



**National Framework for Electricity and  
Gas Distribution and Retail Regulation**

**Submission to the Ministerial Council on Energy**

**from**

**CitiPower and Powercor Australia**

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## Attachment 1

## Executive Summary

- 1 Powercor Australia and CitiPower endorse the submission made by the Energy Networks Association (**ENA**) on the Ministerial Council on Energy Standing Committee of Officials (**MCE**) Issues Paper 'National Framework for Electricity and Gas Distribution and Retail Regulation' (**Issues Paper**). This submission should be read as supplementary to the ENA submission.
- 2 This submission seeks to examine the apparent failure of the Issues Paper to address threshold issues for a truly national regulatory framework, in favour of a review of current jurisdictional regulatory issues. Powercor Australia and CitiPower are also concerned to obtain greater detail of the MCE regulatory reform process and timing, to better allow them to respond appropriately to this process.
- 3 Threshold issues that we consider need to be addressed by the MCE in considering a national framework of regulation include:
  - How does the proposals for regulation of electricity distribution networks fit within the context of the existing legal framework for access to services provided by essential facilities under Part IIIA of the Trade Practices Act 1974 (TPA)?
  - How is the proposed convergence between electricity and gas regulation to be achieved within the structure of Part IIIA, particularly in the light of the fact that gas has followed the 'effective access' regime approach while electricity has adopted the provider 'access undertaking' approach under Part IIIA? and
  - What overriding criteria are to be applied by the MCE for assessing the effectiveness of any proposed new framework.
- 4 This submission raises concerns with the proposed mere 'conversion' of the National Electrical Code (**NEC**) into statutory rules and discusses why this approach may:
  - carry the existing Code provisions covering access (Chapter 5&6) outside what can be seen as a voluntary access undertaking under either s. 44ZZA or s. 44ZZAA Trade Practices Act; and
  - not achieve the stated aim of avoiding the need for authorisation of the NEC by the Australian Competition & Consumer Commission (**ACCC**).
- 5 We conclude that to achieve a single national regulatory regime it is necessary for the approach adopted in the context of Part IIIA TPA to be the same. We suggest that with the proposed transition of the NEC to National Electricity Rules (**NER**), it is no longer appropriate to use the industry access code / access undertaking route, as the NER are not a voluntary access undertaking put forward by an industry body, but are rules comprising a statutory instrument.
- 6 The proposed form of regulation, statutory rules applied by application legislation in each participating jurisdiction, is consistent with the legislative 'effective access regime' approach under Part IIIA as has been used for gas access regulation. We

therefore propose that this be the regulatory approach that should be adopted by the MCE for creation of a harmonised energy access regime.

- 7 If this approach is adopted we suggest that the MCE need not 'reinvent the wheel' and should be informed by the recent Productivity Commission reviews of Part IIIA and of the Gas access regime. This would involve adopting the 'effective access' regime approach under Part IIIA for electricity access and should include adoption of the 'propose/respond' access model currently used for gas access regulation, rather than the more interventionist and costly NEC access model.
- 8 This approach has the benefits of:
  - Streamlining the regulatory process by avoiding the need for ACCC approval of the NER as an access undertaking;
  - avoiding or reducing the need for authorisation by the ACCC under Part VII TPA (being a legislative access regime, rather than an access undertaking agreed by providers, the exposure to Part IV will be commensurately reduced);
  - Achieving a single regulatory access model which applies equally to electricity and gas access, thereby achieving more efficient regulation;
  - Addressing current shortcomings in the NEC and current inconsistent jurisdictional distribution price regulation arising from multiple and universal derogations from the NEC.
  - Being a more light handed form of regulation with lower regulatory costs.
- 9 We also include some initial comments on the crucial importance of merits review, particularly in the context of regulatory price determinations, pending the formal process of consultation we understand will occur in relation to this issue. In particular we refer to the negative effect on investment of any removal of merits review in relation to key regulatory decision making such as price determinations.

## Introduction

- 10 Powercor Australia and CitiPower welcome the opportunity to respond to the MCE National Framework for Electricity and Gas Distribution and Retail Regulation Issues Paper (**Issues Paper**). This submission is in addition to Powercor Australia's and CitiPower's participation and endorsement of the submission made by the Energy Networks Association.
- 11 This submission focuses upon threshold structural and conceptual issues arising from the design and implementation of a national framework for electricity distribution and particularly the need to revisit the basis for access regulation of electricity distribution in order to achieve consistency with gas regulation and best regulatory practice.
- 12 Powercor Australia and CitiPower are supportive of the CoAG agreed objectives for energy market reform described in the Australia Energy Market Agreement (**AEMA**). Relevant objectives include:
- (a) the promotion of the long term interests of consumers with regard to the price, quality and reliability of electricity and gas services; and
  - (b) the establishment of a framework for further reform to:
    - (i) strengthen the quality, timeliness and national character of governance of the energy markets, to improve the climate of investment;
    - (ii) streamline and improve the quality of economic regulation across energy markets to lower the cost and complexity of regulation facing investors, enhance regulatory certainty, and lower barriers to competition; and
    - (iii) enhance the participation of energy users in the markets including through demand side management and the further introduction of retail competition, to increase the value of energy services to households and businesses.<sup>1</sup>
- 13 Powercor Australia and CitiPower are however concerned that the Issues Paper appears not to seek to address the 'big picture' regulatory structure and convergence issues so as to achieve these stated aims and rather appears to base much of its discussion upon aspects of the existing jurisdictional gas and electricity regimes.
- 14 We believe that this approach will not foster the expressed objectives of CoAG or the MCE. In particular we consider that the first step in developing any national framework for energy regulation must be putting in place a legal structure and core criteria that are designed to further the stated aims.
- 15 This submission therefore selectively responds to some of the questions asked in the Issue Paper and in doing so addresses some of these regulatory structural issues

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<sup>1</sup>Ibid, pp ii-iii

and suggests an approach for achieving a true national energy market. We do this by giving an overview of the existing regulatory regimes in the context of the existing framework for access regulation, Part IIIA TPA. We then provide some commentary on the need for core criteria for any regulatory regime in the context of providing regulatory certainty and flag some transitional issues in ensuring regulatory certainty.

- 16 Responses to selected relevant questions in the Issues Paper are shown in boxed text at the conclusion of relevant part of this submission.
- 17 The final section of this submission addresses the importance of merits review in the context of any best practice regulatory regime.

## Existing Regulatory Regimes

- 18 The Productivity Commission (**PC**) in its 2004 *Review of Gas Access Regime* examined the differences between gas and electricity markets.<sup>2</sup> As this was a detailed a recent review, to which energy industry participants made a number of submissions, we suggest that this is the best source of current views on energy regulation.
- 19 The major differences between electricity and gas industries were identified as:
- extent of government ownership in transmission, distribution and production
    - electricity: government ownership remains widespread
    - gas: private ownership predominates
  - extent of horizontal concentration of transmission and distribution within a region
    - electricity: highly concentrated
    - gas: quite high concentration in local distribution; less so in transmission
  - market size and maturity
    - market size much larger for electricity than gas
    - electricity: ubiquitous supply to business and residential consumers
    - gas: large share of primary energy market in South Australia and Western Australia mainly for industrial and commercial use; widespread residential use in Victoria and ACT
  - market operation

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<sup>2</sup> Productivity Commission 2004, *Review of Gas Access Regime*, Report no. 31, Canberra, pp 520-523

- electricity: independent system operator of compulsory spot market across eastern states
    - gas: independent system operator only in Victoria
  - energy production and generation
    - electricity: flexible primary energy source (fuel mix) and location of generation
    - gas: source determined by gas field location
  - transportation technology
    - electricity: requirement for instantaneous balancing of supply and demand
    - gas: slow response to demand changes.
- 20 It was however acknowledged by the PC that as the gas market expands, it is becoming more integrated into the total energy market. Gas competes directly with electricity in the supply of energy to households and industries and provides an increasingly important source of energy in the generation of electricity.
- 21 VENCORP in its submission to the Productivity Commission noted:
- It is clear that the reliability of electricity supply and the smooth operation of the National Electricity Market ('NEM') are increasingly dependent on gas fired power generation in the future. (sub. 23, p. 2)
- 22 A current example of this transition is the reported proposals by Origin Energy to develop a number of base load gas fired generators in the eastern States. This ongoing convergence between electricity and gas has been recognised by CoAG and the MCE, as has the corresponding need for the regulatory regimes applying to gas and electricity to similarly converge.
- 23 At the present time the differences in regulatory arrangements are clearly a factor in constraining market convergence, particularly as the regulation of the terms and conditions of access have an important impact on risk and investment decisions and generally upon the effectiveness of the regulation.
- 24 Submissions to the PC Review and the PC Report detail these differences as follows:
- 'The eastern states is characterised by a reasonably transparent, centralised, real-time, wholesale pool market. Western Australia is soon to develop a pool mechanism. Wholesale power is purchased by retailers and aggregators who hedge risk exposures through financial instruments. Transmission and distribution network usage is determined by the physics of electricity flow.
- The gas industry on the other hand operates without a centralised trading and price making market (with the exception of Victoria). Gas purchases continue to be mostly large long-term block trades, with upstream producers dealing almost exclusively with

retailers and aggregators rather than end-users. Gas sales agreements are typically associated with 'back-to-back' transportation agreements with transmission and distribution owners. (sub. DR101, appendix H, p. 3)

The maturity and interconnectedness of the electricity market in the eastern states of Australia favoured the development of a wholesale (gross pool) spot market for electricity managed by a central system operator, the National Electricity Market Management Company. The market rules are embedded in the National Electricity Code. The AEMC must seek authorisation of rule changes that raise competition issues from the ACCC under part VII of the TPA.

Bilateral contracting is the norm for the Australian gas market with no involvement of an independent system operator, in contrast to the National Electricity Market. For most of the Australian gas market, there is no requirement for ACCC authorisation of market rules under part VII of the TPA.

However, in Victoria, which has a more mature, dense and interconnected gas market than the rest of Australia, there is a limited wholesale (net pool) spot market operated by an independent system administrator (VENCORP). The spot market generates a market price for gas and facilitates the balancing of gas flows in the pipeline network. As noted by VENCORP:

The Victorian wholesale gas spot market is fully integrated with the operation of the PTS [Principal Transmission System], with scheduling of the range of available gas injections to balance demand being determined on the basis of offers made in the spot market. (VENCORP 2003, p. 14)

VENCORP operates under Market and Systems Operations Rules authorised by the ACCC under part VII of the TPA. As with the National Electricity Market, the ACCC might be required to authorise rule changes that affect competition. A major review of the Victorian gas spot market pricing and balancing arrangements is nearing completion (see VENCORP, sub. DR106 for more information).'

- 25 Many of these differences are however primarily historical or reflect the different physical characteristics of gas and electricity. These differences are substantially addressed by different market arrangements as discussed below. The key common feature of the gas and electricity markets is, however, their reliance on fixed infrastructure of transmission and distribution networks and the natural monopoly characteristics common to these network assets. The regulatory 'solution' to addressing any potential for market failure arising from these characteristics therefore can be, and should be, a common one. The primary regulatory issue to be addressed with respect to service provided by infrastructure with natural monopoly characteristics is terms of access, including access pricing.

### Regulatory Context

- 26 Access to 'essential services' is governed in Australia by Part IIIA Trade Practices Act 1974 (Part IIIA). Part IIIA provides essentially three avenues for an access seeker:
- Seeking 'declaration' of the services provided by the infrastructure by National Competition Council (NCC) via recommendation to the relevant

Minister; following which an access dispute can be arbitrated by the ACCC under the terms of Part IIIA;

- A State or Territory putting in place an 'effective access regime', once this has been endorsed by the NCC, such regimes supplant the terms of Part IIIA; or
- Infrastructure owners (providers), or Industry bodies representing providers, offering an access undertaking to the ACCC which, once accepted, supplants the terms of Part IIIA. Undertakings are by nature voluntary and require approval and acceptance by the ACCC under Part IIIA of the TPA. Undertakings do not require ministerial approval.

27 Gas access is regulated under the 'effective access' regime approach with the Gas Code being adopted by each participating regime under application legislation and being endorsed by the NCC. Electricity however took the 'access undertaking' route, with the National Electricity Code being drafted by industry participants and submitted to the ACCC as an industry access Code.

28 The PC suggests that the integration of the electricity market in eastern Australia, together with the relatively high level of ownership concentration of transmission networks within states, might have contributed to the adoption of a Part IIIA industry undertaking as the regulatory instrument for access regulation. While the more disaggregated private ownership and less mature development of the gas infrastructure may be the reason for adoption of the 'effective access regime' approach.

29 Regardless of the original reason for this divergence, Powercor Australia and CitiPower submit that this, the fundamental basis for access regulation, must be brought into conformity as a pre condition for the establishment of a truly national energy market. For the reasons given below we consider that the access undertaking approach for electricity regulation does not meet the requirements of a national energy market and therefore we propose that the 'effective access regime' approach utilised for gas regulation be adopted with the National Electricity Law being the legislative vehicle for this to be achieved.

## **Analysis of the Code and Gas Code approaches to Access in the context of the MCE process**

### **Electricity Code**

30 We understand that it has been proposed that the existing Code be converted to statutory rules under the National Electricity Law. The main reason for this proposal appears to be a desire to streamline the existing Code change process by removing the requirement to seek authorisation from the Australian Competition & Consumer Commission (**ACCC**). Powercor Australia and CitiPower support the need to streamline this process, but have serious concerns regarding a proposal to achieve this by effectively 'enacting' the Code.

31 First, as noted above, the Code has currently been approved by the ACCC as an access undertaking under Part IIIA, as well as having been authorised by the ACCC under Part VII TPA. Converting the Code to rules will remove any vestiges of voluntariness from the access provision of the NEC and arguably it can no longer be treated as a service provider 'undertaking' as envisaged by Part IIIA. It may therefore be ineffective as an access code and, by default, allow third parties to seek access under the Part IIIA declaration process.

32 Secondly, we believe the result sought to be achieved by this approach is unlikely to be achieved. The advice provided by to the MCE by Noel Hutley of Senior Counsel dated 5 August 2004, is that converting the Code to rules will reduce the likelihood of conduct that may constitute a breach of Part IV of the TPA and therefore may avoid the need for authorisation of the code and code changes by the ACCC. This advice is however clearly qualified by its authors as being predicated upon :

- Amendments to the Code to remove aspects of market participants discretion; and
- As being based upon limited examples of conduct under the Code that do not include those Code provision that require market participants to enter into new arrangements.

33 The advice also makes it clear that converting the Code to rules will not necessarily avoid the need for authorisation where the conduct that may contravene Part IV TPA is unilateral (rather than collusive) conduct.

34 Powercor has sought legal advice on the implications of the approach proposed in the light of the Noel Hutley SC advice. This advice indicates that the stated preconditions relied upon by Senior Counsel in the advice to the MCE may not be met. A copy of this advice is **Attachment 1**.

35 Powercor Australia and CitiPower are of the view that the need for frequent authorisation of changes to the NEC could be more easily avoided by identifying whether a particular change will involve market participants in conduct not covered by the existing authorisation. Only if the answer is 'no', it would not be necessary to seek authorisation of that amendment.

36 This more limited approach to authorisation of industry codes has been utilized in other instances, such as with the recent authorisation of the Retail Energy Market Company's (REMCO) gas market rules for South Australia and Western Australia, where only those parts of the market rules that created a identifiable risk of contravention were put to the ACCC for authorisation, and similarly only when those portions of the rules that create such a risk are amended will further authorisation be sought. This is considered to be a better approach than the automatic seeking of re authorisation of the market rules consequent upon any amendment, whether or not that amendment had competition implications.

37 However, if the MCE does not wish to adopt the above proposal to retain the NEC as a voluntary Code while limiting the authorisation applications to areas where a clear risk of contravention of Part IV exists, we note that the proposal to embody the regulatory requirements for access in State based cooperative legislation, is really

adoption of an approach that (in the context of Part IIIA) fits that of an governmental 'effective access' regime and not a voluntary access undertaking by providers. This being the case, we suggest that the MCE not artificially attempt to preserve the NEC's access provisions as an access undertaking by providers, and instead seek to apply these provisions as an effective access regime for the purposes of Part IIIA.

38 A further concern with the proposal to convert the existing NEC to statutory rules is that the portions of the code dealing with access, Chapters 5 & 6, have not been reviewed or substantially amended since they were drafted by a committee comprised of various industry representatives in the mid 1990s. These chapters of the Code were drafted with an electricity transmission focus and do not apply wholly to distribution in any jurisdiction, as most jurisdictions have derogated from these provisions of the Code. It therefore will be necessary to review these provisions carefully, with industry consultation, before they can be strictly applied under any new national regulatory regime.

### Gas Code

39 Unlike the Electricity Code, the Gas access regime has current application and recently has been subject to a detailed and exhaustive review by the Productivity Commission. This review has resulted in recommendations that we consider should also be considered in relation to the access regulation of electricity.

40 In its review of the Gas Access Regime, the Productivity Commission Inquiry Report (**PCIR**) recommended the following considerations be taken into account:<sup>3</sup>

- Pricing and non-pricing aspects of monopoly and competitive market behaviour.
- Different roles and requirements of transmission and distribution networks.
- The need to maintain an appropriate balance between investor, asset operator, gas producer and current and future gas consumer interests.
- Certainty, transparency, timeliness and accountability requirements for regulated network services, compliance costs, and appropriate incentives for longer term efficiency and productivity improvements.
- Economic and regional development, environmental, energy security, fuel choice, financial risk management and business competitiveness considerations.
- Consistency with Part IIIA of the *Trade Practices Act 1974*, in particular with relation to the objects clause and pricing principles.

41 The PC also developed a set of objectives and pricing principles which emphasised:

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<sup>3</sup> Productivity Commission 2004, *Review of Gas Access Regime*, Report no. 31, Canberra, pp v-vi

- promoting economically efficient investment in and use of infrastructure consistent with promoting 'effective' competition in other markets
- regulated tariffs generating expected revenue 'at least' sufficient' to meet efficient costs
- returns on investments being commensurate with the commercial and regulatory risks involved
- regulated tariffs providing incentives to reduce costs or improve productivity.

42 The PC further highlighted the costs of access regulation and proposed ways in which this could be reduced by adoption of lighter handed regulation. National Economic Research Associates (NERA), in a report prepared for the Victorian Essential Services Commission (ESC), described lighter handed regulation as those that:

... place less emphasis on reducing efficiency loss from prices being above costs (and so may involve greater rents), for the potential benefit of reducing administrative or other forms of efficiency loss arising through the conduct of regulation. (NERA 2004, p. 5)

43 The PC identified potential advantages of light-handed regulation as that it<sup>4</sup>:

- imposes lower compliance costs on regulated companies
- is less costly for regulators to implement
- reduces the scope for regulatory error to distort production and investment, given that there is less reliance on a regulator correctly prescribing prices and other conditions of commercial transactions
- reduces regulatory risk, since a company's financial performance is less dependent on how a regulator precisely implements particular rules
- makes businesses more responsive to changing market developments and more likely to innovate, because they are less constrained by the prescriptions of regulators
- reduces opportunities for regulatory gaming and lobbying, since there is greater emphasis on commercial negotiations, rather than prescriptive rules on prices and other conditions of commercial transactions
- enables users to negotiate terms and conditions that meet their unique circumstances, rather than be limited to those approved by a regulator
- provides for the phasing-in of deregulation as a market becomes increasingly competitive.

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<sup>4</sup> Productivity Commission 2004, *Review of Gas Access Regime*, Report no. 31, Canberra, pp 331-332

44 Powercor Australia and CitiPower submit that the current circumstances create an opportunity to similarly seek a more efficient and less interventionist form of access regulation for electricity and embodying this in a uniform energy access regime. This uniform energy access model could encapsulate the following range of approaches as identified by the PC:

- negotiate–arbitrate provisions
- monitoring and information disclosure
- regulatory undertakings
- pricing principles
- legacy pricing, performance-based regulation and total factor productivity
- threshold and control mechanisms.

#### **Conclusion and responses to Issues Paper**

45 We submit that the MCE needs to clearly enunciate what it wishes to achieve by the proposed approach to converting the NEC to NER. If it is merely to streamline the rule change process, then this can clearly be achieved without going to the lengths of converting the NEC to NER. If this is conceived as a first step towards convergence of electricity and gas regulation, then this process should be considered in the context of Part IIIA and a uniform regulatory structure should be applied as the basis for access regulation of both gas and electricity.

46 In considering the best legal form for such a uniform regulatory structure, we submit that the regime that has had the most practical application and has been recently been subject to an in-depth review, the Gas Code approach, should form the basis for any revised form of the NEC. Clearly however, any such approach would require a full review of how this form of arrangement would apply and appropriate consultation on how any such regime would operate.

47 Powercor Australia and CitiPower submit that the adoption of a uniform 'effective access' regime for energy access should be treated as an opportunity to adopt a more light handed regulatory approach, including the propose/respond model as utilised under the Gas Code. Under this access model the provider gives to the Regulator an Access Arrangement, setting out proposed terms and conditions on which access will be provided to the pipeline, for approval by the Regulator.

48 The above analysis is reflected in the responses to the applicable Issues Paper questions as follows:

**MCE Issue 1 (b)** - *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?*

**Powercor Australia and CitiPower Response** – To achieve the objective of a more efficient regulatory system electricity distribution should be governed by a single set of regulatory principles. Further we consider that these should be flexible enough to accommodate both electricity and gas distribution. Jurisdiction-specific characteristics should be addressed in the context of such a regulatory model, for example if this comprises a propose/respond model, the service provider will reflect such differences in their price / service offering submitted for regulatory approval. We also note that there may also be a need for appropriate transitional provisions ensuring that regulatory certainty is not compromised.

We further submit that existing rights for merit review in relation to gas and electricity distribution must be harmonised and extended to apply generally to regulatory decision making under the proposed national regime. The importance of merits review in any regulatory regime is addressed below.

**MCE Issue 2** - *To what extent should the principles relating to electricity distribution pricing be the same as those that relate to gas distribution pricing?*

**MCE Issue 3** - *What are the principles that should be included in any electricity distribution pricing methodology that may be applied in all jurisdictions?*

**MCE Issue 8** - *To what extent should the principles relating to gas distribution pricing be the same as those that relate to electricity distribution pricing?*

**Powercor Australia and CitiPower Response** – The principles governing electricity and gas distribution pricing should be the same. This requires that the MCE revisit, as a threshold issue, the regulatory basis for electricity and gas access under Part IIIA. Currently the Gas access regime utilises the 'effective access regime' model, while the electricity access regime utilises the 'access undertaking' model. We submit that the electric distribution pricing principles adopt the gas 'effective access' regime model for the purposes of Part IIA. This should include adoption of a gas access propose/respond model for access pricing, rather than the more interventionist and costly NEC approach.

**MCE Issue 4 (a)** - *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?*

**Powercor Australia and CitiPower Response** – Achieving the expressed goals of increased regulatory efficiency requires harmonisation of the various regulatory regimes, including those applying to gas and electricity distribution. Jurisdictional specific rules should be limited. The rules applying to regulation of electricity distribution pricing should therefore be a single set of national principles using the effective access regime model adopted by the Gas Code.

**MCE Issue 4 (b)** - *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?*

**Powercor Australia and CitiPower Response** – Key principles should be identified and, to the extent these are compatible across jurisdictions, incorporated in the single national regulatory model. Further if the propose/respond model were adopted, individual service providers could reflect any such rules in their price/service offering.

**MCE Issue 5 (a)** - *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?*

**MCE Issue 5 (b)** - *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?*

**Powercor Australia and CitiPower Response** – Regulated businesses are by nature significant investments that are run with a long term view. Investment certainty and accountability are therefore crucial features of the regulatory regime. The AER should therefore be obliged to give due and proper consideration to the prior regulatory determination in any subsequent determination it makes.

## Need for Specified Objectives of Regulation

49 Ministers, regulators, tribunals and the judiciary responsible for implementing and enforcing regulatory arrangements are guided by objectives, often in the form of an objectives clause. The more clearly specified the objectives, the more effective is the guidance to regulators. In its review of the national access regime (Part IIIA of *Trade Practices Act 1974*), the Productivity Commission noted that access regimes, to function efficiently, must have clear objectives that promote:<sup>5</sup>

- decisions that are well targeted to the identified problem and which minimize unintended side effects
- greater certainty for current and prospective facility owners, access seekers and other interested parties

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<sup>5</sup> Productivity Commission 2004, *Review of Gas Access Regime*, Report no. 31, Canberra, pp 161-162

- consistency among policymakers, the judiciary and those responsible for implementation and enforcement
  - regulatory accountability. (PC 2001c, p. 124)
- 50 Regulatory accountability involves an assessment of whether regulators achieve the objectives. Clear objectives, with observable outcomes, therefore facilitate assessments of effectiveness.
- 51 The PC adopted the generic qualities and benefits of clear objectives, as enunciated in the Commission's review of part IIIA of the TPA, as being equally relevant for the Gas Access Regime. Powercor Australia and CitiPower believe that this need applies equally to electricity regulation.
- 52 Clear objectives improve the likelihood of:
- Reducing administration and compliance costs of regulation.
  - Reducing the scope for conflict and disputes.
  - Achieving more efficient outcomes for the energy industry.
- 53 The Issues Paper does not appear to provide any such framework of principles for assessing the regulatory regime to be applied to gas and electricity. Powercor Australia and CitiPower submit that these criteria should be established prior to further development of the national regulatory regime and endorses the ENA submission in this regard.

### Conclusions and responses to Issues Paper

**MCE Issue 1 (a)** - *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? 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?*

**Powercor Australia and CitiPower response** – The Issues Paper Section 3 objectives and principles are based upon the NEC. There are difficulties with merely adopting the NEC objectives and principles in the context of developing a national framework for electricity and gas distribution and retailing including:

-The NEC has not been substantially amended since it was drafted in the mid 1990s. Further, it has not needed to be due to jurisdictions derogating from the NEC provisions in favour of State based regulatory regimes.

-These objectives and principles do not adequately reflect the CoAG objectives in creating a national energy market and regulation;

- These objectives and principles do not represent any move to convergence between electricity and gas access regimes, and

-Do not reflect recent policy developments in third party access, including the Productivity Commission's reports on Part IIIA and the Gas Access Regime as well as the government response to the Part IIIA review.

Powercor Australia and CitiPower submit that these objectives need to be reviewed and harmonised as part of the development of a uniform access regulatory framework to apply to both electricity and gas.

**MCE Issue 7 (a)**- *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?*

**Australia and CitiPower Response** – The National Gas Code is the only national access regime that currently applies uniformly across the national market. It has benefited from a recent review by the Productivity Commission and the Australian governments have already indicated that the national market will be informed by their joint response to the PC report. It would appear unnecessary to move away from this working model of a national access regime. As noted above it is therefore our proposal that electricity distribution access regulation be harmonised with the current gas regime.

## Merits Review

54 Powercor Australia and CitiPower are strongly of the view that merits review of significant regulatory decisions remains a cornerstone of any best practice regulatory regime. In order to inform this issue it has undertaken a review of available reports on regulatory practice and merits review. This review identifies general support for the need to provide access to some form of merits review and no authoritative instance of denial of such review being supported.

55 The following outlines relevant materials and reports.

### Merit Review under CoAG Stated Policy

56 COAG issued a policy statement on energy reform on 8 June 2001. Consistent with the agreed objectives, and in light of their responsibilities under the Constitution, all Australian Governments agreed a number of objectives including that their energy policies will:

- Enhance the security and reliability of energy supply, encompassing resource availability, conversion, transportation and distribution, and recognising the impact of government policy and the regulatory environment on private sector investment and operation;
- Stimulate sustained energy efficiency improvements to technologies, systems and management proficiency across production, conversion, transmission, distribution and use;

- In view of the importance of long-term investment in the energy sector, provide the degree of transparency and clarity in government decision-making required to achieve confidence in current and future investment decisions;

57 These principles include the concepts of regulatory transparency, certainty and accountability which, by definition, require rights for merits review of important regulatory decision making. We submit that in the light of these principles it is necessary that major regulatory decisions, such as distribution pricing or access determinations, be subject to merits review.

### **Merit Review Recommendations of Administrative Review Council**

58 We refer the MCE to the principles articulated by the Administrative Review Council (a body set up under the Administrative Appeals Tribunal Act 1975, to advise the Attorney-General about merits review, including the types of decisions for which merits review should be available).

59 The Administrative Review Council identifies two basic reasons for merits review:

59.1 to ensure persons whose interests are adversely affected by a decision have an opportunity to have that decision reviewed; and

59.2 to improve the overall quality of government decision-making.

60 While the Administrative Review Council has identified certain factors which may justify the exclusion of merits review (including policy decisions of a high political content or financial decisions with a significant public interest element), none of the factors identified by the Administrative Review Council<sup>6</sup> would apply to distribution pricing determinations of the AER. The factors cited for exclusion of merits review are very tightly confined - for example, the examples given for decisions of 'high political content' include decisions relating to interest rates, the floating of the dollar or setting foreign exchange rates.

61 The Administrative Review Council also notes that the fact that:

- the (original) decision-maker is an expert or requires specialised expertise;
- large numbers of people may take advantage of review; or
- there is potential for the original decision to be subject to judicial review,

are **not** grounds for excluding merits review.<sup>7</sup>

62 The limitations of judicial review are acknowledged by the Administrative Review Council as being, even if grounds for review are established, the likely remedy is that the decision will be remitted to the original decision-maker for re-consideration. This

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<sup>6</sup> In its booklet, *What decisions should be subject to merit review?* See particularly at Chapter 4.

<sup>7</sup> *What decisions should be subject to merit review?*, at ¶¶5.16 and 5.24.

can create the perception that the original decision-maker will reach the same decision, albeit by a process better able to withstand judicial scrutiny.

### **Merits Review Recommendations of Productivity Commission**

63 The PC states: "Good administrative law practice sees benefits in having a merits review available whenever a legislative enactment creates a decision making power, especially where decision making bodies have discretionary powers (as is the case under the Gas Access Regime)"<sup>8</sup>

64 In relation to the Gas Access Regime the PC recommended that limitations on the grounds of appeal under s.39 of the Gas Pipelines Access Law should be removed to allow a full merits review on access arrangements drafted and approved by the regulator. In relation to merits review generally the PC stated:<sup>9</sup>

'In the Commission's view, appropriate protection for property rights and natural justice are key considerations. While the appeal process might take considerable time and expend considerable resources, the regulatory bodies and Ministers have powers to make decisions that have an impact on fundamental rights of service providers. The prospect of exposure to imperfect regulatory instruments means there is a strong case for a merits review.'

The purpose of the merits review is for the appeal body 'to step into the shoes' of the primary decision maker to determine if the decision was 'correct and preferable'. In keeping with this purpose, the Commission considers that it is appropriate to limit the material that can be put before the appeal body. Such a limitation currently exists for s.39 appeals (in relation to access arrangements drafted and approved by the regulator). However, no such limitation exists for s.38 (in relation to coverage decisions). The Commission considers the limitation should be maintained for s.39 and that s.38 should be amended to limit the material that can go before the appeals body to that which was before the primary decision maker.

Regarding the grounds for review, s.38 (for coverage decision merits reviews) is currently unlimited. However, merits reviews under s.39 (for access arrangements drafted and approved by the regulator), impose limitations on the grounds of appeal. The Commission considers there are good reasons for extending the grounds of appeal under s.39. That is, provisions in the merits review should not be confined to the grounds set out in s.39(2)(a) of the GPAL, but should allow scope for a full merits review. The Commission acknowledges the potential costs of widening merits review rights under s.39, but considers they will be mitigated, to

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<sup>8</sup> *Review of the Gas Access Regime*, page 350).

<sup>9</sup> Productivity Commission 2004, *Review of Gas Access Regime*, Report no. 31, Canberra, pp 498-499

some extent, by maintaining the limitations on material that can go before the appeal body.

Regarding the differences for who can appeal, s.38 (relating to review of coverage decisions), allows any party to appeal. However, under s.39, only service providers can appeal a decision to draft and approve an access arrangement. For coverage decisions, the Commission considers it is appropriate that any person can appeal. For access arrangements drafted and approved by the regulator, however, the Commission considers that it is appropriate for only service providers to have the right to appeal. This is because the regulatory intervention is on behalf of the wider economy, including users.

Regarding the outcomes of appeals under both ss38 and 39, the Commission is satisfied that the provisions in the GPAL allow the appeal body to 'step into the shoes' of government decision makers and affirm or remake administrative decisions according to the merits of individual cases.'

## Conclusions

- 65 Continued and appropriate investment in energy infrastructure is dependant upon infrastructure owners having confidence in the regulatory decision making process. The CoAG principles referred to above explicitly recognise this fact. The importance of this is underlined by the PC when its noted in the Gas Code review that it is preferable for a regulator to be too generous in a pricing determination than risk providing insufficient economic return on investment. Without at least a limited form of merits review of key regulatory decision making, investment will necessarily be affected and the rate of return on such investment will increase, ultimately to the detriment of consumers.
- 66 In Powercor Australia's and CitiPower's view, merits review would ensure the AER was held accountable for its decisions, producing - in accordance with the views of the Administrative Review Council - a better quality of decision-making over the long term. This requirement is essential, particularly where the AER is required to perform rule application roles. As such, merits review should improve the accountability and decision-making processes of the AER.
- 67 By way of example of the practical importance of merits review and the clear potential for regulator mistake, in the recent Moomba to Sydney decision of the Australian Competition Tribunal,<sup>10</sup> the Tribunal stated that the ACCC had made "fundamental errors in principle", noting that "There is no logic or reason to [the ACCC's] approach and there is no material to suggest it has any support in the theory or practice of statistics". This demonstrates the risk that on a particular matter any regulator may make significant errors when reaching decisions concerning pricing. Indeed, the past three reviews by the ACT of ACCC tariff determinations have been overturned by the ACT.

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<sup>10</sup> *Application by East Australian Pipeline Limited* [2004] ACompT 8 (8 July 2004).

- 68 These decisions highlight the very real danger to the electricity industry of the denial of merits review of distribution pricing determination (and other forms of decisions influencing pricing), notwithstanding assurances as to the robust nature of the process. Ultimately regulatory decisions can threaten the accrued property rights and significant investment of owners of energy infrastructure, without recourse to merits review of such decisions regulatory risk is heightened and the necessary return to justify private sector investment is increased.
- 69 While arguments can be made that the time and expense of reviewing a revenue determination can be significant, these issues can be easily be addressed by defining the scope and type of merits review available and are not valid reasons for avoiding accountability. Furthermore, it is clear that merits review can be implemented in such a way as to ensure that the review process does not delay the implementation of regulatory decisions and is not prohibitively expensive (see, for example, the appeal panel process under the Essential Service Commission Act (Victoria) and Gas Code appeal provisions).
- 70 We understand that consultation will be undertaken by the MCE on this point and look forward to putting our more detailed reasoning for the retention and extension of merits review processes in the National energy market.