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Streamlining of the Code Change Process
C/- MCE Market Reform
Department of Industry, Tourism and Resources
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esaa Submission on Streamlining of the Code Change Process and on the AER-AEMC-ACCC Memorandum of Understanding Framework.

Thank you for the opportunity to comment on the discussion papers "Streamlining of the Code Change Process" and "AER-AEMC-ACCC Memorandum of Understanding Framework," both dated March 2004. esaa appreciates the consultative approach taken by the Ministerial Council on Energy's (MCE) standing committee of officials. We trust that the comments provided will be incorporated into the final deliberations on this important issue.

We have included in this submission comments on both discussion papers, as we do not believe that the two issues can be examined in isolation. After considering the Discussion Paper and the December 2003 Ministerial Communique, esaa's summarised position is:

- The proposed Code Change process has not precluded a 'two-step' decision making process as the ACCC remains able to commence its own, separate investigation into those Code changes that the AEMC has referred to it for authorisation and is consequently not an improvement on the current approach;
- The denial of a merit review avenue for regulatory decisions of the AER is a significant and unacceptable proposal that is a fundamental departure from existing practice for many regulated energy businesses. It will lead to the pursuit of expensive and often lengthy legal actions to seek remedies when a more simple approach could have been provided; and
- The provision of staff to the AER by the ACCC with the ability for these staff to work on other, competition related matters for the ACCC together with unfettered information sharing powers between the agencies will likely result in the AER being unable to establish its own culture and working methods independent of the ACCC while highly sensitive company information acquired for one specific purpose will likely be used for purposes for which it was not intended. Staffing of the AER in esaa's view should be by the agency itself with no relationship to the ACCC. Information should only be shared between agencies with the express permission of the affected companies.

Our detailed submission is attached for your consideration. I would be pleased to elaborate or clarify any points with you.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brad Page', with a stylized flourish at the end.

Brad Page
Chief Executive Officer

1. Streamlining of the Code Change Process

esaa understands that the core principle behind the proposed institutional change is the acceptance of the need for an effective, transparent and streamlined code change process, where the roles and responsibilities of the various regulatory agencies are clearly defined, and they are accountable for their actions. It is our view that for this to occur the code change process should promote the swift conclusion of matters, and without the potential for duplication or overlap between regulatory bodies. esaa has for some time argued that the simplest way of achieving this is to establish a “one-step” code change process, rather than the duplicative process which currently occurs.

We believe that the proposed code change structure and process, as outlined in the March discussion papers, has the potential to become a duplicative, inefficient process, with many of the same faults as the current process. Our concerns are outlined below.

a. Not a streamlined process

Our major concern relates to the role of the Australian Competition and Consumer Commission (ACCC) in this process. While the roles and responsibilities of the proposed Australian Energy Regulator (AER) and the Australian Energy Market Commission (AEMC) appear to be relatively well defined, the ACCC’s role in regulating the sector is not sufficiently clear.

We note that the MCE, in its December 2003 report to CoAG on Energy Market Reforms, recommended that the ACCC retain responsibility for competition regulation under Part IV of the Trade Practices Act (TPA), for competition-related code-change authorisations under Part VII, and for industry access code approvals under Part IIIA. The latter two responsibilities, in our view, create confusion as to which institution is ultimately responsible for the code change process. This uncertainty over responsibility is one of the major criticisms of the current NECA / ACCC code change process.

It is our understanding that, under the current Code and legislation, many authorisations and approvals are not required to be referred by NECA to the ACCC, but that this process is followed to rule out any TPA implications. esaa’s concern is that the proposed new structure has the potential to lead to the same outcomes, and that we in practice remain with a duplicative two-step process.

Section 12 of the discussion paper covers the issue of concern, explaining that “for competition-related proposed code-changes it is proposed that the AEMC would have the discretion to apply to the ACCC for authorisation under part VII of the TPA and for industry access code approval under PART IIIA of the TPA. “ Further, should the AEMC refer a proposed code change to the ACCC for approval or authorisation, the ACCC has the authority to seek further information and convene its own consultation process. Finally, the ACCC may very well, on competition or access grounds, decline to approve a code change recommended by the AEMC.

The scenario described clearly is not the streamlined process originally intended by Ministers or sought by industry. If pursued, this process has the potential to be confusing, time-consuming and repetitive with additional costs for industry and consumers – which is again a criticism of the current process.

A suggested solution to our concerns would be to amend the TPA to hand over full responsibility for competition-related code changes as well as industry access code approvals to the AEMC. The AEMC would have the requirement to consult with the ACCC on competition related matters, but the final decision on code changes approvals and authorisations would be solely that of the AEMC. In this way, the AEMC would become the only body responsible (and accountable) for code changes and approvals, ensuring a simple, one-step process and avoiding all of the concerns raised above.

Under this scenario, the ACCC's responsibility for competition regulation under part IV of the TPA remains unchanged.

b. Need for economic merit review

esaa has significant concerns regarding rights of review and avenues of appeal for decisions of the AEMC and AER. Section 13 of the discussion paper states that, whilst ACCC decisions will be subject to both merit review by the Australian Competition Tribunal and judicial review on questions of law, decisions of the AEMC will only be subject to judicial review on questions of law. Further, revenue determination decisions made by the AER under the Electricity Code will not be subject to merit review, whilst the existing provision under the Gas Code for merit review of certain decisions will remain.

Clearly, there are a number of inconsistencies in the above proposals. The view of esaa is that all decisions of the ACCC, AEMC and the AER should be subject to judicial review on questions of law as well as merit review by the Australian Competition Tribunal.

We believe that accountability, consistent with independence and an appropriate balancing of interests, is achieved by the imposition of a clear and understandable legal framework, with oversight and supervision provided by a suitably qualified body. It is imperative that stakeholders are not denied the protection of the judicial system in an environment where the regulators have broad powers. We do not promote an environment of US style rate making where legal processes dominate, but recognition needs to be given to the fact that, with so much at stake in regulatory decision-making, resort to legal protection is a basic entitlement.

esaa also strongly believes that an appropriate appeal forum should be available to review the regulator's decision on merits, rather than simply exercise a supervisory jurisdiction. Regulatory decisions, especially in the determination of price paths, revenue caps and allowed rates of return involve subjective judgements that can critically alter outcomes for the affected businesses. For example, the price re-set process for regulated businesses is lengthy and intricate in which errors of calculation can be easily made and where the technical and economic application of the Codes can be open to reasonable debate. As such, esaa recommends that the Australian Competition Tribunal be used as an appropriate forum for appeal of decisions by the AEMC and AER, in the same manner as it is used for reviewing decisions of the ACCC. This is also consistent with practice in the United Kingdom, where the Competition Commission reviews decisions of the UK energy regulators on merit.

2. AER / AEMC / ACCC Memorandum of Understanding Framework

esaa has also considered the separate discussion paper on a framework for an MoU between the AEMC, AER and ACCC. While we welcome the use of an MoU to clearly define the roles and responsibilities of the various institutions, esaa believes that detailed discussion on the MoU is premature until discussion over the regulatory structure is finalised and can be properly reflected in an MoU. Nonetheless, there are some significant aspects of the draft MoU that we would expect to not be affected by further consideration of regulatory structure matters and which cause esaa some concern.

a. Independence of AER staff

We note the proposal that, while the AER will be a separate legal entity, the staff of the AER will be employed directly by the ACCC and then will be seconded to the AER. Further, it is envisaged that AER staff will assist the ACCC in relation to its functions in the energy sector, including potential breaches of Part IV by energy market participants, for example through mergers and acquisitions.

We also note with unease that there is proposed to be no limitation whatsoever on the sharing of information between the ACCC and AER, on the basis of the policy decision that the AER is a constituent part of the ACCC.

This raises significant concerns for esaa. These relate primarily to the issues of privacy and confidentiality, and information being used only for the purpose for which it was intended.

In the course of their day-to-day business of regulating the industry, members and staff of the AER will be provided with access to significant detail on the inner workings of energy supply companies. This is particularly true where the AER is responsible for economic regulation of gas pipelines, and electricity wholesale markets and transmission networks. Much of this information will be provided to the AER for the express purpose of undertaking a regulatory access price review, or in assisting the AER in making a relevant regulatory decision. This could include information on hedging and other risk management strategies, financial arrangements with funding organisations, comprehensive technical analyses and details of core strategic plans.

Under the current proposals, the ACCC would have access to any or all of this information during the course of any investigation into a potential breach of the TPA, for example a potential merger or acquisition. Furthermore, the ACCC can make use of the detailed knowledge of the staff and members of the AER in assisting with its own investigations. Whilst both the ACCC and AER will be subject to appropriate limitations on disclosure to third parties, this does not apply between the two parties.

In our opinion, this proposal is wholly inappropriate, and we oppose this in the strongest possible terms. We believe that confidential information provided to the AER for a particular purpose should be used only for that purpose, and should not be available for use outside the legal entity. Any proposal to share information should only occur with the express permission of the affected companies. Similarly members and staff of the AER should be prohibited from assisting the ACCC on matters related to the enforcement of the TPA, where there is the potential for disclosure of confidential information.

b. AER to develop its own culture

Flowing from this, we believe that it is essential that the AER develop its own identity, culture and method of operation. In our view, operating as a specific sectoral industry regulator is significantly different from operating as a broad-based competition regulator. It is important that the AER is provided with sufficient room to establish its own culture, under the guidance of its own leadership team. We do not believe this is possible in an environment where AER staff are actively involved in projects on behalf of the ACCC and are employees of the ACCC.

A simple solution to our concerns would be for the AER to recruit its own staff under the name of its own legal entity, and not rely on secondments from the ACCC. Seconded staff inevitably have dual loyalties and responsibilities, something we think is essential to avoid if the AER is to truly be an independent regulator. We do not see any compelling reason for staff to be seconded by the ACCC to the AER - only cause for concern.

As you will be aware, the need for an efficient, effective and robust regulatory framework is essential to attract the necessary infrastructure investment our economy requires. Investors need to be confident that their investments will not be caught up in an inefficient, bureaucratic regulatory environment where lengthy processes dominate and urgent action is delayed. Similarly, investors require assurance that regulators are accountable for their actions and that they have in place legislated rights of appeal against both the process followed and the economic merits of a decision. Industry also seeks assurance that sensitive information provided to regulators for a particular purpose is subject to strict disclosure limitations, and will not be made available to other regulatory bodies for unrelated activity.

We commend the MCE in recognising the importance of creating this framework, and are anxious to ensure that the opportunity for effective reform is not lost.