



INDEPENDENT PRICING AND REGULATORY TRIBUNAL
OF NEW SOUTH WALES

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Dear Sir/Madam,

National framework for energy distribution and retail regulation

The Independent Pricing and Regulatory Tribunal of NSW (the Tribunal) is currently the jurisdictional regulator in NSW for gas and electricity distribution and has a role in administering the energy licencing regime and regulating relevant retail prices for electricity and gas. The Tribunal has extensive experience in the areas under consideration in your consultation on the national framework for energy distribution and retail regulation.

In principle, the Tribunal agrees with the framework established in the paper written for you by NERA and Gilbert + Tobin. We support the legal architecture set out in the paper, including the separation of rule making and enforcement and the ability for Governments to make Jurisdictional Directions in a transparent manner. In particular, the Tribunal supports streamlining the current regulatory requirements.

Drawing on the Tribunal's experience in energy distribution and retail regulation, we have attached more detailed comments on the NERA and Gilbert + Tobin paper.

If you have any queries or would like to meet with the Tribunal to discuss our comments, please contact Ms Anna Brakey on 02 9290 8438.

Yours sincerely,

Dr Michael Keating AC
Chairman

Comments on the paper prepared by NERA Economic Consulting and Gilbert + Tobin to inform the further development of the national framework.

The Tribunal agrees with the legal architecture proposed in the paper, including the separation of rule making and enforcement and the ability for Governments to make Jurisdictional Directions in a transparent manner. In particular, the Tribunal supports streamlining the current regulatory requirements and more rigorous drafting of rules to make obligations clearer.

The Tribunal supports, where appropriate, consistency between regulation of gas and electricity. However, it is important to note that the electricity and gas markets have different characteristics and the Rules and regulatory frameworks need to consider those characteristics.

The proposed framework will affect distribution businesses and their customers. The Tribunal recommends that transitional arrangements be put in place, where appropriate (particularly in relation to capital contributions and contestable services, as discussed below).

Scope of distribution price regulation

The Tribunal supports clarifying the scope of distribution services subject to price regulation.

As noted in the paper, in determining the scope of distribution price regulation, it is important to have regard to the market for the services being provided. The Tribunal considers that one factor that must be considered in determining the scope for distribution price regulation is whether a service is contestable and the extent to which there is effective competition. In NSW, whether a service is contestable is currently a policy matter for Government. The contestability of services currently differs between states. Because the paper suggests that distribution price regulation should be determined on a national basis, across all jurisdictions, there are transitional issues that will require close attention.

For example, in NSW customer-funded electricity construction services are generally contestable. In other states they are not contestable and must be provided by the distribution network service provider (DNSP). If the proposed approach was introduced and the Australian Energy Market Commission (AEMC) deemed these services to be within the price cap regulation, it could alter the market for accredited service providers (those businesses that compete with the DNSPs for the customer's construction work). Alternatively, if the AEMC deemed these services outside the scope of price regulation, it may be necessary to facilitate competition in this market in other states. Further, in some geographic areas effective competition for contestable services will possibly never develop, and there could be a case for some form of price regulation or monitoring.

The NERA and Gilbert + Tobin paper suggests that the AEMC should review whether a given service (or element of a service) should be withdrawn from or added to the scope of regulation. The Tribunal considers that it would be useful to consider giving the Australian Energy Regulator (AER) this discretion as it is likely to have more 'hands-on' experience with the distribution market and, at least in the transitional phase, the treatment may need to

be flexible. An alternative arrangement could be to view contestability as a policy issue determined by the Government and have the AEMC establish the criteria for determining the scope of distribution price regulation and the AER apply those criteria, having regard to any jurisdictional direction over the contestability of parts of the market.

As part of its 2004 electricity distribution review, the Tribunal established a competition test to determine which contestable distribution services are subject to light-handed regulation and which services are not subject to economic regulation. While the test could benefit from some refinement, it is a useful reference point.

Services associated with the provision of streetlighting also currently differ between states and require further consideration.

Under the propose-respond model in the current Gas Code, the business determines what services are reference services, subject to some criteria set out in the Gas Code.¹ Therefore, setting the scope of distribution price regulation in the Gas Rules would be a significant change to the current arrangements.

Including private networks and resellers (e.g. shopping centres and caravan parks) under *distribution* economic regulation, even on a basis other than a price cap, is a significant change from the status quo and the Tribunal considers that this should be subject to more targeted public consultation and consideration.

Price cap regulation

The Tribunal considers that continuing to use a building block approach to set revenue requirements is appropriate, particularly given the extent of changes that will occur in the market. The building block approach is a well understood and accepted form of regulation.

However, TFP can be a useful tool in establishing the building block components and its use should not be prohibited.

The NERA and Gilbert + Tobin paper sets out the content of the Rules on various elements of costs. The paper states that 'the business's assessed costs should reflect the cost of complying with government obligations as outlined in the Jurisdictional Direction'. The Tribunal considers that these costs should be subject to a prudence or efficiency test. Further, the Tribunal recommends that a cost pass through mechanism should be considered but considers that such a mechanism should only be applied in exceptional circumstances where the financial implications to the business are significant and the costs eligible for a cost pass through event should be limited.

Regulatory requirements in relation to tariff setting

The Tribunal generally supports the principles relating to tariff setting set out in the NERA and Gilbert + Tobin paper. In particular, the Tribunal supports the use of constraints on the extent to which tariffs can be changed year-on-year. The Tribunal considers that the most effective means of constraining changes in tariffs is to limit changes to a customer's bill

¹ S. 3.3 of the National Third Party Access Code for Natural Gas Pipeline Systems.

(assuming the same volume and pattern of consumption as the previous year). It is not clear that the drafting of the current Part E of chapter 6 of the Electricity Rules facilitates this type of constraint.

The Tribunal notes that the paper considers that distributors should be permitted to give discounts on published tariffs. The Tribunal considers that there should be criteria for discounting (for example, to ensure that tariffs lie above the incremental cost). It is important to note that not all distribution tariffs are published with some large customers being on confidential tariffs (calculated on a cost reflective basis). It could be appropriate for the distributor to offer a discount on a non-published tariff.

The NERA and Gilbert + Tobin paper suggests that the principles for tariff setting should be set out in the Rules. Further the principles proposed in the paper include the tariffs being set to take into account any explicit jurisdictional policy requirements as set out in the Jurisdictional Direction. However, because the principles would be set out in the Rules (as made by the AEMC) and the Jurisdictional Directions apply to the AER, not the AEMC or the DNSP, the legal architecture for this section may need to be tailored.

Given that under the proposed framework the DNSP has discretion in setting its tariffs (subject to the principles set out in the Rules), it may be appropriate to require the DNSP to disclose information in relation to its tariffs and movements in tariffs.

Service performance targets

The Tribunal is generally supportive of the recommended approach.

The Tribunal considers that service quality (such as voltage fluctuation) can be important factors to consumers and should not necessarily be automatically excluded from economic regulation. There is, however, measurement difficulties associated with voltage fluctuation.

In order for the AER to implement an effective service performance target mechanism, it must have the powers to collect the relevant information.

Process for regulation for price capped services

The Tribunal considers that the process for economic regulation set out in the NERA and Gilbert + Tobin paper is appropriate, although considers that there should be a formal requirement on the AER to consult with interested parties in setting out the framework and approach for the price review and, particularly, after releasing its draft decision.

The Tribunal supports the Rules setting out clear provisions relating to timing of the review process, including allowances for the timetable to be stopped for non-provision of information by the regulated businesses.

Information disclosure

The Tribunal supports the approach to information disclosure set out in the NERA and Gilbert + Tobin paper and considers that:

- the Rules should specify whether that information is collected annually or upon request (or both) and set out what information can be publicly released by the AER;
- the statements of requirements should be flexible to respond to changes to the industry and its participants; and
- the current jurisdictional guidelines may need to remain in place until the AER revises them rather than falling away upon transfer of regulation to the AER.

Connection and capital contribution requirements

The Tribunal supports the proposed basis for charging for connection assets, as set out in the NERA and Gilbert + Tobin paper, but emphasizes that capital contributions policies require detailed consideration. Capital contributions for connection can have significant financial implications for individual customers, including residential customers. It would be appropriate to give interested parties sufficient notice of a change to the capital contributions policy as there can be relatively long lead-times between customers inquiring about connection to physical connection taking place.

Licensing

The Tribunal agrees with the NERA and Gilbert + Tobin conclusion that general consumer protection should be provided via the Trade Practices Act and Fair Trading Act, but considers that due to the essential nature of energy, additional consumer protection is required for:

- disconnections and reconnections;
- billing and charging;
- obligations to provide connection services;
- affordability issues; and
- dispute resolution.

It should be noted that if there is a move to greater reliance on state-based legislation such as Fair Trading and Door to Door Acts, that national consistency will not be achieved as there are differences that exist in the requirements of these Acts across the various States. This issue might be resolved through current and pending reviews aimed at harmonising State and Territory laws.

Market entry

The Tribunal has found the licence application process a useful means of ensuring licensees develop appropriate compliance systems prior to entering the market. Monitoring the activities of new market participants may be an alternative way to manage the risk of

significant non-compliances of new entrants in the absence of a licencing regime. The Australian Prudential Regulation Authority (APRA) experience would suggest that an effective compliance monitoring and enforcement regime is needed to support regulatory regimes.

Consumption Thresholds

The consumption thresholds proposed by NERA and Gilbert + Tobin, below which mandatory 'protections' should apply, would involve a significant increase of the current NSW threshold for gas from 1TJ to 10TJ. The Tribunal considers that, from a NSW perspective, there could be an argument for reducing the threshold rather than increasing it based on the effectiveness of competition.