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Industry Levy
C/- MCE Market Reform
Department of Industry, Tourism and Resources
GPO Box 9839
CANBERRA ACT 2601

7 April 2004

Dear Sir/Madam

Application of the industry levy to fund the AER and the AEMC

With over 800 000 customers, Integral Energy is the second largest electricity distributor and retailer in New South Wales and also has electricity retail operations in jurisdictions outside of New South Wales. This letter sets out Integral's comments in relation to the Ministerial Council on Energy's Discussion Paper on the above topic. Integral does not agree with the arrangements proposed in the Discussion Paper and suggests improvements to the framework prior to implementation.

Proposed governance arrangements

Integral understands that the Australian Energy Regulator (AER) and Australian Energy Market Commission (AEMC) will be statutory bodies, which have no accountability to energy industry participants. It is disappointing that, under the proposed arrangements, participants will have no say in the appointment of commissioners to these bodies or in the approval of their budgets.

If implemented as proposed, industry participants would have no control over the scope of these bodies' activities nor, therefore, the costs they will incur in carrying out these activities. Integral is concerned that it will be levied costs, largely not of its own making and otherwise beyond its control and be asked to pass these onto its customers.

As a principle, Integral believes that the industry should be allowed to participate in the governance structures associated with the AER and AEMC. While a levy is one form of participation, this should be linked to a framework that provides scope for the industry to provide advice on the development of these new bodies.

Appropriate cost allocation

The Discussion Paper espouses a number of principles for the funding mechanism to achieve. These include that the mechanism is, amongst other things:

- simple to understand;
- predictable and able to be estimated by participants; and
- economically efficient (including that attributable costs should be borne by those participants who cause those costs).

Integral sees considerable difficulty in being able to adequately quarantine the costs associated with market regulation, market development and rule making between the gas and electricity industries, then between the retail, distribution, transmission and generation sectors within these industries. Further difficulty is seen in then equitably allocating costs to participants. Inevitably the outcome will need considerable trade-offs between economic efficiency and simplicity and it is arguable whether both these principles can be achieved at once.

Integral also notes that where the Discussion Paper canvasses recovering costs from participants in each sector it does not include an option of recovering any costs from generators. Integral considers this is an unintended oversight as costs associated with some activities such as market surveillance or rule changes associated with the scheduling and dispatch systems would largely if not entirely be for the benefit of, or incurred as a result of, the generation sector. For these reasons, the generation sector must contribute.

Passing costs through to end-users

The Paper proposes that funding arrangements will need to commence in July 2004. While it appears that most costs are ultimately to be borne by end-users, distributors and retailers (where the vast majority of end-users reside) will not be brought into the national framework until 2006. It is therefore not clear how and when costs will commence to be recovered.

Distributors and most retailers also have substantial customer bases supplied under regulated tariffs. While the intent may be that retailers and/or distributors will pass funding costs through to end-users, this presupposes that these participants have adequate pass-through mechanisms to allow this. This is currently not the case in New South Wales nor, we believe, in other jurisdictions.

A second issue related to pass-through costs is that of constraints on price movements. In New South Wales, the local jurisdictional regulator, the Independent Pricing and Regulatory Tribunal, has imposed restrictive constraints on price movements on regulated retail and network tariffs. These price constraints are designed to ameliorate price shocks to customers but can delay or even prevent recovery of additional pass through costs.

Jurisdictional regulators would need to be adequately bound through legislation to ensure that both adequate pass-through mechanisms are in place and price movement constraints do not prevent recovery of these costs.

Integral's position on funding

Were an industry levy to be imposed to fund the AER and AEMC, Integral would recommend that the framework be amended to:

- allow for the inclusion of industry participants in the governance arrangements;
- allow for the recovery of costs from the generation sector;
- clarify the timeframe envisaged for the recovery of costs from distribution and retail businesses, due to the fact that these sectors are not brought into the new arrangements until 2006; and
- ensure jurisdictional regulators provide adequate pass through mechanisms for the recovery of costs associated with the industry levy.

For further information on this submission please contact Karen Waldman, General Manager Regulatory and Corporate Affairs on 02 9853 6166 or David Neville, Manager Regulatory and Pricing either by phone on 9853 6144 or via email: david.neville@integral.com.au.

Yours faithfully

Richard Powis
Chief Executive Officer
In reply please quote file no.: 2004/00299/001