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The Manager
MCE Secretariat
Department of Industry, Tourism and Resources
GPO Box 9839
CANBERRA ACT 2601

Dear Sir/Madam

2006 LEGISLATIVE PACKAGE – GAS AND CONSUMER ADVOCACY

Country Energy appreciates the opportunity to comment on the exposure draft of the National Gas Law (NGL) and related explanatory material (the legislative package). The legislative package represents a vital component in the new economic regulatory framework for service providers in the energy sector.

This letter contains a general overview of Country Energy's view on the legislative package, followed by a specific discussion on various aspects of the NGL that Country Energy believes are critical issues for consideration by the Ministerial Council on Energy (MCE).

Overview

Country Energy is disappointed with aspects of the legislative package release. Country Energy considered that the national market reform process presented the energy sector with the opportunity to streamline and improve the quality of economic regulatory frameworks.

On the whole, the package is inconsistent with the MCE's stated objectives to lower the cost and complexity of regulation, enhance regulatory certainty and lower barriers to competition¹. The exposure draft of the NGL fails to meet the objective of achieving consistency where possible between transmission and distribution across gas and electricity sectors, thereby perpetuating differences in regulatory arrangements and processes.

¹ Ministerial Council on Energy, *Report to the Council of Australian Governments: Reform of Energy Markets*, December 2003 p4.

Governance arrangements

The exposure draft of the NGL is not consistent with the new institutional and governance arrangements for access price regulation in the National Electricity Market (NEM) endorsed by the Council of Australian Governments (COAG)². These arrangements comprise the MCE as the national policy and governance body, the Australian Energy Market Commission (AEMC) as the rule making body, and the Australian Energy Regulator (AER) responsible for administering and enforcing the rules. The central foundation of these arrangements is a distinct separation of rule making and rule enforcement functions.

Country Energy is concerned that the exposure draft dilutes the institutional and governance arrangements described above.

First, the MCE has taken on a rule making responsibility in developing the package, rather than setting policy direction for the AEMC to make the rules. The MCE made a commitment to not engage itself directly in the daily operations of the energy sector or conduct of regulators³, however the package significantly diminishes this pledge.

Second, the exposure draft offers little in regulatory certainty and transparency in decision making for regulators and market participants due to the broad discretionary powers made available to the AER. Many of the finer details of the economic regulatory framework will not be clear to participants until either the AER makes a determination or develops and releases a statement of regulatory principles for the economic regulation of service providers, a flawed approach that was a key driver in the AEMC's development of new transmission rules.

Structure and Content of Law, Rules and Regulations

It is appropriate that the NGL should only contain fundamental rights and obligations, establishment and conferral of powers on institutions, and guiding principles that limit rule making and define discretion for regulators. This has been the approach taken in the current composition of the Gas Pipelines Access Law (GPAL) and Natural Gas Access Code (the Code), and the National Electricity Law (NEL) and National Electricity Rules (NER). In neither case do these instruments contain any major components of the regulatory arrangements or processes for economic network regulation.

In contrast to these existing arrangements and recommendations made by the Expert Panel on Energy Access Pricing (the Expert Panel), almost all provisions and obligations for service providers have been placed into the exposure draft of the NGL. The Expert Panel stated in their report to the MCE:

The degree of detail included in the Law also needs to take account of the aim of promoting common approach to network access pricing across the energy market. This means that the

² Council of Australian Governments, *Intergovernmental Agreement on an Australian Energy Market*, 30 June 2004.

³ Australian Energy Market Agreement (as amended), 2 June 2006

principles in the Law are best cast at a level such that they can be expressed in common terms across transmission and distribution facilities in both the electricity and gas markets, with scope for divergence in the application of the common principles to account for differing market and technical characteristics being reflected in the Rules and regulatory decision making. As market and technical characteristics change and allow for greater convergence, this approach permits corresponding changes in the Rules and regulatory decision making, within the common legislative provisions. Where differences reflecting current market and technical characteristics are contained in the Law, those differences are more likely to be perpetuated.⁴

The MCE in its Statement of Scope⁵ also promoted the fact that the legislative package would be designed to achieve unanimity between energy sectors. It is not clear from the exposure draft of the NGL that the advice from the Expert Panel or the MCE's own statements has been heeded. The exposure draft of the NGL as it stands risks stalling national market reform by sustaining divergent approaches across transmission and distribution and between the electricity and gas sectors.

Rules encompass issues that have industry wide impacts and should cover substantive procedures, and detailed regulatory requirements and technical matters, so that there is adequate scope and flexibility to make changes in an evolving national market. An example of where detailed issues are inappropriately contained in the exposure draft of the NGL is in Part 4, which lists detailed procedural matters relating to the decision making criteria and access disputes for an access arrangement that would be more suitably addressed in Rules. Rules also offer the added benefits of being open to transparent rule change consultation processes with industry, consumers and the public able to take part and contribute.

Country Energy is also concerned with the proliferation of Regulations in the exposure draft of the NGL. As advocated by the Expert Panel, Regulations should only be required for transitional and whole of government policy matters that may change on a regular basis⁶. Consultation procedures for the making of Regulations are not required and there is also no obligation for the Regulations to promote the market objective, so the inappropriate use of these instruments is undesirable and should be avoided.

The inappropriate use of Regulations in place of Rules or Law undermines the governance arrangements and market reform agenda. The use of Regulations can lead to a reduction in accountability and may limit the streamlining of regulatory processes and hinder the transparency and predictability of regulatory outcomes.

The MCE stated in its Statement of Scope that:

'...the NGL will be supplemented by ...a limited number of regulations dealing with minor matters and the prescription of civil penalties.'⁷

⁴ Expert Panel on Energy Access Pricing, *Report to the Ministerial Council on Energy*, April 2006 p24.

⁵ Standing Committee of Officials of the Ministerial Council on Energy, *Statement of Scope – A National Legislative Framework for Gas and Electricity*, July 2006.

⁶ Expert Panel, *op. cit.*, p.23.

⁷ Standing Committee of Officials of the Ministerial Council on Energy, *op. cit.*, p.14.

However, the exposure draft of the NGL contains more than forty provisions which anticipate Regulations, and in many instances, the provision relates to much more than a minor matter.

Country Energy believes that the prescription of the majority of matters in Law and the extensive scope for MCE to develop Regulations leaves little scope for future Rules to develop in a flexible, market driven manner.

Information Gathering Powers

Country Energy is concerned at the broad and extensive information gathering powers provided to the AER under the exposure draft of the NGL that are, as far as Country Energy is aware, unprecedented in any Australian regulatory environment. The powers go far beyond those recommended by both the Productivity Commission in its review of the Gas Access Regime⁸ and the Expert Panel in its report to the MCE⁹.

The information gathering powers also appear to surpass those envisaged in the MCE's Statement of Scope which stated:

*'The NGL will also set up the framework for information required for general regulatory reporting, ring-fencing (maintenance of accounts) and at the time of assessing and/or revising access arrangements consistent with the concerns expressed by the Expert Panel.'*¹⁰

The extent and form of information that could be required to be produced by service providers and their associates go well beyond the MCE statement above.

Given that it is proposed that a failure to comply with any AER information request provides grounds to refuse to grant leave for a merits review, Country Energy believes it is imperative that the information gathering provisions are revisited and limited to the recommendations made by the Productivity Commission and Expert Panel.

The information gathering powers in the exposure draft of the NGL also lack both limits and effective guidance to the AER on how these powers are to be used. At a minimum, appropriate checks and balances need to be inserted into the NGL to guide the AER. At the very least, information requests should have to be reasonable and necessary after considering the costs and benefits of providing the information.

We note that the expanded provisions relating to confidential information anticipate such a cost and benefit type analysis.

However, we remain seriously concerned about those expanded provisions also. Where currently the regulator cannot release confidential information if it would be unduly harmful to the legitimate business interests of the service provider, the exposure draft of the NGL allows the release of confidential information if it considers

⁸ Productivity Commission, *Review of the Gas Access Regime*, June 2004.

⁹ Expert Panel, *op. cit.*, p.129.

¹⁰ Standing Committee of Officials of the Ministerial Council on Energy, *op. cit.*, p.16.

that the public benefit outweighs the detriment caused to the information provider. This an unacceptable position for both service providers and their associates.

Total Factor Productivity

Country Energy agrees with the MCE's reasoning for not allowing TFP as a revenue setting tool in the early stages of the new economic regulatory framework, but cannot reconcile this with the MCE's proposal to allow TFP to be used as a benchmarking tool to assess cost building blocks. Country Energy does not understand how the MCE envisages these benchmarks are obtained, and how Country Energy could be compared against them given that no thorough study or review has yet taken place across the national energy market. This approach could undermine the MCE reform objectives stated in its report to COAG of improving the quality of regulation across energy markets, lowering the cost and complexity of regulation, and enhancing regulatory transparency and predictability.¹¹

The MCE states in its overview and response to the Expert Panel that the regulatory environment is not well informed on the TFP issue and would prefer to wait until the AEMC has had the chance to undertake a detailed review and wait for the new economic regulatory reform arrangements to have been operating for a time before committing to the use of TFP for setting revenues.¹² Country Energy finds it difficult to comprehend why TFP should be used as a regulatory analysis tool to assist in the building block evaluation process before the AEMC review has taken place.

Clause 70(2) and the extensive information gathering powers contained in the exposure draft of the NGL would allow for the possible scenario of the AER commencing its own TFP study and data collection exercise in parallel with the MCE directed AEMC review of TFP methodology. This would create unnecessary duplication and uncertainty in the national market, and be a highly inappropriate and unacceptable position in which to place service providers.

Country Energy suggests that if clause 70 is to remain, it needs to be amended to expressly exclude the use of TFP as both a revenue setting tool and a building block analysis tool. The section could then be deleted at a later date if the AEMC's detailed review results in a recommendation that TFP should be an option in setting revenues for service providers. This approach is much more open and transparent than implementing TFP through the provision of a Regulation for the reasons and concerns Country Energy has with the use of Regulations described above.

¹¹ Ministerial Council on Energy, *op. cit.*

¹² Standing Committee of Officials of the Ministerial Council on Energy, *2006 Comprehensive Legislative Package: Overview and Response to Expert Panel on Energy Access Pricing*, November 2006 p21.

Fit for Purpose

Country Energy believes that the exposure draft of the NGL is inconsistent with the stated MCE policy decision that a fit for purpose decision making model would apply through the Rules¹³. The key sections that prevent the adoption of a fit for purpose model that would need to be redrafted or removed to obtain consistency with the MCE policy decision are sections 24, 170(3)(c)(i) and 178(3)(a). These three sections combined, effectively make the receive-determine model the default and only available AER decision making model, contradicting the stated intent of the MCE not to mandate any single specific regulatory model in legislation.

We would be pleased to discuss the matters raised in this submission with the MCE. If you require further information or clarification in relation to this submission please feel free to contact Jason Cooke on 02 6338 3685 or Natalie Banicevic on 02 6589 8419, or myself on 02 9249 3105.

Yours sincerely

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¹³ MCE Communiqué, May 2006