



12 January 2005

Manager – MCE Secretariat
Department of Industry, Tourism and Resources
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CANBERRA ACT 2601
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Dear Sir,

RE: National Framework for Distribution and Retail Regulation

Thank you for the opportunity to comment on the Paper prepared by NERA Economic Consultation and Gilbert + Tobin, released by the Ministerial Council on Energy's Standing Committee of Officials.

Gas Market Company Limited and Retail Energy Market Company Limited, the gas market operators in NSW and the ACT, and SA and WA respectively, have prepared a joint submission on the Consultation Paper which is attached for consideration.

Should you require any further information or clarification of any of the issues raised, please contact Patricia McKenzie on (02) 9418 2660 or Steve Thomson on (03) 8862 6476.

Yours sincerely,

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Submission on the Paper on a National Framework for Energy Distribution and Retail Regulation prepared by NERA Economic Consulting and Gilbert + Tobin for the Ministerial Council on Energy Standing Committee of Officials

Overview

The Paper on a National Framework for Energy Distribution and Retail Regulation sets out wide ranging recommendations which significantly affect the operation of the competitive retail markets in the gas industry and the role and operation of the Independent Market Administrators.

The gas industry participants in NSW, ACT, SA and WA have expressed a clear desire to maintain the co-regulatory model represented by Gas Market Company Limited (GMC) and the Retail Energy Market Company Limited (REMCo). In response to the development of a national framework for distribution and retail regulation, the REMCO and GMC Boards have approved in principle a merger of the two entities into a single market administrator. A project to develop a detailed proposal has now commenced, and will focus on the preparation of a resolution to be put to the members in 2006.

GMC and REMCo welcome the proposal in the Paper for the continuation of Independent Market Administrators. However, we seek confirmation which is absent in the Paper, that the existing market administrators will be automatically approved in this role. Overall, the recommendations in the Paper generally appear to support the co-regulatory model, but there are areas in which it appears that the model has not been fully understood, and this submission points out the key recommendations which will need some amendment to fully reflect the co-regulatory model under the new national regime.

GMC and REMCO also welcome the proposals for a single overseeing authority in the Australian Energy Market Commission (AEMC), and the changes to licensing which we assume includes a removal of the current requirement for licensing of Independent Market Administrators in some jurisdictions.

It is our belief that, despite the jurisdictional nature of the gas markets in Australia, the industry participants in NSW, the ACT, Victoria, SA and WA have worked cohesively and cooperatively to develop gas markets with a strong degree of consistency. The merger of GMC and REMCO will itself achieve a further convergence of the rules over time, when such convergence is cost effective for gas industry participants. The development and enhancement of the rules should continue to be driven by commercial imperatives in response to consistent public policy.

PART B PRICE REGULATION OF DISTRIBUTION

This submission does not respond to Part B of the Paper, as the recommendations in that section do not relate to the operations of the Independent Market Administrators. However, we note that the proposed changes to licensing of Distribution Businesses (to be state based licences dealing solely with technical matters) implies that there would no longer be a Retail Market Administrator licence applicable in South Australia, and therefore that there would no longer be a need for a Price Determination related to the revenue for a South Australian Market Administrator.

PART C: CONSUMER PROTECTION

Section 3 – Distributor Disconnections and Reconnections of Small End-Customers

NERA/Gilbert and Tobin Paper

The Paper proposes processes and obligations to ensure that small end-customers can only be disconnected in circumstances which are considered fair by the AEMC and that customers are reconnected when appropriate.

GMC/REMCo Response

The REMCo rules contain details of the business processes related to disconnection and reconnection of customers. Any rules developed by the AEMC in relation to disconnections and reconnections should consider the impact of these rules on established processes and systems that accord with current approved business practices.

Section 5 - Retailer Obligation to Supply to Small End Customers

NERA/Gilbert and Tobin Paper

A Move In Customer Regime is proposed to ensure that customers have a designated retailer on moving into new premises. It proposes a regime of contracts and notices to occur on move in.

GMC/REMCo Response

Any move in customer regime should take into account portability of contracts under retail competition. A customer may move into premises in circumstances where they wish to retain their existing retailer, but notification of this has not been given to the retailer at the premises. It is confusing, and possibly anti-competitive, for a customer to receive notices from a retailer which the customer has not chosen and does not expect to have a relationship with.

GMC rules are currently being developed to facilitate portability of contracts on move in and avoid inappropriate communications from

outgoing retailers. Should the customer not choose to transfer an existing contract, they are considered to be under contract with the retailer to which the delivery point is allocated in the GMC Registry. These Rules would need to be taken into account in any Move-In Customer Regime developed by or approved by the AEMC.

The REMCo rules provide for a "move in" transfer process, where a customer who is moving into a premise may elect to choose their gas retailer and that transfer is not subject to the objection period that a normal transfer is subject to. If the customer does not make a choice of retailer, the customer is considered to be under contract with the retailer to whom the delivery point is allocated in the REMCo Registry. The contractual provisions for this are dealt with in SA regulatory documents. REMCo considers that this process is consistent with the proposal in the consultation paper.

Section 7 Retail: Small End Customer Marketing

GMC/REMCo Response to NERA/Gilbert and Tobin Paper

Both the GMC and REMCo Rules reflect the existing requirements for customer marketing under jurisdictional legislation, and changes to those assumptions could require changes to the rules and systems. This should be taken into account in determining the costs of implementing a national system, and transitional arrangements should take account of the changes which would need to be introduced.

PART D: OTHER DISTRIBUTION AND NON-PRICE RETAIL REGULATION

Section 2 Business Authorisation

NERA/Gilbert and Tobin Paper

In section 2.3, the Paper recommends that:

"There should be no national regime for the licensing or authorisation of energy retailers. Legal obligations should be set out in the National Gas Law or Rules made under that law. Compliance with Gas Retail Market Rules should be a direct legal obligation. We recommend that retailers be subject to direct legal obligations covering:

...(b) compliance with Gas Retail Market Rules; and...

(d) compliance with Retailer Failure Rules.

...The areas in which we recommend that distributors (other than private network/resellers) be subject to direct legal obligations include:

...(c) compliance with Gas Retail Market Rules....

There should be a regime for the prudential regulation of gas retailers that participate in schemes for the balancing and settlement of wholesale

exchanges and networks. The obligation to satisfy prudential requirements should be set out in a legislative instrument (Rules). That regime should promote national consistency in the content and application of prudential requirements.

IMAs should continue to register retailers and distributors.”

GMC/REMCo Response

1. Under the co-regulatory model currently employed for GMC and REMCo, the legal requirement for retailers and distributors is to participate in an approved scheme for full retail competition. Retailers and distributors become members of the legal entity which is the market administrator, and as a result are bound through the Constitution by the gas market rules of that entity. This system has delivered efficient and effective results, as it facilitates both the requirement to comply with the rules, and the industry controlled compliance regime which is a part of those rules. Legal obligations to comply with the Rules will not adequately replace the existing requirement to become a member of an approved scheme.

Membership of the approved scheme also brings with it membership of the IMA (for GMC and REMCo, a company limited by guarantee), with attendant voting rights and Board structures agreed by industry in establishing the schemes. In some instances, the obligations to fund the IMA are separate to the rules. This representative governance arrangement is fundamental to the success of the model as it ensures support from industry participants. A legal requirement relating only to the Rules will not incorporate this scheme membership.

It is recommended that the legal requirement for retailers and distributors should be to participant in an approved scheme, with approval of the scheme being moved from the individual jurisdictions to the AEMC.

2 The Paper proposes imposing legal obligations on retailers and distributors. However, some large end-users in the gas markets choose to contract directly with wholesalers and distributors to purchase gas, and accordingly must interact with the market and the market systems for balancing purposes. The self contracting users will have no legal obligation to comply with the rules under this proposal.

It is recommended that the legal obligations be extended to self contracting users to bind them to the scheme.

3. GMC has a prudential regime which deals with exit from the market whether by choice or due to outside circumstances and REMCO is currently developing a prudential regime for the same purposes. These provisions need to be considered in the transition to a national scheme.

Section 5: Balancing Regime and Settlements, effecting customer transfers in balancing and settlements system

NERA/Gilbert and Tobin Paper

In section 5.1 Recommended Policy Criteria, the paper states:

“Rules for balancing systems, supply/consumption reconciliation and settlements and customer transfers should:

- (a) be made or approved by a party independent of the market administrators;
- (b) be administered by a party independent of the market participants (an Independent Market Administrator) in regions where the distribution network owner/operator is vertically integrated into either production or retailing of gas (which is commonly the case);
- (c) be as consistent as reasonably possible between gas and electricity;
- (d) be as consistent as possible on a national basis, having regard (in gas) to the different architecture and operation of the gas distribution networks in the Jurisdictions;
- (e) while conforming with the required safety and reliability standards, provide incentives to balance injections and withdrawals;
- (f) make full and efficient use of the infrastructure available in each system;
- (g) not relevant
- (h) accurately measure and allocate the costs of theft and leakages;
- (i) be transparent and as simple as possible and have an efficient and open process for rule change; and
- (j) be compatible with the metering, consumer protection requirements and retailer failure arrangements.”

In section 5.2 Recommended Approach, the Paper states:

“While jurisdictional variation in balancing, settlement and customer transfer arrangements is likely to continue to be appropriate (to reflect different models and physical architecture), that variation should be limited to only that which is practically necessary and can be accommodated within a national regulatory regime.

We recommend that the NGL provides:

- (a) for the approval of Regional Independent Market Administrators (IMAs) by the AEMC in Jurisdictions with Full Retail Contestability in gas;
- (b) the IMAs should develop and administer rules for the distribution network balancing, settlement and customer transfer (Gas Retail Market Rules);
- (c) that retailers and distributors in Jurisdictions with FRC should be obliged to comply with the Gas Retail Market Rules that apply in the jurisdictions in which they operate;
- (d) the IMAs should be obliged to consider applications by participants for changes to the Gas Retail market Rules and should be required

- to consult with interested parties in developing proposals for change to the Gas Retail Market Rules;
- (e) the AEMC should approve amendments to the Gas Retail Market Rules; and
 - (f) the AEMC should only be required to carry out limited consultations of those parties who had made submission to the IMA and should have the ability consider all matters put before the IMA in the context of the IMA's consultation process."

In section 5.3 Transitional Arrangements, the Paper recommends that existing Gas Retail Market Rules should be grandfathered.

GMC/REMCo Response

In relation to the recommendations in section 5.1:

- (a) *rules should be made or approved by a party independent of the market administrators.*

Under the co-regulatory model, the rules are developed and adopted by the independent market administrators, subject to differing requirements for approval of the changes. GMC has a system of approval which has proven effective over 4 years, under which the Minister or his nominee considers rule changes against a criteria of the approved scheme. In practice, this has meant that rule changes are submitted to the nominee, and if no response has been received within 28 days, the rule changes are deemed to have been acceptable. This has allowed for a very efficient rule change process. The REMCo arrangements have been operational for over 12 months and have also proven effective across two jurisdictions where the jurisdictional regulators are required to provide a formal approval of the rule changes prior to any rule change being implemented. However, the consultation conducted by jurisdictional regulators following broad and inclusive consultation that has been conducted by REMCo and its Rule Change Committee can be of limited value and result in unnecessary delay to the implementation of improvements to the operation of the gas market and delay of benefits to the participants and consumers. REMCo and GMC consider that the 'deemed approval' approach adopted in the NSW gas market should be adopted by the AEMC, so that the progress of rule change is not made inefficient by further consultations and long waiting periods.

Further, the purpose of the approval process should be clearly established. The gas industry participants develop rule changes following an exhaustive process of working group consideration, and widespread consultation of both industry participants and other stakeholders. Any efficient approval role should be limited in scope to considering the proposed rule change for consistency with defined policy outcomes, such as delivering improvements to the public interests and convergence where economically efficient.

(b) be administered by a party independent of the market participants (an Independent Market Administrator) in regions where the distribution network owner/operator is vertically integrated into either production or retailing of gas (which is commonly the case)

(c) be as consistent as reasonably possible between gas and electricity;

GMC and REMCo agree that consistency is a valuable objective. However, consistency must take into account the fundamental differences between the distribution of the two energy forms and the market structures that apply in the various jurisdictions (contract carriage and market carriage).

(d) be as consistent as possible on a national basis, having regard (in gas) to the different architecture and operation of the gas distribution networks in the Jurisdictions;

It has been a fundamental principle in developing the gas markets that consistency should not be achieved at unreasonable costs – convergence, whilst desirable, must nevertheless be subjected to cost benefit analysis and should only be pursued where it is economically sound to do so.

(e) while conforming with the required safety and reliability standards, provide incentives to balance injections and withdrawals;

Commercial incentives under existing arrangements should also be taken into account and in general would outweigh any material incentive included in rules. A significant incentive of rule based balancing is the fact that failure to comply with rules could lead to suspension from the market, and should not require necessarily additional monetary or other incentives within the rules themselves.

(f) make full and efficient use of the infrastructure available in each system;

(g) not relevant

(h) accurately measure and allocate the costs of theft and leakages;

The REMCo and GMC rules already deal with the measurement and allocation of unaccounted for gas in a manner that is consistent with the jurisdictional market requirements. A cost benefit analysis should be applied before any changes to these arrangements are implemented.

- (i) *be transparent and as simple as possible and have an efficient and open process for rule change;*

The rule change processes of REMCo and GMC are transparent, provide for broad consultation and have delivered significant and comprehensive rule changes to meet the evolving needs of the gas markets. In relation to transparency and simplicity, REMCo and GMC have developed rules, processes and systems through lengthy consultation with their market participants. The rules dealing with customer transfers are generally consistent across the jurisdictions. Any variations arise due to particular regulatory and consumer protection requirements in the jurisdictions at the time that the rules were developed. The rules related to reconciliation and settlement, whilst complex, reflect the complex nature of reconciliation and settlement under FRC. Both REMCo and GMC are developing improvements to the reconciliation and settlement rules which are leading to greater convergence across the four gas markets that operate gas FRC under contract carriage wholesale arrangements.

- (j) *be compatible with the metering, consumer protection requirements and retailer failure arrangements.*

The REMCo and GMC rules deliver customer transfers, reconciliation and settlement outcomes that are consistent with the constraints of the gas metering and consumer protection requirements. Arrangements for retailer failure are also provided for by REMCo and GMC.

Recommended Approach

The concept of limiting variation in balancing, settlement and customer transfer arrangements to that which is practically necessary is supported by GMC and REMCo. However, the sunk costs in the existing systems should be accommodated within a national regulatory regime, and movements to convergence considered on a cost benefit basis over time.

In relation to the recommendations in section 5.2

- (a) *for the approval of Regional Independent Market Administrators (IMAs) by the AEMC in Jurisdictions with Full Retail Contestability in gas;*

GMC and REMCo seek confirmation that the approval for both companies and schemes will be grandfathered as approval of them as Independent Market Administrators under these proposals, and that the merger of the two entities will similarly be approved.

- (b) *the IMAs should develop and administer rules for the distribution network balancing, settlement and customer transfer (Gas Retail Market Rules).*

GMC and REMCo note that for this purpose, the existing gas market rules will be grandfathered.

- (c) *that retailers and distributors in Jurisdictions with FRC should be obliged to comply with the Gas Retail Market Rules that apply in the jurisdictions in which they operate;*

As noted in our response to Part D, this should be a requirement that retailers, distributors and self contracting users participate in an approved scheme.

- (d) *the IMAs should be obliged to consider applications by participants for changes to the Gas Retail market Rules and should be required to consult with interested parties in developing proposals for change to the Gas Retail Market Rules;*

The existing rule change processes included in the REMCo and GMC rules already require the market administrators to consider all rule change submissions received and will be grandfathered.

- (e) *the AEMC should approve amendments to the Gas Retail Market Rules;*

GMC and REMCo agree with the proposal for the AEMC to take over the approval role, as outlined in section (a) above.

- (f) *the AEMC should only be required to carry out limited consultations of those parties who had made submission to the IMA and should have the ability consider all matters put before the IMA in the context of the IMA's consultation process.*

As noted above, the REMCo arrangements, which in South Australia require a second round of consultation after the REMCo processes are completed, have been operational for over 12 months. Experience in that market shows that the consultation conducted by jurisdictional regulators following broad and inclusive consultation that has been conducted by REMCo and its Rule Change Committee can be of limited value and result in unnecessary delay to the implementation of improvements to the operation of the gas market and delay of benefits to the participants and consumers. REMCo and GMC consider that the 'deemed approval' approach adopted in the NSW gas market should be adopted by the AEMC, so that the progress of rule change is not made inefficient by further consultations and long waiting periods.

To summarise, it is recommended that:

- *approval of GMC and REMCo as Independent Market Administrators should be explicitly grandfathered*
- *rules should continue to be made by the Independent Market Administrators under current processes, which provide transparent and efficient rules for the gas industry*
- *the AEMC should be given an approval role on rule changes, adopting the “deemed approval” approach operating in the NSW gas market, to be exercised by reference to clearly stated policy objectives*
- *that the objective of consistency between gas and electricity, and between jurisdictions in gas, should be measured on a cost benefit basis and pursued where it is economically sound to do so*

Section 6 Metering

NERA/Gilbert and Tobin Paper

The Paper recommends that metering rules be set by a party independent to participants, and the recommended approach is for the NGL to provide:

- (a) authorised IMAs to develop Metering Rules for inclusion in the Gas Retail Market Rules which must provide for:
 - (i) types of permitted meters (and metering standards)
 - (ii) procedures for data estimation; and
 - (iii) collection, retention and access to meter data.
- (b) the AEMC should approve the Metering Rules, having regard to the recommended policy criteria; and
- (c) Retailers and distributors are required to comply with the Metering Rules.

GMC/REMCo Response

Both the REMCo rules and GMC rules already establish procedures for the estimation of metering data and for the collection and retention of metering data. These would be retained in the grandfathered rule sets.

Access to metering data, which can incorporate access to metering installations for data collection purposes, could be covered in the IMA rules or, as there may be safety and technical standards involved, this could be included in the jurisdictional licencing arrangements.

REMCo and GMC are prepared to take on additional roles in relation to metering rules should all parties consider the additional roles appropriate and these can be performed in the most cost effective manner and with appropriate liability and indemnity protections for the IMA. In reaching this decision, the nature of the detailed technical and safety related matters relating to metering must be taken into account, and the parties may consider that there are more appropriately dealt with by a jurisdictional Technical Regulator.

Section 7 Load Shedding and Curtailment

NERA/Gilbert and Tobin Paper

Subject to the outcomes of the Gas Emergency Protocol Working Group, policy criteria has been suggested for emergency powers and the development of Curtailment Rules for each jurisdiction.

It is proposed that the AEMC would approve the Curtailment Rules and amendments to them, and that the designated IMA would be responsible for the administration of the Curtailment Rules, although it is noted that this is not technically possible in all Jurisdictions at this stage. There would be statutory immunity on the IMA.

GMC/REMCo Response:

At present, the network operator administers load shedding provisions in SA, WA, NSW and the ACT.

Although GMC and REMCo may be willing to take on this role, GMC and REMCo believe that the current arrangements are effective and do not need to be changed. Furthermore, the implementation of curtailment obligations can introduce safety concerns due to the potential risks associated with restarting equipment and appliances following a gas shut off. As such it may be more appropriate to assign the management and oversight of the implementation of curtailment to a local Technical Regulator rather than an IMA.

Section 8 Retailer Failure Arrangements

NERA/Gilbert and Tobin Paper

The Paper recommends national arrangements to deal with the failure of a retailer which would relate to all customers of that retailer by the appointment of a Step In Retailer (overtaking the ROLR schemes currently in place). In relation to gas, the Step In Retailer scheme should only operate in those jurisdictions or markets where:

- (i) the absence of Step In retailer regime would jeopardise the integrity of the wholesale market; or
- (ii) the relevant Jurisdictional Minister has notified the AEMC that the Jurisdiction is to participant in the Step In Retailer regime.

GMC/REMCo Response

In NSW, there is in place a two part scheme to deal with failed retailers:

1. the Government requirements for a ROLR for small customers, which are supported by complex gas market rules determined by industry to implement the high level scheme
2. the User Exit rules which deal with the orderly and disorderly exit of a user from the market and relates to all customers. These rules incorporate prudential requirements to protect remaining users on a disorderly exit.

REMCo has established ROLR arrangements and processes which align with the requirements of the WA jurisdiction and is currently developing provisions to deal with certain wholesale market risks associated with the failure of a retailer which would be applicable in both SA and WA.

There appear to be significant differences between the proposal and the rules which industry have adopted, particularly in relation to the extension of the ROLR rules to all customers. It is not clear whether all of these requirements will be replaced on a national basis or whether there will be some areas which move to a national regime and others which stay within the rules. It is unclear whether the IMA is intended to administer the scheme, other than being involved in the specific areas outlined in the paper. In any event, significant expense has been incurred in implementing the rules to support ROLR arrangements, and this expense should be considered in any transition to a national arrangement.