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Telephone 02 9922 0101

Facsimile 02 9957 3671

Industry Levy
C/- MCE Market Reform
GPO Box 9839
CANBERRA ACT 2601

**Ministerial Council on Energy Standing Committee of Officials
Application of the Industry Levy to fund the AER and AEMC:
Discussion Paper**

Dear Sir or Madam,

1. Introduction

The Australian Gas Light Company (AGL) welcomes the opportunity to comment on this discussion paper.

AGL has substantial interests across the Australian energy sector, including gas and electricity retailing, energy wholesaling, the ownership and operation of gas and electricity networks and interests in power generation. The discussion paper's proposals for the application of an industry levy to fund the the AER and AEMC would necessarily involve many aspects of AGL's total business.

2. Summary of AGL concerns

AGL's main concerns arising from the discussion paper are:

Consultation:

The current consultation is insufficient both in scope and time, leaving many important issues unresolved. AGL suggests that it is premature to discuss industry funding in detail until the AEMC and AER are fully established, and have taken over all their proposed responsibilities. AGL understands that a further discussion paper on the levy will be released (at an unspecified time) and such a paper should certainly address the major industry concerns arising from this consultation.

Cost recovery principles:

- It needs to be established that the total costs of regulation under the new agencies will less than today's total costs of regulation, as a result of the promised efficiencies from energy market reform;
- It would be inappropriate for industry to fund future activities of the AEMC and AER which are incidental or irrelevant to their primary purposes;



- An industry levy should take a medium term perspective, and not include start-up costs of the AEMC and AER, or current regulatory costs that are temporary and/or transitional in nature;
- Cost recovery structures must be as simple as possible, and not involve significant transaction costs.

Levy pass through:

As a matter of efficiency and equity, Australian jurisdictions must provide for full and transparent pass through of a levy from the regulated energy sectors to end users.

Regulatory performance:

It is important that the funding regime establishes a mechanism that results in continuous improvement in regulatory performance and the containment and control of regulatory costs.

These matters are expanded below.

3. Current consultation is too short to establish a levy

AGL observes that the current consultation timeframe to *establish the framework for the levy* is highly compressed. This is in marked contrast to the process described in the discussion paper for *review of the levy every three to five years*. Section 4 of the paper proposes a 10-step consultation process for periodic review, including several rounds of stakeholder consultation, multiple submissions and draft recommendations. All this would take many months - yet the current consultation to lock in a conceptual and practical framework for a levy lacks any such process. AGL strongly suggests that a more considered and timely consultation is required in this initial phase.

AGL suggests that it would be desirable to delay the implementation of a levy until major outstanding issues are fully resolved. In this regard, AGL welcomes very recent verbal advice in the consultation process that the AER will be funded from a budget allocation for 2004/05 and that the AEMC will be funded from levies already being collected to cover NECA's costs. AGL believes such arrangements are entirely appropriate and could be extended until AER and AEMC are fully established and the operating costs of both agencies can be quantified with sufficient certainty to determine a levy.

4. Cost recovery principles

The discussion paper begins with a presumption that financial efficiency would be promoted by "full cost recovery for the AEMC and AER" (page 6). The paper does not (as one might expect it to do) support the case for an industry levy with a preliminary assessment of the total costs of operating these agencies and some categorisation of their activities.

4.1 Total regulatory costs

If the regulatory framework envisaged by the MCE is fully implemented, the total costs of the AER and AEMC will eventually comprise:

- a) regulation presently funded by the public sector;
- b) regulatory activities which are currently funded (in whole or part) by industry;
- c) possible new activities.



It would have greatly assisted the current consultation if the discussion paper had provided (i) an estimate (however broad) of the total annual costs of running the AER and AEMC; and (ii) the costs of regulating the gas and electricity sectors today, based on a quantification of the costs of categories (a) and (b) above. Appendix A of the discussion paper presents some indicators of existing regulatory cost recovery across Australian jurisdictions but the information is inadequate to permit an estimate of today's total regulatory costs.

AGL submits that a guiding principle for recovery of AEMC and AER costs must be that the costs of regulation should be less under the new framework than they are today, given the efficiencies available from streamlining regulation. This would realise the commitments made in the 11 December CoAG report that economic regulation "must be made more efficient and streamlined" and that it "should be nationally uniform or consistent ---- (to) reduce the cost to business of operating across the markets" (page 8).

4.2 Activities of AEMC and AER which require industry funding

The AEMC will eventually subsume administration functions presently carried out by existing bodies for both the electricity and gas industries (eg NECA, NGPAC and the Gas Code Administrator). Yet there are indications that its proposed structure and operations will have some of the attributes of a high level policy body. The AEMC will be a statutory commission appointed by Ministers. The December 11 report to CoAG refers to the functions of the AEMC as including "undertaking reviews as directed by the MCE" and that "the AEMC's role in market development will be further developed by the MCE". In AGL's view, it would not be appropriate for industry to fund non-regulatory activities such as policy investigation and advisory initiatives, which may well include extensive consultant services.

Similarly, while the AER's initial role will encompass regulatory functions which are now funded by public sector budgets (such as the ACCC's regulation of electricity transmission) that role will expand over time and industry will need evidence that extraneous activities have not been incorporated into AER costs.

In this regard, the proposed Memorandum of Understanding between the ACCC, the AER and AEMC requires close examination. The ACCC will provide full staffing to the AER, and there will be "encouragement" of staff sharing between the ACCC and AEMC. Disclosure as to how "shared staff" costs will be made transparent and justified under these arrangements is required.

4.3 Start-up costs and other costs

The discussion paper proposes that industry should fund "fees to recover costs of extra-ordinary and one-off events, such as the set-up of the AEMC and AER and appeals to arbitration or legal appeals" (page 5). AGL considers that the recovery of start-up costs would be inappropriate for a number of reasons:

- such costs appear to be potentially "open ended" with no discipline available to ensure that least cost arrangements are implemented;
- industry will not be responsible for these costs, and there is no proposal to provide industry with a forum to have these costs substantiated and justified;
- unless the most careful controls were in place, there is a real danger that "start-up" costs will duplicate costs already recovered from industry via state licences. This is especially so, given that it is proposed to transfer current regulatory functions (eg distribution and part of retail) to the AER



over a number of years. To levy any costs now in anticipation of these functions – when there is still a possibility that they may be either not transferred, or transferred later than anticipated - is far removed from efficient pricing.

With regard to other one-off events, AGL does not believe that industry should be required to fund such activities unless some firm budget discipline is imposed on the new agencies (for example, with regard to legal fees). AGL suggests that one-off events that exceed the periodic budget allocation should be publicly funded.

4.4 Cost recovery structures

The discussion paper canvasses a number of very detailed cost attribution methodologies and charging structures. A preliminary estimate of the total costs of operation the AEMC and AER could well suggest how much effort needs to be expended in designing intricate cost recovery procedures.

In this regard, AGL urges that cost recovery procedures must be as simple as possible, having reasonable regard to equity and efficiency. It makes little sense to design and implement mechanisms which themselves could add markedly to regulatory costs, and thus costs to end users. As the discussion paper points out, “it should be recognised that ultimately, it is the end user who pays for all efficient costs in the supply chain” (page 10). Further analysis may indicate that total regulatory costs are best levied at an efficient point of collection (for example, the network) rather than dispersed completely throughout the chain. However, the fundamental principle to be observed is that regulatory costs must be completely passed through to end consumers without regulatory obstruction. This requirement is discussed in section 5 below.

AGL also submits that the (justifiable) costs of regulation for the gas and electricity sectors should be separately identified and applied – a position not inconsistent with the notion of separate “cost pools” proposed in section 3.1 of the discussion paper. As discussed, it is not yet clear what further degree of sophistication in cost attribution is required.

5. Levy pass-through issues

Electricity and gas prices to small retail customers are currently regulated in all jurisdictions. Some jurisdictions do not explicitly provide for a pass through of additional costs.

In such cases, the pass through of an industry-wide levy poses particular problems.

To now propose a new industry wide levy (involving transfer of much regulatory funding from the public to the private sector) will create difficulties for retailers operating under these kinds of price path regimes unless the additional costs can unequivocally be recovered from end users. Australian regulatory jurisdictions must allow full pass through of the levy – as they obviously should, given the stated intention that consumers will ultimately bear the cost of the levy.

6. Regulatory performance

It is important that the funding regime establishes a mechanism that results in continuous improvement in regulatory performance and the containment and control of regulatory costs.

In particular, the considerations in 4.2 raise the whole matter of financial responsibility by the new agencies and the exposure of their budgeting processes for industry comment. AGL believes that a mechanism is required which applies firm budget review and performance criteria which involves both government and industry.



7. Further information

If there any queries arising from matters in this submission, please contact Jane McAloon, Group Manager External Affairs and Regulation, AGL.

Yours faithfully

*Unsigned electronic copy
Original sent by post*

Jane McAloon
Group Manager External Affairs and Regulation

