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NE Rule Change Process
C/o MCE Market Reform
Department of Industry, Tourism and Resources
GPO Box 9839
Canberra ACT 2601

Via Email: MCETMarketReform@industry.gov.au

Dear Sirs

Proposed National Electricity Rule Change Process

- 1 Thank you for the opportunity to comment on the proposed National Electricity Rule (**NER**) change process.
- 2 Powercor and CitiPower are Victorian electricity distribution businesses and therefore will not be subject to the majority of the proposed NER 'until no later than 31 December 2006'. However, as the Victorian electricity distribution price reset scheduled for 1 January 2011 and all future regulatory reviews are likely to be conducted by the AER, subject to the terms of the NER, the NER change process clearly is of significant importance to our businesses.
- 3 In this regard I note that the electricity distribution price reset process under the NER will in effect govern the allowable return on Powercor/CitiPower's combined distribution assets of \$3.43 billion.
- 4 From the perspective of Power/Citipower, and all other economically regulated businesses, a number of regulatory characteristics are of paramount importance. These include:
 - certainty;
 - transparency;
 - natural justice (the right to be heard/consulted); and
 - appropriate rights for independent merits review of regulatory decisions.

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- 5 With regard to the MCE Proposed National Electricity Rule Change Process Consultation Paper (**Consultation Paper**) we consider that the issues of transparency of the NER rule change process and natural justice issues are satisfactorily addressed by the proposed process. We however reserve our position on these aspects until such time as the draft legislation to enact this process is available for review.
- 6 Powercor/CitiPower however has significant concerns regarding both regulatory certainty and the lack of any independent merit review process as outlined in the Consultation Paper.

Regulatory Certainty

- 7 It is crucial for both regulated businesses and the regulator that key provisions of the NER relating to price resets are not subject to even the possibility of change or variation, at least not within the relevant 5 year regulatory period. This need for regulatory certainty has been recognised in the Victorian regulatory context by key principles of the regulatory model being statutorily 'entrenched' and therefore not able to be altered without legislative amendment. In particular the Victorian Industry Tariff Order enshrined the concepts of CPI-X regulation; the 'locking in' of the base case asset valuation and the distinction between services regulated under a price determination and 'excluded services'.
- 8 The proposal that 'any person' can institute a NER change process therefore is of significant concern to Powercor/CitiPower. The expressed view that the potential flood of NER changes will be effectively controlled by the AEMC as 'gatekeeper' misses the point that even the potential for intra regulatory period changes to the regulatory pricing/access model is inimical to the key concept of regulatory certainty. Any reduction in regulatory certainty will translate into increased regulatory risk which impacts on future investment. Any actual or perceived deterrent to investment would appear to be inconsistent with encouraging efficient investment and would not be in the long term interests of customers.
- 9 We are therefore strongly of the view that the NER Code change process as it relates to regulatory pricing/access provisions for networks should only be able to be instituted by network operators and the AER. To do otherwise, would serve to undermine the "regulatory bargain" reached between the AER and the networks that would ultimately increase the costs of all market participants and customers. While we acknowledge that this will mean user representatives or customers would not then have the ability to institute a change process in their own right, we submit the interests of consumers generally will continue to be well represented by the Australian Competition & Consumer Commission and AER and therefore these organisations should remain the proper avenue for any customer applications for NER change related to pricing/access matters.

Protected provisions

- 10 In addition we submit that key regulatory pricing and access principles, such as those currently embodied in Chapters 5 and 6 of the National Electricity Code, must be protected from intra-regulatory period amendment or review. This should be achieved by ensuring the legislation put in place to convert the NEC to statutory rules

also ensures that identified key regulatory principles are not subject to change intra-regulatory period. As the regulatory periods of different jurisdictions are staggered, such a provision should ensure that the effect of any amendment or variation does not apply until the price review occurring after that jurisdiction's next price reset.

- 11 In this regard we submit that both regulated businesses and the AER should be consulted as to what provisions of the NER are agreed to be 'key principles' and therefore should be afforded protection from intra regulatory period amendment.
- 12 Similarly we submit that key regulatory pricing principles, such as those currently embodied in Chapters 5 and 6 of the National Electricity Code and the Victorian Electricity Supply Industry Tariff Order, must be protected from inter-regulatory period amendment or review. This should be achieved by ensuring the legislation put in place to introduce the statutory rules also ensures that identified key regulatory principles are not subject to change inter- regulatory period.
- 13 In this regard we submit that both regulated businesses and the AER should be consulted as to what provisions are agreed to be 'key principles' and therefore should be afforded protection from inter regulatory period amendment.

Right to Merit Review

- 14 We note that the Consultation Paper states that AEMC decisions on NER changes will be subject to only judicial review. In this regard we acknowledge that arguments for merits review of a NER change decision are less strong than for economic regulatory decisions such as a price determination. However we consider that the potential implication of NER changes are such that merits review should be made available in relation to such decisions by the AEMC. The following arguments however apply more strongly to any economic regulatory decision making.
- 15 Regulators are not immune to error. Changes to the NER will, in some instances, impact significantly upon the property rights of regulated businesses. In these circumstances it is inconsistent with regulatory best practice not to have some form of independent merit review.
- 16 We submit that regulatory best practice accepts that merit review is necessary to ensure:
- Regulator accountability;
 - Protection of property rights;
 - The quality of regulatory decision making.
- 17 In Victoria Powercor/CitiPower presently have access to a limited form of merits review of economic regulatory determinations of the Essential Services Commission. A review of the results of past appeals lodged under this process clearly demonstrates that the Office of the Regulator General (the ESC's predecessor) has made manifest errors which impacted significantly upon the property rights of regulated businesses. In the absence of even this limited right of merit review these errors would not have been corrected, businesses would have forgone significant

revenue to which they were entitled and the ESC's imperative to perform its role conscientiously and with attention to detail would be less than it is today.

- 18 In this regard we note that the Productivity Commission Recommendation in its 'Review of the Gas Access Regime' released by the Govt on 10 August 2004 was to remove the limitations on the grounds of appeal from a regulator's decision on the approval of an access arrangement under s39 of the Gas Pipelines Access Law, to allow a full merits on access arrangements drafted and approved by the regulator. However, the material that can be put before an appeal body should be limited to that that was before the regulator.
- 19 Similarly access decisions of the ACCC remain reviewable by the Australian Competition Tribunal and this right has been expressly supported by Mr Ed Willett, ACCC Commissioner for Energy and Mergers, in the context of the Productivity Commission's gas access inquiry.
- 20 While we acknowledge that the timeliness of any appeal process is of concern, it would be very short sighted to remove all rights of merit review of important regulatory decisions to avoid the relatively minor cost and delay that may be occasioned by review proceedings. Any such cost and delay can be demonstrated to be more than outweighed by the public benefit of ensuring the quality and accuracy of regulatory decision making.
- 21 We also submit that the failure to provide a right to merits review would be contrary to the expressed intention of the Council of Australian Governments that the reforms to the Australian energy market 'strengthen competition and encourage investment in the Australian energy market'. Removal of rights to merit based review of significant regulatory decision making dramatically increases regulatory risk for business and therefore is a significant disincentive to new investment. Without a right to merit review of significant regulatory decisions future investment in the Australian energy industry by overseas investors, including Powercor/CitiPower's parent company Cheung Kong Infrastructure, could be put in doubt.

Market Objectives

- 22 The Market Objectives proposed by the MCE's Consultation Paper are of critical significance to the effectiveness of the proposed National Electricity Rule Change Process, as they are an essential element of the Rule Making Criteria to be applied by the AEMC in assessing a Rule Change Proposal. The Rule Making Criteria are the primary 'check' on the exercise by the AEMC of its rule making powers. Accordingly, the Market Objectives play a critical role in ensuring confidence and certainty around the regulatory framework, such as to minimise any distortion of investment.
- 23 Powercor/CitiPower broadly agrees with the primary Market Objective cited in the MCE's Consultation Paper, in particular the inclusion as a component of the primary objective the promotion of 'economically efficient investment and innovation'. However, Powercor/Citipower is of the view that the current proposed wording of the primary objective does not provide sufficient clarity around the equal weighting to be

given to the objective of facilitating efficient investment, as against the objective of promoting the long term interests of electricity consumers.

24 Accordingly, we submit that the Market Objectives should be amended to read as follows:

- 'The primary market objective of the national energy market is to:
 - (a) promote the long term interests of consumers of electricity with respect to price, quality and reliability of electricity services; and
 - (b) promote economically efficient investment and innovation.
- In seeking to fulfil this primary objective, regard is to be had to the following objectives:
 - (a) Existing and potential owners of energy infrastructure must be provided with appropriate incentives to operate, invest and innovate in an economically efficient manner, including through the provision of regulated returns sufficient to meet the efficient long run costs of providing access to regulated services and a return on investment commensurate with the regulatory and commercial risks involved;
 - (b) The market should be competitive;
 - (c) To the extent that it is economically efficient to do so, customers should be able to choose their energy supplier;
 - (d) Third party access to energy infrastructure should be provided on a basis that does not discriminate between access seekers, but also provides an economically efficient return to the infrastructure owner and operator.
 - (e) To the extent that it is economically efficient to do so, the market should not discriminate between inter and intra State energy trading.'

25 This is consistent with the Productivity Commission's recommendations in its Report on its *Review of the Gas Access Regime*, released on 10 August 2004, and the Government's response in February 2004 to the Productivity Commission's recommendations in relation to Part IIIA of the *Trade Practices Act 1974 (Cth)* ('TPA'). In its Report on the National Gas Access Regime, the Productivity Commission recommended the inclusion in the National Gas Access Regime of an objects clause that gives primacy to the promotion of efficient investment in gas pipeline infrastructure. Specifically, the Productivity Commission recommended inclusion of the following overarching objects clause, consistent with that proposed by the Government for inclusion in Part IIIA of the TPA:

'To promote the economically efficient operation and use of, and economically efficient investment in, the services of transmission pipelines and distribution networks, thereby promoting effective competition in upstream and downstream markets.'

- 26 The rationale for providing at least equal weighting to the objective of promoting incentives for efficient investment in transmission and distribution infrastructure, as against the objective of promoting the long term interests of electricity users, is elegantly articulated by the Productivity Commission in its *Review of the National Access Regime* Report, as follows:

'Third party access and the resulting benefits to service users are only possible over the longer term if there is continuing investment in the essential infrastructure services themselves. On the other hand, while denial or monopoly pricing of access imposes costs on the community, such behaviour cannot threaten the continued availability of the services concerned. This asymmetry in potential outcomes highlights the priority that access regulation must be give to ensuring that there are appropriate incentives for efficient investment.'

- 27 The suggested alternate wording for the Market Objectives set out above would, by dint of the requirement for those Market Objectives to be taken into account by the AEMC in assessing Rule Change Proposals, minimise the potential distortionary effects on investment arising from regulatory risk associated with an excessive number of Rule Changes. By requiring the AEMC to consider the effect on investment of any Rule Change Proposal, the AEMC must explicitly take account of regulatory risk.

Transitional arrangements

- 28 Consideration should be given as to how the National Electricity Code Changes currently open for consultation will make the transition into the statutory rules which will replace the National Electricity Code. Similarly, consideration should be given to how important new initiatives, such as national B2B procedures, can be progressed expeditiously for inclusion in the National Electricity Code/Statutory Rules during the transition from NECA to the AEMC.

Yours sincerely

Richard Gross
General Manager Regulation