

Industry Levy
C/- MCE Market Reform
Department of Industry, Tourism and Resources
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Dear Sir

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

The National Generators' Forum (NGF) supports the broad thrust of the discussion paper released by the Ministerial Council on Energy Standing Committee of Officials (SCO) outlining possible cost recovery mechanisms to fund the proposed Australian Energy Regulator and the Australian Energy Market Commission (March 2004).

The discussion paper focuses on a review of general objectives for designing cost recovery mechanisms and describes a range of possible options for funding the new institutions. Given the lack of specific detail on the possible allocation of costs, the following NGF comments are limited to a discussion of the principles that should shape the new funding arrangements.

AEMC and AER accountability

Under any compulsory funding arrangement, industry participants will seek an assurance that the overall quantum of funding is appropriate and that processes are in place to ensure that the regulatory bodies face reasonable disciplines on the expenditure of industry funds. The discussion paper sets an objective of encouraging financial responsibility yet fails to provide any detail on accountability arrangements for the AEMC and the AER other than noting a direct line of report to the MCE.

The MCE alone will not be capable of assessing the performance of the new institutions on an ongoing basis. The Ministers and their advisors are well placed to give broad directions to the AEMC and AER but cannot be expected to have a detailed understanding of the day-to-day operations of the regulatory bodies.

One of the motives for the energy market reforms was to improve governance of the energy market institutions. This will only be true if the participants have some meaningful decision rights that they can exercise in respect of the performance of the entity in question.

The NGF believes there should be a role for industry to monitor and review the activities of the new institutions and provide feedback to the MCE. Market participants or their

representatives should have the ability to influence the overall budgets and the breakdown of overall expenditures of both institutions on an annual basis. In addition, the MCE should engage independent auditors to regularly review the operations of both organisations as a further way of overcoming the inherent information problems associated with monitoring the performance of regulatory agencies.

Passing through rule making and regulatory costs to customers

The discussion paper raises two key issues relevant to the discussion of funding mechanisms:

1. the allocation methodology used to attribute cost recovery between energy sectors in a competitively neutral manner; and
2. the means of allocating the sector cost recovery between industry participants and industry activities in the relevant energy sector.

The paper refers to a range of costs – attributable (direct), non-attributable (joint and common), standard and extraordinary. There is little discussion of how specific rule making and regulatory activities would be categorised, other than by example. The NGF does not dispute the broad categorisation of costs but cannot provide specific comment on this issue until the SCO undertakes a complete analysis of the key functions and activities of the new bodies. The SCO must provide industry participants with the opportunity to review a detailed cost breakdown and any cost categorisation methodology prior to the commencement of the new funding arrangements.

The paper adopts the principle of “causer pays” for the attributable portion of costs – “regulatory costs should be borne by those industry participants who give rise to costs”. However, it is not at all clear that the regulated participant is the causer. If we think of a regulator as fulfilling a public service by acting as a non-market proxy for the competitive processes, then the ‘causer’ may be the end users who benefit from the regulator’s service. For example, the regulator’s activities are demanded by the community in order to protect them against the economic implications of monopoly network services.

The NGF supports the SCO’s analysis of the efficiency effects of alternate cost recovery arrangements and agrees with the SCO that cost pass through arrangements would minimise distortions and improve economic efficiency. Charging industry fees to market generators without an explicit mechanism to pass through those costs to end users can alter behaviour in a competitive market and act as a deterrent for new entry into the wholesale market. Any substantial restructure of existing fees would create winners and losers amongst market participants, which would fail the objective of delivering equity to participants.

The NGF supports the introduction of an explicit cost pass through mechanism to recover the full cost of operating the AEMC and AER from end users. Spread across the entire market, the incremental cost of regulatory fees for end users would be negligible.

The discussion paper outlines four options for recovering regulatory costs from customers – via: retailers, transmission businesses, distribution businesses and wholesale energy purchases.

The NGF supports the inclusion of a levy for regulatory and rule making services as part of the setting of service charges that apply to transmission or distribution businesses. Given the monopoly nature of these businesses, the choice of transmission or distribution should not be a problem provided that the business is allowed to pass

through all relevant costs to the next stage in the marketing chain. This approach has a range of advantages:

- monopoly network charges are set by independent regulators based on actual costs;
- the new national arrangements should see a single national regulator setting all network charges over the few years;
- the move to a national regulator applying a uniform pricing methodology should allow for the inclusion of all regulatory and rule making fees in transmission or distribution charges;
- retail contracts should allow retailers to pass through monopoly network service charges to end-use customers without dispute.

The approach is competitively neutral for all market participants and would incur minimal implementation and administrative costs as a funding mechanism.

The NGF has not had sufficient time to fully assess the scope for cost pass through arrangements in each jurisdiction. State and territory arrangements have retained various forms of retail price protection for residential and small business customers. These arrangements allow for the pass through of actual costs in most cases, although there may be delays in some jurisdictions. The move to a uniform national retail regulation should allow for the design of arrangements that allow the pass through of actual network charges over time.

Summary

The design of cost recovery arrangements has the potential for much debate amongst industry participants over the breakdown and allocation of costs. The SCO discussion paper is a high level document outlining options, making it difficult to endorse or criticise the proposed arrangements. The NGF supports the SCO's case for recovering all non attributable costs from customers through a direct pass through mechanism. We believe that the SCO should apply the same mechanism to the recovery of all regulatory and rule making costs. Such an arrangement would remove the scope for dispute and ensure that customers, who are the ultimate beneficiaries of regulation, are the group that funds the new institutions.

The NGF notes that the SCO made a commitment at the recent industry forums to consult on the detail of the proposed funding arrangements. The NGF would therefore appreciate the opportunity to comment on the draft legislation that will establish the AEMC and AER.

Yours sincerely



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