



**Submission to the Ministerial Council on Energy
Standing Committee of Officials**

**Public consultation on a national
framework for energy distribution
and retail regulation**

**Response to Paper prepared by NERA Economic
Consulting and Gilbert + Tobin**

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1. Overview

The Energy Networks Association (ENA) welcomes the opportunity to respond to the NERA/Gilbert+Tobin paper released by the Ministerial Council on Energy Standing Committee of Officials in October 2005 on developing a national framework for energy distribution and retail regulation (the *Consultants' Paper*).

This submission applies the set of criteria developed by the ENA in response to the August 2004 SCO Issues Paper to the proposed framework in the *Consultants' Paper*, to see if it would achieve a net improvement in the regulation of distribution networks.

While some elements of the proposed framework outlined in the *Consultants' Paper* are supported, the framework, considered in total, does not meet the requirements of ENA members that the new national distribution framework delivers a net improvement in the regulation of distribution businesses (see Section 8, Table 2).

The ENA seeks clarification on a number of issues before it can support the removal of distribution licences. ENA members are concerned to ensure that property rights bestowed by existing jurisdictional licences and arrangements are protected under the future national framework, and that retail prudential issues are considered adequately. There is also potential that jurisdictional licences for safety, technical and environmental regulation may increase the risk of dual obligations at state and national levels, increasing uncertainty and regulatory burden for distributors.

The ENA does not support a jurisdictional power of direction over the AER and distribution businesses. Providing a power of direction over the AER circumvents accountable and transparent regulatory decision-making and is inconsistent with establishing an independent regulator. Jurisdictional community service obligations (CSOs) should instead be established through legislation, and other factors addressed through transitional and savings provisions. The AER must be obliged to recognise and accommodate all obligations placed on distribution businesses through legislation, including CSOs and service standard obligations.

The ENA supports the approach to the management of the transfer of functions, which includes high level provisions in legislation, with detailed rules to be developed by the AEMC following the transfer. Issues relating to the rules to apply to businesses immediately after the transfer, their regulation, and the process for developing new rules, still need to be clarified. It is essential that the AEMC be adequately staffed and resourced to undertake the considerable task of drafting new national distribution rules following the transfer of regulatory responsibility to the AER.

The ENA notes that price and access parts of the paper will be considered as part of the MCE expert panel process, and therefore does not address them here.

The ENA does not support the arbitrary imposition of a single approach (triangular approach) to contracting between retailers, distributors and customers. The ENA considers that the contractual approach should match the circumstances, and that national consumer protection obligations can be imposed without forcing national consistency in contractual approaches.

Much of the discussion in Part D of the *Consultants' Paper* ignores current industry and co-regulatory processes working towards developing efficient, nationally consistent rules in areas such as metering and balancing and settlements, and is therefore not supported by ENA members.

The ENA considers that the next steps in this process will necessarily involve considerable consultation with industry as the legislative framework is developed. The ENA and its members are prepared to provide considerable expertise and resources to this process.

2. Background

This submission responds to the NERA/Gilbert+Tobin paper released by the Ministerial Council on Energy Standing Committee of Officials in October 2005 on developing a national framework for energy distribution and retail regulation (the *Consultants' Paper*).

The Energy Networks Association is the national representative body for gas and electricity distribution network businesses. Energy network businesses deliver electricity and gas to over 12 million customer connections across Australia through approximately 800 000 kilometres of electricity lines and 75 000 kilometres of gas distribution pipelines. These distribution networks are valued at more than \$35 billion, and each year energy network businesses undertake capital investment of more than \$5 billion in network reinforcement, expansions and greenfield extensions.

3. Policy framework for ENA response

Support for MCE decision on the transfer of distribution and non-price retail regulation to national regulatory arrangements

The ENA welcomes the recent agreement by energy ministers to a clear framework for the transfer of distribution and non-price retail regulation to national regulatory arrangements. This clear commitment provides a degree of certainty to industry over the future reform program of governments, and resources to be devoted to this process.

The 1 January 2007 deadline set by the Ministerial Council on Energy is clearly ambitious, however the ENA considers that this timeframe is achievable, provided clear policy decisions on the scope of the overall framework and regulatory guidance are made in a timely fashion. This submission highlights some of these decisions, however some, such as a final decision on review arrangements for key electricity and gas regulatory decisions, and outcomes of the Expert Panel consideration of pricing and revenue rules for the energy sector are related to other Ministerial Council on Energy work programs.

ENA approach to proposals in the *Consultants' Paper*

The ENA submission of October 2004, responding to the MCE SCO *Issues Paper* on the Distribution and Retail framework, outlined the ENA approach to the MCE work program on the development of a distribution and retail framework. The ENA approach had a number of elements, including the separation of consideration of functional allocation issues from issues relating to the quality of regulation, and the development of a set of criteria against which the ENA would assess any future distribution regulatory framework.

Separation of consideration of functional allocation issues from issues related to the quality of regulation

The ENA has already commented on a proposed framework schedule for the transfer of functions to the national energy bodies.¹ In its submission, the ENA supported the apparent approach of energy ministers of considering functional allocation issues separately from issues related to the quality of regulation, such as pricing and access regulation. The ENA supported the proposed framework allocation, subject to the satisfactory clarification of the detail behind some of the functional descriptions.

Since this time, issues related to the pricing and access regulation recommendations of the Productivity Commission review of the gas access regime, and an assessment of the appropriateness of this approach for the energy sector, have been referred to an expert panel for consideration.² These recent developments have significant implications for consideration of the *Consultants' Paper*, which also includes recommendations on the approach to energy distribution pricing and access. These recommendations are now superseded by the decision by ministers to establish the expert panel.

The ENA supports the separation of consideration of issues related to access and pricing for the energy sector as a whole, from the development of the distribution and retail framework. The ENA intends to provide detailed submissions to the expert panel's considerations to assist its consideration of energy pricing and access issues, as directed by the Ministerial Council on Energy. The ENA will not, therefore, respond to the approaches proposed in the *Consultants' Paper* in detail, but will provide some guidance on issues raised in the *Paper* that are not expected to be addressed by the expert panel.

ENA criteria for assessment of framework for distribution regulation

The development of a national distribution framework represents a clear opportunity to create a more efficient and effective environment for distribution sector regulation. The ENA has been a vocal supporter of the move to national regulatory arrangements, however, this support has always been predicated on achieving net improvements in the quality and accountability of regulation of networks across the country through the new framework.

In response to the SCO Issues Paper released in August 2004, ENA members developed a set of criteria against which to assess any future distribution framework to see if it would achieve a net improvement in the regulation of distribution networks. The criteria present a benchmark against which to test the final form of the framework, and the treatment of transitional issues. ENA members also outlined the outcomes that could be expected if these criteria were satisfied. The criteria are listed in Box 3.1.

The ENA intends to use these criteria throughout this submission to assess the approaches outlined in the *Consultants' Paper*.

¹ Energy Networks Association Submission, *Response to proposed amendments to the Australian Energy Market Agreement: Distribution and retail framework*, November 2005.

² Ministerial Council on Energy, *Energy Market Reform Bulletin No. 56: Expert Panel Review of Revenue and Network Pricing across the Energy Market*, 7 December 2005.

Box 3.1: Criteria for an effective national framework for distribution

An effective national framework for distribution 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 **outcomes** which would be expected from this framework include:

- enhancing the medium-term interests of consumers through timely infrastructure investment and non-discriminatory access to network services valued by customers;
- elimination of regulatory overlap (avoiding dual national/jurisdictional regulation);
- provision of clear objectives to guide rule-making bodies, including a need to appraise the costs and benefits of rule changes;
- well defined regulatory discretion;
- alignment, where appropriate, of the frameworks governing gas and electricity in order to maximise efficiencies achievable by entities providing services in both markets; and
- recognition of key linkages and costs between technical and economic regulation.

4. Institutional framework

Introduction

The development of a new national regulatory framework for distribution and retail regulation is the central focus of the *Consultants' Paper*. This regulatory framework is fitted into the new energy governance and institutional structure that has been established by energy ministers. This governance approach is set out in the *Australian Energy Market Agreement* and clearly establishes the roles of various institutions as:

- **Ministerial Council on Energy (MCE)** - national policy and governance body for the Australian energy market. Responsible for energy legislation and able to issue policy directions to the AEMC.
- **Australian Energy Market Commission (AEMC)** - rule-making and market development for the electricity and gas sectors, and electricity and gas market reviews.
- **Australian Energy Regulator (AER)** - energy transmission and distribution economic regulation, market rule enforcement and monitoring.

This structure conforms to the ENA criteria for assessing the distribution framework, outlined in the previous section, through the separation of rule making from enforcement, and the establishment of an equitable and transparent rule change process through the AEMC.

The *Consultants' Paper* largely reflects a reasonable split of rule making and rule enforcement between the AEMC and AER. Some areas of concern arise for ENA members in the section of the *Consultants' Paper* addressing pricing and access issues, in particular in relation to the regulation of service standards (Part B). These are addressed in section 5 of this submission.

Other issues of ENA member concern with the governance framework in the *Consultants' Paper* relate to the approach to licensing, the proposed power of jurisdictional direction on the AER, and the role of the AER in setting service standard targets. These issues are discussed in the following sections of this submission.

The final part of this section of the submission considers the management of the transfer of functions to the AER and AEMC, and the role of the AEMC in developing detailed national rules, as anticipated in the *Consultants' Paper*.

Distribution and retail licences

Approach of *Consultants' Paper*

The *Consultants' Paper* proposes that there be no national distribution or retail licensing/authorisation regime. Instead, the *Paper* proposes that distribution licences (or business authorisations) remain a jurisdictional responsibility, and relate mainly to

safety, environmental and technical regulation. Retail licences would no longer be required at all under the framework.³

ENA consideration

The ENA supported the development of a national high-level distribution licence in its submission on this matter of October 2004. This support was predicated on the licence being a simple document establishing the licence holder's technical and financial capacity to operate a network, identifying the legally responsible party for the operation of the network, and containing no substantive rules and obligations. Similar to the approach outlined above, the ENA considered that it was not appropriate to impose or enforce substantive obligations through an administrative instrument.

The ENA does not consider that the *Consultants' Paper* makes a convincing case that the above concept of a simple national licence should be abandoned. The ENA is interested, however, in investigating the approach to licensing outlined in the *Consultants' Paper*, provided a number of regulatory and commercial issues can be satisfactorily resolved. ENA members are concerned to ensure that property rights bestowed by existing jurisdictional licences and arrangements are protected under the future national framework. Further, the comments below seek to ensure that the framework facilitates investment certainty and produces the least overall compliance burden necessary, as outlined in the criteria in section 3 of this submission.

The appropriate party to be licensed

Under current licensing regime in each state and territory, the licence holder is the person responsible for compliance with all applicable laws, rules and regulations. The *Consultants' Paper* appears to confuse this role with that of the network operator, which can be the same party as the licence holder, or can be an asset management company contracted to the licence holder. In any case, legal responsibility for compliance currently clearly rests with the licence holder. It is important that under an arrangement where there is not a licence in place, the legal obligation for compliance with jurisdictional and national laws, rules and regulations clearly rests on a single party, and that that party is the appropriate one. The ENA considers that this should be the asset owner, rather than the asset operator, as the asset operator can change from time to time through contractual changes.

Conferral of rights and obligations

Licences do not only impose obligations on licence holders, but also confer rights on licence holders, including franchise areas and access to private property and easements. Licences are a simple instrument for granting these rights, as a licence refers to a particular party as holding these rights, rather than legislation which usually refers to a class of person with rights. It is possible that this issue could be addressed through regulations, which are more readily changed than legislative provisions and therefore can refer to particular parties. The ENA considers, however,

³ Ministerial Council on Energy Standing Committee of Officials, *Public Consultation on a national framework for energy distribution and retail regulation*, prepared by NERA and Gilbert + Tobin, May 2005, pp 65-6.

that a persuasive argument has not yet been made to move away from the potentially simpler licensing approach.

Need to avoid duplication in regulation between state/territory and national levels

The ENA is also concerned that the proposed jurisdictional licensing regime for environmental, technical and safety matters may create duplication in regulatory obligations to state and federal bodies if the scope of these responsibilities is not clearly defined. This is a particular risk in relation to technical regulation, which can cross into areas of service standard regulation undertaken by the economic regulator, for example. It is also critical that there be a clear obligation on the national regulator to recognise and make allowance for jurisdictional obligations imposed through legislation, regulations or licence conditions.

If issues of duplication of obligations can be addressed, the ENA considers that a limited jurisdictional distribution licence for safety, technical and environmental competence may resolve some of the issues outlined above about the identification of the responsible party for compliance, and the rights of that party. National legislation can refer to this jurisdictional licensing regime as a way of identifying the party responsible for compliance for the national laws, rules and regulations.

Proposal to abolish retail licences

The ENA considers that arguments for and against a national retail licence are different than for those for distribution licences.

In normal operation, a retail business can accrue considerable debt to a distribution business through use of system charges. In commercial contracts, this credit risk can be addressed. However, in a situation where distribution businesses are obliged to provide access, a distribution business may not be able to manage exposure to a party that it may consider to be a bad credit risk.

The distribution business must be able to ensure that the retail business is sufficiently resourced to be able to honour outstanding debts. This can be managed through a licensing regime that includes prudential checks, or can be addressed through use of system contracts. It is important that, if the contractual approach is relied upon, distribution businesses are not unnecessarily fettered in their ability to impose prudential obligations through use of system agreements.

Recognising that distributors may not be permitted to refuse access to retailers, then in the absence of licences, particularly in the gas market, legislation or rules should ensure that (in addition to prudential requirements) retailers must have demonstrated capacity to meet their operational and risk related obligations to distributors.

ENA position

The ENA would consider supporting the approach to licensing outlined in the *Consultants' Paper* provided that:

- Property rights bestowed by existing jurisdictional licences and arrangements are protected under the future national framework

- Obligations and rights imposed through legislation or rules are imposed on the appropriate party consistently and transparently
- There are clear constraints on the scope of jurisdictional technical, safety and environmental licences and regulation to avoid the risk of dual regulation
- There is a clear obligation on the national regulator to recognise and provide sufficient funds to meet jurisdictional obligations
- Distribution businesses are not fettered in their ability to manage retailer credit risk through use of system contracts; and
- Retailers are required to demonstrate financial, operational and commercial competency.

Jurisdictional directions to the AER

Approach of *Consultants' Paper*

The *Consultants' Paper* recommends that the distribution framework provide for mandatory jurisdictional directions to which the AER, retailers and distributors must comply. The scope of these directions is proposed to be limited to:

- the equalisation of distribution tariffs across specified classes of customers
- the values to be included by the AER in the regulated asset base for specifically identified network infrastructure assets (Victoria and South Australia only)
- community service obligations (CSOs) to apply to distributors
- environmental obligations relating to energy, including greenhouse gas emissions, consideration of demand-side management or undergrounding
- taxes and levies.⁴

ENA consideration

The ENA considers that providing a power of jurisdictional direction over the AER is inconsistent with the ENA criteria outlined in section 3 that require the national framework to be:

- adaptable to change through transparent and equitable processes; and
- accountable to all parties through fair processes and merit review mechanisms on key regulatory decisions.

The proposal potentially allows jurisdictional governments to unilaterally determine key regulatory parameters without reference to the Rules, the market objective, or the interests of other parties, and without any review mechanisms being available to challenge those decisions. The ENA cannot support this approach.

The proposed power of direction is intended to be limited. The ENA considers, however, that *any* power of government direction over the AER is inappropriate. The ENA further observes that the proposed “limited” scope of direction includes the potentially broad category of community service obligations (CSOs).

⁴ MCE SCO, *Consultants' Paper*, May 2005 p 92.

The ENA considers that the proposed approach undermines previous MCE decisions to establish a national distribution and retail framework, to place into legislation an overarching objective to govern decision making of the AER and AEMC, and to establish a clear and equitable rule change process. It is also important that the AER retain its current independence from jurisdictional direction to effectively carry out its functions as the energy sector regulator. The ENA notes that currently, no jurisdictional government has a similar power of direction over their local energy regulator. It is unclear why such a power is considered necessary under the national regulatory regime.

Particularly with respect to the application of CSOs and the treatment of regulated asset bases, the ENA considers it essential that the national regime offers certainty in the areas that are proposed to be subject to jurisdictional direction. The ENA does not consider that jurisdictional directions on the AER, as outlined in the *Consultants' Paper*, are an appropriate mechanism through which to achieve this certainty.

As an alternative approach, the ENA considers that jurisdictional CSOs are most appropriately imposed through specific legislation. Legislative drafting requirements mean that such obligations must be clearly defined, and the appropriateness of the CSO scrutinised and debated by parliament. Clear and unambiguous legislative requirements, including jurisdictional CSOs, could be recognised by the AER without undermining independence in its goal of achieving the market objective within the constraints of the legislative framework.

Other areas where the *Consultants' Paper* proposes that jurisdictional directions apply relate to transitional issues that the ENA considers are better addressed through savings provisions and temporary derogations from the National Electricity or Gas Rules, which would require MCE agreement.

The ENA supports the position in the *Consultants' Paper* that in the future, policy issues are decided on a national basis by the MCE, and obligations imposed through the National Electricity or National Gas Rules.

ENA position

The ENA does not support the inclusion of a power of jurisdictional direction (however limited) on the AER. As an alternative, the ENA proposes that the specific areas of direction raised in the paper should be address through:

- **CSOs** - jurisdictional legislation with a parallel obligation on the AER to recognise and fund these obligations.
- **Transitional issues** - savings provisions and transitional derogations that provide investment certainty to businesses through the transfer of current regulatory approaches for an appropriate period.

Role of the AER in setting service standards

Approach of *Consultants' Paper*

The *Consultants' Paper* sets out a process for setting service performance targets.⁵ The approach includes minimum technical and safety standards to be set by technical regulators, and scope for further performance targets in excess of minimum technical levels where customers are willing to pay for higher service. The latter are considered the domain of economic regulation.

The *Paper* argues that service performance targets in addition to minimum performance requirements should be set by jurisdictional governments, or, failing that, the AER. The *Paper* also argues that service performance targets be transparent and set at both average and minimum levels.

ENA consideration

The ENA does not support the approach set out in the *Consultants' Paper*.

Regulatory pricing decisions represent the outcome of an optimisation of the price, service and risk relationship between distribution businesses and customers. This is sometimes referred to as the regulatory bargain. It is important that the regulatory regime ensures that the balance struck between price, service and risk is appropriate, such that it does not discourage efficient investment.

The ENA does not consider that it is appropriate for the regulator set service standards as part of the regulatory bargain. To do so would effectively substitute the regulator in the place of the customer in deciding how the balance between price, service and risk should be made. The ENA considers that the regulator should not be a substitute for the customer in determining customer preferences. The customer should instead be involved in this decision through customer preference analysis, such as customer willingness to pay surveys, threshold analysis, or values of reliability or unserved energy.

The regulator, in determining network price and service, should balance these customer service expectations with the short term price changes that these service expectations suggest. The regulator also needs to recognise and take account of the prevailing circumstances in each jurisdiction, including recognition that governments sometimes set service standards.

ENA position

The AER should not set service standard targets under the national regulatory framework. Service standards are an integral part of the regulatory bargain and the optimisation of price service and risk within that bargain should be determined with reference to customer preferences and any regulatory or government requirements on the distributor for service delivery.

⁵ MCE SCO, *Consultants' Paper*, May 2005, p 31.

Management of transfer of functions to the AER and AEMC

Approach of *Consultants' Paper*

The *Consultants' Paper* framework for the transfer of functions involves establishing high level principles in the national gas and electricity laws. These principles would then provide guidance to the AEMC in developing detailed rules to apply to distribution businesses, following the transfer of functions.

This approach is similar to that which occurred in the development of the new *National Electricity Law* and establishment of the National Electricity Rules, and which was foreshadowed in a recent MCE SCO paper on the development of the *National Gas Law*.⁶ In these cases, many provisions that currently reside in codes and rules are “uplifted” to legislation to provide rules for industry to follow and a decision-making framework for the AER and AEMC.

Differences arise however, as there is currently no national distribution framework to move to the national regulatory arrangements, so these rules must be developed as part of the transfer of functions. The *Consultants' Paper* advocates that many of these rules can be developed by the AEMC following the transfer of functions. Assumed under this approach (though not articulated) is that current jurisdictionally-based rules would continue until replaced or removed by national rules, but would be enforced by the AER.

ENA consideration

There are a number of ways that the transfer of functions to the AER and the AEMC could be managed. Three possible options include:

1. All new national distribution and retail legislation and rules are developed *before* the transfer of functions to the AER and AEMC. This can be done in a number of ways:
 - a. By rules developed by the AEMC after legislation is passed giving it the power to develop national rules in the distribution sector before the formal transfer of functions
 - b. By governments (specifically SCO) and enacted through a “one time” legislative act (similar to the enactment of the National Electricity Rules)
 - c. By governments and industry through focused working groups, also enacted through “one time” legislative act
2. The transfer of all *current* jurisdictionally-specific distribution and retail rules to the AER and the AEMC and entrusting the AEMC to work to bring national consistency across the rules over time
3. A combination of these approaches, where some national rules are developed before the transfer of functions and placed in legislation, and other areas deferred for the AEMC (or other party) to work to bring national consistency across the rules over time.

⁶ Ministerial Council on Energy Standing Committee of Officials, *Statement of Approach: A new legislative framework for gas*, September 2005.

The approach of the *Consultants' Paper* appears align with option 3, with a number of key principles and parameters to be specified in the national electricity and gas laws before the transfer of functions, with further rules developed by the AEMC following the transfer and in line with the guidance provided in legislation.

The ENA supports this approach in principle, provided a number of issues can be resolved. These are considered below and relate to ensuring that the framework facilitates investment certainty, and is developed through fair and equitable processes.

Clear direction on the rules that apply to distribution businesses

As the ENA understands it, it is intended that ministers will introduce enabling legislation into the appropriate parliaments before the end of 2006, for the transfer of economic regulation of distribution networks to the national regime by 1 January 2007. This will necessarily involve changes to the *National Electricity Law* and *National Gas Law* (proposed) to confer responsibility for distribution regulation in the NEM states onto the AER, and rule-making onto the AEMC. Alongside this legislation, various state and territory governments will need to pass legislation that repeals the current responsibilities of jurisdictional regulators for energy distribution regulation.

It is important to ensure that at all times throughout this transfer process, distribution businesses, retail businesses, the AER and the AEMC are clear as to the rules that apply to them. Ordinarily, this would not prove a particular challenge, however, not all national rules can be finalised before the transfer of functions. It is expected that the transfer of functions would be staged, and see current jurisdictional rules continue to apply under the national framework, until alternative national rules were developed, or it was found that the rules were no longer necessary.

The ENA supports this staged process, as it appears to be the only way to ensure that no gaps appear in the regulation of the distribution sector while national rules are developed. This approach satisfies the ENA criterion that the framework facilitate investment by ensuring regulatory certainty. It also produces the least compliance burden necessary over the transitional period while ensuring that adequate regulation remains in place.

The ENA considers that it would not be possible to develop a full set of national rules to apply to the distribution sector before 1 January 2007. To do so would risk insufficient consultation on key regulatory provisions, possibly meaning that issues of jurisdictional difference may not be able to be considered and addressed appropriately in the new framework.

The ENA considers that it is far more desirable to take the time necessary to ensure that the rules that apply under the national framework are appropriate, take account of all interests, and are workable, than to rush through a framework that may not be adequate in meeting the needs of the community. There may be some areas, however, such as detailed rules relating to pricing and access, where there has already been considerable debate, which can be developed and implemented before the transfer of functions.

Clear allocation of responsibility for enforcement of rules and for economic regulation of networks

As part of the transfer of jurisdictional rules to the national framework, it is essential that responsibility for enforcing those rules is clearly articulated. This will include both transitional responsibilities, and responsibilities longer term.

A number of price reviews are scheduled for the period immediately following the proposed date for the transfer of economic regulation to the AER. The ENA understands that, as these processes are likely to start before the transfer date, they will be completed by the current jurisdictional regulator. If this is the case, it is essential that:

- all decisions to which this special arrangement will apply are clearly determined as soon as possible
- transitional rules are established (possibly through derogations) to formally recognise that this will occur, and ensuring that the appropriate powers rest with the jurisdictional regulator to complete the process
- enforcement of the decision upon completion is undertaken by the AER for the remainder of the determination.

Apart from the pricing decisions where the above arrangements will apply, it is essential that responsibility for all other rules, jurisdictional or national, is unambiguously transferred to the AER for enforcement from the commencement date. Clear responsibility for rule-making must also transfer to the AEMC from the same date.

It may be appropriate to ensure that jurisdictional regulators are able to advise the AER on the intent of jurisdictional rules, as well as their usual regulatory practice in enforcing the rules throughout the transitional period, to ensure that this process is managed smoothly.

Process for developing and approving new national distribution rules

The *Consultants' Paper* proposes that following the transfer of functions to the AER and AEMC, the AEMC will develop new national distribution rules in specific areas. The development of these rules is to be guided by provisions outlined in the relevant legislation. The *Paper* is ambiguous on whether these rules will be incorporated into the current *National Electricity Rules* and proposed *National Gas Rules*, or be included in an alternative instrument.

The ENA would prefer that all national distribution rules be included in the National Electricity and Gas Rules. This approach will bring all relevant rules for each sector into a single document, as some rules applying to distribution businesses currently reside in the *National Electricity Rules* (for example for metering and connections) and others are in various jurisdictionally-based documents.

This approach will also ensure that, as amendments to the Gas and Electricity Rules, that they are developed through the Rule change process established under legislation, and that they satisfy the market objective. This approach will also ensure that industry

is involved in the process and that consumer interests can be adequately represented through the MCE agreed advocacy arrangements.

Funding and resources of the AEMC

The approach outlined in the *Consultants' Paper* allocates a considerable amount of work to the AEMC in the years immediately following the transfer of functions. The ENA considers that the AEMC is the most appropriate body to develop the detailed national distribution rules, however, the transitional process may be lengthy if the AEMC is unable to meet this challenge through inadequate resources. It is critical that the AEMC is adequately resourced, both through funding and appropriate staff, to meet the challenge of developing detailed national rules for the distribution sector within a reasonable amount of time.

ENA position

The ENA supports the approach to the transfer of functions to the AER and AEMC that is outlined in the *Consultants' Paper*, where detailed rules are finalised by the AEMC following the formal transfer of functions. This support is subject to the framework providing:

- clear direction as to the rules that apply at the time of the transfer of rules
- a clear allocation of responsibility for enforcement of rules transitionally and long term; and
- a well-defined process for developing and approving the new national distribution rules that clearly includes industry involvement in the development and approval of rules.

It is also essential that the AEMC is adequately resourced, both through funding and appropriate staff, to manage the considerable workload that this process would create.

5. Price regulation of distribution

Part B of the *Consultants' Paper* focuses on the price regulation of energy distribution services.

Consideration of distribution price regulation in the *Consultants' Paper*

The development of detailed potential regulatory approaches to energy distribution pricing through the same MCE process directed at effecting the functional transfer of distribution and retail to the national level was not supported by energy networks businesses. In particular the ENA considered energy distribution pricing issues should be resolved, as MCE had previously foreshadowed, in the context of an MCE response to the Productivity Commission *Review of the Gas Access Regime*.

Addressing matters of the detailed nature of energy access pricing through the distribution and retail work program would risk a fragmentary approach which fails to adequately take into consideration broader regulatory developments, and the desirability of integrating some specific elements of access regulation across electricity and gas transmission and distribution.

Policy developments since the development of the *Consultants' Paper*

A number of developments have taken place following industry raising these concerns with the Standing Committee of Officials. MCE is scheduled to finalise its response to the Productivity Commission *Review of the Gas Access Regime* through December 2005. As part of this response, the MCE has advised that an expert panel will be appointed to examine a range of energy access pricing issues, with the explicit task of seeking a consistent regulatory framework which could be applied to energy distribution and transmission businesses.⁷

Role of MCE expert panel

The terms of reference for the expert review panel make clear that MCE envisages the expert panel to guide SCO directly on a range of policy issues relating to energy distribution pricing, and make it inappropriate for the distribution and retailing work program to now progress these issues. This would create an inefficient and unintended overlap of policy development processes. This can be demonstrated by examining the scope of the expert panel and the matters raised in Section 2-9 of Part B of the *Consultants' Paper* (see [Table 1](#)).

⁷ Ministerial Council on Energy, *Energy Market Reform Bulletin No. 56: Expert Panel Review of Revenue and Network Pricing across the Energy Market*, 7 December 2005.

Table 1 – Potential overlaps and duplication – Part B and Expert Panel

Scope of price regulation	✓
Form of regulation (price/revenue caps)	✓
Regulatory requirements in tariff setting	✓
Service performance targets	✓
Regulatory process	✓
Information disclosure	✓
Connection and capital contributions	✓ - Not specifically referenced but would be integral part of any new pricing arrangements determined by panel
Distribution network expansion rules	✓ - Not specifically referenced but would be integral part of any new pricing arrangements determined by panel

The ENA intends to provide detailed submissions to the expert panel to assist its consideration of energy pricing and access issues, as directed by the Ministerial Council on Energy. The ENA will also make submissions, if appropriate, on the MCE’s further proposed response to the Productivity Commission *Review of the Gas Access Regime*. The ENA will not, therefore, respond to the approaches proposed in the *Consultants’ Paper* in detail. In order to ensure the consistent and holistic treatment of these issues, the ENA would not support the distribution and retailing work program progressing any of the issues raised in Part B, noting that the draft terms of reference directs the expert panel to take into account this now superseded part of the *Consultants’ Paper*.

6. Consumer protection, other distribution and non-price retail regulation

Consumer Protection

Approach of *Consultants' Paper*

The *Consultants' Paper* proposes to include consumer protection obligations applying to distributors and retailers in the *National Electricity Law* and proposed *National Gas Law*. Specific rules relating to these obligations are to be made by the AEMC, applying to the electricity and gas sectors, with specific matters that AEMC must include or consider in making rules set out in the legislation. These matters include:

- the desirability of consistency between the regulation of gas and electricity, and between jurisdictions
- whether the scope of some obligations should be limited to “monopoly services”
- ensuring the benefits to consumers from regulation outweigh the costs of regulation
- ensuring regulation is clear and simple and does not duplicate consumer protection regulation of general application.⁸

Distribution-specific consumer protection laws would cover:

- an obligation on designated distributors to provide standard connection services to end-customers
- a standard contractual approach to the relationship between the customer, retailer and distributor for electricity and gas
- distributor disconnections and reconnections
- distributor-small end customer dispute resolution.

Compliance with the rules would be subject to a civil penalty scheme.

ENA consideration

The ENA recognises that there are likely to be benefits in developing uniform national rules for the retail sector, as most retail businesses operate in multiple jurisdictions, and many also operate across both electricity and gas. Most of these benefits are expected to be derived from lower transaction costs for those businesses that operate nationally. 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.

Achieving consistency in the interface between distributors and retailers may also give rise to cost savings, however, changing these systems would require significant investment in new systems for both retail and distribution businesses. It is important to ensure that any decision to change already established contractual and systems

⁸ MCE SCO, *Consultants' Paper*, May 2005, p 47.

approaches achieves a net benefit for the community. This approach is consistent with the ENA criterion that the framework creates the least overall compliance burden necessary to meet the objectives of the framework.

The ENA therefore supports the requirements proposed in the *Consultants' Paper* that the AEMC consider the desirability of national and fuel-type consistency, as well as net benefits of any change, in developing rules in this area. The ENA is disappointed that the same tests were not applied to the recommendation in the *Consultants' Paper* to move to nationally uniform (triangular) contractual relationships between customers, distributors and retailers for electricity and gas.

Contractual arrangements between retailers, distributors and customers

The ENA does not support the arbitrary assignment of a single approach to supply contracting between customers, distributors and retailers for electricity and gas.

Current contractual arrangements between distributors, retailers and customers reflect a variety of approaches. It is not accurate to describe the approach in any particular jurisdiction or energy type as being strictly linear or triangular, as all approaches have elements of each. The final form of contracting between these parties is usually determined with reference to the most appropriate way to allocate rights and responsibilities on the different parties. Depending on the issue, this can be either closer to linear or to triangular contracting relationships. The decision as to the most appropriate approach is not arbitrary, but is instead related to the rights and responsibilities being established and the best way to allocate them.

The relevant recommendation in the *Consultants' Paper* appears to have been made without any consideration of the total costs or benefits of a change towards uniform arrangements, or the reasons why changes may be pursued. The ENA considers that it is unlikely that moving to consistent contractual arrangements will significantly reduce the collective costs for retailers or distributors and therefore achieve benefits for customers.

Application of consumer protection rules to distribution businesses

The ENA supports the position in the *Consultants' Paper* that consumer protection obligations be imposed on businesses directly through legislation rather than through licence or authorisation conditions. It is not necessary, however, to impose a single contractual approach on distribution businesses to be able to impose nationally consistent obligations on distributors to provide connection and related services to users, and regulate the terms and conditions on which those services are provided.

An alternative approach would be to include in legislation and rules a set of obligations on distribution and retail businesses with respect to consumer protection. The responsibility would then fall to the businesses to ensure these are met, and the best contractual approach in which to achieve this. The regulator would be responsible to ensure that the approach adopted by businesses meets the regulatory requirements. This approach would ensure that overly complex and prescriptive rules did not constrain innovation in customer service, while still fulfilling consumer protection obligations.

ENA position

The ENA does not support the arbitrary imposition of a single approach to contracting between retailers, distributors and customers. The ENA recommends further consideration of this issue, including analysis of the costs and benefits of requiring a uniform approach across the energy sector. If a uniform approach is considered appropriate after consideration of all the issues, then the MCE should consider a gradual transfer to uniform arrangements aligned with business decisions over the appropriate timeframe to replace current systems.

Distributor interface with retailers

The *Consultants' Paper* acknowledges that not all jurisdictional regulatory regimes regulate the relationship between retailers and distributors. Despite this, the *Paper* recommends heavy regulation of this relationship, through the development of default use of system agreement, without any analysis of whether this regulation is necessary or warranted.

The argument for regulation in the *Consultants' Paper* is based on the fact that distribution businesses are suppliers of a monopoly service, and the assumption is that this means that distribution businesses have no incentive to negotiate balanced contractual agreements with retailers. This assumption ignores that fact that distribution businesses are obliged to provide access to retailers, and that the financial terms of that access are largely determined by the regulator. The *Paper* states that the default use of system agreement would be limited to the minimum necessary to support the consumer protection regime. As mentioned above, it is not necessary to regulate the mechanism for compliance with consumer protection obligations – to do so would unnecessarily stifle innovation in service delivery.

A national approach to use of system agreements is already in place for gas, where terms and conditions are approved by the regulator in a price review and become the default “use of service agreement” as part of the access arrangements. Further regulation in this area will stifle innovation and undermine the service proposal approach.

Use of system agreements can also protect distribution businesses by ensuring that the party to which it is forced to provide access is able to meet its financial obligations to the distribution business. This is essential for distribution businesses, particularly if other mechanisms that can ensure the financial capacity of the retailer, such as licences, are discontinued.

It is important that distribution businesses are not unnecessarily hampered by regulation that imposes obligations on the conduct of normal business activities. Distribution businesses are in the best position to ensure compliance with legislation and rules-based requirements, and do not need additional regulation to govern how this compliance is achieved through contracts.

Distributor interface with embedded generators

The *Consultants' Paper* proposes to impose a highly prescriptive approach to the regulation of the distributor interface with embedded generators. This approach includes rules on how avoided TUOS payments are calculated and the calculation and distribution of avoided network augmentation costs.

The ENA supports the development of national rules for the connection and operation of embedded generators. This issue requires considerable policy consideration, as the approach to embedded generation will necessarily involve resolution of issues such as:

- the role of embedded generation in the network with regard to network augmentation
- the degree to which embedded generators should bear the costs of connection; and
- the appropriate allocation of service performance risk where embedded generators accept payment for avoided network costs.

These are complex issues related to the future emphasis of the market on embedded generation, and they require balanced and comprehensive policy and regulatory consideration, beyond that given in the *Consultants' Paper* or processes undertaken to date. The ENA considers that these issues need to be considered by the MCE Renewable and Distributed Energy Working Group and resolved before detailed rules are developed in this area.

In addition to the need to resolve these high level policy issues, the ENA considers that the approach of the *Paper* disregards the considerable work on embedded generation connection rules that has occurred to date, particularly conclusions drawn in South Australia and Victoria, on the appropriate scope of regulation and rules for the connection of embedded generators.⁹

The *Consultants' Paper* immediately assumes a heavy-handed regulatory approach, ignoring the potential for commercial negotiation of many aspects of connection and distribution of deferred network costs, as was recognised in both the South Australian and Victorian approaches. These approaches are more consistent with the ENA criteria that regulation address areas of clear market failure and produce the least overall compliance burden necessary to meet the objectives of the framework.

The *Consultants' Paper* also recommends many areas that are already part of the National Electricity Rules, including the distribution of avoided TUOS to embedded generators. Other aspects that may require consideration, such as access to network capacity where a number of embedded generators are seeking connection, are not recognised in the *Paper*.

⁹ Essential Services Commission of South Australia, *Amendments to Chapter 2 of the Electricity Distribution Code – Connection of Embedded Generation Units, Final Decision*, June 2005; Essential Services Commission, *Electricity Industry Guideline No. 15: Connection of Embedded Generation*, Issue 1, August 2004.

Balancing regime and settlements, effecting customer transfer in balancing and settlements system

Gas balancing and settlement regimes have in the past been developed through co-regulatory regimes that include industry, governments and regulators working together to develop workable industry rules. This approach has been highly successful, and the ENA does not consider it necessary to impose additional regulatory requirements that may interfere with the current cooperative approach.

ENA notes that balancing and settlements in the national electricity market are handled through NEMMCO.

Metering

The *Consultants' Paper* recommends the development of a national framework for metrology, including prescriptive national metering rules for electricity and gas. This approach ignores the considerable work that has occurred to date in developing a national approach to metrology through the *Joint Jurisdictional Review of the Metrology Procedures*, a process which has the support of most electricity distribution businesses.

The ENA also considers that for the gas industry, an approach that involved the development and implementation of Australian Standards for gas metrology would be preferable to a rules based approach led by the AEMC. This is because Standards Australia has an established process and consultation framework with industry, including metering providers, for developing gas industry standards of this type.

The ENA supports moves to ensure that the national legislative framework continues to provide distribution businesses with essential rights in relation to metering, including access to properties to read meters.

Load shedding and curtailment

Ensuring that energy load shedding and curtailment rules are clear and well understood is essential for distribution businesses and governments.

The ENA supports the current process of the *Gas Emergency Protocol Working Group* in developing a national approach to inter-jurisdictional gas supply emergencies, as well as the current emergency load shedding arrangements in electricity managed by NEMMCO. The ENA notes, however, that the gas emergency protocol work does not consider load shedding associated with local operational issues such as a burst pipe or loss of pressure.

The ENA supports load shedding as part of the distribution framework. The ENA notes that it is often distribution businesses that must implement load shedding in response to emergencies in both electricity and gas supply, and therefore these rules must be clear and provide statutory immunity, as provided in the *Consultants' Paper*, in relation to the implementation of curtailment rules and tables.

The ENA considers that the implementation of gas load shedding is a network management issue, rather than a market supply or consumer protection issue. It should therefore be managed by distributors, as part of individual access terms and conditions, and the constraints of the safe operation of the network.

Retailer failure arrangements

The ENA supports existence of arrangements that ensure that customer supply is not disrupted in the event of retailer failure. The ENA notes, however, that retailer failure can have significant impacts on distributors, particularly as the retailer can have existing financial obligations to the distributor, and the distributor may also be the designated step-in retailer.

The ENA supports the main elements of the retailer failure arrangements set out in the *Consultants' Paper*. The ENA considers, however, that some factors allocated to the AEMC, related to the satisfaction of specific obligations, may be more appropriately undertaken by the AER.

Distributors must have fair and adequate protection of their interests post failure. The ENA considers that any costs incurred by distribution businesses resulting from retailer failure should be able to be passed-through. This provision, however, does not remove the need to ensure that appropriate procedural provisions (discussed above with respect to licences and use of system agreements) are in place to protect distributors and customers from the risk of retailer failure.

Further, it is essential to ensure that there are clear rules establishing the parties responsible for supply after retailer failure, as well the rules of that supply, both over the short term with the transfer of any liabilities, and the longer term as the customer moves to alternative retail arrangements. The ENA urges further consideration of whether it is appropriate to designate distribution businesses as step-in retailers, particularly given that many of these businesses do not have current retail responsibilities.

7. Next steps

The commitment by energy ministers to transfer distribution regulation to the national arrangements by 1 January 2007 sets an ambitious timeframe for governments, industry and the energy market bodies. The ENA welcomes the continuation of industry consultation represented by the release of the *Consultants' Paper*.

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.

The ENA considers that the ministerially-agreed timetable is achievable, provided that ministers accept that some of the details of the national approach to distribution regulation must be developed following the formal transfer of functional responsibility to the national energy bodies. This will mean that the legislative framework that is developed over the coming year must provide adequate guidance to the AEMC in developing Rules under the framework, such that the expectations of ministers, industry and end-users are met in the future development of the framework.

As mentioned in section 4 of this submission, the ENA considers that the AEMC is the most appropriate body to develop detailed rules under the agreed legislative framework. This will ensure that the Rules meet legislative requirements, are consistent with the market objective, and are developed with industry and consumer consultation.

8. Assessment of proposed framework against ENA criteria

The ENA has undertaken an assessment of the proposed distribution regulation framework against the ENA criteria developed in response to the MCE SCO Issues paper of last year. A summary of this assessment is presented in [Table 2](#) below.

Table 2 – Summary assessment of proposed distribution framework against ENA criteria.

Criterion	Assessment	Positive elements	Areas to improve
Is based on a clear separation between rule-making and rule enforcement	Largely complies	Role of the AEMC in developing future distribution framework rules	Existence of power of jurisdictional direction on the AER Approach to service standard regulation
Produces the least overall compliance burden necessary to achieve the objectives of the framework	Does not comply	Support for reliance, where possible, on generic consumer protection legislation	Include process to assess whether regulation is necessary in particular areas before developing rules Give serious consideration to whether regulation is needed in areas such as use of system agreements, single approach to contracting
Is adaptable to change through transparent and equitable processes	Largely complies	Role of the AEMC in developing future distribution framework rules	Role of jurisdictional directions on the AER Clarification of future process to be undertaken by the AEMC in developing distribution Rules
Is accountable to all parties through fair processes and merit review mechanisms on key regulatory decisions	Not yet fully resolved - consideration of issues in separate workstream	Role of the AEMC in developing future distribution framework rules	Role of jurisdictional directions on the AER Separate MCE decision on merit review also required for this criteria to be met.
Is directed to addressing clear market failure, and where competition is feasible, relies to the maximum extent possible on the outcomes of competitive markets	Not yet fully resolved - consideration of issues by expert panel	Proposed AEMC focus on cost/benefit analysis of need for regulation before some rules developed	Approach to embedded generation, recognition of co-regulatory approaches for developing settlement and balancing rules Give serious consideration to whether regulation is needed before it is applied
Facilitate investment certainty in the non-competitive sectors of gas and electricity markets	Not yet fully resolved - consideration of issues by expert panel	Clear process for developing rules under the new framework	Clarification of application of rules under the transitional period