



Response to proposed amendments to the Australian Energy Market Agreement

Distribution and retail framework

10 December 2005

1. Introduction

The Energy Networks Association (ENA) welcomes the opportunity to comment on the proposed framework schedule for the transfer of distribution and retail functions to the national energy bodies. The development of a national approach to distribution and retail regulation is a core issue for ENA members, who own and operate energy distribution network infrastructure valued at more than \$35 billion.

The ENA responded to the proposed framework schedule document in the lead up to the 22 September 2005 Standing Committee of Officials (SCO) meeting, in response to a request from federal government officials. The ENA understands that its response to the federal officials was to be provided to all SCO officials at that meeting.

This response is substantially the same as that provided to federal officials in a letter dated 21 September 2005.

The ENA supports the goal of reaching a high level commitment from the Council of Australian Governments to the transfer of distribution and retail regulatory obligations under a national distribution and retail framework. The ENA does not object to the functional allocations in the schedule, subject to satisfactory clarification of the detail behind some of the functional descriptions.

The ENA does, however, have a number of specific areas of concern on which we seek further information or alterations to the proposed schedule, particularly in the italicised elements and their relationship to functions. Detailed comments on the table are provided at **Attachment A** to this letter.

The ENA notes that the proposed framework schedule is derived from the NERA / Gilbert + Tobin paper titled *Public Consultation on a National Framework for Energy Distribution and Retail Regulation – May 2005*. The ENA comments in this submission on the framework schedule should not be construed as support or otherwise for other aspects of the NERA / Gilbert + Tobin paper, on which the ENA expects to make a submission early in 2006, in line with the SCO timetable.

2. Energy network approach to development of distribution framework

The ENA submission of October 2004 on the development of the distribution framework established a set of criteria against which the distribution network sector would assess the appropriateness and success of a national distribution framework. Briefly, these criteria are that an effective distribution framework is one which:

- is based on a clear separation between rule making and rule enforcement;
- produces the least overall compliance burden necessary to achieve the objectives of the framework;
- is adaptable to change through transparent and equitable processes;
- is accountable to all parties through fair processes and merit review mechanisms on key regulatory decisions;
- is directed to addressing clear market failure, and where competition is feasible, relies to the maximum extent possible on the outcomes of competitive markets; and
- facilitates investment certainty in the non-competitive sectors of gas and electricity markets.

The ENA has also called for a separation between the policy consideration of the *functional allocation* of responsibilities, powers, legislative and regulatory instruments, from issues related to the *nature* of the regulatory regime. To assist government consideration of functional allocation issues, the ENA has developed its own detailed matrix of functional and institutional allocations which would meet the criteria listed above (**Attachment B**). The ENA also notes that the Ministerial Council on Energy has recently resolved to establish an Expert Panel to consider issues related to the nature of the regulatory regime, including detailed pricing and other economic regulatory issues.

3. ENA comments on framework schedule

The ENA is concerned that in a number of areas the proposed framework schedule currently embodies both a functional description of obligations to move to the national arrangements, as well as principles related to the nature of regulation. For example, item number three of the framework schedule relates to the process for setting tariffs, and specifies one particular operational principle for how individual tariffs should be set, as opposed to the function of tariff setting and where this should lie in a national framework. The ENA considers that this approach is inappropriate and risks unintentionally locking ministers into particular approaches without appropriate policy consideration or consultation. The ENA recommends that the list be drafted to reflect a straightforward list of functional responsibilities, rather than remain in its current form where it embodies some judgements over how those functions will be administered.

Need for clarity over institutional allocation

The proposed framework schedule is a useful first step in developing a framework to describe how distribution and retail functions will be transferred to the national arrangements. The ENA is concerned, however, that the framework does not describe how the functions outlined in the framework schedule will be managed under the national framework, in particular the split of responsibilities between the Australian Energy Market Commission (AEMC), the Australian

Energy Regulator (AER) and the Ministerial Council on Energy, and the role, if any, of jurisdictional governments. This is a critical element which will determine the success of the regime, and whether the ENA and members will ultimately support a move to a national framework. As noted, the ENA has developed its own detailed matrix which sets out a model of institutional allocations consistent with the MCE's agreed separation of rule making and rule enforcement activities (**Attachment B**).

Need for a policy commitment from Ministers

The ENA also queries whether agreeing to a high level and potentially ambiguous list of functions to move to the national bodies sufficiently embodies a policy commitment from all governments to move to a genuinely national framework for distribution and retail regulation.

The ENA considers that, alongside agreement to the functional allocation, a commitment from ministers to ensure the development of the national framework meets the ENA criteria outlined above would represent a significant policy step forward and provide certainty to the energy industry on the outcomes sought by ministers in developing a national framework. A critical element of this would be a commitment from ministers to the timely removal of all instruments no longer required at a jurisdictional level, which may include amending relevant Acts, removing licensing requirements and sunsetting relevant instruments. This would limit the risk that ENA members are subject to dual regulatory regimes as a result of an incomplete transfer of functions.

Need for clarity over national uniformity

The proposed framework schedule is silent on whether rules related to functions moved to the national bodies will be made uniform. The ENA recognises that there are clear benefits in developing uniform national rules for the retail sector, as most retail businesses operate in multiple jurisdictions.

The same pressure for uniformity on all issues does not arise for most distribution businesses as they are geographically bounded to the extent of the physical network. For example, there are clear policy and pragmatic reasons why both the approach and targets sought under a service standard regulatory regime might be different across different jurisdictions. This is due to the different age and profile of networks across the country, past regulatory experience, climatic differences and government priorities for service delivery and community service obligations.

The development of a national distribution framework represents a clear opportunity to create a more efficient and effective environment for the regulation of the distribution sector. The ENA is disappointed that the proposed allocation document only anticipates the abolition of regulatory requirements that are incorporated in other parts of the framework. Current jurisdictional arrangements are patchy, with the burden of regulation in some jurisdictions being considerably higher than in others. A simple transfer of functions into a single regulatory document that embodies the most onerous level of regulation in each state is likely to lead to a highly inefficient outcome, and a "worst of all possible worlds" model.

Such an approach cannot be supported by the ENA, as it will not lead to a net improvement in the quality of regulation of network businesses and would decrease rather than increase regulatory efficiency. The driver for distribution businesses to support a move to a national framework is predicated on achieving a net improvement in the *nature* of regulation in the distribution sector, including improved governance and accountability through the national

energy institutions. A clear commitment to the ENA criteria outlined above, including that the national framework “produces the least overall compliance burden necessary to achieve the objectives of the framework”, would address this issue.

4. Next steps in the development of a national distribution and retail framework

The ENA welcomes the continuation of industry consultation represented by the recent release for industry comment of this framework schedule and the NERA / Gilbert + Tobin paper. The ENA considers that a commitment from energy ministers to the transfer to distribution and retail functions to the national energy bodies in line with that outlined above will provide impetus to this process and allow real progress to be made in the coming 12 months towards the transfer of functions scheduled for the end of 2006.

The next stage of this process will necessarily involve a major increase in the level of complexity of the framework, and will require meaningful consultation with industry, where work on the structure and content of regulatory instruments is undertaken. The ENA and its members are prepared to provide considerable expertise and resources to this process to develop a cooperative and effective national framework that is functional and acceptable to industry, end users and governments.

ENA comments on proposed functional allocations

No	Function	ENA Comment
	National	<p>The ENA understands that this functional allocation only attempts to specify which functions will be managed at a national level, and which will remain jurisdictionally-based. The ENA considers that two other aspects are critical to the development of a clear policy agreement to a national distribution and retail framework:</p> <ol style="list-style-type: none"> 1. specification of whether the rules and approaches for these functions will be nationally uniform, or will instead be jurisdictionally-specific but administered at a national level. This question will necessarily involve intensive industry consultation as it relates specifically to the nature of regulation; and 2. specification of the roles of the AEMC as rule-maker and the AER as regulator for each of these functions.
1	Scope of distribution price regulation (services included, services excluded) – <i>determination of basic regulated services/core services which are to be included in price regulation.</i>	<p>Appropriate at the national level.</p> <p>The ENA notes that numbers 1-13 of this functional allocation table are currently covered under national rules through the Gas Access Regime (including possible amendments to the regime in response to the PC review of the Gas Access Regime) and the National Electricity Rules (including possible amendments to the regime in response to the AEMC review of chapter 6 of the Rules).</p> <p>Query the use of the word “determination”. Does this mean specifying which services are regulated and which are not or does it mean setting out criteria against which it is assessed whether services are regulated?</p>
2	Price cap regulation for distribution services - <i>CPI-X price or revenue cap (or some incentive-based variant) form of regulation.</i>	<p>Appropriate at the national level.</p> <p>Schedule should not pre-empt the form of policy/regulation that may emerge under the national framework – it is not clear how this category, as currently drafted, allows for some form of price monitoring, as anticipated in the SCO consultation paper responding to the review of the gas access regime.</p> <p>Query why the term “price cap” is used to refer to both price and revenue caps – suggest use term “pricing regulation”.</p>
3	Regulatory requirements in relation to tariff settings – <i>Tariffs for small customers which should lie between the incremental cost (lower bound) and the stand-alone cost (upper bound) of serving them.</i>	<p>Appropriate at the national level.</p> <p>Schedule should not pre-empt the form of policy/regulation that may emerge under the national framework – the italic description included with this function relates directly to the quality of regulation rather than the transfer of the function.</p> <p>The principle that distribution tariffs should be set between the stand-alone and incremental costs of service is a lower level principle related to pricing structures rather than pricing and revenue in general.</p>

4	Service performance targets – <i>Service reliability, service quality and customer service measures.</i>	<p>Appropriate to develop service standard regulatory framework at a national level and support national consistency in the definition of service measures. It is not clear, however, that the service performance regimes that apply in each jurisdiction should be nationally consistent.</p> <p>Recommend remove term “targets”. Targets are not in place in all jurisdictions. For example, the Victorian incentive-based service standard regime sets incentive rates that incentivise the efficient level of service delivery and investment.</p> <p>Query whether the intention is to develop nationally consistent targets and measures.</p>
5	Information disclosure – <i>Rules that define the information that must be provided to AER by distributors for regulatory functions.</i>	<p>Appropriate at the national level.</p> <p>Functional description should note the different information requirements for an access regime, compared to a regime for enforcing market rules.</p>
6	Connection and capital contributions requirements – <i>basis for the distributor to charge for new connections and capital contributions for capital works.</i>	<p>Appropriate at the national level.</p> <p>This is just one component of the detailed pricing rules contained as a subset of items 1, 2 and 3. It is unclear why it needs to be separately specified.</p>
7	Distribution network expansion rules – <i>rules clarifying when extensions are part of a regulated service and how charges are levied on a national basis.</i>	<p>Appropriate at the national level.</p> <p>Remove “on a national basis” as it is redundant.</p>
8	Distributor obligation to provide connection services – <i>distributor to provide connection and related services to users; the contractual relationship between distributor, retailer and end-use customer.</i>	<p>Appropriate at the national level.</p>
9	Distributor disconnections and reconnections of small end-customers – <i>regulation of circumstances in which a distributor can disconnect or reconnect a small end-user customer and circumstances in which a retailer can arrange a disconnection.</i>	<p>Disconnections may occur for either financial or technical/safety reasons.</p> <p>Rules relating to disconnections for financial reasons are appropriate at the national level. Rules relating to disconnections for technical and safety reasons are linked to safety and technical regulation which is expected to remain at the state and territory level.</p> <p>Should specify <u>rules</u> related to connection and disconnection rather than their <u>regulation</u>. This is a reflection of the functional description, rather than its administration.</p>
10	Distributor interface with embedded generators – <i>regulation of relationship between electricity distribution businesses and embedded generators.</i>	<p>Appropriate at the national level.</p> <p>Connection of embedded generation in some jurisdictions is classed with other connection rules. Currently not all states have deemed it necessary to develop specific rules for embedded generation.</p> <p>Should specify <u>rules</u> related to connection and disconnection rather than their <u>regulation</u>. This is a reflection of the functional description, rather than its administration.</p>

11	Distributor interface with retailers – <i>regulations relating to dealings between retailers and distributors including use of system agreements.</i>	Appropriate at the national level. Query whether intention is to develop nationally consistent Use of System agreement. Currently scope for Use of System agreement to vary to those approved by regulator through negotiation between the distribution and retail business. Should specify <u>rules</u> related to the relationship between retailers and distributors, rather than their <u>regulation</u> . This is a reflection of the functional description, rather than its administration.
12	Other distribution related market rules.	This implies no remnant functions (other than safety and technical regulation) at a jurisdictional level and is supported as a policy statement.
13	Network planning – <i>determination of network investments.</i>	Distribution network planning is currently undertaken by distribution businesses as part of normal business operation and is <u>not</u> overseen by jurisdictional regulators. The distribution pricing process instead governs the determination of efficient investment, which can be influenced by governments and regulators through service standard regimes. Given this, the ENA considers that to the extent necessary these issues are already addressed in items 1-3, and does not consider that any further requirements are appropriate matters for consideration through the national framework.
14	Metering – <i>obligations to install, maintain and read meters. Includes the rights in relation to entry of premises for metering purposes.</i>	Appropriate at the national level.
15	Retail price regulation – <i>relates to the model to be developed by the Commonwealth.</i>	Primarily a retail issue.
16	Retailer obligation to supply to small end-customer – <i>obligations on designated retailers (local retailers) to supply customers and minimum protections in terms and conditions of default/standing offers.</i>	Primarily a retail issue, though retail obligation to “sell” must be consistent with distributor obligations to “connect and supply”.
17	Retailer failure arrangements – <i>arrangements to ensure the continuity of energy supply to customers and integrity of wholesale market settlements.</i>	Appropriate at the national level. Retailer failure involves significant obligations on the distributor to manage metering arrangements and immediate customer transfer to default retailer. Retailer failure can also give rise to counterparty credit risks (as the retailer is often the agent for the distributor collecting DUOS). Governments need to resolve the related issue of specifying any businesses as retailers of last resort before settling this matter.
18	Retailer: Small end-customer market contracts – <i>retailers must obtain informed customer consent to enter Market Contracts.</i>	Primarily a retail issue.
19	Retailer: Small end customer marketing – <i>regulation of marketing conduct of energy retailers.</i>	Primarily a retail issue.
20	TPA and Privacy Act provisions relevant to market contracts and marketing.	Primarily a retail issue.
21	Other retail related market rules not covered elsewhere.	Primarily a retail issue.

22	Balancing regime and settlements, effecting customer transfer in balancing and settlements system – <i>regulation to ensure settlements and accurate financial reconciliation of supply/consumption transactions and regulate churn of contestable customers.</i>	Appropriate at the national level. <u>Rules</u> related to settlements rather than <u>regulation</u> . This is a reflection of the functional description, rather than its administration.
23	Merits and judicial review.	Support national arrangements for merits and judicial review. Note that this approach would be inconsistent with state-based bodies, such as courts, undertaking reviews of decisions made under a national regime.
	States/Territories	
24	Business authorisation – <i>refers to licensing and authorisation schemes that require distributors to demonstrate technical capability.</i>	Support at state/territory level, however framework must ensure that this licensing power does not allow a dual level of economic or service standard regulation.
25	Distributor – Small end-consumers dispute resolution – <i>distributors’ requirement to have internal dispute resolution schemes for the small end-customers and participate in independent alternative dispute resolution schemes.</i>	Support at jurisdictional level but note that under a national regulatory and pricing regime, state-based dispute resolution schemes may not be the most efficient approach.
26	Retailer – Small end-customer dispute resolution – <i>obligation of retailers to have internal dispute resolution/record keeping procedures and participate in independent alternative dispute resolution schemes.</i>	Primarily a retail issue, but note that arrangements for distribution and retail dispute resolution schemes will most likely be common.
27	Load Shedding and curtailment – <i>rules for reduction of supply of energy to customers in order to maintain system security.</i>	Support at state/territory level and note parallel MCE process developing governing rules for this function.
28	Community Service Obligations – <i>jurisdictionally based service obligations applied on distributors and retailers.</i>	Support at state/territory level and note the COAG commitment to administer CSOs through transparent mechanisms that do not distort other market outcomes. CSOs must also be fully funded by jurisdictional governments or recognised and funded through the regulatory regime. Query how CSOs embedded in other market rules (such as obligations to connect) will be treated under a national framework.
29	Environmental obligations – <i>relates to jurisdictionally based greenhouse gas abatement schemes and consideration of demand side response.</i>	Support environmental obligations at state/territory level but query the inclusion of all demand side measures with environmental obligations. Much of the activity currently happening in the market on demand side management relates to market and capital efficiency rather than environmental obligations – capital efficiency issues (such as the treatment of demand management by the regulator) are part of economic regulatory functions that should be included under the national arrangements above.
30	Local gas market arrangements.	Support at state/territory level.
31	Fair trading legislation provisions relevant to market contracts and marketing.	Support at state/territory level.

	Abolish	
32	General business authorisations (licensing) for retailers and distributors – <i>includes any matters other than technical capability and safety.</i>	Abolition of licences potentially impacts the rights of distribution businesses. This approach was not anticipated in the distribution and retail framework <i>Issues Paper</i> of August 2004. Further industry consultation required as to legal consequences of removing licences from the regulatory framework before approach can be supported.
33	Taxes and levies – <i>jurisdictionally based which are linked to energy services.</i>	Support the abolition of jurisdictionally-based levies and taxes. The ENA requests clarification about how the linkage to “energy services” may qualify this commitment
34	Redundant regulatory instruments – <i>recognising that some requirements may have been incorporated elsewhere.</i>	Support removal of redundant and duplicative regulation, especially where this regulation poses the risk of dual (state/territory and federal) regulation or inconsistent regulatory rules. This category appears to only anticipate abolition of rules/requirements that are duplicative and does not consider the abolition of rules that are unnecessarily onerous. The ENA support of a national framework has always been predicated on their being a net improvement in the quality of regulation that applies under a national framework, including a reduction in the burden of regulation of businesses.

ATTACHMENT B

Functions of governments and market institutions*

	MCE	AEMC	AER	Jurisdictional governments	Jurisdictional regulators	Participants	Review
National Licence							
Need to licence	✓						
Develop		✓					
Amend		✓					Judicial
Grant, suspend and revoke			✓				Judicial & Merit
Exempt		✓ (if required)					Judicial
Enforce			✓				Judicial
Jurisdictional licence schedule (if required)							
Need for schedule	✓						
Develop		✓					
Amend		✓					Judicial
Issue			✓				
Exempt		NA					
Enforce			✓				Judicial
National Electricity Rules – established governance provisions							
Initiate amendments	✓	X	✓	X	NA	✓	
Develop		✓					
Amend/change		✓					Judicial
Issue		✓					Judicial
Enforce			✓				Judicial
<i>Jurisdictional derogations (Chap 9)</i>							
Initiate				✓			
Issue		✓					Judicial
Enforce			✓				Judicial
<i>Individual derogations (Chap 8)</i>							
Initiate						✓	
Issue		✓					Judicial
Enforce			✓				Judicial

* Functional split as contained in ENA submission in response to the MCE SCO Distribution and retail framework issues paper.

	MCE	AEMC	AER	Jurisdictional governments	Jurisdictional regulators	Participants	Review
National distribution industry rules/codes							
Initiate development	✓					✓	
Develop		✓					
Initiate amendments	✓					✓	
Amend		✓					Judicial
Issue		✓					Judicial
Exempt		NA					
Enforce			✓				Judicial
Code interpretation guidelines							
Develop			✓				
Issue			✓				
Jurisdictional distribution industry codes/rules							
Initiate development				✓		✓	
Develop		✓					
Initiate amendments	✓					✓	
Amend		✓					Judicial
Issue		✓					Judicial
Exempt		NA					
Enforce			✓				Judicial
Network pricing							
Electricity determination			✓				Judicial & Merit
Gas reference tariff			✓				Judicial & Merit
Price or Tariff Order (existing)	replace with national access pricing principles						
Price or Tariff Order (new)							
Technical, safety, environmental regulation							
Issue					✓		Judicial
Enforce					✓		Judicial

- ✓ Indicates the institution which the ENA considers should be allowed to carry out a particular function. Where governance arrangements have already been established, for instance for the National Electricity Rules, the ticks reflect ENA's understanding of the current functional allocation.
- X Indicates where the ENA understands specific prohibitions have been established in legislation or by agreement.
- NA Indicates where no functional allocation is necessary as the function is not available under the ENA preferred arrangements.