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National Energy market Branch
Department of Industry, Tourism and Resources
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Submission on the National Framework for Electricity and Gas Distribution and Retail Regulation

ENERGEX Limited (ENERGEX) appreciates the opportunity to respond to the questions raised in the Ministerial Council on Energy's (MCE) issue paper, *National Framework for Electricity and Gas Distribution and Retail Regulation*.

ENERGEX understands that the task is an extensive one and the paper itself includes a comprehensive list of issues. However, ENERGEX is concerned that the current process of simply transferring the state-based regimes to a national framework may result in:

- a missed opportunity to develop a "best practice" regulatory framework as foreshadowed in various MCE communiqués; or
- a reopening of the debate on economic regulation while ignoring the well-researched and substantive independent recommendations of the Productivity Commission's *Review of the National Third Party Access Regime* and *Review of the Gas Access Regime*.

ENERGEX submits that the essential outcomes for a national framework for Distribution and Retail regulation are:

- achieving conformity between gas and electricity is achieved except in instances where there are no net benefits;
- adopting the substantive recommendations in the Productivity Commission's *Review of the National Third Party Access Regime* and *Review of the Gas Access Regime* ;
- with regard to governance arrangements, clarifying the extent of the powers afforded to the MCE, the Australian Energy Regulator (AER) and Australian Energy Markets Commission (AEMC) in respect of rule-



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- making, energy market reviews and information collection and sharing powers; and
 - adopting a national licensing framework for the retail energy market to ensure jurisdictional differences in regulatory requirements are harmonised at the national level and any overlap in regulatory functions is removed. This national framework should apply to distribution where there are obvious net benefits.

ENERGEX's position on these major issues is detailed below.

Convergence with gas and electricity

The frameworks governing gas and electricity should be closely aligned for both the distribution and retail sectors. This will maximise the net benefits of the national framework by allowing participants that provide services in both electricity and gas markets to capitalise on achievable efficiencies.

ENERGEX recognises that in specific instances, convergence between gas and electricity may not be appropriate and does not advocate conformity for conformity's sake. However, it is very important that the principles and objectives of economic regulation are the same for gas and electricity.

Productivity Commission Review

The Productivity Commission recommended a number of regulatory reforms in its *Review of the Gas Access Regime*. Although the Commission's recommendations are still being considered by government, ENERGEX believes that these reforms should be fully adopted in the new national framework for the regulation of electricity and gas distribution. Specifically, it is important that energy distribution regulation incorporate:

- a two-tiered approach to regulation;
- clear objects clause and pricing principles;
- acceptance of the propose-respond regulatory model; and
- full merits appeal of all regulatory decisions.

The Productivity Commission has recommended that two tiers of regulation be available for regulation of gas businesses. ENERGEX believes this approach is clearly transferable to electricity network regulation.

Price regulation would apply at Tier 1 where it is assessed that there is evidence of a company exercising substantial market power. Price regulation under Tier 1 does not necessarily continue what currently occurs, but also provides for non-building block regulatory alternatives as long as they satisfy the objects clause.

Price monitoring, a light-handed alternative form of regulation to Tier 1, would apply at Tier 2 and be available for businesses that do not exercise market power. The Commission advocates a monitoring regime which would provide for satisfying the unique needs of customers and user industries and acknowledges that there are various techniques which could be applied under monitoring. There would be a credible threat that the misuse of market power under Tier 2 would trigger a return to the condition of Tier 1, where prices are regulated.

As stated above, regulation under Tier 1 would need to be assessed against a clear objects clause and set of pricing principles. The Productivity Commission's *Review of the National Access Regime* and more specifically, the *Review of the Gas Access Regime*, recommended the removal of many conflicting objectives in the Gas Code and their replacement with:

“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.”

The Commission also proposed that the pricing principles in the Gas Code be replaced with:

“A reference tariff or reference tariff policy should be designed with regard to the overarching objects clause, s.2.24 and the following principles:

- (a) that reference tariffs should:*
 - (i) be set so as to generate expected revenue for a reference service or services that is at least sufficient to meet the efficient costs of providing access to the reference service or services*
 - (ii) include a return on investment commensurate with the regulatory and commercial risks involved*
- (b) that reference tariff structures should:*
 - (i) allow multi-part pricing and price discrimination when it aids efficiency*
 - (ii) not allow a vertically integrated service provider to set terms and conditions that discriminate in favour of its associated businesses in upstream or downstream markets, except to the extent that the cost of providing access to non-associates is higher*
- (c) that reference tariffs should be set so as to provide incentives to reduce costs or otherwise improve productivity.”*

It is recognised that the National Electricity Code also contains many conflicting objectives and pricing principles. Given this, ENERGEX believes that Commission’s recommendations for the objects clause and accompanying set of pricing principles be accepted within the national energy access regime as they are the result of a comprehensive review of all stakeholder views by an independent authority.

Similarly, the ‘propose-respond’ model for economic regulation is currently used within the Gas Code and the Productivity Commission’s *Review of the Gas Access Regime* judged it to be an effective model of regulation.

This model has also been clarified in the Epic (WASC), GasNet and EAPL judgements where it was ruled that regulated companies may submit proposals and the task of the Regulator is to assess proposals against the objectives of the legislation and not to prefer some alternative.

ENERGEX believes the ‘propose-respond’ model is an essential part of an effectively operating regulatory framework and should also be adopted within national energy regulation.

Finally, the lack of merits-based review for most networks regulated under the National Electricity Code is a significant omission.

Access to merits-based review was a core recommendation of both the Productivity Commission’s *Review of the National Access Regime* and its *Review of the Gas Access Regime*. ENERGEX strongly believes that merits based review should be available for all regulatory decisions such as the economic regulatory decisions of the

AER, but also other decisions which affect service providers such as the granting or withdrawal of an operating licence.

Governance

Distribution and retail businesses are currently regulated under a mix of national and jurisdictional legislation, regulations, rules, codes and guidelines.

In moving to national arrangements, consideration must be given to:

- the division of powers between the MCE, AEMC and AER;
- the functions that should be made national; and
- the development, amendment and enforcement of these functions.

ENERGEX supports governance arrangements where:

- the MCE is to provide policy guidance and a legislative framework within which the AER and the AEMC operate. This includes distribution regulation and market development under the new national framework;
- the functions of market development sit within the AEMC and it should hold the power of development and amendment of the rules that apply within the national framework; and
- the AER is to function as the economic regulator and will be limited to the enforcement of the market rules and requirements as developed through the MCE and AEMC processes.

A move to national governance arrangements will still require that legitimate jurisdictional differences are accommodated. ENERGEX notes that any obligations that are imposed on businesses due to jurisdictional legislation must be taken into account by the AER within their economic regulation of the businesses.

National Licensing

Australian energy retailers have long argued for the jurisdictional differences between retail regulatory requirements to be standardised. This is because of the significant compliance costs currently being faced by energy retailers attempting to participate in the various states of the national energy market.

ENERGEX understands that the control of retail prices for both electricity and gas are not included within the MCE reforms and will remain with jurisdictions. However, a standard form of national retail licence should exist for electricity and gas to allow licence holders to carry on their retail activities in any State within the national market.

A national distribution licence should also be introduced where the development of such a licence is beneficial. The benefits will be largely dependent on the sufficient transfer of jurisdictional conditions to a national licensing body and subsequent removal of these conditions from the state-based schemes.

ENERGEX would note that the conditions, guidelines and rules to be attached to the national licence should not attempt to accommodate the requirements of all current jurisdictional arrangements. Consideration needs to be given to the benefits and costs of implementing each of the multitude of conditions, guidelines and rules that are currently in place in each jurisdiction so that national consistency is achieved with minimal compliance cost.

ENERGEX has specifically addressed the individual questions and the framework proposals raised in the MCE's Issues Paper in the attached submission.

If you have any questions, ENERGEX would be happy to discuss its views in further detail.

Yours sincerely

Jennifer Hocking
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