

“Streamlining the Code Change Process”

Comments on the Discussion Paper of the MCE Standing Committee of Officials by Chair, NGPAC

Preface

While the following comments and observations are based on my experience as independent Chair of the National Gas Pipelines Advisory Committee (NGPAC) they represent a personal view and do not purport nor should be taken to represent the collective view of NGPAC. Inevitably my views will reflect experience with the gas access regime and no claim is made to any detailed knowledge of the electricity regime. Never-the-less I have attempted to confine my remarks to general principles which should be relevant to both.

Passing reference is made to the AEMC-AER-ACCC Memorandum of Understanding (MoU) Framework discussion paper. No separate submission will be made on that paper.

It is acknowledged, and taken as a given, that the institutional framework for Code Change has been set out in the MCE Report to CoAG on Reform of Energy Markets of 11 December 2003 (“the MCE Report”).

Overview

There is a cast to the proposed Code Change Process which seems to be adrift of the policy principles set out in the CoAG Competition Principles Agreement of 11 April 1995 (the CPA), in particular, Clauses 6(3) and 6(4) (<http://www.ncc.gov.au/pdf/PIAg-004.pdf>). This could lead to access regime Codes which become a travesty of the CPA principles.

If there are to be “Prescribed Criteria for Assessing Code Change Proposals” (and I would support this) which include “Market Objectives”, then the Criteria should also include “Code Principles” based on Clause 6 (4) of the CPA.

It would be a mistake to treat the Discussion Paper as being only about the process for Code change. It is precisely the process, with its specification of stakeholder inputs, roles and “Prescribed Criteria”, which has the potential to change the policy basis of the rules governing access to national energy delivery infrastructure.

My comments are made at two levels. The first level concerns the importance of preserving, perhaps by restating and clarifying, the foundation policy principles on which the national access regimes are based. The broad policy perspective was set out in the National Energy Policy Framework (NEPF) which was reproduced as appendix 1 of the MCE Report. But the quite specific original intentions or “policy principles”, in the context of access regimes, were set out in Clause 6 of the CPA. There has always been an emphasis on the importance of commercial agreement based on a level playing field, leading to market development and investment and ultimately to reliable and cost effective energy for Australian industry and end users.

Unfortunately there is a perception that the present regulatory framework seems to be drifting towards a consumer protection focus and an emphasis on the “regulatory industry” rather than on energy infrastructure, its development and equitable access thereto. My concern is that the proposed Code Change Process will accelerate that drift. My thesis relating to this cause for

dissatisfaction among stakeholder is that some stakeholders may have either forgotten or are now failing to correctly interpret and apply the policy principles. At very least it appears that the intent of these policy principles is interpreted differently by the various stakeholders.

The second level comments are about specific aspects of the regulatory framework envisaged in the Discussion Paper. Adherence to the policy principles demands that such framework remains responsive to legitimate requirements of stakeholders in the market for access to energy transmission and distribution, rather than merely that it produces an elegant and effective process which is really about regulation per se.

It appears that once a Code change proposal is lodged, it takes on a life of its own, with the proponent marginalised during the rest of the process and apparently having limited right to withdraw the proposal.

Principles

Concern has been expressed that the present regulatory framework is not delivering light handed “touch on the tiller” facilitation of development of the market for energy transmission and distribution as envisaged by stakeholders from a reading of the Hilmer Report and the CPA. The Discussion Paper is clearly not intended and does not attempt to address all the issues which have arisen from this concern and led to various enquiries, including the Productivity Commission (PC) review of access regimes and the CoAG Energy Market Review. But it does address how the present regime may be amended and on what basis, not merely by what process, proposed amendments are in future to be approved by the Australian Energy Market Commission (AEMC). Unless the “Prescribed Criteria” referred to and the process outlined in the Discussion Paper derive explicitly from the policy principles only a temporary “fix” will be achieved.

Further, in my view, in the remits of both the AEMC and the Australian Energy Regulator (AER) and also in the AER-AEMC-ACCC Memorandum of Understanding (MoU) Framework there will need to be an unequivocal linkage back to the policy principles. To avoid a further future blurring of the focus of the CPA and the National Energy Policy Framework principles, the operational paradigm and “culture” of the new institutions must be established as discrete to the specific access regime Codes to be administered. The cultures of the ACCC and some of the other State regulators inevitably incorporate a wider operational paradigm, often with historic linkages to consumer protection, price setting and/or surveillance. Without firm specific linkage to the CPA policy principles there is a risk that cultural carry-over among staff, particularly in the AER, will inhibit delivery of a regulatory approach which is access regime specific

The CPA policy principles envisage that an efficient, transparent market will deliver the optimum energy infrastructure investment and services for Australian industry and energy users. The MCE Report reaffirms these principles.

Because an important aspect of the access regimes is their uniform national character individual markets within this framework, with their differing geography and supplier/user mix, may produce outcomes for certain stakeholder groups with which the responsible jurisdiction is not comfortable. For example, regional development policy may not be well served by pricing outcomes in a particular geographic market. The potential for this outcome is flagged in the NEPF. The solution should be specific and transparent remedial action (eg price subvention) under the appropriate domestic policy, rather than imposition of a market distortion, eg through a geographically specific pricing cap. The latter approach is not obviously excluded by the MCE Report. There would seem to be no need for regional development policy implementation to

distort CPA access Code principles. To do so would quickly lead to stakeholder concern about investment climate certainty.

The proposed Code change process, unlike the present one, does not afford individual Ministers the opportunity to “second guess” the new institutions through proposal or approval of specific Code change measures. However, “Ministers acting jointly will have the power to issue binding policy directions on and commission inquiries by, the AEMC” (MCE Report, appendix 2). Also, the MCE as a whole can apparently proscribe consideration of Code changes relating to “protected provisions” of the Code. These new arrangement will be a significant improvement over the present process in terms of policy principle, with their specific focus on energy policy and particularly if they are linked to the CPA principles.

It will be the extent to which such principles are taken up and adhered to as the operational paradigm and culture of the new institutions that will underpin the credibility of the new Code change and regulatory arrangements.

Process

Flowing from my views on the importance of primacy of the CPA principles is my belief that the AEMC and AER should have a bias **against** regulatory intervention, whether in the context of Code change or application. This is not the traditional bias of regulators generally, and nor has it been the experience with regulators under the current access arrangements. Under the wider remit of most of the staff of most of the present regulatory bodies, a number of which include historically or currently consumer protection (particularly the ACCC) there has been a bias **towards** involvement. In my submission to the PC review of the gas access regime I have argued that this may derive from a culture of risk aversion not only by regulators, but also by those being regulated choosing certainty of outcome at the expense of freedom to negotiate (which does not seem to inhibit the latter from complaining of heavy handedness by the former). In summary on this point, it is my observation that unless the AEMC and the AER are established with remits and cultures under which their respective roles are fully discharged by intervening only when market initiatives or outcomes infringe the policy principles or specific provisions of the Codes. Thus, for example, there should be a bias towards acceptance of an Access Arrangement, coupled with a preparedness to rigorously enforce penalties for any breaches of the Codes.

Clause 3.2 of the Discussion Paper in my view correctly places emphasis on the responsibilities of the proponent of a Code change. It also infers that compliance with the conditions set out in that clause will lead to a smooth and normally quicker, favourable outcome. It is in the process beyond that point where potential difficulties arise.

Embedding the CPA policy principles in the culture and operational paradigm of the new institutions will be a challenge, particularly for the AER, given the organizational efficiencies to be gained from staffing and administrative hosting arrangements with ACCC.

The conformance of the “Prescribed Criteria” to the policy principles, of the CPA as well as the NEPF, is therefore absolutely crucial. As set out in Clause 4 of the Discussion Paper such criteria represent only partially the NEPF principles and completely omit some of important themes of the CPA. They also appear to be much more narrowly focussed on end user interests than would seem justified by the principles set out in Clauses 6(3) and 6(4) of the CPA. This impression may to some extent depend on the very wide connotations of the term “consumer”; why not stick with the terms employed in the CPA so as to avoid confusion and retain focus on the energy delivery infrastructure.

Even with tighter terminology, the “Market Objectives” of 4(2) do not give sufficient emphasis to the objective of encouraging the enormous investment in infrastructure acknowledged in the MCE communiqué and the Objectives and Principles of the NEPF. As stated above, if there are to be “Prescribed Criteria for Assessing Code Change Proposals” which include “Market Objectives”, then the Criteria should also include “Code Principles” based on Clause 4 of the CPA.

The Discussion Paper on the MoU Framework places considerable emphasis on the close cooperation, consultation and (in the case of AER -ACCC) staffing links between and among the new institutions. It is of concern that similar emphasis is not given to the appropriate cultural and operational ring fencing. Stakeholders complaining about the present system will be looking for a formally discrete approach by the AER.

Turning to more specific aspects of the Code change proposal process in the Discussion Paper, I submit the following comments and observations:

1. Is it envisaged in 3.1 that AER could propose a Code change? If so, an important concern of gas service providers will have been overlooked.
2. Consistent with my concerns expressed above, in my view the AEMC should be directed much more clearly on the net benefit test, with the emphasis being on the CPA principles rather than “long term interests of consumers”.
3. I have the same concern about 4(2) Market Objectives in which the “primary objective” is linked to “consumers” rather than the CPA principles and the NEPF. As stated above, my solution would be to include a set of “Code Principles” based on clause 6(4) of the CPA.
4. Step 1. There is a bias in the wording that the AEME “will” amend or reject a proposal. Surely the bias should be to accept unless there is clear cause to intervene, particularly at that early stage.
5. If the AEMC does in step 1 make an amendment, the proponent should have the right to withdraw the proposal if it does not wish to proceed with the amended version. Otherwise who is to assess whether the amendment does “not alter the proponent’s original intent”?
6. Initial involvement of the AER and ACCC. If these bodies advise AEMC that they have issues, the proponent should be advised and brought into the loop, with the right to withdraw the proposal.
7. Under 5.2, 6.2, 6.3, 7.4 and 12 the AER and/or the ACCC have rights to intervene or be consulted in one way or another. This seems a bit excessive, particularly as the AEMC must “explicitly address” issues raised by ACCC and AER along the way. Such opportunities for intervention do not really have the feel of addressing the stakeholder concerns about the involvement of Regulators in the present Code change process.
8. Working Groups. The proponent should be a member of any working group under 7.2, as of right.
9. There are numerous opportunities in the process for the originally proposed Code change to be amended. As a general principle the proponent should be notified on every occasion it proposal is amended and on each such occasion have the right to withdraw the proposal. It would seem reasonable to make any such withdrawal late in the process dependent on the proponent demonstrating that its original intentions for a Code change have been frustrated or distorted by such amendment(s).
10. Reference is made to decisions of AEMC being subject to judicial review on questions of law. Does this mean that no appeal is available “on merit of the case”? For example, there are several stages in the process in which analysis is undertaken by AEMC. Is it intended that a conclusion based on such analysis would not be appealable? This would certainly be contrary to the spirit of the Gas Code.

1. Conclusions

- Linkage of the National Energy Policy Framework (NEPF) and the role of the MCE should produce benefits to the Code change process and administration.
- For these benefits to emerge the new institutions must be, and be seen to be, derivative of the CPA principles and the NEPF and not creatures of consumer protection policy.
- As such, the AEMC and AER should have a cultural bias against intervention.
- If there are to be “Prescribed Criteria for Assessing Code Change Proposals” which include “Market Objectives”, then the Criteria should also include “Code Principles” based on Clause 6(4) of the CPA.
- The proponents of Code changes should have the right to withdraw a proposal where cause is shown.
- Consideration should be given to appeal against AEMC determinations on merit.

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