

13 January 2006

Manager – MCE Secretariat  
Department of Industry, Tourism and Resources  
GPO Box 9839  
Canberra ACT 2601

By email: [MCEMarketReform@industry.gov.au](mailto:MCEMarketReform@industry.gov.au)

## **SUBMISSION TO MINISTERIAL COUNCIL ON ENERGY**

### **PUBLIC CONSULTATION ON A NATIONAL FRAMEWORK FOR ENERGY DISTRIBUTION AND RETAIL REGULATION**

#### ***Introduction***

This submission outlines the views of the following second tier electricity retailers operating in the National Electricity Market (“NEM”):

- Powerdirect Pty Ltd, and
- Jackgreen (International) Pty Ltd

Each company holds a retail licence or equivalent authorisation to operate as an electricity retailer in one or more of the NEM jurisdictions. The companies have normal “arm’s-length” commercial relationships with Distribution Businesses (“DBs”) in those jurisdictions. Apart from joint participation on various industry bodies, there are no other formal relationships, either between the companies making this submission, or between those companies and the DBs. The views contained in this paper are also supported by prospective Victorian electricity retailer Our Neighbourhood Energy Pty Ltd, which is currently applying for its retail licence with the Victorian Essential Services Commission.

The views of companies that are first tier retailers or that have other existing relationships with DBs are not covered in this submission. For completeness however, Powerdirect Pty Ltd notes that its parent entity is currently in the process of recommending to its shareholders a scheme of arrangement with a Queensland based energy incumbent, Ergon Energy. It is the view of Powerdirect that this association will, among other things, ease some of the significant regulatory burden present for second tier retailers in the current climate. Some of those issues are discussed in this submission.

The submission is set out with reference to Parts A – D of the Consultation Paper.

## **Part A - Overview**

The retailers welcome the Ministerial Council on Energy (“MCE”) release of the consultation paper setting out NERA and Gilbert & Tobin proposed best practice approach to regulation of energy distribution and retailing. In this submission, the retailers agree that regulatory responses to date have resulted in “... a substantial number of very detailed obligations contained across a range of legal instruments ... There is limited consistency in requirements between jurisdictions and between sectors.”

The retailers note that the release of the paper does not constitute MCE endorsement of the proposals, but nevertheless consider the paper a good contribution to continue development of better regulation of the energy distribution and retail sectors. It confirms general observations made over many years that regulation must be improved if the full benefits of competition are to be realised, and, in particular, it points to inconsistent regulation across Australian jurisdictions as a significant impediment to continued productivity and economic efficiency gains.

In addition, these regulatory complexities create both significant barriers to entry and issues of continuing viability in retail electricity and gas supply, leading to excess profits being earned by the holders of incumbent franchise territories.

In general, the retailers support the legal architecture recommended in the paper, and particularly the elimination of duplication of general obligations with industry specific obligations, which has led to “...a myriad of instruments of different types applying to Australian energy retailers and distributors.” If adopted, the recommendations would “... improve the transparency of the regulatory arrangements, lessen duplication and reduce compliance costs”. This rationalisation would lead inevitably to benefits for consumers as available resources could be devoted to activities which are valued by them.

Simplification would also provide for a virtuous circle, where simpler regulation can be more easily reviewed by stakeholders and participants, leading to further simplification and reduced costs of regulation and compliance.

## **Part B - Price Regulation of Distribution**

The retailers making this submission have no vested interest in any DBs, so distribution price regulation is not an area of the consultation paper where detailed submissions are proposed.

However, the retailers do have extensive experience in dealing with the issue of credit support in our relationships with the DBs in the various jurisdictions. The opportunity is taken to comment on this issue insofar as it can be addressed in price regulation of distribution.

One of the major issues affecting the interface between the retail and distribution sectors is the allocation of risk, with the risk of a retailer insolvency being a significant concern for DBs. The DBs state that there is no provision in the regulated rate for recognising this risk, and consequently a range of heavy-handed and ineffective approaches have been presented in various jurisdictions which consistently create points of contention

between second tier retailers and DBs. Depending on the jurisdiction, this has taken the form of onerous credit support provisions in default “Use of System” or “Connection” agreements (such as Victoria, South Australia and Australian Capital Territory) or in Market Operation Rules (such as New South Wales).

In the retailers’ view, compliance with arbitrary investment grade ratings or bank guarantees or other credit support provisions requires inefficient allocation of scarce working capital resources. These requirements are a significant barrier to market entry by retailers that do not conform to a traditional incumbent retailer profile, whether stapled to a DB or not. The problem has been raised in many different ways over several years, but remains a contentious issue. The retailers submit that much more needs to be done in this area if regulation of the electricity distribution and retail sectors is to be improved.

Initiatives which should be considered include better utilisation of the NEM’s financial structure and use of insurance products. NEMMCO has commenced reviews of ways to make better use of the inherently robust nature of the NEM, but these reviews have not led to any improvement to date. Innovative solutions using insurance products have been implemented by a limited number of innovative DBs, but are not universal. A simple second step, of moving the obligation for insurance of Distribution Prudential risk from the retailer to the distribution cost structure would have the added advantage of aligning the benefit of the insurance (lower DB WACC) with the cost (the insurance allowance).

To the extent possible in this review, the MCE is encouraged to focus on establishing fair, equitable and economically efficient prudential management which is consistent across jurisdictions and does not distort energy pricing.

### ***Part C – Consumer Protection***

The particular focus of the retailers’ submission in this part is on:

- The obligation of retailers to supply smaller customers (section 5);
- Retailers’ obligations in respect of smaller customer retail market contracts (section 6);
- Retailers obligations in respect of marketing to smaller customers (section 7); and
- Mechanisms for dispute resolution between retailers and smaller customers (section 8).

The retailers support the consultation paper’s general proposition that industry specific consumer protection requirements, if any, should not be imposed as licence conditions, and that this should be common to all jurisdictions. The retailers also support the proposal that the scope of consumer protection regulation should not be so wide or prescriptive as to impose regulatory costs which exceed benefits. Retailers that operate in one or more of the jurisdictions must deal with the up front costs such as fees, compliance and reporting requirements in each of the jurisdictions, and in our view there is evidence that regulatory costs exceed benefits. For example, there are actual examples of consumer protection issues with negligible value (in one case a dispute as to profit earned on an annual charge totalling \$4.55) being handled through established

dispute settling processes which trigger many thousands of dollars in fees and other costs, plus management time and effort to resolve.

The paper's observation that current arrangements are neither simple nor consistent across jurisdictions is endorsed, and is a significant reason to support continuing efforts to rationalise industry regulation in the electricity distribution and retail sectors. For second tier retailers operating in multiple jurisdictions, the resultant complexity in sales and marketing material, staff education and regulatory compliance systems are evidence of the onerous and unnecessary approach to regulation adopted at present.

The retailers support, as policy guidance, the triangular relationship (described in Figure 2 on page 48) between distributor, retailer and end customer because it most accurately describes the actual commercial and operational relationships between the parties. When and if distribution system failures occur, the allocation of rights and liabilities can be resolved most effectively with this model. The scope of the recommended approaches to regulation outlined in the paper is generally acceptable to the retailers, as are the transitional arrangements proposed.

In the competitive market, retailers develop their customer bases by offering innovative products and services. Customers are the ultimate beneficiaries in this scenario. Over time, the retailers are confident that the perceived need for standard contract regulation, including price regulation, will diminish as consumers become more confident of market mechanisms providing the best price and quality outcomes. While not supporting the extent of regulation which has accompanied NEM development, nevertheless the retailers can understand political pressures which have led to regulation imposing standard contract terms and conditions, including a regulated default tariff if necessary in the short term, as full retail contestability has been introduced. However, care should be taken not to stifle the market through regulatory action.

A simple step would be to ensure that customer protection measures imposed as an explicit policy requirement to protect households from a perceived politically risky market for the sale of energy do not distort the sale of energy to business. The current application of Consumer Protection measures in energy markets is via usage thresholds which are clumsy indicators of consumer size. This can be evidenced in certain jurisdictions where the Consumer Protection measures apply to large corporations occupying numerous supply points, but where consumption at each supply point is below the relevant threshold. Some jurisdictions apply aggregation rules to prevent this from occurring. In any event, regulation could be simply and quickly simplified to exclude all non-residential supply, narrowing the policy focus and improving the market delivery of business services.

Another area requiring special mention is in relation to the private networks and resellers which provide services to third parties, such as shopping centres and caravan parks. The retailers strongly support the proposition that so-called "embedded networks" should be required to comply with Rules made by the AEMC, in the same way as other NEM participants. There are anecdotal accounts of actions undertaken by embedded networks which place retailers and consumers at a disadvantage, and ultimately act against the interests of consumers. There are many consultative processes at different stages of development in the various jurisdictions and at NEMMCO in connection with this issue. As with other industry issues outlined in the paper, the opportunity to address the problem and achieve consistency across jurisdictions should be taken.

In relation to alternative dispute resolution (ADR) schemes, the retailers are currently faced with different approaches in each of the jurisdictions in which they operate, so any improvement in uniformity and consistency would be well-received. While the recommended policy criteria out for ADR in section 8.1, and the recommended approach outlined in section 8.3, are noted and endorsed, it is the retailers' experience that the current schemes are not always used by "vulnerable" consumers in line with the spirit of the schemes. There is also scope to separate access to regulated ADR schemes to consolidate rights for small residential consumers (who are the most likely "vulnerable" group) compared to business consumers, that are invariably sophisticated buyers of a number of economic services including energy.

In our view, there are occasions when the schemes are abused to circumvent or delay consumers' obligations to pay for electricity they have consumed, or for other reasons not connected with consumer protection. In establishing a system which provides an effective means for the "vulnerable" consumers to protect their interests, the opportunity should be taken to ensure that administrative processes which support the schemes are not open to abuse by frivolous, vexatious or otherwise wrongly motivated individuals or businesses, and satisfy threshold substantive standards so that the costs of the schemes do not outweigh the benefits. The schemes should have a merit filter, such that claims on the schemes that are without merit are rejected quickly and without cost to the retailer. All schemes, and most notably EWOV, deal with a claim without necessary reference to the merits of the claim, leading to some grossly inappropriate outcomes, especially in B2B transactions.

#### ***Part D – Other***

The retailers support the view that licensing / authorisation regimes create barriers to entry and regulatory costs should only be imposed where the benefits clearly outweigh the costs. The retailers note and endorse the paper's general principle that licences should not be the repository of legal obligations, which should be found in legislative instruments if considered to be necessary and serious.

As mentioned in Part B of this submission, the retailers concur with the proposal that prudential rules in markets like the NEM should be set as part of regulatory regimes for the balancing and settlement of wholesale exchanges and networks. The current arrangements, which unilaterally impose default prudential conditions on a small proportion of retailers, are ineffective and have been a long-running point of contention between these retailers and DBs. The retailers submit that much more attention should be paid to other potential forms of prudential management, such as insurance products with appropriate cost signals to DBs, in order to resolve a major flaw in current market arrangements affecting the electricity distribution and retail sectors.

The retailers agree that retailers solely engaged in the commercial aspects of the industry without involvement in physical delivery should not be required to satisfy technical entry criteria. This simply reflects the different electricity retail business models which have been developed and operated successfully in the NEM as it has matured. A regulatory architecture based on substantive obligations being set out in the National Electricity Law in areas such as consumer protection, metering and retailer failure

appears to be a sensible means of achieving consistency across the jurisdictions, particularly if it rationalises and simplifies the elements covered in licences.

The retailers note and endorse the proposal that existing jurisdictional legislation and related instruments should be limited. The list set out in the consultation paper includes environmental matters, public health matters, occupational health and safety matters and technical matters associated with the physical and system integrity of the physical networks. In each case, the retailers submit that a fundamental threshold should be addressed before jurisdictional legislation is automatically rolled over. The opportunity for reviewing jurisdictional legislation should confirm the continuing need for the legislation itself, and if it is decided that it is required, whether it can be further rationalised and/or brought into line with other jurisdictions. For example, one of the most complex and disruptive of all regulatory areas is greenhouse response because each jurisdiction is pursuing a different political agenda in its suite of greenhouse response measures.

The paper examines the interface between distributors and retailers at some length in section 3. The point is made that, given that distributors are generally suppliers of monopoly services, they do not face any real incentive to negotiate balanced contractual arrangements with retailers. The retailers can confirm this observation from dealings which each has had with various DBs.

The flow on implications for the effectiveness of consumer protection regimes and other commercial arrangements between the sectors is certainly an area for further attention during this review. It should be noted that the default Use of System Agreements referred to in the consultation paper were themselves developed with minimal consultation with retailers, and consequently contain clauses which have consistently been contentious, particularly in the area of credit support. It is suggested that to be effective, a more evenly balanced set of conditions should be renegotiated. If the interface between the sectors is to improve following this review this will be a critical area for attention.

The retailers agree that establishment of an effective regulatory regime for energy distribution and retail must take account of balancing systems, supply / consumption reconciliation and settlements and customer transfers. As mentioned in the paper, the National Electricity Law arrangements are consistent with the direction proposed more generally. However there are many practical issues arising in this area which could be examined later in the review process.

The retailers have no specific submissions to make on regulation of the gas market at this stage. However the general point about the desirability of consistency between gas and electricity regulation, metering etc is well made, and should provide guidance for the review so that the energy industry is positioned to deal with continuing change in the sector.

Similarly, metering is a critical part of continuing industry reform, and needs to be included in the review. In the electricity industry NEMMCO has taken a prominent role in the issue, and the consultation paper's examination is supported by the retailers as a sound basis for review.

The examination of the Retailer of Last Resort schemes and proposed approach are considered to be well-structured and sensible, but the retailers have no substantive comments.

Finally, the paper's examination of jurisdictional directions notes the fundamental interest to provide a national approach to regulation of energy distribution and retail. This direction is strongly supported by the retailers. However the identification of jurisdiction-specific issues across a range of subject areas suggests that the clarity of that vision could be lost and compromises made over time to satisfy the various jurisdictions. In our view the MCE is the only forum in which these issues can be resolved in the national interest. This submission encourages the MCE to use every effort to minimise jurisdictional issues interfering with the review of energy distribution and retail regulation.

The retailers would certainly appreciate being kept informed of any developments or open forums on these or similar issues addressed by the MCE.

Yours sincerely  
Andrew Bonwick, Chief Executive Officer  
Powerdirect

on behalf of:  
**Powerdirect Pty Ltd**  
**Jackgreen (International) Pty Ltd**  
**Our Neighborhood Energy Pty Ltd**