

Ministerial Council on Energy

Energy Market Reform Bulletin No. 56

Expert Panel Review of Revenue and Network Pricing across the Energy Market

At its meeting in Hobart on 4 November 2005, the Ministerial Council on Energy (MCE) agreed, as part of its response to the Productivity Commission Review of the Gas Access Regime, to establish an Expert Panel to advise on a model to achieve a common approach to transmission and distribution revenue and network pricing across electricity and gas.

As foreshadowed in MCE Bulletin No. 53, the Council has appointed Roger Beale AM, as Chair of the Expert Panel. Mr Beale is a Senior Associate of The Allen Consulting Group, former Head of the Commonwealth Department of Environment and Heritage and a key player in the development and implementation of the National Competition Policy Principles Agreement. The other members of the Panel are: Greg Houston, Director, NERA Economic Consulting, Paul Kenny, Partner, Allens Arthur Robinson and Euan Morton, Principal, Synergies Economic Consulting. Mr John Tamblyn, Chair of the Australian Energy Market Commission, has been appointed an observer to the Panel.

The Panel's principal role is to develop a common set of arrangements for economic regulation of electricity and gas transmission and distribution networks. In fulfilling this role, the Panel will consider pricing principles, regulatory guidance/discretion and any associated changes to established regulatory processes. The Panel's terms of reference are at Attachment A.

The Panel proposes to release a draft of its findings for public comment in early February 2006. However, in order to inform its deliberations, the Chair has indicated that the Panel would welcome early submissions from stakeholders on any of the issues raised in the terms of reference. In particular, the Panel would welcome early submissions and comments on:

Distinction and Commonality

- The extent to which technology, market circumstances or other differences between the electricity and gas sectors (and transmission and distribution within each sector) may best be reflected within a common regulatory framework and whether, and if so how, distinctions need to be reflected in separate provisions;

Possible Alternatives to Current Regulatory Methodologies

- The scope of regulation (ie services to be regulated, service definitions, reliability mechanisms etc);
- The extent to which it is feasible, and appropriate, to develop alternatives to the building blocks methodology (such as Total Factor Productivity analysis) and the circumstances in which they may be appropriate;

- Related to the above is the guidance appropriate on the form of the control over prices, including the relative merits of capping *prices* versus capping *revenue* and the circumstances in which each is most appropriately applied; and
- Furthermore, an important matter for the Panel will be to identify the economic principles (for example the relative weights to be attributed to allocative, dynamic and productive efficiency; the trade off between the risks and costs of regulatory failure versus the risks and costs of market failure) that should govern the consideration of these matters, and the implications to be drawn from those principles for the different sectors;

Regulatory Discretion

- The level of regulatory discretion/guidance that should be provided to the Australian Energy Regulator when setting or assessing regulated prices and to the Australian Energy Market Commission when assessing changes to the 'Rules' for electricity and gas. In particular, the Panel will need to arrive at a view on the extent to which, and the level at which, common or differentiated principles should be:
 - included in the National Gas Law;
 - included in the initial version of the new National Gas Rules, and permitted or required in future changes to those initial Rules (i.e. guiding the Australian Energy Market Commission's consideration of future rule changes);
 - contained in any Statement of Policy Principles for gas that is issued by the Ministerial Council on Energy; or
 - included in any consequent amendments to the National Electricity Law, proposals for changes to the National Electricity Rules, and/or any Statement of Policy Principles for electricity that is issued by the Ministerial Council on Energy.

The closing date for submissions is close of business 22 December 2005.

The Panel recognises that it is calling for submissions in a short timeframe and assures stakeholders who are unable to comment within this time frame that there will be opportunity to comment on the Panel's draft report in early February 2006.

Submissions should be addressed to:
 Manager, MCE Secretariat,
 Department of Industry, Tourism and Resources,
 GPO Box 9839, Canberra, ACT 2601.
MCETMarketReform@industry.gov.au

MCE Standing Committee of Officials
 7 December 2005

Expert Panel Review of the Guidance for a National Approach to Economic Regulation for Energy Transmission and Distribution Network Access

Terms of Reference

November 2005

Review of Revenue and Network Pricing across the Energy Market

Background

The Ministerial Council on Energy (MCE) agreed on 4 November 2005 to establish an Expert Panel to advise on a model to achieve a common approach to revenue and network pricing across the energy market.

The MCE released on 9 November 2005 a draft decision paper on the national gas access regime. The draft paper was prepared by officials and released for consultation prior to the MCE making a final decision by 7 December 2005. The draft paper included proposed terms of reference for the Expert Panel. The MCE will settle the terms of reference for the Panel as part of the MCE's decision on the national gas access regime. Any difference between this work and the Terms of Reference out for consultation depends on the extent to which the Productivity Commission's recommendations on the Gas Access Regime are accepted or modified on 7 December.

The Panel should note therefore that the final decision on the gas access regime may amend the scope of the Panel's work.

Role of the Expert Panel

The principal role for the Panel is to develop a common set of arrangements for economic regulation of access to electricity and gas transmission and distribution networks, covering:

- Pricing principles;
- Regulatory guidance (ie, how the principles are applied, the extent of the regulator's discretion, and related matters); and
- Any associated changes necessary to established regulatory processes (ie, the steps in the assessment process, timelines, etc.).

The Panel should provide a final Report to the MCE giving high level policy guidance and recommendations on pricing principles and regulatory methodologies suitable for inclusion in a national energy access regime.

Relevant matters for consideration

The Panel should note that a key objective of the MCE's energy market reform program is to ensure that, where the decision has been made to impose price regulation, costs are kept to a minimum while maintaining the effectiveness of regulation in achieving the objectives of the National Electricity Law (NEL) and National Gas Law (NGL). In determining a common approach to revenue and network pricing, it will be important to consider what high level direction should be given to the regulator and whether this should be in the law or in the rules.

The Panel should note also MCE decisions that in performing or exercising any economic regulatory function or power (which includes but is not limited to revenue and network pricing), the Australian Energy Regulator (AER) will be required to perform or exercise that function or power in a manner that will, or is likely to contribute to the achievement of the national electricity market objective (see s. 16(1)(a) of the NEL) or gas access objective (a similar requirement is likely to be imposed in the proposed National Gas Legislation).

The Panel should note also that the MCE has agreed that part of the common approach to energy access under the *Trade Practices Act 1974* will be that the national electricity and gas access regimes will be certified under s. 44N of the *Trade Practices Act 1974* and will remain effective access regimes. The criteria on whether a regime can be certified are in clause 6 of the Competition Principles Agreement. Further to the Australian Government's response to the Productivity Commission's Review of the National Access Regime, the Trade Practices Amendment (National Access Regime) Bill 2005 will make the proposed objects clause of the National Access Regime relevant for certification. The Australian Government's response to that Review also proposes inclusion of the pricing principles for the National Access Regime in the criteria for certification in the Competition Principles Agreement. Consequently, the Panel's work should consider how the revenue and network pricing principles can be applied to the energy sector in a workable and appropriate way such that certification requirements can be met.

Matters for review

In undertaking the review of revenue and network pricing, the principal objective for the Panel should be to develop appropriate criteria for determining the level of prescription in the law and subsidiary rules for a common energy access pricing model.

The Panel's advice should include the scope for the law and statutory rules on access pricing to be common across all electricity and gas transmission and distribution. The advice should identify those areas where technology, market circumstances or other factors may necessitate distinctions between electricity and gas and/or between transmission and distribution sectors.

Matters to be addressed in developing the Panel's advice should include:

- The form of price control and guidance;

- CPI-X building block revenue control;
- Potential alternatives to the building block methodology, including TFP and an evaluation of the circumstances in which each methodology may be appropriate;
- Incentive arrangements for reliability;
- The scope of the regulator's discretion (including propose/respond models);
- The scope of regulation (ie services to be regulated, service definitions, reliability mechanisms etc);
- Regulatory procedures; and
- The appropriate scope of the regulator's information gathering powers for economic regulation.

The Panel's report in making recommendations on these issues should also provide the MCE with specific proposed responses to any recommendations of the Productivity Commission's Review of the Gas Access Regime which are explicitly referred to the Panel in the MCE response.

Relevant Considerations

The MCE's objective is consistency and harmonisation between the electricity and gas access regimes such that investment in, and use of, energy is not distorted by differing regulatory regimes. With this aim in mind the Panel should take into account all of the relevant existing access models, related reform programs and recommendations in relevant reports. Relevant reports include:

- The recommendations and findings of the Productivity Commission's Review of the Gas Access Regime, and the MCE's response to those recommendations;
- The recommendations and findings of the Productivity Commission's Review of the National Access Regime, and the Australian Government's response to that review and the provisions of the Trade Practices Amendment (National Access Regime) Bill 2005;
- The objects clause and pricing principles proposed for the National Access Regime and the certification criteria;
- The recommendations and findings of the Parer Review;
- The Gas Pipelines Access Law and the current Gas Code;
- The NEL and the current National Electricity Rules;
- The work undertaken by the MCE on extending a national framework for energy access to electricity and gas distribution and retail (other than retail pricing);

- The AEMC's current review of the rules for the economic regulation of electricity transmission;
- The AER Compendium of Transmission Guidelines;
- The ACCC's Statement of Regulatory Principles;
- Australia's Export Infrastructure (Report to the Prime Minister by the Exports and Infrastructure Taskforce May 2005);
- NECA transmission and distribution pricing reviews and related ACCC authorisations;
- The *Electricity Networks Access Code 2004* developed under the *Electricity Industry (Western Australia) Act 2004*; and
- The Victorian Essential Services Commission's research into the measurement of TFP for electricity distribution, the analysis and quantification of the incentive power of alternative regulatory regimes and the implementation issues associated with indexing.

For the purpose of its review, it is not intended that the Panel revisit the following matters:

- the objects clause currently contained in the NEL and the proposed objects clause for the National Gas Law as set out in the MCE paper for public consultation on the Government Response to the Productivity Commission's review of the National Gas Access Regime (except to the extent that a single but equivalent objective could cover the whole energy sector). Should the MCE agree to an alternative objects clause, the implications of this change would need to be considered;
- the MCE's response to the Productivity Commission's Review of the Gas Access Regime including any measures to increase regulatory certainty for greenfields projects (when agreed);
- the existence of the current coverage test for gas infrastructure;
- the certification criteria under Section 44N of the *Trade Practices Act 1974*;
- the MCE's decisions on the availability of review mechanisms in the gas and electricity regulatory frameworks (when agreed); and
- the enforcement provisions as set out in the NEL and already drafted for the NGL.

Process and Timing

The Panel is requested to develop a draft report on the matters in these terms of reference for public consultation in early February 2006 and a final report to the MCE in early March 2006.

This timeframe is to meet the MCE timetable for the development of the national gas legislation in the first half of 2006. At this time, the NGL has been scheduled for public exposure by the end of March 2006. The Panel will be kept informed of any amendments to the timing of the NGL.
