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Dear Sir/Madam,

### **Expert Panel on Energy Access Pricing – Submission on Draft Report**

Toward the end of 2005 the Ministerial Council on Energy (**MCE**) established an expert panel to advise on a model to achieve a common approach to revenue and network pricing across the energy market (**Expert Panel**). Shortly thereafter the Expert Panel released a brief Issues Paper seeking comments. It noted that a draft report would be released in February 2006 at which time there would be a further opportunity to make comments. The Expert Panel issued its *Draft Report to the Ministerial Council on Energy (Draft Report)* on 10 March 2006.

The MCE sought submissions on the Expert Panel's Draft Report by Friday 31 March 2006. The Commission welcomes the opportunity to participate in this consultation and makes this submission accordingly.

Briefly, the Commission considers the proposed approach to energy access pricing set out by the Expert Panel adequately balances regulator requirements and consumer interests with service provider interests and fully supports most of the recommendations. It also supports the Expert Panel's recommendations that more common principles and approaches across the National Electricity Law (**NEL**) and proposed National Gas Law (**NGL**) be established to promote increased certainty and consistency. The Commission considers that these common principles and approaches then form the basis upon which the Australian Energy Market



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Commission (**AEMC**) determines the Rules and the Australian Energy Regulation (**AER**) administers and implements those Rules, as proposed by the Expert Panel.

The Commission limits its comments in this submission to those matters with which it either has some issues or wishes to indicate support for the Expert Panel's proposal.

### *Legal and regulatory framework*

The Commission agrees with the Expert Panel's recommendation that the NEL and NGL establish a common legislative framework with respect to access pricing that addresses objectives, the scope of regulation, form of regulation, regulatory procedures, pricing principles, information disclosure and review of decision making. To limit the complexity of the range of regulatory instruments the AER has to consider, the Commission also agrees with the Expert Panel's recommendation that guidance to the AER in the NEL and NGL be limited to the proposed objects clause, with more detailed guidance to the AER set out in the Rules.

### *Objectives for the energy access regimes*

The Expert Panel considers that a single objective would have significant benefits in developing a common approach to revenue and network pricing across the energy sector. The current objects clause for the NEL is as follows:

The national electricity market objective is to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.

The Draft Report considers an objects clause the MCE is currently proposing for the proposed NGL. The Commission understands this objects clause is internal to the MCE as a work in progress.

The Commission considers the objects clause for gas that, according to the Draft Report, the MCE is currently considering is lengthy and confusing and, as the Expert Panel says, likely to result in confusion and inconsistencies in their application across the energy sectors. As such, the Commission supports the Expert Panel's recommendation that the objects clause for the proposed NGL reflect that of the NEL with references to 'electricity' replaced by 'natural gas' and with the difference in the industry structure accommodated.

### *Selection of the form of regulation*

The Commission agrees that the regulatory response should be commensurate with the extent of market power involved. It also agrees that the forms of regulation most appropriate to energy infrastructure services, depending on the degree of a participant or an industry sector's market power, should be:

- direct price or revenue controls
- commercial negotiation with dispute arbitration
- price monitoring and reporting

- no regulation.

The degree of regulation required would depend on the outcome of any assessment of market power of the relevant service provider. To determine this, the Expert Panel proposes that the extent of market power associated with the supply of a network service be determined by assessing the service against a list of factors (**energy market factors**). The Expert Panel suggests that the energy market factors be specified and commonly reflected in the framework of the respective laws and Rules.

The energy market factors the Expert Panel suggests are:

- (a) the nature and extent of market power
- (b) the presence and extent of barriers to entry [rephrasing of section 50(3)(b)]
- (c) the existence and extent of network interdependencies and externalities [this is an industry specific one and probably worthwhile including]
- (d) the presence and extent of countervailing power on the part of service users [rephrasing of section 50(3)(c)]
- (e) the presence of competitive and substitution possibilities [rephrasing of section 50(3)(f)]
- (f) the extent and impact of information asymmetries [this is a regulatory specific one and probably worthwhile including]
- (g) any other factors that the AEMC considers relevant [this gives the AEMC the flexibility to consider more industry specific factors and probably worthwhile including]

The Commission considers that the first factor the Draft Report lists – the nature and extent of market power – essentially is what an analysis of the subsequent factors is designed to determine and queries whether it should be treated as a separate factor.

The Commission also notes that while some of the listed factors are designed to address specific industry requirements, others are a rephrasing of comparable provisions set out in section 50(3) of the *Trade Practices Act 1974* (Cth) (**TPA**). Section 50(3) of the TPA requires the ACCC to consider certain matters when determining whether an acquisition would have the effect, or likely effect, of substantially lessening competition in a market, such as:

- the height of barriers to entry to the market
- the extent to which substitutes are available in the market or are likely to be available in the market
- the dynamic characteristics of the market, including growth, innovation and product differentiation
- the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor

The section 50(3) matters have been subject to extensive judicial and/or regulatory consideration. It is unclear to the Commission as to why the Expert Panel would recommend that the energy market factors be worded differently from the comparable section 50(3) provisions. It is the Commission's view that rephrasing these provisions for the purposes of the NEL and NGL can only lead to confusion, an outcome the Expert Panel has said, in its discussion of the NEL/NGL objectives clauses, that it is keen to avoid.

There is a need for a degree of uniformity of regulation across the energy industry to ensure certainty and a degree of consistency in the application of regulation. The section 50(3) matters are not industry specific (although some of them are likely to be less relevant to the gas and electricity industries, at least in the short term) and thus can be applied to the analysis of market power in the energy industry. That is, the AEMC and the AER can be guided by previous judicial and regulatory experience in the application of the section 50(3) when considering the energy market power assessment factors.

In short, the Commission considers the Expert Panel should adopt wording of the energy market factors that is identical to the relevant provisions in section 50(3) of the TPA. Those factors that are specific to the energy industry should be worded as clearly and straightforwardly as possible.

The rate of change in market structure and the implications for investment certainty and regulatory risk, the Expert Panel says, will influence which agency – the AEMC or the AER – is best placed to decide the form of regulation. Where the relevant infrastructure services market is relatively stable, for example electricity transmission, the need to review the appropriateness of the form of regulation is likely to be infrequent. In this case the AEMC should be authorised as the agency most responsible for deciding the form of regulation. In such cases the need for reviews need only occur in the medium and longer terms. Where markets are more dynamic, ongoing change may require frequent changes to the form of regulation. In that case, the discretion and need to conduct review is best placed with the AER within the framework and guidance of the Rules.

The Commission notes that if the market is reasonably dynamic such that frequent changes to the form of regulation are necessary, it suggests that the relevant market already may be reasonably competitive. The Commission considers it vital to ensure that the framework and guidance of the Rules by which the AER is granted the flexibility to make such decisions are sufficiently prescriptive to ensure a form of regulation is not imposed unnecessarily.

#### *Framework for regulatory decision-making*

The Expert Panel considers the various advantages and disadvantages of the 'receive-determine' vs the 'propose-respond' process and the various administrative and regulatory processes regulators must meet when making price determinations under the various regulatory instruments.

The Expert Panel proposes a raft of recommendations and/or suggestions such as that:

- the NEL and the NGL contain common provisions requiring the AEMC to make the Rules on the procedures for making network pricing determinations with the regulator required to comply with specified processes and time constraints.
- it is inappropriate for any preference for receive-determine or propose-respond as the form of regulation to be mandated. Instead, such approach must be determined by the AEMC in the Rules developed for each of the alternative available forms of regulation.
- in exercising their functions the AEMC/AER should give explicit consideration to the risks and costs of both under- and over-investment and under- and over-utilisation of existing infrastructure.
- the speed and certainty of coverage decisions for greenfields projects needs to be improved with scope for exemption of certain major greenfields projects.
- it would be desirable to provide merits review of decisions by the AER in relation to price and revenue control but that the review should be limited to a consideration of the proposal and submissions made to the AER and the AER's determination in that light.

The Commission agrees with these and other recommendations made by the Expert Panel in relation to the framework for regulatory decision-making. In relation to merits review, the Commission notes the Expert Panel's recommendation with the exception that the Commission considers the review body should be able to accept subsequent information in certain and very specific circumstances.<sup>1</sup>

#### *Guidance on the application of price control*

The building block approach provides the basis upon which Australian regulators generally make price determinations in the energy industry. The Draft Report reviews the advantages and disadvantages of the building block approach as against the total factor productivity (TFP) approach. The Draft Report then explores the likelihood of it being adopted in Australia taking note of its benefits but also its limitations.

The two essential differences in the outcome of regulation is that with the TFP there would no longer be a need to specify a minimum or fixed term regulatory period (instead there would be built-in triggers that would indicate an update was necessary) and there would be an industry-wide forward looking assessment rather than a business-specific one.

The Expert Panel believes there are significant difficulties with adopting the TFP approach at present, one being the lack of long term reliable information on outturn costs of supply. In addition the industry-wide forward-looking assessment is as controversial as the business-specific one. However, the Expert Panel considers it appropriate that the TFP approach be available to the regulator as an alternative to the building block approach across gas and electricity, distribution and transmission.

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<sup>1</sup> See the *Submission by the Independent Competition and Regulatory Commission to the Ministerial Council on Energy, Standing Committee of Officials on the Review of Decision-making in the Gas and Electricity Regulatory Frameworks Discussion Paper* under cover of letter 9 November 2006

The Expert Panel also recommends that there be principles common across energy regulation.

The Commission agrees and endorses the Expert Panel's recommendations and suggestions.

*Information requirements*

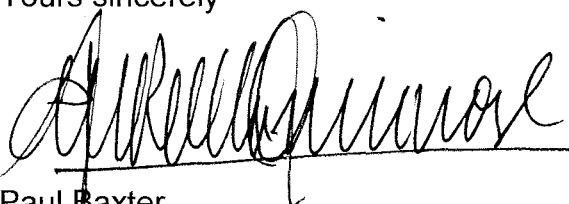
The Draft Report summarises the barriers to accessing sufficient information currently experienced by regulators when undertaking their functions and the different powers available to regulators under the NEL/NER and the existing Gas regulatory regime. The Expert Panel recommends that a framework for information gathering powers should be common across the energy sector. The framework should comprise:

- statutory powers for the AER (which should be modelled on section 28 of the NEL) to obtain information that is relevant to the performance of its economic regulatory functions from any person
- statutory guidance to the AEMC concerning the scope and content of Rules prescribing regular regulatory reporting requirements
- Rules promulgated by the AEMC specifying the scope and content of regular reporting requirements
- guidelines issued by the AER in accordance with the Rules specifying the format requirements and timelines for regular reports.

The Expert Panel then recommends a list of factors that should be included to provide statutory guidance to the AEMC in developing the Rules. Again the Commission considers this proposal to be most sensible.

Please do not hesitate to contact Ian Primrose, Chief Executive Officer, on 02 6205 0779 should you have any queries.

Yours sincerely

*per* 

Paul Baxter  
Senior Commissioner  
31 March 2006