition by comparison should have the same outcome. The best way to provide a competitive environment for a regulated business is to establish a penalty/bonus arrangement which rewards out performance and punishes under performance.

**Performance targets and achievements of the regulated businesses should be published and also provide the basis for a penalty/bonus scheme**



## OTHER FUNCTIONS OF JURISDICTIONAL REGULATORS

### Issue 29 – Transfer of Ancillary Functions to Australian Energy Regulator

*Which of the ancillary functions that the jurisdictional economic regulators currently perform in relation to electricity and gas retail and distribution regulation should be transferred to the Australian Energy Regulator?*

There are basically three types of activities which the jurisdictional regulators are required to manage

- Those activities which are directly related to the electricity and gas markets, which fall into the role of the AER acting as a national regulator and which have a national focus. Such activities would include involvement with a national disputes resolution scheme a national receiving reports from it (replacing the jurisdictional ombudsman schemes), “stepping in” when a licensee defaults in its duties, and approving safety net schemes with the retailer of last resort.
- Those activities which are directly related to the gas and electricity markets but have a jurisdictional focus such as reviewing the VENCORP charges, and establishing maximum retail price caps.
- Those activities which are essentially unrelated to the gas and electricity markets and should be managed by other regulators. Such activities include the IPART involvement in the NSW greenhouse scheme, dispute resolution between market participants, and between suppliers and consumers, and examining jurisdictional constraints on cross ownership.

The AER should only be involved with those aspects which have a direct relationship with ensuring the energy markets operate satisfactorily to the benefit of all consumers, and have an economic impact on the regulatory bargain. Such activities would include the relationship with the ombudsman scheme, “stepping in”, reviewing the VENCORP charges and ensuring the retailer of last resort scheme operates satisfactorily.

The AEMC should be involved with those issues which affect the national electricity and gas markets but do not impinge directly on the performance of the markets or those issues affecting the regulatory bargain. Such activities might include the setting of jurisdictional price caps.

Those activities outside direct involvement in the gas and electricity markets should be addressed by other regulators. Such activities such as the cross ownership rules might be managed by the ACCC, greenhouse programs by the jurisdictional regulator (eg a “slimmed down” IPART which still has to manage water and transport issues), and disputes between market participants by the courts or the new Energy Tribunal. Disputes between consumers and energy suppliers would be handled by a national ombudsman scheme.

*To the extent any of these ancillary functions (or any retail price regulation functions) are transferred to the Australian Energy Regulator, how should the costs of performing those functions be funded?*

Cost reflectivity underpins the national regulatory regimes. As such those costs which can be identified with providing a specific benefit to a specific user or class of users, should be levied on the beneficiary. Using this approach as a template, those costs which can be related directly to a specific jurisdiction, such as setting jurisdictional price caps should be recovered from the beneficiaries of such decisions.

### **Issue 30 – Provision of Advice to Governments**

*Will Governments still require the advice that is being provided to them by their jurisdictional economic regulators in relation to the electricity and gas industries?*

It is expected that from time to time jurisdictions will require advice relating to the energy markets. A case in point is the recent request for advice from the Victorian ESC regarding the “Significant Producers’ Legislation (SPL)” and whether it should be repealed.

*If so, will those regulators continue to be able to provide that advice once most of their electricity and gas retail and distribution regulation functions have been transferred to the Australian Energy Regulator?*

Whether the remaining elements of the jurisdictional regulators will have the capacity or competence to provide such advice is an issue that should be addressed by the jurisdiction at the time. However it should be remembered that the AEMC and the AER can provide such advice, or provide assistance to the jurisdictional regulator. For example in the case of the SPL, it might be agreed that the AEMC is the most appropriate body to undertake such an investigation.

### **Issue 31 – Impact of National Framework on Jurisdictional Regulators**

*To the extent that the existing jurisdictional economic regulators continue to have any functions to perform, will the removal of most of their electricity and gas retail and distribution regulation functions have an adverse impact on:*

- *their viability and their ability to perform those functions;*
- *their ability to attract and retain qualified staff;*
- *the regulatory expertise that they would otherwise gain from regulating a range of industries;*
- *consistency in the application of a regulatory principle across a range of industries; or*
- *their funding arrangements?*

There is no doubt that the major activities of the jurisdictional regulators have been their electricity and gas regulation functions. In some cases and at some time, the jurisdictional regulators have had only those functions. It is the

responsibility of each of the jurisdictions to assess the viability of their regulators after the electricity and gas functions have been transferred to the national regulator.

One of the concerns with the move to a national energy regulator has been its ability to attract and retain appropriately qualified staff, and to ensure that they have adequate experience of regulation in other disciplines. For the AER, this has been overcome by its close relationship with the ACCC and the streaming of staff through both organizations.

The AER has indicated that it might need to have staff located in each major jurisdiction. There is no reason why there is not a relationship between the AER and the jurisdictional regulators which provide a similar streaming as is anticipated between the AER and the ACCC.

## **OTHER ISSUES**

### **Issue 32 – Other Issues**

*Are there any other issues that are not canvassed in this Issues Paper that should be taken into account in the establishment of a national framework for electricity and gas distribution and retail regulation?*

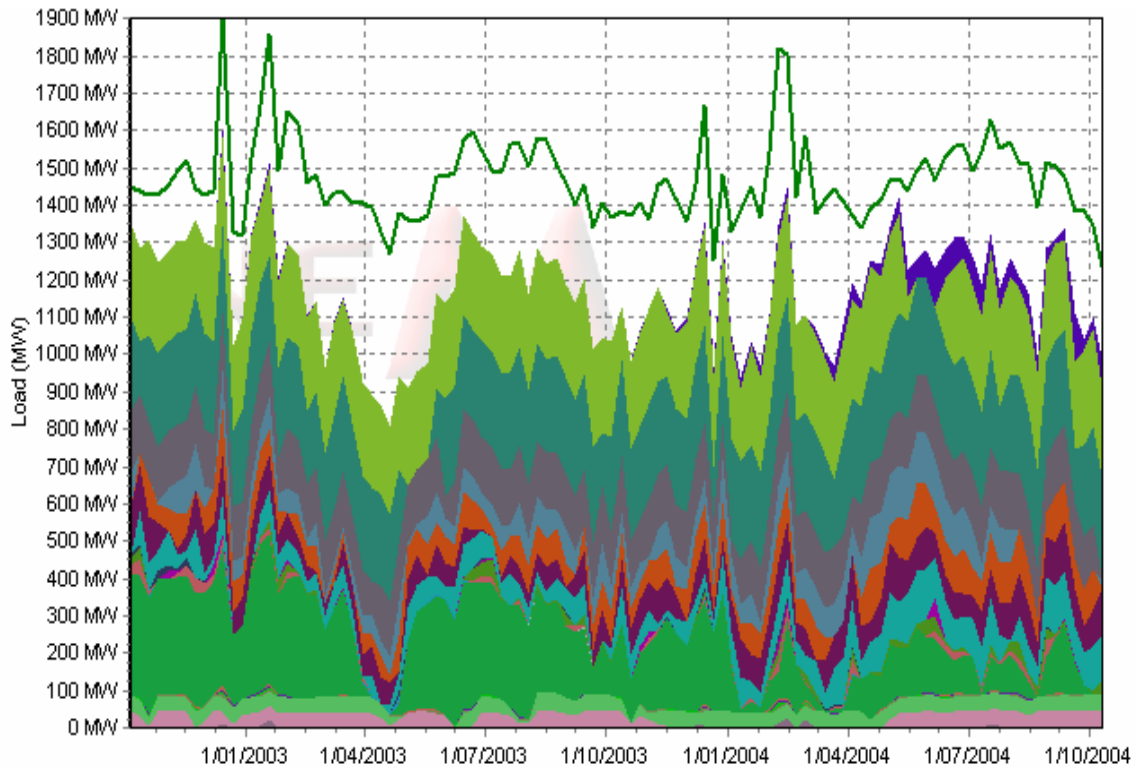
## Appendix 1

### **Analysis of South Australian and NSW regional demand/supply balance of electricity, and the proportion of indigenous electricity generated from gas.**

The SA region has the highest dependence on gas for generating electricity. Below is a chart showing for the past two years the average weekly demand in the South Australian region (green line) and (shown as stacked) all scheduled and dispatched generation in the region. This data is sourced from NEMMCo and presented by the NEM Review package. The chart shows that the SA region is a continuous importer of electricity.

The generation dispatch included in the stacked data includes the coal fired power stations of NRG and the gas fired stations of Osborne, Ladbroke Grove, Quarantine, Hallett, Pelican Point, Synergen and Torrens Island.

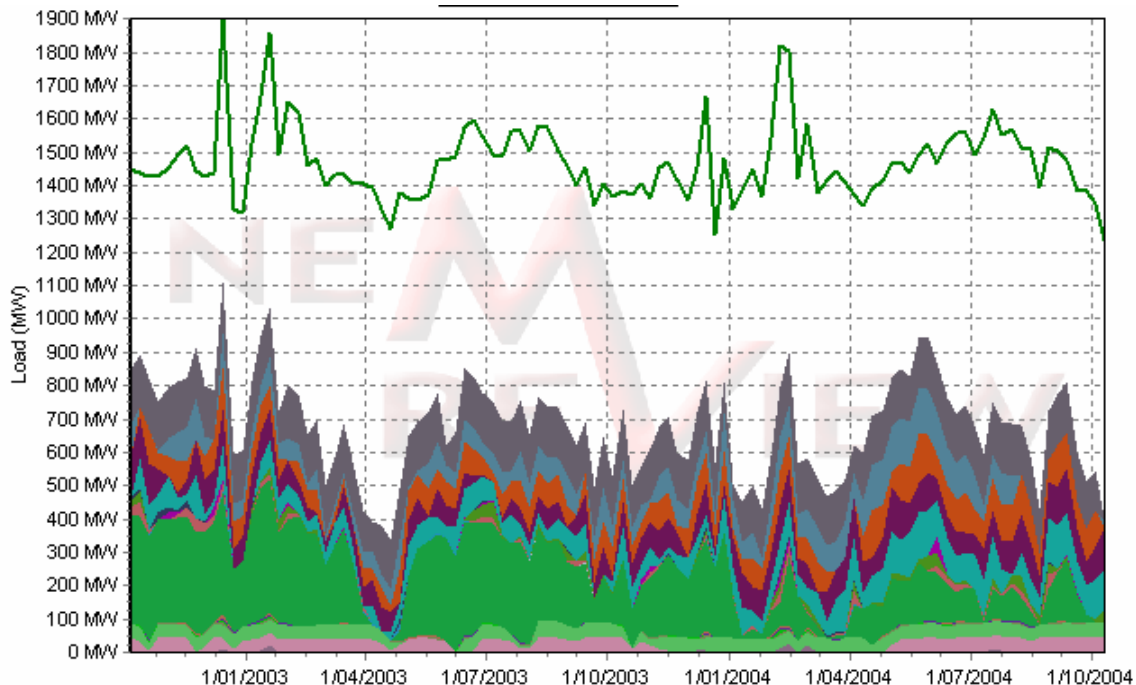
Figure 1 – Indigenous generation and demand SA region



The following chart shows the same data over the same period but deleting the generation based on coal (NRG's Northern Power Station units 1 and 2 and the aggregated output of Playford Power Station). This shows that at most the amount of electricity generated from gas in South Australia is about 50%. The

balance is sourced from coal either from the indigenous power stations or from Victoria where electricity is predominantly generated from coal.

Figure 2 – Gas fired indigenous generation and demand SA region



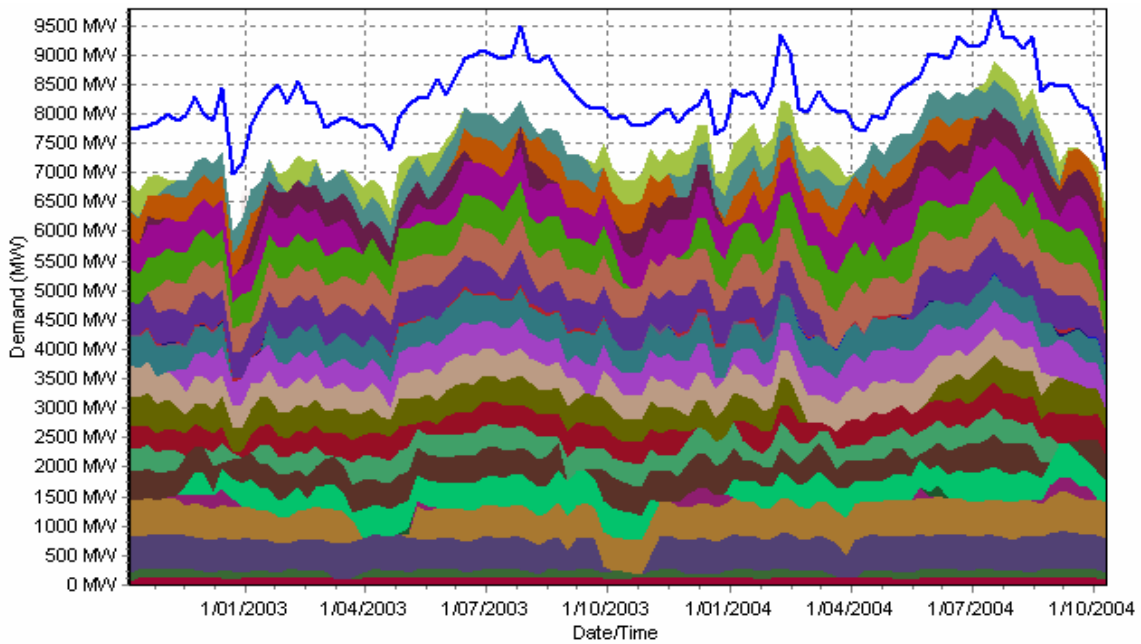
Thus, in the South Australian region there is as strong an argument for convergence of coal and electricity as there is for gas and electricity. Notwithstanding that the South Australian region is by the far the most dependent on gas when compared to all other regions in the NEM, there is still not a compelling case for there to be a “convergence” between gas and electricity in that region.

There is absolutely no case for such a convergence between gas and electricity in any other region.

By comparison, the equivalent usage of gas by NSW region (the largest in the NEM) is demonstrated in the following charts – figures 3 and 4. As can be seen NSW is also a net importing region (mostly from Snowy supplying hydro electricity) with some from Victoria (brown coal) and Queensland (black coal). Its use of gas for electricity generation is at most 2-3% of total generation.

This supports the view that there is a very modest use of gas for electricity generation throughout the NEM and therefore there is little reason to actively support the convergence of gas and electricity pricing.

Figure 3 – Indigenous generation and demand NSW region



These two charts include NSW regional demand (blue line) and all NSW regional generation (figure 3) and all gas fired NSW regional generation (figure 4) but excluded the electricity imported from Snowy, Queensland and Victoria.

Figure 4 – Gas fired generation and demand NSW region

