

SUBMISSION TO THE MINISTERIAL COUNCIL ON ENERGY

Re NATIONAL FRAMEWORK FOR DISTRIBUTION AND RETAIL REGULATION



**UNITED ENERGY
Distribution**

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HIGHLIGHTS OF THE UNITED ENERGY DISTRIBUTION SUBMISSION

The National Gas Code (NGC)

- The Productivity Commission has reviewed the NGC and these recommendations should be adopted by governments quickly.
- The NGC would become a best practice regulatory code.

The National Electricity Code (NEC)

- The NEC has not been comprehensively reviewed since its establishment in 1998
- The NEC is subject to many of the criticisms that the Productivity Commission made of the NGC.
 - A mix of objectives
 - No overarching objectives
 - Not consistent with Part III A of the Trade Practices Act
 - Too much regulatory discretion
 - No clear pricing principles
 - Lack of best practice pricing principles
- Many governments have derogated away from the NEC given its lack of best practice principles

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A new National Energy Code for Pricing and Access (NEAC)

- UED proposes a best practice regulatory solution to these problems with the NEC.
- A best practice regulatory solution model includes:
 - appropriate objectives and pricing principles,
 - submission of pricing proposals by regulated businesses which are considered by regulators for reasonableness rather than regulators searching for precise outcomes,
 - adequate appeal rights.
- UED proposes that the NGC (after adapting the Productivity Commission recommendations) be amended to include electricity distribution to form a National Energy Code for Pricing and Access.

The Transition to the National Model

- Electricity distributors should not be disadvantaged in the move to national regulation.
- Electricity distributors should not have to give up best practice jurisdictional principles to move to national regulation that is not based on best practice.
- These best practice Victorian jurisdictional processes (which are also part of the NGC) include:
 - Merit appeal arrangements (currently available for Victorian electricity distributors) compared to the NEC which allows no such appeals.
 - No reconsideration of the initial asset base of electricity distributors with “roll forward” of the asset base for net investments in later reviews. This is the model adopted by the Victorian ESC while the NEC allows for continuing review.

In addition major government initiatives should be allowed for in AER pricing decisions such as the Victorian interval meter rollout.

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National Regulatory Instruments

- UED submits that the MCE should move to national regulatory instruments only where there is a clear net benefit in doing so, including net benefits to distributors.
- National instruments are to be preferred over jurisdictional instruments providing the outcomes meet the net benefit test.
- Where there are jurisdictional rules these should be set by jurisdictional governments and administered nationally by the AER to avoid dual regulation and promote net overall benefits

Best Practice Principles for the National Model

- A clear separation between the rule maker, the Australian Energy Markets Commission (AEMC) and the rule enforcer and market regulator, the Australian Economic Regulator (AER)
- AER and AEMC must be legislatively bound by best practice regulatory principles.

1. Introduction and Summary

United Energy Distribution Pty Ltd (UED) is one of five electricity distribution businesses operating under licence within the State of Victoria, with assets totalling approximately \$2.0 billion. UED's network provides services to some 600,000 end-use customers in Melbourne's southern and eastern suburbs, with its area of operation confined to geographically defined boundaries set out in the Distribution Licence.

The Ministerial Council on Energy (MCE) Paper on the national framework for electricity and gas distribution has been released for comment in the context of a number of reviews by the Productivity Commission (the PC hereafter) and others.

The reviews are the PC's National Access Regime review, the National Gas Code (NGC) review and the Parer Inquiry into Energy Markets. In response to the PC's National Access review, the Commonwealth Government has made some decisions on the objectives of Part III A of the Trade Practices Act. All these initiatives will impact on decisions to be made in regard to the objectives and pricing principles for the distribution of electricity in the National Electricity Code (NEC).

UED is surprised that the MCE Paper has not raised the issue of the impact of these reviews for the review of distribution pricing in electricity given the pricing and access issues are almost identical.

UED advocates that:

- Australian governments finalise their response to the PC Review of the Gas Access Regime as a matter of priority; and
- The framework for the economic regulation of distribution services in electricity be undertaken as part of this MCE Issues Paper process, recognising and adopting the PC's recommendations in gas, but without delaying the implementation of those recommendations.

The PC has reviewed the objectives and the principles of the NGC and the National Access Regime and, given they cover many of the same regulatory issues in the NEC, the PC's findings and recommendations will be a relevant consideration given:

- the need to establish a best practice economic regulation model (and given the recent review of the NGC this is considered to be the best practice regulatory model);
- in comparison the NEC has not been reviewed since its establishment and review is overdue especially given the different approaches between the energy codes, the move to a national regulatory model and the fact many states have derogated away from it because of its age and lack of review;

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- a best practice model includes:
 - appropriate objectives and pricing principles,
 - submission of pricing proposals by regulated businesses which are considered by regulators for reasonableness rather than regulators searching for precise outcomes,
 - adequate appeal rights.
- a best practice model must be consistent with other codes and the National Access Regime as the Gas regime will do once the PC's recommendations are adopted; and
- decisions already made on the objectives of the National Access Regime and the recommendations of the PC Review of the NGC will impact on a consideration of the NEC; or on the development of a National Energy Access Code.

That the energy industry has also changed dramatically over the past decade and this implies a different approach to regulation, with the greater consolidation of the industry with vertical and horizontal mergers and the development of firms holding a range of energy assets.

A critical concern of UED lies with the approach of the MCE Paper in its focus on distribution pricing regulation without adequately considering a range of recent policy developments and outcomes from these independent reviews of third party access pricing regimes.

UED does not consider it appropriate for the development of the distribution regulatory framework program to pre-empt or delay the implementation of outcomes from the current separate process of Australian governments finalising a joint response to the recent PC Review of the Gas Access Regime. Following previous statements, UED had understood that these issues would be addressed through the development of an intergovernmental response to the PC Review of the Gas Access Regime.

UED has reviewed the objectives and pricing principles of the NEC in light of the PC review of the Gas Access Regime and has found that the problems raised by the PC on the NGC can also be applied to the NEC for pricing and access. Under these circumstances the objectives of the NEC can be replaced by those in the NGC as amended by the PC.

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The Development of a New National Energy Access Code for Gas and Electricity

Despite the lack of any consideration of best practice regulatory principles by the MCE Paper, UED considers that these reviews and market developments have all implied that the time has come to establish a new National Energy Access Code (NEAC) for Pricing and Access by amending the NGC (by the acceptance of the PC recommendations on the review of the NGC) and including the pricing and access issues from the NEC in the new NEAC.

UED supports the following steps to ensure that the new national regulatory framework becomes a best practice regulatory framework:

- The adoption of all of the PC's recommendations on the Review of the Gas Access Regime to form the new NGC;
- The replacement of the NEC objectives and pricing principles with those in the NGC as reviewed by the PC;
- The removal of those sections in the NEC dealing with pricing and access and the amendment of the NGC to form the new NEAC for pricing and access for energy distribution and transmission companies;
- The remaining technical and market operation rules of the NEC can be put into the new National Electricity Rules;
- The insertion of a number of sub-objectives to the NEAC to operationalise the new overarching objective based on economic efficiency; and,
- That a new clause is added to the National Energy Legislation that clearly states the hierarchy of instruments in the national regulatory framework, with national instruments to prevail over inconsistent jurisdictional instruments.

UED considers that this would deliver a best practice regulatory model that would be necessary for any move to national uniform regulation.

Other Recommended Changes for the National Regulatory Model

Governance Issues

UED recommends the following in terms of the issues around the role of governments in the new national framework:

- That distributors moving to the AER should retain all benefits currently permitted by relevant state regulatory regimes especially those on asset valuation and appeal rights;

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- Coordination between the national regulators and jurisdictional rule makers should be based on a model of published Memorandums of Understanding (MOU);
- That such MOU's should be based on specific responsibilities and clearly set out objectives, targets and associated measures;
- That a pass through/cost recovery model is implemented (see Appendix 1) to allow for jurisdictional imposed costs to be passed through to the national regulatory framework to ensure that distributors are not disadvantaged by the move to a national framework for regulation;
- That jurisdictional policies such as interval metering roll out be accepted by the AER and recovered as efficient costs by distributors.

The National Licensing Regime

In terms of the licensing issues raised by the MCE Paper in the new national framework UED recommends the following:

- That a new clause is added to the national legislation based on the PC recommendation for the NGC reforms that states that a regulator can only use information collected under the information collection powers specified in the new NEAC codes (or in the relevant codes) for pricing decisions by the AER;
- That the new national legislation include a requirement that any jurisdictional "licence" derogations be for a limited term and if retained must be subject to a public cost benefit analysis approved by the AEMC;
- That any new jurisdictional "licence" derogations be approved only if it can be shown that they are a net benefit to society as assessed by the AEMC as part of a public cost benefit analysis;
- That the development of a national licence and exemption system operates on the basis that in the move to the national regulator the distributor retains all the rights and obligations provided by the jurisdictional regulator until the end of the regulatory period for that distributor. Planning can then ensure the national model can operate for the next regulatory period and the time can be used to effectively and efficiency introduce the national model.

The MCE Paper misunderstands the Victorian arrangement for the contract between distributors and retailers. In the triangular approach there can be no "use of system agreement" because the distributor has a supply contract with the customer – the retailer does not "use the system". In Victoria there is a linear approach where the distributor has a supply contract with the retailer (a use of system agreement) and the retailer has a supply and sale contract with the customer – there is simply the additional deemed

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contract between distributor and customer which makes the rights and obligations in the Distribution Code binding on the parties.

UED supports the following approach:

- That the Victorian linear model is adopted as the basis of the national uniformity and that working parties are established to progress it.

National Industry Codes and Rules

UED recommends the following in terms of the issue of the industry codes and rules, that:

- the AEMC be given the responsibility of developing a national set of distribution related codes and guidelines and that a cost benefit approach is used in the process;
- the AER be given responsibility for developing any necessary non-rule based guidelines to guide distributors in interpreting and complying with AER regulation;
- a national set of regulations should be developed that applies minimum terms and conditions and that any jurisdictional differences should be phased out for each distributor at the completion of its regulatory period except for key jurisdictional policies such as merit appeals, asset valuations and policies on interval meter rollouts; and,
- in the development of this national set of regulation there should be an objective to minimise the number of regulatory instruments.

Associated Energy Schemes

In terms of the role of associated electricity and gas schemes in the development of the new national framework UED recommends that:

- a national set of regulations should be developed that applies to retailer of last resort and dispute resolution.
- any move to a national uniform approach be considered in a cost benefit framework.

Service Standards

UED recommends the following in terms of the issue of service standards:

- a national framework for service standard measures be developed by the AER;
- jurisdictions should be responsible for setting service standards and these should only be administered by the AER, as these are critical for state economic development and

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for consumers (important that the AER does not set these in its advising role to the jurisdictions);

- the AER should evaluate service standards against the benchmarks established by jurisdictions using the uniform measures and publish conclusions;
- where the data systems support the use of service standard incentive programs these should be used by the AER to set regulatory prices.

Jurisdictional Regulators

In terms of the issue of the other functions of jurisdictional regulators in the development of the new national framework UED recommends:

- That the policy position be based on the principle that where it is possible to develop national approaches on a net benefit approach then this could be transferred to the AER or the AEMC. In addition that there is an agreement between the national regulators and the jurisdictions to jointly consider all remaining functions of jurisdictional regulators and recommend which could be transferred to a national level using the net benefit test;
- That a census is undertaken by the national regulators and the jurisdictions to identify each local responsibility and to ensure that each level of government is able to clearly understand their responsibilities in the new national framework;
- That the census is used to enable the effective coordination of jurisdictional and national responsibilities and enable a range of MOU's to be developed and any necessary pass through of costs or cost recovery for distributors to be organised;
- That it should also be possible for jurisdictions to refer any responsibility to national regulators with any appropriate guidelines for operation at the national level.
- That the AER who will have offices in each state becomes a source of advice to governments on various energy matters under an MOU arrangement with a local jurisdiction.

UEL considers that the options set out above will establish the new national framework as a best practice regulatory model.

2. The Review of the Gas Access Regime and its Implications for the National Electricity Code Objectives

2.1 Introduction

The MCE Paper on the national framework for electricity and gas distribution has been released for comment in the context of a number of reviews by the Productivity Commission (the PC hereafter) and others.

The reviews have included the PC's reviews of the National Access Regime and the National Gas Code (NGC) and the Parer Inquiry into Energy Markets. In addition, the Commonwealth Government has made some decisions on the objectives of the national access regime. Both these initiatives will impact on the decisions made in regard to the objectives and pricing principles of the National Electricity Code (NEC) for a number of reasons.

The reasons include that the energy industry has also changed dramatically over the past decade which supports changes to energy codes with the greater consolidation of the industry with vertical and horizontal mergers and the development of firms holding a range of energy assets.

The PC has reviewed the objectives and the principles of the NGC and the National Access Regime and, given they cover many of the same regulatory issues as the NEC, the PC's findings and recommendations will be a relevant consideration given:

- the need to establish a best practice economic regulation model (and given the recent review of the NGC this is considered to be the best practice regulatory model);
- in comparison the NEC has not been reviewed since its establishment and review is overdue especially given the different approaches between the energy codes, the move to a national regulatory model and the fact many states have derogated away from it because of its problems;
- a best practice model includes appropriate objectives and pricing principles, adequate appeal rights and must be consistent with other codes and the National Access Regime as the Gas regime now does; and
- decisions already made on the objectives of the National Access Regime and the recommendations of the PC Review of the NGC will impact on a consideration of the NEC; or on the development of a National Energy Access Code.

A critical concern for UED with the approach of the MCE Paper is its initial focus on distribution pricing regulation without adequately considering the range of recent policy

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developments and outcomes from independent reviews of third party access pricing regimes.

UED does not consider it appropriate for the distribution framework work program to pre-empt outcomes from the current separate process of Australian governments finalising a joint response to the recent PC Review of the Gas Access Regime. Following previous statements, UED had understood that these issues would be addressed through the development of an intergovernmental response to the PC Review of the Gas Access Regime. In addition UED is surprised that the MCE has not raised the issue of the impact of the PC review of the Gas Access Regime for the review of the NEC given the pricing and access issues dealt with in each code are almost the same.

In the Review of the Gas Access Regime, the PC undertook a comprehensive analysis of the gas regulatory regime resulting in some 51 Findings and 55 Recommendations covering virtually every aspect of the Code's operation as demonstrated in Table 1 below.

Table 1 - Productivity Commission Findings and Recommendations on the Review of the National Gas Code by Code Section

| Section | Code Area | Findings/Recommendations |
|---------|--|--|
| 1 | Coverage | Findings: 6.1-6.6 Recommendations:6.1-6.5 |
| 2 | Access Arrangements | Findings: 5.1-5.4 Recommendations:5.1-5.6, 7.13 |
| 3 | Content of an Access Arrangement | Findings: 7.6, 8,1 Recommendations:7.15, 11.3 |
| 4 | Ring Fencing | Findings: 10.1, 10.4 Recommendations:10.4, 10.5 |
| 5 | Information and Timelines | Findings: 7.7, 7.8 Recommendations: 7.11, 11.2 |
| 6 | Dispute Resolution | Findings: Recommendations: |
| 7 | General Regulations and Miscellaneous | Findings: 7.12, 9.2, 9.3, 10.2 –10.4 Recommendations 7.14, 10.1, 10.2, 10.4 |
| 8 | Reference Tariffs | Findings: 4.5, 7.1-7.5, 7.6, 7.7, 7.11, 7.12, 8.1-8.4 Recommendations: 7.5-7.10, 8.1-8.13 |
| 9 | Code Changes | Findings: 12.5 Recommendations: |
| Other | Appeals (National Access Law) | Findings: Recommendations: 11.4, 11.5 |
| Other | Price Monitoring, Investment and Other | Findings: 3.2,-4.7, 8.2-8.4, 9.1-9.4 Recommendations: 8.1- 8.13, 9.1, 9.2 |

2.2 An Assessment of the Objectives of the National Electricity Code

2.2.1 Introduction – NEC Objective Issues

Given the principle laid down by the PC in the reviews of the National Access Regime and the Gas Access Regime a wider assessment is possible of the National Electricity Code than proposed by the MCE Paper.¹

In this context the problems with the NEC objectives include:

- a multiplicity of objectives some of which conflict;
- the mix of Code objectives and pricing principles;
- the lack of an overarching objective based on the key objective of efficiency; and
- the duplication of objectives

2.2.2 A Multiplicity of NEC Objectives and the Lack of an Overarching Objective

On the vast number of objectives in the NGC the PC concluded that:

“It is clear from the preceding section that there are many references in the Gas Access Regime documentation to objectives, and there are many different objectives. To some extent, this is a consequence of the negotiation process at the time the Gas Access Regime was established. The range of objectives resulted from an attempt to balance the different interests of jurisdictions, pipeline owners and users to obtain agreement.

In practice, it is common to give regulators (and the courts) some discretion to take into account factors that might vary from case to case. However, in the case of the Gas Access Regime, the Commission has concluded there are too many objectives, some of which are in conflict and not directly relevant to the overall policy objective of the regulation.”²

It might not be clear, for example, how regulators tradeoff objectives or decide on a relative weighting when balancing conflicting objectives, or what factors they consider in assessing public interest objectives. The PC in the NGC Inquiry on this issue concluded

¹ The numbering system used in this assessment is taken from the MCE paper, which sets out the objectives and pricing principles of the NEC. See Appendix 2 where these are reproduced

² Productivity Commission, Inquiry Report, Review of the Gas Access Regime, No. 31, June 2004, Australian Government, p. 167

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“In the Commission’s view, the objectives of the Gas Access Regime are not well specified in the enabling documentation. In particular, there are too many objectives, some potentially in conflict with insufficient guidance to regulators on how to weigh up the tradeoffs. In addition, the consequential explicit capacity of the regulator to apply virtually unlimited discretion carries with it its own disadvantages, such as reduced transparency and increased uncertainty.

The Gas Access Regime’s effectiveness (and the regulator’s task) would be assisted by better specification of the objectives in the relevant documentation. This might involve the insertion of a single overarching objective, the removal of unnecessary objectives spread throughout the documentation, and modification of other factors to make them consistent with the overarching objective.”³

Ministers, regulators, tribunals and the judiciary are responsible for implementing and enforcing regulatory arrangements, are guided by objectives, often in the form of an objects clause. In the recent report of the PC on the NGC they commented:

“The more clearly specified the objectives, the more effective is the guidance to regulators. In its review of the national access regime (part IIIA of *Trade Practices Act 1974* [TPA]), the Productivity Commission noted that access regimes, to function efficiently, must have clear objectives that promote:

- decisions that are well targeted to the identified problem and which minimise unintended side effects
- greater certainty for current and prospective facility owners, access seekers and other interested parties
- consistency among policymakers, the judiciary and those responsible for implementation and enforcement
- regulatory accountability. (PC 2001c, p. 124)”⁴

There is no overarching objective in the NEC as it covers a multiplicity of objectives and does not meet the requirements of a best practice regulatory model.

A clear set of objectives would provide greater certainty for infrastructure owners, access seekers, investors and other interested parties, and provide clarity for decision makers, and enhance transparency and timeliness with respect to decision making. The PC in the NGC concluded that:

“The Commission considers that a single clearly specified objects clause would improve the effectiveness of the Gas Access Regime. It would guide regulators and provide greater certainty for infrastructure owners and access seekers. It would identify the priority of the regime and carry more

³ *ibid*, p.171

⁴ *ibid*, p.167

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weight than the list of objectives in the existing preamble to the legislation. It should reduce the conflict among objectives.

Subsidiary factors and principles to provide guidance to regulators in decisions about coverage and access arrangements, should flow from and be consistent with an overarching objects clause. Clear guidance for regulators in relevant documentation would also assist the delivery of effective regulation.”⁵

In addition, the PC in the NGC Inquiry also considered that all industry specific regulatory regimes should also be consistent with the national access regime in the Trade Practices Act (TPA):

It is desirable for the objects clause in the Gas Access Regime and other industry specific regimes to be consistent with that of the national access regime. This in fact is indicated in clause (b) of the objects clause for the national access regime recommended by the Commission and endorsed by the Australian Government. Clauses 6(1) and 6(3) of the CPA state that one of the conditions for establishing legislation for third party access to infrastructure facilities is that ‘access to the service is necessary in order to permit effective competition in a downstream or upstream market’ (box 5.8). An objects clause that includes a reference to downstream and upstream competition would be consistent with this. (emphasis added)⁶

Recommendation 2.1

That the overarching objective of the NEC for energy distribution prices objective should be consistent with the PC’s recommendations on the review of the Gas Access Regime and the Commonwealth Government’s statements on the objectives for the national access regime.

2.2.3 Lack of a Key Objective on Efficiency in the NEC and Conformance with National Access Law

The NEC deals with a range of issues including:

- Efficient investment;
- Monopoly power;
- Recognition of previous government policies;
- Competition in upstream and downstream markets;
- Balancing of the interests of distributors, users and the public interest

⁵ *ibid*, pp.172-173

⁶ *ibid*, p. 176. CPA refers to the Competition Policy Agreements between Australian jurisdictions.

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The current National Electricity Code also has the following multiple objectives that deal with aspects of economic efficiency including an:

- (a) efficient and cost-effective regulatory environment.
- (d) environment which fosters an efficient level of investment within the distribution sector, and upstream and downstream of the distribution sector.
- (e) environment, which fosters efficient operating and maintenance, practices within the distribution sector.
- (f) environment which fosters efficient use of existing infrastructure.

The use of a new overriding objective clause in the NGC was considered in detail between the PC and the Commonwealth Government and was to be based on economic efficiency:

“The Gas Access Regime is part of Australia’s competition policy and law framework and is complementary to part IIIA of the TPA, along with other industry-specific access regimes (such as for the telecommunications sector) that target the problem of the supply of and access to bottleneck facilities. In considering an overarching objects clause, guidance can be found in the Commission’s review of part IIIA of the TPA (PC 2001c) and the Australian Government’s response to that review (Costello 2004).

Part IIIA of the TPA does not have its own objects clause. However, the TPA has an objects clause that applies to the whole of the Act and therefore applies to part IIIA. The TPA objects clause is to ‘enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.

In its review of the national access regime, the Commission considered that the objects clause for the TPA was too broad and focused on promoting competition. Competition was seen by the Commission as a means to an end and not an end in itself. The promotion of competition is only desirable if it promotes efficiency.

Therefore, the Commission recommended that a specific objects clause be incorporated into part IIIA, which had an explicit efficiency objective reflecting both short-term and long-term considerations (box 5.7). The intention was to change the emphasis from promotion of competition to promotion of economic efficiency

The Australian Government has responded to the Commission’s recommendation by proposing to include an objects clause in the national access regime (Costello 2004). However, the wording differed from the Commission’s recommendation in relation to clause (a) by adding ‘thereby promoting effective competition in upstream and downstream markets’, in addition to the statement

The Australian Government’s response to the Commission’s part IIIA review noted:

The promotion of economic efficiency is a fundamental objective of competition policy. The first objective explicitly recognises the importance of fostering efficient investment in new essential infrastructure, while at the same time encouraging the efficient use of existing facilities through innovation and productivity improvements.(Costello 2004, p. 3)

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An objects clause focused on efficiency would be consistent with the rationale of the Gas Access Regime. The problem being addressed by the regime is the potential for the exercise of market power by owners of transmission pipelines and distribution networks because of the natural monopoly characteristics of pipelines.

The market power could be used either to deny access to potential competitors or charge monopoly prices. This might lead to economic inefficiencies and the possibility that access regulation could reduce these inefficiencies by facilitating competition and reducing monopoly pricing.”⁷

These issues raised in the review of the National Gas Code are the same as the issues with the NEC and this Code can be revised accordingly, based on the PC’s recommendations for the NGC. This duplication of objectives in the NEC dealing with efficiency can be replaced by the overarching clause that the PC has recommended for the NGC. It must also be consistent with the requirement of the Commonwealth Government’s approved objectives for the national access regime.

UED agrees with the views of view of the PC in the Review of the National Access Regime where it recommended that that the objects clause should not simply be viewed as extrinsic material to be referred to only when the meaning of a constituent provision is unclear. Rather, it should condition the interpretation of relevant provisions of the code.

Recommendation 2.2

It is therefore recommended that the overarching objective of the new NEC be:

To promote the economically efficient operation and use of, and economically efficient investment in, the services of distribution networks, thereby promoting effective competition in upstream and downstream markets.

That the legislation clearly states that “the objects clause must be taken into consideration in all determinations of the regulator”.

2.2.4 A Mix of Pricing Principles and Code Objectives

Objective (b) of the NEC objectives deal with revenue and pricing matters and these should not be broad Code objectives. They are considered in the section below on pricing principles.

In addition, Principle G (point four) deals with the service provider complying with legal requirements and other decisions, which pertain to the operation of its distribution business. This is not a pricing principle but rather an overall objective of the regulatory model or a licence requirement.

⁷ *ibid*, p 173-174

2.3 Detailed Assessment of Objectives in the National Electricity Code

This section applies the assessment of the PC review of the NGC to consider individual objectives of the NEC. The numbering system for this section is taken from the MCE Issues Paper and reproduced as Appendix 2.

Objective (h)

Promotion of competition in upstream and downstream markets and the promotion of competition in the provision of network services where economically feasible.

The first part of this objective deals with upstream and downstream competition and as this is now covered in the overarching objective above can be deleted from this objective.

The PC expressed some concern about the use of a “competition” objective given the wide possible interpretations:

“Effective competition and related concepts (such as workable competition) imply a realistic concept of competition where some degree of market power might be present, in contrast to a theoretical ideal of ‘perfect’ competition which does not replicate real-world market behaviour.

Replicating the outcome of a competitive market (s.8.1(b) of the Gas Code) is an unachievable objective for setting reference tariffs. Seeking to apply the concept of workable competition does not provide a practical approach to this problem.”⁸

In addition, the use of the term “where economically feasible” provides no separate guidance for regulators and should be deleted along with the “competition” objective.

Recommendation 2.3

That number (h) of the NEC Code on the objectives of distribution pricing be deleted.

Objective (g)

Reasonable recognition of pre-existing policies of Governments regarding distribution asset values, revenue paths and prices.

It is likely that this objective is no longer relevant given the:

- time that the Code has operated;
- acceptance of all regulators for a Depreciated Optimised Replacement Cost (DORC) asset valuation;

⁸ *ibid*, p 261

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- acceptance by the ACCC of reviewing asset values of transmission companies under a new forward looking regulatory model;
- acceptance by state regulators of updating asset values from an initial DORC valuation; and the
- development of a national approach to electricity distribution regulation.

However, the issue remains important in the move to a national regulatory model and this issue is dealt with later in this submission.

Recommendation 2.4

That objective (g) should be deleted from the NEC objectives on distribution pricing section.

Objective (c)

Prevention of monopoly rent extraction by distributors

The promotion of competition in related markets and the constraints on monopoly power are the means by which the benefits of network efficiency improvements are transmitted to other parts of the electricity supply chain, to other industries and to final consumers. In this way, the promotion of network efficiency leads to economy wide efficiency improvements. Therefore for this reason this objective is covered by the overarching objective and can be deleted.

Recommendation 2.5

That objective (c) of the NEC objectives on distribution pricing section be deleted.

Objective (i), (j) and (k)

Reasonable regulatory accountability through transparency and public disclosure of regulatory processes and the basis of regulatory decisions

Reasonable certainty and consistency over time of the outcomes of regulatory processes, recognising the adaptive capacities of industry participants and customers in the provision and use of distribution network assets.

Reasonable and well defined regulatory discretion, which permits an acceptable balancing of the interests of distributors, distribution network users and the public interest

These objectives are of little use as they fail to provide the regulator with any guidelines as to how to balance these interests. This was a similar issue in the Productivity Commission Inquiry into the National Gas Code where it concluded:

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While ss2.24 (a) and (f) recognise the interests of users and service providers, they do not give guidance about how to establish the right balance among the various interest groups. Since there is no mention of the criteria or basis on which the interests of service providers and users would be assessed, the objectives as expressed do not help the regulator.

There can sometimes be difficulties for regulators in resolving tensions between the interests of service providers and users. The Hilmer Committee noted:

Neither the application of economic theory nor general notions of fairness provide a clear answer as to the appropriate access fee in all circumstances. Policy judgments are involved as to where to strike the balance between the owner's interest ... and the user's interest ... (Hilmer Committee 1993, p. 253)

The Commission considers that conflict in perceptions and evaluation of the appropriate role and impact of s.2.24 (a) could be exacerbating uncertainty in decisions about access arrangements. The replacement of s.2.24 (a) and (f) by the efficiency objective in the objects clause, together with the reforms to s.8 of the Gas Code (described in chapter 7), should provide a reasonable basis and better guidance for establishing the right balance between the interests of service providers and users, and might reduce the conflict of views.”⁹

The PC also dealt with the issue of the “public interest” in its inquiry into the National Gas Code:

There are a variety of other possible objectives of competition policy, apart from economic efficiency. A joint study by the World Bank and OECD (1999) on competition law and policy noted a spectrum of views on the objectives of competition policy, ranging from *economic efficiency* at one end of the spectrum to *public interest* at the other end. Public interest is a relatively broad concept embodying social factors that are inherently difficult to quantify and ‘loaded with value judgements’ (World Bank and OECD 1999, p. 1). The World Bank and OECD study concluded:

This overview of the different objectives of competition policy indicates that in most jurisdictions the basic objectives are to maintain and encourage competition in order to promote efficient use of resources while protecting the freedom of economic action of various market participants. (World Bank and OECD 1999, p. 8)

Consequently the objectives reference to “public interest” is of limited interest in the National Electricity Code objectives for distribution pricing.

Recommendation 2.6

That numbers (i), (j) and (k) of the NEC objectives on distribution pricing be deleted.

⁹ *ibid*, p. 186

2.4 Conclusion of the Review of the Objectives of the NEC for Pricing and Access

The above review has demonstrated that the objectives of the NEC can be replaced by the objectives of the NGC as proposed by the PC without impacting on the process of making pricing decisions.

There can be no doubt that the MCE should be concerned to implement a best practice regulatory model in electricity and the conclusions of the PC report on National Access and the NGC and the Australian Governments decisions on those inquiries means that the NEC objectives should be replaced with the NGC objectives, as amended by the PC to deliver a best practice model.

This move will provide a best practice energy code for pricing and access that encourages efficient long term investment in essential infrastructure

3. An Assessment of the NEC Pricing Principles in Light of the PC Review of the Gas Access Regime

3.1 Introduction

There is a vast range of pricing principles in the current NEC, which need to be reviewed in the context of the PC's review of the National Gas Code to ensure that a best practice regulatory code is developed for the new national regulatory model.

In the review of the National Access Regime the PC argued that pricing principles in a best practice regulatory model were required to:

- provide better guidance on how the broad objectives of the regime should be applied in setting more detailed terms and conditions;
- provide a measure of certainty for regulated businesses and access seekers to help address concerns that a regulator's own values will not unduly influence decisions on terms and conditions;
- provide guidance on how the broad objectives of the regime should be applied in setting reference tariffs; and
- provide greater certainty for regulated businesses and access seekers, and reduce the scope for regulatory risk and error (arising from regulatory discretion).

In light of the overarching objective and the new tariff setting principles adopted from the NGC it is now important to review the pricing principles in the NEC in the context of these other changes.

3.2 An Overarching Pricing Principle for the NEC Based on Efficiency

3.2.1 Objectives of the Current NEC

The NEC states that:

- (a) The form of economic regulation to be applied:

is to be the prospective CPI minus X form, or some incentive-based variant of the CPI minus X form which is consistent with the other objectives and principles of distribution service pricing, and which takes the form of a revenue cap, a weighted average price cap or a combination of them;

Must not be changed during a regulatory control period, which must be for at least 5 years.

- (b) If the Regulator proposes to amend this form of economic regulation, the Regulator must:

- (i) give two years prior notice to the distributor of the new economic regulation arrangements to apply from the commencement of the next regulatory control period; and

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- (ii) publish a description of the process and timetable for re-setting the form of economic regulation at a time which provides all affected parties with adequate notice to prepare for, participate in, and respond to that process, prior to the commencement of the regulatory control period to which that form of economic regulation is to apply.

In addition Pricing Principle (e) on page 34 of the MCE Paper specifies the use of a cost of service model in the NEC:

- (e) In setting the caps to be applied to each distributor, the Regulator must take into account each distributor's revenue requirements during the regulatory control period, having regard for: the distributor's weighted average cost of capital applicable to the relevant network service, having regard to the risk adjusted cash flow rate of return required by investors in commercial enterprises facing similar business risks to those faced by the distributor in the provision of that network service;

The interpretation of the CPI-X approach to pricing in the NEC has been to use a form of cost-based price regulation using what is known as the 'building block' approach. In particular, a target is calculated for *expected* total revenue by building up the cost base from its individual components.

This requires, among other things, forecasts of future capital expenditure, operating costs and demand. The expected total revenue target is then used to set regulated prices — termed reference tariffs — for individual reference services (services specified in an access arrangement with an associated reference tariff)

The reference tariff variation method typically used between cost-based access arrangement reviews involves a CPI-X price (growth) cap. In such models reference tariffs are only allowed to grow at a rate of CPI-X per cent. CPI is the consumer price index and is used to adjust for inflation. The value of X is based, among other things, on an assessment of how far the service provider can reduce its future costs.

In the PC's Inquiry into the NGC they noted:

“the Australian Government's view that pricing principles under existing access codes are consistent with those that might be included in the national access regime”.

The PC therefore recommended that:

There would be benefits in replacing the existing reference tariff objectives (s.8.1 of the Gas Code) with the pricing principles that the Australian Government has agreed to adopt for the national access regime. This would provide more specific and operational guidance for setting reference tariffs under the Gas Access Regime and ensure consistency with the national access regime.

UED considers that this principle of coordination between the access codes and the national access regime should be extended to the electricity industry and that the NEC should adopt the following key pricing principle:

Recommendation 3.1

In order to provide more specific and operational guidance for setting network tariffs under the revised NEC, and to ensure consistency with the national access regime, a new pricing principle should be inserted in the NEC:

A reference tariff or a reference tariff policy should be designed with regard to the overarching objects clause (as set out above), and the following pricing principles:

(a) That reference tariffs should:

- (i) be set so as to generate expected revenue for a reference service or services that is at least sufficient to meet the efficient costs of providing access to the reference service or services**
- (ii) include a return on investment commensurate with the regulatory and commercial risks involved**
- (iii) allow multi-part pricing and price discrimination when it aids efficiency**
- (iv) not allow a vertically integrated service provider to set terms and conditions that discriminate in favour of its associated businesses in upstream or downstream markets, except to the extent that the cost of providing access to non-associates is higher**
- (v) be set so as to provide incentives to reduce costs or otherwise improve productivity.**

If this new principle is accepted it is also necessary to delete other parts of the original NEC pricing principles that could conflict with the recommended pricing principles:

3.2.2 Implications of the New Pricing Principle

The adoption of such a principle will mean that any conflicting or duplicative principles in the existing NEC must be deleted including:

- Principle (c) (iv) first paragraph and Principle (e) and (f) on page 34 (“in setting the caps”) imply returns are to be fair and reasonable which is covered by (a) (ii) above.
- Principle (c) (ii) is replaced by the new overarching objective set out above.
- Principle (c) (v) dot point one and (c) (iii) refer to balancing the risks and this is also replaced by (a) (ii) above.
- Principle b (iii) is not required in the new approach described in this submission.

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- Principle c (i) deals with efficiency and is replaced by (a) (i) above.
- Principle a (i) deals with tariffs and is replaced by a (iii) above.
- Principle g dot points three and four are overly detailed as pricing principles.
- Principles (a), (b), (c), (e), (h) and (i) on page 34 are overly detailed and provide additional unnecessary objectives for designing references tariffs. The NEC should be simplified to refer only to the overall objectives outlined above

Principle (b) should also be deleted as under the approach in the National Gas Code the PC has proposed that the service provider can determine if the regulatory model can change. Principle k deals with the use of financial indicators and should also be deleted.

Recommendation 3.2

That the above principles be deleted from the NEC distribution pricing principles.

3.3 Other Change to the NEC on the Basis of the PC Report

3.3.1 Asset Valuation Principles

There are major differences between the NEC and the NGC on asset valuation. The NGC values assets only once and treats the asset base as a historical cost while the NEC allows for asset valuations at each price reset. These pricing principles in the NEC include Principle (c) (iv) and (v) dot point 2, which states that:

- (c) The regulatory regime to be administered by the Regulator must have regard to the need to:
- (iv) provide a fair and reasonable risk-adjusted cash flow rate of return to distributors on efficient investment given efficient operating and maintenance practices where:
 - assets created at any time under a take or pay contract are valued in a manner consistent with the provisions of that contract;
 - assets in existence and generally in service on a specified date ("sunk assets") are valued at a value determined by the Regulator or consistent with the regulatory asset base established by the relevant Government;
 - the valuation of assets brought into service after the specified date ("new assets"), and any subsequent revaluation of any sunk or new assets, is to be undertaken on the basis of their deprival value unless the achievement of the other objectives and principles for distribution pricing renders another basis more appropriate;
 - benchmark returns to be established by the Regulator are to be consistent with the method of valuation of new assets and revaluation, if any, of existing assets and consistent with achievement of a commercial economic return on efficient investment;

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- (v) provide reasonable certainty and consistency over time of the outcomes of regulatory processes having regard for:
- the capital intensive nature of the distribution sector, the relatively long lives of distribution assets, and the variable and frequent augmentation of the distribution network;

All regulators of electricity distribution and transmission have adopted a DORC asset valuation for both distribution and transmission assets. The ACCC as the electricity transmission jurisdictional regulator argued that:

“Under the current Draft Regulatory Principles (DRP), our stated approach is to revalue all assets every five years on the basis of up to date replacement cost estimates, adjusted for asset age (through depreciation), and optimising out redundancy.” (Speech by ED Willet, ACCC to the Australian Energy and Utility Summit, Sydney 22 July 2004, p.6.)

However, the ACCC are planning to move away from the periodic revaluation of the capital base of transmission companies:

“The ACCC intends to resolve this uncertainty by locking in the asset base by accepting initial jurisdictional valuation and adding in new investment at cost. The attraction of this option is that a lock in of the jurisdictional asset base is unlikely to deter new investment and will produce a smoother price path than periodic valuations.” (Speech by ED Willet, ACCC to the Australian Energy and Utility Summit, Sydney 22 July 2004, p.7.)

The most important feature of the NGC and its clear advantage over the NEC is that, once the initial regulatory asset base is set, that value is set forever, and there is no further reopening of that value (with the exception of identified redundant assets) at future price reviews. Updating the regulatory asset base to reflect new capital invested and the return of funds to investors (regulatory depreciation) provides greater certainty that investments made in the networks will be recovered, and thus provide further incentive for investment.

UED supports the position the initial asset valuation, providing it is based on the DORC valuation, should be fixed and updated as an historical cost as happens currently under the NGC. In addition it also reflect general regulatory practice currently in some jurisdictions for electricity distribution regulation:

- It reflects existing practices in electricity as evidenced in the last price determination by the Victorian ESC; and,
- Wherever there is an incentive mechanism for capital works in place past capital can be assumed to be efficient.

Recommendation 3.3

That the NEC adopts the NGC generalised model of updating the capital base and the above pricing principles in the NEC dealing with asset valuation should be deleted.

Where an incentive mechanism is in place past capital expenditure can be judged as efficient.

3.3.2 Efficiency Gains in the NEC

The two codes are also different in their approach to efficiency gains. The NGC allows an efficiency carryover model while the NEC is silent on the matter¹⁰.

Efficiency carryover schemes enable service providers to keep the benefits of lower than forecast costs for a certain length of time beyond the current access arrangement. The NEC states:

Pricing principle (d) on page 34 refers to the issue of efficiency gains.

In setting the caps to be applied to each distributor, the Regulator must take into account each distributor's revenue requirements during the regulatory control period, having regard for:

- (d) the Regulator's reasonable judgment of the potential for efficiency gains to be realised by the distributor in expected operating, maintenance and capital costs, taking into account the expected demand growth and applicable service standards;

While the pricing principles set out above allow that they should “*be set so as to provide incentives to reduce costs or otherwise improve productivity*” the PC in the NGC Inquiry proposed a role for such carryover models:

“The Commission notes that in a competitive market at least some of the benefits of productivity improvements tend to be redistributed eventually to customers as lower prices. If a pipeline has market power, then such a distribution is less likely to occur and this might inhibit more efficient outcome in upstream and downstream markets. Thus there appears to be a case for regulators to distribute at least some of the efficiency gains of such schemes to users”¹¹

¹⁰ However, some regulators of electricity distributors allow a carryover model to operate. For example, the Victorian ESC allows such a model as the Victorian Government has derogated the operations of the NEC so pricing in Victoria follows the ESC Act.

¹¹ Productivity Commission, Op cit, pp. 246-247

Recommendation 3.4

That a requirement for efficiency carry over be introduced into the NEC to provide a more incentive driven regulator model. That this new section be based on the section in the NGC.

3.3.3 Contractual Obligations

The current NEC has a pricing principle that deals with the matter of contractual obligations such that:

- (iv) provide a fair and reasonable risk-adjusted cash flow rate of return to distributors on efficient investment given efficient operating and maintenance practices where:
 - assets created at any time under a take or pay contract are valued in a manner consistent with the provisions of that contract;

Section 2.24(b) of the Gas Code states that a regulator must take into account ‘firm and binding contractual obligations of the service provider or other persons (or both) already using the covered pipeline’ when assessing a proposed access arrangement. The CPA also requires that the terms and conditions of access take into account contractual obligations. The PC in the Inquiry into the NGC recommended that:

As discussed in chapter 2, foundation contracts are important to the development of transmission pipelines. It is important that the provision of access to third parties does not impinge on the property rights of service providers and foundation customers. Further, impinging on these rights could have adverse implications for future investment in pipelines. For these reasons, s.2.24 (b) should be retained.

Recommendation 3.5

That clause (iv) is deleted as it has been replaced by the overarching pricing principles based on efficiency and consistency with National Access Law.

That the point to clause (iv) is retained in the NEC as it is consistent with the principle in the NGC.

3.3.4 Ongoing Financial Viability

Objective (h) of the NEC states that:

- (h) the on-going commercial viability of the distribution industry

The ongoing financial viability of the distribution industry is a common feature of the Victorian legislation and should remain a pricing objective as it reinforces the intent of the other recommended pricing principles.

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The PC in the review of the Gas Access Regime rejected the need for a similar objective namely 2.24 (a) the Service providers legitimate business interests. However, UED believes that adopting the objective from the ESC Act adds to the security of the industry in terms of the new national regulatory model and is not inconsistent with the efficiency objective

Recommendation 3.6

That ongoing financial viability of the industry is used as a guiding pricing principle in the NEC to reinforce the “efficiency” objective.

3.3.5 Safe and Reliable Operation of the Network

A key objective in the NGC which was supported by the PC in the Inquiry into the NGC is Section 2.24(c) that states that a regulator must take into account ‘the operational and technical requirements necessary for the safe and reliable operation of the covered pipeline’ when assessing a proposed access arrangement. Safety standards must be met irrespective of market conditions and access arrangements.

However, clause 6(3) of the Competition Policy Agreement (CPA) requires that, for an access regime to conform to the principles, it should apply to services where:

- (a)(iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist ...

Safety issues are most likely to be of relevance at the time a third party user seeks access, rather than at the time a coverage decision is made. Further, one argument for an industry-specific access regime for electricity is that there is potential for many third party access seekers. This suggests that it is important to transfer this requirement of the NGC to the NEC as a factor to be considered in pricing decisions.

Recommendation 3.7

That the new objective is placed in the NEC based on the above clause in the CPA.

3.4 Dealing with Uncertainty

In order to calculate target revenue, it is necessary to set an *ex ante* regulatory rate of return on capital. This expected rate of return is generally required to be commensurate with prevailing conditions in the market for funds and the risk involved in delivering relevant reference services.

The rate of return is usually based on an estimate of the Weighted Average Cost of Capital (WACC) which is part of the Capital Asset Pricing Model (CAPM). This weights

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the rates of return required by a business's equity investors and debt providers by, respectively, the amount of equity and debt relative to the business's total capital.

There have been substantial concern expressed by academics, industry participants and others about the uncertainty of the empirical basis of the CAPM/WACC model that has been reflected in the PC reviews of the Gas Access Regime and the National Access Regime. This concern led the PC in the Review of the Gas Access Regime to recommend a different regulatory model and to reform the use of the WACC in regulatory pricing decisions.

While the debt costs of a service provider are relatively straightforward to assess, the return required by equity investors is not. The return on equity is typically estimated using the CAPM. This method depends on the measurement of two contentious variables — a service provider's 'beta' (a measure of its risk relative to that of the total market for risky investments) and the market risk premium.

In the NGC Inquiry the PC concluded that:

"Implementing the WACC/CAPM approach is not a precise science, given the numerous debatable assumptions involved. There is even disagreement on the precise formulas to use, due to different views on how issues such as tax should be treated. Hence, a range of plausible values can be generated for the regulatory rate of return using the WACC/CAPM approach. This in turn implies that it does not automatically lead to a single indisputable number for a reference tariff."¹²

And

"An important insight from the Tribunal's decisions is that the regulator's role is to assess whether an Access Arrangement falls within a reasonable range before amending it. This is a fundamentally different approach from that which has been adopted by regulators to date, where the regulator has felt empowered to substitute its view for that of the service provider, irrespective of whether or not the service provider's position fell within a reasonable range. (sub. DR100, p. 11)"¹³

Given that the CAPM is a theoretical model based on debatable assumptions, the

PC was concerned that the model has become a de facto requirement under the regulatory regime. The PC considered that it needed to be made more explicit that there is no single correct method to calculate a rate of return and there can be a range of plausible values used in applying a method. Such a conclusion would also be made in respect of regulatory pricing decisions under the NEC that is also based on the CAPM/WACC model.

¹² *ibid*, p 296.

¹³ *ibid*, p 299.

Recommendation 3.8

That a new objective is placed in the NEC, which has been recommended by the PC in the review of the Gas Access Regime, and which states that:

If a Rate of Return is used in determining a Reference Tariff then the method used to calculate the Rate of Return and the values used in applying that method shall in the first instance be proposed by the Service Provider. In assessing the Service Provider’s proposal the Relevant Regulator must take account of the fact that there is no single correct method to determine a Rate of Return and there is often a range of plausible estimates that could be used in applying a Rate of Return method.

The role of the Relevant Regulator is therefore to assess whether the Service Provider’s:

- (a) proposed method has a plausible conceptual basis; and**
- (b) values used in applying the method lie within the range of plausible estimates.**

The Relevant Regulator must approve the proposed method if (a) is satisfied. The Relevant Regulator must approve the values used in applying a method if (b) is satisfied.

3.5 Dealing with Uncertainty – Alternative Pricing Models

In the NGC Inquiry the PC had serious concerns about the cost-based price regulation being a key feature of the regime. Therefore, the PC considered that the Gas Code should be amended so that service providers have a genuine option to use a method other than the building block approach.

The PC concluded that rather than prescribe the details of new methods in the Gas Code, it should be up to service providers to devise innovative new proposals for assessment by their regulator. Regulators should assess such proposals in the context of the new objects clause recommended above.

The PC therefore recommended that:

“To provide greater flexibility for price regulation than that provided by the current building block approach, s.8.5 of the Gas Code should be replaced with the following:

s.8.5 A Service Provider can use another method to calculate Total Revenue, provided the Relevant Regulator is satisfied that the proposed method is more likely to meet the overall objective of the Gas Access Regime.”¹⁴

¹⁴ *ibid*, pp 273-274.

Recommendation 3.9

That a new objective is placed in the NEC that states that states:

A Service Provider can use another method to calculate total revenue and tariffs, provided the regulator is satisfied that the proposed method is more likely to meet the overall objective of the NEC distribution pricing section.

3.5.1 Alternative Pricing Models

Currently, the NEC distribution pricing section requires the use of only one pricing model – the CAPM/WACC model although the regulator can change the method of regulation with a notice period. In the NGC Inquiry the PC favoured a light-handed regulatory approach that could deliver appropriate outcomes at a lower cost in some circumstances, and it recommended making a monitoring option available for some covered pipelines. That is, there would be two alternative forms of regulation (a light-handed monitoring option and a model of access arrangements with reference tariffs based on the CAPM/WACC model) should be available to covered pipelines.

The PC recommended that the NCC would assess the form of regulation and make a recommendation to the relevant Government Minister who would determine the application.

The PC also considered that the decision on the form of regulation should be linked to an assessment of the coverage of the network.

A decision on the form of regulation needs to weigh up the benefits and costs of the two different forms of regulation. The coverage decision currently involves an assessment of benefits and costs of the current form of regulation. The PC considered it would be desirable for the assessment and decision on the form of regulation to be a part of, but follow from, the assessment and decision on coverage.

“It is important that policy-type functions are separate from administrative-type regulatory functions (institutional arrangements are discussed in chapter 12). Consequently, the Commission considers that the NCC should continue to recommend whether a pipeline should be covered, and also recommend on the form of regulation to apply, with the Minister making both decisions following the NCC’s recommendations. This approach is supported by the NCC, which considered it is in a good position to make an informed decision as to the appropriate form of regulation (sub. DR92, p. 11).”¹⁵

¹⁵ Ibid, p 227.

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The PC also considers that the form of regulation decision be covered by similar administrative processes to the coverage decision, such as public consultation and merits appeal. UED considers that the PC recommendations should also be used as a NEC objective.

Recommendation 3.10

The NEC should be modified such that the Minister and National Competition Council, in making a decision and recommendation, respectively, to cover a network should also decide and recommend, respectively, the form of regulation to apply.

3.5.2 The Range of Pricing Approaches

In the NGC Inquiry the PC concluded that given the costs of the CAPM/WACC model of reference tariffs (including the potential for distorted investment), it was important that such regulation is applied to gas networks only where there are clearly greater net benefits to the economy. Therefore, the PC considered that the decision and recommendation on the form of regulation to apply should err on the side of coverage with monitoring.

The PC recommended that with regulation with reference tariffs should be applied only where the net benefits of access arrangements with reference tariffs is markedly greater than the net benefits of the monitoring option. Where the difference in net benefits are marginal or the net benefits of the monitoring option are greater than the net benefits of access arrangements with reference tariffs, then the PC recommended that the monitoring option should be applied.

Recommendation 3.11

The decision and recommendation on the form of regulation to apply should be based on an assessment of the net benefits to the economy of each form of regulation (a model of reference tariffs or a monitoring option).

Access arrangements with reference tariffs should be applied only where the net benefits of its application are markedly greater than the net benefits of the monitoring option. Otherwise the monitoring option should be applied.

The NCC should use the assessment criteria recommended by the PC in the review of the Gas Access Regime.

4. The Need for a National Energy Access Code

4.1 Introduction

The previous section has indicated that if the NEC is reviewed according to the principles laid down by the PC review of the Gas Access Regime it is clear that the NEC can be replaced by amending the NGC to become the new NEAC. In addition the recommendations of the PC in terms of amending the NGC can also be applied to the regulation of electricity distributors and transmission companies.

UED does not consider it appropriate for the distribution and retailing framework work program to pre-empt outcomes from the current separate process of Australian governments finalising a joint response to the recent PC Review of the Gas Access Regime. Given the criticisms made by the PC of the objectives and pricing principles in the NGC it is surprising that the MCE has not attempted to apply the principles used by the PC in this review and apply these to the objectives and pricing principles in the NEC.

In addition, the MCE Paper is deficient in that it fails to adequately consider the agreed Australian government response to the recent PC review of Part IIIA of the Trade Practices Act, which provides the overarching guiding framework for industry-specific access regimes such as the National Electricity Code and the National Gas Code.

Following previous statements, UED had understood these issues would be addressed through the development of an intergovernmental response to the PC Review of the Gas Access Regime.

4.2 The Basis of a New National Energy Access Code

UED considers that the regulatory model that should be included in the NEAC is the propose/ respond model that currently forms the basis of the NGC. This model is recommended because:

- It represents best practice regulation as it has been recently reviewed and amended by the PC;
- It more clearly establishes and formalises the rights of both industry and regulators than the current NEC does;
- All regulators adopt a version of the propose/respond model in practice for electricity price setting pricing despite the fact that the NEC or relevant state legislation does not specify it; and
- It has a range of legal decisions behind it, which serve to make the application of the propose/respond model in the NGC more certain to both the industry and regulators.

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This model of propose/respond as represented in the NGC is outlined below:

The process whereby a compulsory Access Arrangement is approved can be summarised as follows:

- *The Service Provider submits a proposed Access Arrangement, together with the Access Arrangement Information, to the Relevant Regulator.*
- *The Relevant Regulator may require the Service Provider to amend and resubmit the Access Arrangement Information.*
- *The Relevant Regulator publishes a public notice and seeks submissions on the application.*
- *The Relevant Regulator considers the submissions, issues a draft decision and then, after considering any submissions received on the draft, makes a final decision which either:*
 - *approves the proposed Access Arrangement; or*
 - *does not approve the proposed Access Arrangement and states the revisions to the Access Arrangement which would be required before the Relevant Regulator would approve it; or*
 - *approves a revised Access Arrangement submitted by the Service Provider which incorporates amendments specified by the Relevant Regulator in its draft decision.*

Recommendation 4.1

That the pricing and access section of the NEC is replaced by amending the National Gas Code to encompass electricity distribution and transmission pricing and access and that the new code becomes a National Energy Access Code (NEAC) for pricing and access for electricity and gas distribution and transmission.

4.3 New Sub-Objectives for the NEAC

In addition a series of sub-objectives need to be incorporated in the NEAC to operationalise the above overarching objective and provide more detailed guidance to both regulators and the energy industry. These are considered below.

Provide a framework with separation between rule making and enforcement

This sub-objective is consistent with the MCE proposals to date and the recommendations of the Parer Review. It is also consistent with best practice regulation.

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Institute a regulatory design which, provides accountability and review (appeal) mechanisms

This is also part of a best practice regulatory model and adopts the PC's recommendations that a best practice regulatory model has appropriate merit and judicial appeal arrangements.

Institute a regulatory design which, allows regulation only where the benefits of regulation outweigh the costs

It should be an overall objective of an energy code to minimise the cost of regulatory actions as this would be best practice regulation.

This principle is similar to s. 33 (4) of the Victorian Essential Service Commission Act, which requires that:

In making a determination under this section, the Commission must ensure that—

- (a) wherever possible the costs of regulation do not exceed the benefits;

Recognise key linkages between technical and economic regulation and the pass through of any changes from state to national level

This sub-objective recognises the need for coordination between jurisdictions and the new national framework where some decisions will remain at the local level and that cost impacts need to be passed through to ensure an effective and efficient regulatory model.

Recommendation 4.2

It is therefore recommended that the new Sub-Objectives for the NEAC be:

Consistent with this objective, the national framework for distribution regulation shall:

- **provide an institutional framework with an appropriate separation between market and rule development, price setting, enforcement and consumer advocacy**
- **institute a regulatory design which:**
 - **provides accountability, with decision makers subject to transparent, consultative and participative processes and review (appeal) mechanisms;**
 - **allows regulation only to address clearly established market failures or social objectives, where the benefits of regulation outweigh the costs, and in manner which achieves the least overall regulatory burden: and,**

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- **recognises the key linkages between technical and economic regulation and the pass through of costs resulting from any changes from state to national level.**

5. The Role of Government in the New National Regulatory Model

5.1 Introduction

There are substantial differences between the operations of the NEC and the NGC. All gas transmission and distribution companies work under the NGC and deviations from this are generally in the area of licences and associated guidelines and codes.

The application of the electricity distribution pricing objectives and principles, as set out in the National Electricity Code, has been modified or restricted in some jurisdictions (such as Victoria and South Australia) through the relevant Government making a tariff or pricing order that binds the jurisdictional economic regulator in the manner in which it regulates electricity distribution charges. In addition the regulatory model for electricity has been extended by the use of licence conditions and by codes and guidelines.

The MCE has requested submission on a range of issues dealing with the role of governments in the national regulatory model. These issues include the role of the different levels of governments in the new national regulatory model and how the new AER and AEMC will interact with these governments.

5.2 Relationship between the AER and Other Governments

5.2.1 Governments and the National Regulator

There are a number of issues that need to be considered in such a new national regulatory model including:

- the need for a national approach implies the minimisation of state based controls;
- the need for consultation with relevant arms of state governments on service standards;
- if states retain non-economic regulation (eg. Safety, trade measurement, road management, etc.) then there needs to be a model where consultation occurs and the pass through of costs or cost recovery is allowed for utilities.

UED supports the proposition that all economic regulation should be moved to the AER with states not retaining any powers to separately regulate any aspects of economic regulation. This would mean that all economic related codes and guidelines should also be passed to the AER by state jurisdictions.

However, there are many differences between the states in regards to the regulation of distribution companies. In particular, in the regulation of Victorian electricity distribution businesses have appeal rights against pricing determinations under the Victorian Essential

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Services Commission Act. These rights do not exist for electricity distributors under the NEC. It would substantially disadvantage Victorian electricity distributors to lose merit appeal rights in any move to a national regulator. This is particularly important, as the PC has proposed that adequate appeal rights are an essential component of a best practice regulatory model.

In the establishment and operations of the AER there should be a requirement to ensure that best practice regulation is maintained:

- Distributors moving to the AER should be able to retain all the benefits currently permitted by relevant state governments especially those on asset valuation and merit appeal rights which reflect best practice regulation; and
- Coordination between the national regulators state agencies should be under a model of Memorandums of Understanding.

In addition the constitutional rights of state governments must be protected in the move to a national regulator. For example if a state wants to introduce policies such as interval meter rollouts these should be included in AER price decisions.

The MCE paper states that at this stage it is not proposed that the national regulatory framework would result in the transfer to the AER of responsibility for regulating environmental, occupational health or safety matters. However, it is a critical issue that the costs imposed in the regulation of such matters are taken into account by the AER in regulating the prices charged by electricity and gas distributors.

It is also for this reason that a number of states already require consultation between the local economic regulator and non-economic regulators to ensure coordination is undertaken and cost increases on distributors are clearly assessed.

In addition, legislation in many jurisdictions requires the economic regulators, in performing their functions, to take into account a range of factors, many of which are beyond their area of direct expertise. Memoranda of understanding with the bodies that are primarily responsible for these kinds of matters may also provide a means whereby the relevant economic regulator can obtain the information it requires to fulfil its statutory objectives in this regard. In such instruments it is important to ensure that they are based on clear de-lineation of responsibilities and operating and communication protocols and do not become generalised agreements with little use.

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Recommendation 5.1

That in the establishment and operation of the national regulatory model there should be a requirement for:

- **Distributors moving to the AER and the AEMC should be able to retain all benefits currently permitted by relevant state governments especially those on asset valuation and appeal rights;**
- **Distributors moving to the AER should be able to recover costs associated with government policies such as interval meter rollout;**
- **Coordination between the AER, the AEMC and governments and between the national regulators and state agencies should be under a model of Memorandums of Understanding; and**
- **Such MOU's should be based on specific responsibilities and performance standards.**

5.2.2 Interaction with the AER and the Cost Recovery/Pass Through of Costs

Objectives of the distribution service pricing principle (g) on page 34 of the MCE Paper deals with the issue of the pass through of state and Commonwealth taxes. This issue becomes more important in the development of a new national regulatory regime. In addition to state taxes and charge changes cost recovery would have to deal with other costs arising from legislation dealing with safety, consumer protection, road management and other legislative or regulatory changes at the state or local level that impact on the costs of a service provider.

The MCE Paper refers to this issue in the following context:

As stated in Section 2, at this stage it is not proposed that the national regulatory framework would result in the transfer to the AER of responsibility for regulating environmental, occupational health or safety matters. However, it is critical that the costs imposed in the regulation of such matters are taken into account by the AER in regulating the prices charged by electricity distributors. It is for this reason that this concept has been incorporated in the electricity distribution pricing objectives and principles set out in the annexure to this Section. (p.30)

A proposal for pass through of costs and cost recovery in the new national framework is provided in Appendix 1 of this submission.

Recommendation 5.2

That the pass through model in Appendix 1 of this submission is adopted in the national model to deal with the issue of a national economic regulator and its coordination with non-economic regulation remaining at the state or territory level.

6. Licensing

6.1 Introduction

In most jurisdictions it is a requirement that electricity generators, transmission entities, distributors and retailers, and gas distributors and retailers, be licensed or otherwise authorised to carry on their operations in those jurisdictions.

However, this is not always the case as in some states the requirements of the National Electricity Code and associated legislation are considered sufficient to dispense with separate licensing. In other jurisdictions, other activities in the electricity or gas industries may also be required to be licensed or otherwise authorised.

Licensing is part of a wider set of legal instruments, which are designed to ensure compliance with governmental laws. These instruments include:

- legislation which can only be amended by Parliament and so should include those elements of the regulatory framework that are to have the most protection from change (typically the basic parameters of the regulatory framework);
- regulations which can only be amended by the executive and so should include those elements of the regulatory framework that "flesh out" the basic parameters of the regulatory framework;
- licences which confer an authority on the licence holder to undertake the licensed activities and so should specify the parameters of that authority (including any limitations on it) and certain fundamental obligations that attach to that authority.

The proposed move to a national regulatory framework has raised a number of issues regarding the need for licensing and its interaction with other legislative and regulatory instruments.

6.2 Aspects of a Best Practice Licensing Model

Licensing has also been used by some regulators to extend their powers that would otherwise arise under industry access and pricing codes and the PC was highly critical of this practice in its review of the Gas Access Regime:

“The Commission is concerned that regulators could use State-based powers to obtain information (beyond that specified in the Gas Access Regime) for the purposes of approving a service provider’s access arrangement. This approach lacks transparency, could impose unwarranted costs and lead to inconsistencies in the information requirements placed on service providers by regulators across different jurisdictions.

There is scope for some regulators to use State-based powers to obtain information from regulated distributors that is beyond what is specified in the Gas Access Regime. This could impose unwarranted

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costs and lead to inconsistencies in the information requirements on service providers across jurisdictions.”¹⁶

The point is however, of general application. Any national licensing regime, including jurisdictional schedule, should contain no provisions which are inconsistent with or expand upon the powers of the AER (or the AEMC) as derived from the primary national regulatory instruments (preferably in legislation) conferring that power.

The PC recommended that:

“To ensure that regulators cannot use State-based powers to access information beyond that specified in the Gas Access Regime, a new clause should be inserted into s.7 of the Gas Code as follows:

The Relevant Regulator for the purposes of approving a Service Provider’s Access Arrangement can only use information collected under the information collection powers specified in the Gas Access Regime.”¹⁷

In addition, the issue of how the licence scheme is administered as part of the operation of the national model is also a best practice issue. In particular during the transition to a national model there may be some specific jurisdictional licence requirements that are included in the national model as jurisdictional schedules. However, in a best practice national model there should be some limit to the operation of these jurisdictional additions and some principles for review.

UED proposes that the jurisdictional additions or derogations be limited to the term of the pricing review that the jurisdictional regulator has begun even if they are completed under the AER model. In addition the maintenance or addition of new licence conditions should always be subject to a public cost benefit analysis.

However, this general rule needs some qualifications when best practice regulation is considered. This relates to three areas:

- asset valuations only once with updating on net investment;
- merit appeals;
- interval meter rollouts determined by jurisdictions and other major jurisdictional policies.

These are all considered best practice initiatives as supported by the PC (merit appeals), or backed by the ACCC (asset valuations) or as a matter of constitutional principle (interval meter rollout). As such given the national model may change over time there is

¹⁶ ibid, p.314 and Finding 7.8

¹⁷ ibid, Finding 7.8, p.314

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no reason to dispense with jurisdictional best practice policies. For these reasons UED supports the extension of these principles across the national model.

The issue of the development of a national approach also means that some legislative instruments may exist at two levels of government. Some rules are necessary to ensure that the national instruments must prevail over jurisdictional instruments wherever they are in conflict.

Recommendation 6.1

The Relevant Regulator for the purposes of approving a Service Provider's Access Arrangement or pricing can only use information collected under the information collection powers specified in the legislation.

That jurisdictional additions or derogations be limited to the term of the pricing review that the jurisdictional regulator has began even if it is completed under the AER model.

That any derogations relating to asset valuation, merit appeals or interval meter rollout should continue as part of best practice regulation.

That a new clause is added to the new National Energy Legislation that clearly states the hierarchy of instruments in the national framework, with national instruments to prevail over inconsistent jurisdictional instruments.

6.3 Licensing Issues

The MCE Paper sets out a number of key principles, which could underlie a national approach to licensing:

Licences should only contain fundamental obligations that are likely to be common to all electricity and gas licences;

- Consumer protection provisions in existing licences should be included in a national consumer protection code;
- Safety, occupational health and environmental provisions should be included in jurisdiction-specific instruments;
- Jurisdiction-specific differences should be included in jurisdictional legislation (and regulated at a national level) although many of the details in current licences could be made more uniform;
- There may be a need for different classes of licences to deal with different circumstances such as greenfield developments; and

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- Licences should be relatively simple and short, as it is likely to be much easier to reach agreement on a nationally uniform set of licences if they are so.

Where customers are disadvantaged a distributor should be licensed. For example in the case of “embedded networks” such networks can escape the regulatory requirements that distributors are under by such arrangements. Under these circumstances customers may be at risk and the need for licencing is required.

6.3.1 Legislative Instruments

UED supports a nationally uniform set of distribution licences with minimum conditions providing that a net benefits approach is taken with all national instruments. Safety, occupational health and environmental provisions specific to jurisdictions can be generally dealt by a licence requirement to comply with relevant and applicable laws.

In addition to the requirement for minimum conditions in national licences there should also be an objective to minimise the compliance costs of the licences.

6.3.2 Licence Conditions

The principal licence conditions listed in the MCE Paper include a range of conditions including compliance schemes, information provision, and customer obligations.

UED supports these licence conditions as the ideal national set of conditions to go into the national regulatory model. UED also notes that the principle of regulatory simplification should be followed to include most regulatory obligations in the relevant Code and minimise the conditions included in licences.

UED recommends that the allocation of responsibilities between the AER and the AEMC is based on the principle of separation between rule maker and rule enforcer which was the basis of the national regulatory model proposed by the Parer Inquiry. In the MCE Issues Paper there appears to be a breakdown of this key best practice regulatory principle.

UED consider that the most appropriate basis for the division of roles and functions between the AEMC, AER and jurisdictional governments is to continue to apply the model of separation of rule enforcement and rule making powers which the MCE has developed for the Australian energy market, recognising that in some cases there will be a case for jurisdictional governments to retain some residual jurisdiction-specific rule making power especially in non-economic areas.

UED notes the MCE proposals in relation to dispute resolution, business to business information exchange schemes, customer transfer schemes, retailer of last resort schemes and community service obligations are not currently set nationally. However, UED also

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notes that initiatives are underway to develop a number of national approaches and these should be progressed to their finality.

UED also submits that the adoption of a net benefit test to develop a national approach to any regulatory instrument must also include the net benefits to distributors in addition to other parties. In particular, UED notes that the national uniformity of Use of System/Coordination agreement must deliver benefits not just to retailers but to distributors as well.

There is also the important issue regarding the ability of state governments to vary derogations or seek new derogations after the initial set is approved. It is important to ensure that all governments adopt a model of derogations based on the net benefit to the public test. This test is also proposed for changes to market rules via the AEMC.

Many governments have adopted a regulatory reform policy, which specifies the assessment of regulations via a cost benefit approach, and Victoria has now extended this requirement to legislation. It is also important in a move to national regulation that all regulatory instruments and derogations that deviate from those instruments are subject to rigorous assessment.

Recommendation 6.2

That the following principles be adopted:

- **That the allocation of responsibilities between the AER and the AEMC is based on the principle of separation between rule maker and rule enforcer.**
- **That there should be a net benefit test to develop all national regulatory instruments and that any such analysis must also include the net benefits to distributors.**

6.3.3 Ability to Vary Licences

UED supports the principle of a clear separation between the rule maker and the rule enforcer as supported by all the inquiry bodies from the PC to the Parer Review. As such UED supports the AEMC as the appropriate body to deal with licences which contain regulatory obligations.

The AEMC should have the ability to vary a licence condition to ensure that any changes can be effectively and efficiently adopted. This may include the following reasons to allow for a:

- change of ownership in the network or some other change required by the distributor;
and

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- change in the network coverage area (eg greenfield sites) or for variations in the regulatory regime where certain customers can opt out of distribution regulation requirements (eg embedded networks).

Recommendation 6.3

That the new national regime adopt the following objective:

- **That in prescribing the matters to be considered when reviewing a licence application and, by extension, the circumstances in which a licence may be revoked, the MCE must have regard to the need to allow businesses to develop efficient business structures.**

6.3.4 Granting and revoking licences

In prescribing the matters to be considered when considering a licence application and, by extension, the circumstances in which a licence may be revoked, the MCE must have regard to the need to allow businesses to develop efficient business structures. For example, a licence should not be revoked where the original licensee has contracted a number of functions to a third party whilst still retaining responsibility for meeting the conditions of the licence. This issue has recently arisen in Victoria and there will be a need to examine it in some detail with the businesses and the Essential Services Commission. Licensing rules must not inhibit the incentives for efficiencies and this is an important principle for the MCE to adopt.

6.4 A Linear or Triangular Approach

One of the issues raised by the MCE Paper is the nature of the contractual relationship between retailers, distributors and end-use customers, and the division of rights and obligations between them. In this regard the MCE argues there are broadly two approaches which have been adopted:

- a triangular approach – where the distributor has a supply contract with the customer (which may be deemed to exist by virtue of legislation or be required to apply in a regulated form) and the retailer has a sale contract with the customer, but a coordination or use of system agreement between the retailer and the distributor ensures that the retailer is the primary interface with the customer so that, for instance, the customer receives a single consolidated bill; or
- a linear approach – where the distributor has a supply contract with the retailer and the retailer has a supply and sale contract with the customer, so that the retailer has the sole contractual interface with the customer and effectively on-sells to the customer the distribution services that the retailer purchases from the distributor.

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The MCE Paper misunderstands the Victorian arrangement. In the triangular approach there can be no “use of system agreement” because the distributor has a supply contract with the customer – the retailer does not “use the system”. In Victoria there is a linear approach where the distributor has a supply contract with the retailer (a use of system agreement) and the retailer has a supply and sale contract with the customer – there is simply the additional deemed contract between distributor and customer which makes the rights and obligations in the Distribution Code binding on the parties.

UED favours this Victorian linear model. Given this issue is dealing with commercial underpinning of the businesses and ultimately their financial viability, it is critical that an industry working group be established to progress it to a national approach.

Recommendation 6.4

That the Victorian model is adopted as the basis for a national uniform model and that an industry working party is established to progress it to a national level.

6.5 Administration and Enforcement of Jurisdictional Licences

The MCE Paper demonstrates that there are a significant number of differences across the jurisdictions in relation to the administration and enforcement of their licensing systems in the network electricity and gas industries. In the development of a national approach it is important that such differences be reduced and the MCE Paper describes the possible elements of a national licensing scheme.

The MCE Paper argues that the structures, which apply to the administration and enforcement of the jurisdictional licensing systems, can be characterised as falling within one of two models:

- the Government–controlled model – under which a Minister or public servant administers the licensing system (eg. determines the licence conditions, issues the licences and approves their transfer) and enforces the licence conditions (sometimes acting on the advice of an independent regulator); or
- the regulator–controlled model – under which a regulator that is independent of Government administers the licensing system (eg. determines the licence conditions, issues the licences and approves their transfer) and enforces the licence conditions.

UED favours a model where there is a clear separation between the rule maker (AEMC) and the regulator (AER) as the rule enforcer as it conforms to the principle that the body that makes the law does not also administer the law. UED also favours the regulator controlled model to administer the licence system under the legislation enacted to guide the regulator.

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It will be important to ensure that if there is to be any jurisdictional regulation (in terms of derogations or “schedules” to national instruments), there are all administered by the national regulator and that a net benefit test applies to such matters.

6.6 Suggested National Exemption Scheme

The MCE Paper argues that the ability to grant exemptions from the requirement to hold an electricity or gas licence has the potential to detract from the uniformity of the licensing system across Australia.

The MCE has proposed the basic elements of a national exemption regime (which would be enshrined in legislation), these include:

- Nationally uniform regulations will provide for circumstances in which an exemption from the requirement to hold an electricity or gas retail or distribution licence applies.
- The AEMC will also have the power to grant exemptions from the requirement to hold an electricity or gas retail or distribution licence.

If new nationally uniform licences and exemptions are to be issued, it will be necessary to implement a mechanism for them to replace the existing licences and exemptions. The MCE paper has proposed two possible options:

- a legislatively sanctioned substitution of licences and exemptions; or
- a voluntary surrender and replacement of licences and exemptions.

The MCE propose that in either case, a transitional period could be provided to enable industry participants to make any arrangements necessary to accommodate the introduction of the new licences and exemptions.

An advantage of the first option is that it ensures that, with effect from a particular date, all licences and exemptions on issue will conform to the national "model". A disadvantage is that the compulsory substitution of new licences and exemptions with different provisions may trigger defaults under a range of commercial and financing arrangements. A disadvantage of the second option is that, given many licences are issued for an indefinite period, a refusal by the licensee to voluntarily surrender an existing licence for a new licence will detract from the ideal of national uniformity.

UED favours the development of a national licence and an exemption system on the following basis:

- The development of a national uniform model and the agreement to this model of all relevant jurisdictions and the energy industry;

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- The replacement of existing licences with the new national licence in a seamless manner at the point in time the distributor operates under the AER for a new pricing period (after the jurisdictional review is completed); and
- Any licence changes are based on a public cost benefit approach.

Recommendation 6.5

That the development of a national licence exemption system operates on the following basis:

- **The development of a national uniform model and the agreement to this model of all relevant jurisdictions and the energy industry;**
- **The replacement of existing licences with the new national licence at the point in time the distributor operates under the AER for a new pricing period (after the jurisdictional review is completed); and**
- **Any licence change is based on a public cost benefit approach.**

6.7 Alternatives to Licensing

The MCE has raised the issue of the alternatives to licensing which would include a requirement that such industry participants must be registered before they are able to retail or distribute electricity or gas. Such registration could be subject to conditions and could be liable to revocation or suspension where the registered industry participant breaches those conditions or any other applicable law. Registration is the form of regulation, which is currently adopted under the National Electricity Code in relation to distributors as Code Participants.

UED considers that only a licensing scheme should be necessary as long as the above principles outlined by the company are adopted.

7. Industry Codes and Rules

7.1 Introduction

The licences or authorisations which electricity and gas distributors are required to hold often require the licensee to comply with various industry codes or rules. The MCE Paper argues that a national framework for the regulation of distribution networks requires that, to the extent practicable, industry regulation should apply uniformly across the Australia.

The MCE Paper also qualifies this position by arguing that it may be that complete uniformity is neither necessary nor desirable for at least two reasons:

- there are justifiable jurisdictional differences: many of the technical regulatory requirements that are imposed on distributors are specific to the distribution networks in each jurisdiction as they relate to the particular technical characteristics of those networks. There would be little point in seeking to impose uniformity in relation to such requirements; and
- the cost of uniformity: whenever assessing the desirability of change, it is necessary to weigh up the costs and the benefits arising from the change.

The MCE in starting this assessment process has proposed the development of a national consumer protection code.

UED supports the principles outlined above about the development of a national regulatory model where a cost benefit approach is used in determining the move to national uniformity.

However, UED does not support the development of the national consumer protection code. The Victorian regulatory approach has progressed on from such a code (the Retail Energy Code) and has developed a much cleared approach to the responsibilities of the different parties (retailers and distributors) which is more consistent with a significantly vertically disaggregated industry.

UED notes that the MCE paper (page 66) states that “the important point is that all provisions dealing with these matters should be located in a discrete set of regulatory instruments rather than spread among a diverse range of instruments”. UED supports such a principle.

7.2 Responsibility for Making Industry Codes and Rules

All distribution codes and guidelines seek to:

- prescribe behaviour between retailers and distributors;
- prescribe behaviour between retailers/distributors and consumers;
- describe behaviour related to market power or anti-competitive behaviour;
- establish regulatory accounting requirements; and,
- set out service incentive systems in some states.

The differences in these codes between the states and territories will not be significant and the companies believe that a national uniform approach to distribution significant codes will be possible. This is already the case with some codes already being developed as national instruments. However it is important to note that as these national codes are adopted their relevant state based codes will need to fall away.

The MCE Paper raises the issue of whether such codes or rules should be developed by or otherwise subject to the approval of a regulator or Government. In some jurisdictions the regulator is empowered to make and revoke codes and rules but must consult with the relevant minister.

An alternative approach would be for such a role to be conferred on the AEMC, which has rule making responsibilities for the national codes. This would mean the separation of rule making (vested in the AEMC) from enforcement (vested in the AER) and so mirror the wholesale energy market governance arrangements to that extent.

However, UED considers that the AER be given responsibility for developing necessary non-rule based guidelines to guide distributors and retailers in interpreting codes, because the national regulatory framework is predicated on separating rule making from rule administering.

In light of this conclusion the question of who should develop and vary over time the new national codes arises. UED considers that this task should be allocated to the AEMC to preserve the model of rule maker and rule enforcer. The AEMC must adopt the principles of best practice regulation in its activities.

Recommendation 7.1

That the AEMC be given the responsibility of developing a national set of distribution related codes and non-rule based guidelines and that a cost benefit approach is used in the process.

7.3 Standard Terms and Conditions

The MCE paper points out that a number of jurisdictions regulate the "default" or "minimum" terms and conditions on which electricity and gas retailers and distributors must contract where they distribute or retail electricity or gas to (small) customers – particularly (but not only) where they have a franchise in respect of such customers.

This regulation may take the form of specifying the actual terms and conditions or merely regulating them at a more general level (eg. by prohibiting the inclusion of certain exclusions of liability or by requiring that certain procedures be followed prior to disconnection).

UED supports the move to a nationally uniform regulation based on best practice regulation that applies to the minimum terms and conditions wherever this is possible and to minimise jurisdictional differences over time.

However, UED notes that a best practice principle should override a completely national approach in the short to medium term until the national approach becomes best practice.

In terms of the type of regulation UED considers that there should generally be less prescription in relation to contestable customers (except where these are members of embedded networks) as such customers should be more aware of the issues than other consumers.

Recommendation 7.2

That a national set of regulation should be developed that applies minimum terms and conditions. That jurisdictional differences should be phased out with the completion of the price review established by the jurisdictional regulator.

That any jurisdictional derogation or schedule based on best practice regulation continue in the national model.

8. Associated Electricity and Gas Schemes

8.1 Introduction

The MCE Paper states that in addition to having to comply with obligations that are set out in their licences or applicable industry codes and rules, electricity and gas retailers and distributors in each jurisdiction are also required to comply with various associated schemes such as:

- dispute resolution schemes (such as ombudsman schemes) have been established in a number of jurisdictions under which an industry-funded, but independent, ombudsman is charged with receiving, investigating and facilitating the resolution of a range of customer complaints and disputes up to a specified threshold amount against electricity and gas retailers and distributors.
- retailer of last resort schemes with differences between states on coverage in gas and differences with who is the “retailer of last resort”;
- differences in customer transfer schemes where a number of jurisdictions have developed or are developing rules relating to customer transfers and the responsibilities of retailers and distributors in such schemes while schemes differ in term of customer numbers;
- differences in business to business information exchange schemes which support retail competition where technical details are set out for customer transfers and the rules governing transfers; and
- community service obligations where a number of jurisdictions require industry to provide community services.

UED supports the move to a nationally uniform regulation that applies to dispute resolution and retailer of last resort schemes. The retailer of last resort should be a retailer and not a distributor, as distributors generally would not have the requisite billing systems, energy trading and retailing skills to undertake such a task.

The development of some key national initiatives are currently with the National Electricity Code Administrator (NECA). For example, a national B2B framework is being developed and when this is approved jurisdictional schemes will fall away. Also MSATS procedures are becoming national in approach and this will have implications for jurisdictional approaches.

In terms of community service obligations these should be the province of the jurisdictions and cost recovery should operate as a pass through as approved by the AER.

Recommendation 8.1

That a national set of regulation should be developed that applies to retailer of last resort and dispute resolution.

That any move to a national uniform approach be considered in a cost benefit framework. That the existing national developments in B2B and MSATS be progressed.

9. Service Standards

9.1 Introduction

Service standards are an integral component of the incentive based pricing regulation that is implemented for electricity and gas distribution charges. They are also a critical part of the "regulatory bargain" under which distributors are allowed to earn revenue that is commensurate with the efficient costs of meeting the service expectations of consumers.

The MCE Paper points out that it is inevitable that the empirical measures of the service standards that retailers and distributors are required to achieve will vary between jurisdictions, eg. because of the nature of the distribution network or because of the geography, population density and other characteristics of the region in which the distribution or retail business operates.

However, there is also considerable disparity between the jurisdictions as to the kinds of service standards which are measured, the definition of the measures of those service standards, the purpose for which those service standards are measured, and who is responsible for the setting of those service standards. The MCE argue that in Victoria, South Australia and Tasmania the service standards are typically set by the regulator, whereas in jurisdictions such as New South Wales the service standards are typically set by the relevant Minister. In addition some jurisdictions operate an incentive scheme for exceeding service level targets.

The MCE have established that there are a number of purposes for which such service standards may be measured. For example, they could be measured for the purpose of:

- making an adjustment to the revenue which a distributor is permitted to earn so as to reward performance that exceeds a particular level as measured using that service standard or to penalise performance that is below a particular level as measured by that service standard;
- requiring the distributor or retailer to make a payment to customers who are affected by the failure of the distributor or retailer to meet a particular level of performance as measured by that service standard; or
- benchmarking a distributor's or retailer's performance against that of other distributors or retailers, or against a particular level of performance, as measured by that service standard.

Codes and rules which regulate electricity and gas distribution can also impose obligations in relation to the quality (as opposed to the reliability) of supply which has not been include in the MCE detailed assessment.

9.2 Uniformly Defined Service Levels

The key question is the extent of national uniformity possible with:

- Establishment of service measures
- Setting of service targets

UED supports the development of a consistent national framework for measuring service levels and suggest that this should be the basis of a public consultation process by the AER. There should also be a national framework for service measures used by the Australian Energy Regulator in each jurisdiction.

However, UED considers that jurisdictional governments should set service targets, as these are critical for state economic development and for consumers.

UED considers that the AER should evaluate service standards against the benchmarks set by the jurisdictions using the uniform service measures and publish its conclusions. UED also considers that service incentive schemes should only be used by the AER where a distributor has the requisite quality data systems to support the use of such schemes.

Recommendation 9.1

That the development of a consistent national framework for measuring service levels should be the basis of a review by the AER as part of a public consultation process.

That a national framework for service measures be developed and used by the Australian Energy Regulator.

That jurisdictional governments should set service targets, as these are critical for state economic development and for consumers and that there should be adopted by the AER for price setting purposes.

That jurisdictions can refer the service target setting function to the AER with necessary guidelines to guide the AER

That the AER should evaluate service standards using the uniform measures against the benchmarks set by the jurisdictions and publish conclusions.

That where the data systems support the use of incentive programs these should be used by the AER

10. Other Functions of Jurisdictional Regulators

10.1 Introduction

The MCE paper points out that while distribution price regulation and licensing are the primary functions undertaken by the jurisdictional economic regulators, such regulators are also responsible for a range of other electricity and gas-related functions. For example, in the context of the regulation of electricity retail and distribution in the National Electricity Market jurisdictions alone:

- The regulators in some jurisdictions play a role in the "step in" regimes that apply where a licensee's default threatens the adequacy of the electricity supply;
- The regulators in some jurisdictions which have ombudsman schemes are responsible for various matters relating to those schemes;
- Many regulators play a role in approving the safety net terms and conditions for small customers and some regulators play a role in the approval and/or operation of the jurisdictional retailer of last resort schemes;
- Some of the regulators play a role in the resolution of various kinds of disputes;
- Some regulators set the maximum prices at which electricity may be supplied through inset networks;
- Some regulators also approve documents such as safety, reliability, maintenance and technical management plans and coordination agreements between distributors and retailers.
- The NSW Independent Pricing & Regulatory Tribunal plays a part in the administration, monitoring, auditing and enforcement of, and in the making of determinations under, New South Wales' greenhouse gas scheme;

The MCE also advise that the list above is not exhaustive of the range of ancillary functions that are performed by these jurisdictional economic regulators.

10.2 Transfers of Ancillary Functions

The MCE Paper raises the issue that although the AER will have offices in each jurisdiction, it is not necessarily appropriate that all of these ancillary functions should be transferred from jurisdictional regulators.

UED favours the policy position that where it is possible to develop a national approach to the function then this could be transferred to the AER or the AEMC. In addition there should be an agreement between the AER (and the AEMC where relevant) and the

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jurisdictions to jointly consider all remaining functions of jurisdictional regulators and recommend which could be transferred to a national level.

This would enable a census to be taken to ensure that each level of government is able to clearly understand their responsibilities in the new national framework and to enable coordination of jurisdictional and national responsibilities and enable a range of MOU's to be developed and pass thought of costs to be organised.

UED considers that it should also be possible for jurisdictions to refer any jurisdictional responsibility to the AER with any appropriate guidelines for operation at the national level.

Recommendation 10.1

That the policy position be based on the principle that where it is possible to develop a national approach to the function then this could be transferred to the AER or the AEMC. In addition that there is an agreement between the AER (and the AEMC where relevant) and the jurisdictions to jointly consider all remaining functions of jurisdictional regulators and recommend which could be transferred to a national level.

That a census is undertaken by the AER and jurisdictions to identify each jurisdictional responsibility ensure that each level of government is able to clearly understand their responsibilities in the new national framework

That the census is used to enable the effective coordination of jurisdictional and national responsibilities and enable a range of MOU's to be developed and pass thought of costs to be organised.

That it should also be possible for jurisdictions to refer any jurisdictional responsibility to the AER with any appropriate guidelines for operation at the national level.

10.3 Provision of Advice to Governments

The MCE raises the issue that the development of a national approach could lead to jurisdictional regulators being deskilled.

The MCE also argue that the jurisdictional economic regulators are an important source of advice to their Governments (including through the conduct of inquiries and making of reports) and they play an important role through liaising with other jurisdictional bodies, such as technical regulators, ombudsmen, advisory committees and local industry participants.

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Finally, a number of the jurisdictional economic regulators also play a role in the regulation of electricity and gas retail prices (eg. through regulating these prices either in accordance with a Governmental order or following a Government reference to investigate such prices). While there will be no blanket transfer of retail price regulation to the AER, it will be possible for the AER to assume responsibility for the regulation of retail prices in any jurisdiction at the request of that jurisdiction.

UED considers that the issue of deskilling will not be a problem for jurisdictional regulators because:

- Some jurisdictional regulators have other regulatory responsibilities such as water, ports, railways, taxis and other industry regulation which utilises the same cost based regulatory models and this role will continue in some jurisdictions;
- Some government departments also are a source of expert advice to their governments such as those in departments of energy; and
- Another model could see the AER who will have offices in each state becoming a source of advice to governments on various energy matters under an MOU arrangement with a local jurisdiction.

Recommendation 10.2

That the AER who will have offices in each state becomes a source of advice to governments on various energy matters under an MOU arrangement with a local jurisdiction.

APPENDIX ONE – PROPOSED MODEL OF A STATE COSTS PASS THROUGH APPROACH

1.1 What can an energy distributor do if a change in cost based event occurs?

If a *change in costs event* occurs, a distributor may give a statement to the AER within 3 months of the *change in costs event* occurring specifying:

- (a) details of the *change in costs event* concerned;
- (a) the date the *change in costs event* took or takes effect;
- (b) the estimated financial effect of the *change in costs event* on the distributor;
- (c) the *pass through amount* the distributor proposes in relation to the *change in costs event*; and
- (d) the basis on which the *pass through amount* is to apply.

1.2 What must the AER do if it receives a statement under clause 1.1?

- (a) If the AER receives a statement under clause 1.1, the AER must decide whether the *change in costs event* specified in the statement occurred or is continuing, and if the *change in costs event* occurred or is continuing, the AER must decide:

- (1) the *pass through amount*; and
- (2) the basis on which the *pass through amount* is to apply,

and notify the distributor in writing of the AER's decision.

- (b) If the AER does not give a notice to the distributor under clause 1.2(a) within 20 *business days* of receiving a statement from the distributor under clause 1.1, on the 21st *business day* after receiving the statement from the distributor under clause 1.1, the AER is taken to have notified the distributor of its decision under clause 1.2(a) that the *pass through amount* and the basis on which the *pass through amount* is to apply are as specified in the statement given by the distributor under clause 1.1.

1.3 What can the Regulator do if a change in costs event occurs?

- (a) If a *change in cost event* occurs and a distributor affected by the *change in costs event* does not give the AER a statement under clause 1.1 concerning the *change in costs event*, the AER may decide on a *pass through amount* and the basis on which the *pass through amount* is to apply.

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- (b) Where under clause 1.3(a) the AER decides on a *negative pass through amount*, the AER:
- (l) may decide to require a distributor to pass through the *negative pass through amount* decided by the AER on the basis decided by the AER; and
 - (1) where the AER decides to require the distributor to pass through the *negative pass through amount*, it must notify the distributor in writing, of the *negative pass through amount*, the basis on which the *negative pass through amount* is to apply and the reasons for the AER's decision.

1.4 What factors must the AER consider in making a decision under clause 1.2 or 1.3?

In deciding the *pass through amount* and the basis on which the *pass through amount* is to apply under clause 1.2 or 1.3, the AER must ensure that the financial effect on the distributor associated with the *change in state costs event* concerned is economically neutral taking into account:

- (a) the relative amounts of *tariffed services* supplied to each *Customer*;
- (e) the time cost of money for the period over which the *pass through amount* is to apply;
- (f) the manner in which and period over which the *pass through amount* is to apply;
- (g) the financial effect on the distributor directly and indirectly attributable to the *change in costs event* concerned, and the time at which the financial effect arises;
- (h) the amount of any change in another state cost which, in the AER's opinion, was introduced as complementary to the *change in costs event* concerned;
- (i) the effect of any other previous *change in costs event*;
- (j) any *pass through amount* applied under this section 1 relating to a previous *change in costs event* which resulted in the distributor recovering an amount either more or less than the financial effect on the distributor of that previous *changes in costs event*.

1.5 When does a distributor apply a *pass through amount*?

- (a) A distributor:
- (1) may, after
 - (A) receipt of a notice from the AER or a deemed receipt of a notice under clause 1.2 as to a *positive pass through amount*; and
 - (B) notifying its *Customers* of:
 - (i) the *positive pass through amount* which the AER has approved or is deemed to have approved; and
 - (ii) the basis on and date from which the distributor will apply the *positive pass through amount*,apply the *positive pass through amount* specified in the notice to *Customers* on the basis indicated in the notice; and
 - (2) must, after receipt of a notice or deemed receipt of a notice from the AER, under clause 1.2, or after receipt of a notice under clause 1.3 as to a *negative pass through amount* apply the *negative pass through amount* on the basis decided by the AER.
- (b) The *pass through amount* must be identified in a manner approved by the AER in matters to customers.
- (c) A distributor can only seek to reclaim from *Customers positive pass through amounts* in respect of services provided from the time that the distributor:
- (1) notified its *Customers* under clause 1.5(a)(1)(B); and
 - (1) showing or identifying the *positive pass through amount* as required under clause 1.5(b).

Definitions

change in costs event A change in the way in which states and territories change legislation, regulation or other statutory rules to impose costs on regulated entities. Such cost impact could include safety-related requirements, metering measurement requirements or changes to gas and electricity industry acts that impose a cost on distributors. A change by the AEMC on market structure or the change to any code or licence or other instrument, which has a cost, impact on the distributor.

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| <i>Positive pass through amount</i> | In relation to the occurrence of a <i>change in cost event</i> , an amount that a <i>Customer</i> is required to pay to a distributor or a factor by which amounts the <i>Customer</i> is required to pay the distributor are increased. |
| <i>Relevant cost event</i> | <p>Any changes to state or territory legislation, regulation or statutory rules which impose a cost on a regulated entity and includes:</p> <ul style="list-style-type: none"> (a) a change to road management legislation and regulations and codes governing distributors works that has a cost impact; (b) a change in metering rules and in meter measurement requirements or in meter quality rules that has a cost impact; (c) fees and charges paid or payable to the jurisdiction for <i>distribution licences</i> or any other membership, contribution or other charge payable to other jurisdictional regulatory bodies in the <i>gas or electricity</i> industry; (d) land tax changes or any other tax on the ownership or occupancy of premises; (e) a change in safety related legislation or regulation or statutory rules or codes of practice which has a cost impact; (f) a change in the level of the goods and services tax; (g) any change to gas and electricity industry acts and related acts, regulations, statutory rules and codes which impose a cost on distributors; and (h) any change to any state acts, regulations, statutory rules and codes which impose a cost on distributors. |

**APPENDIX TWO – NATIONAL ELECTRICITY CODE
OBJECTIVES AND THE PRODUCTIVITY COMMISSIONS
RECOMMENDATIONS FOR THE OBJECTIVES IN THE
NATIONAL GAS CODE**

| Objectives of electricity distribution service pricing | Objectives of gas distribution service pricing from the Productivity Commission |
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| (a) An efficient and cost-effective regulatory environment. | <p>To promote the economically efficient operation and use of, and economically efficient investment in, the services of transmission pipelines and distribution networks, thereby promoting effective competition in upstream and downstream markets.</p> <p>In addition:</p> <p>(a) that it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline</p> <p>(b) that access (or increased access) to the Services provided by means of the Pipeline can be provided without undue risk to human health or safety</p> <p>(c) that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest.</p> <p>(d) that account is taken of firm and binding contractual obligations of the Service Provider or other persons (or both) already using the Covered Pipeline</p> <p>(e) that the operational and technical requirements necessary for the safe and reliable operation of the Covered Pipeline are considered.</p> |
| (b) An incentive-based regulatory regime which: | |
| (i) provides an equitable allocation between distribution network users and distributors of efficiency gains reasonably | |

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| <p>expected by the Regulator to be achievable by the distributors;</p> <p>(ii) provides, on a prospective basis, for a sustainable commercial revenue stream which includes a fair and reasonable rate of return to distributors on efficient investment, given efficient operating and maintenance practices;</p> <p>(iii) ensures consistency in distribution service pricing; and</p> <p>(iv) preserves the location and time signals of customer-specific transmission usage charges;</p> | |
| <p>(c) Prevention of monopoly rent extraction by distributors.</p> | |
| <p>(d) An environment which fosters an efficient level of investment within the distribution sector, and upstream and downstream of the distribution sector.</p> | |
| <p>(e) An environment which fosters efficient operating and maintenance practices within the distribution sector.</p> | |
| <p>(f) An environment which fosters efficient use of existing infrastructure.</p> | |
| <p>(g) Reasonable recognition of pre-existing policies of Governments regarding distribution asset values, revenue paths and prices.</p> | |

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| <p>(h) Promotion of competition in upstream and downstream markets and promotion of competition in the provision of network services where economically feasible.</p> | |
| <p>(I) Reasonable regulatory accountability through transparency and public disclosure of regulatory processes and the basis of regulatory decisions</p> | |
| <p>(j) Reasonable certainty and consistency over time of the outcomes of regulatory processes, recognising the adaptive capacities of industry participants and customers in the provision and use of distribution network assets.</p> | |
| <p>(k) Reasonable and well defined regulatory discretion, which permits an acceptable balancing of the interests of distributors, distribution network users and the public interest.</p> | |

APPENDIX THREE – NATIONAL ELECTRICITY CODE PRICING PRINCIPLES AND THE PRODUCTIVITY COMMISSIONS RECOMMENDATIONS FOR PRICING PRINCIPLES IN THE NATIONAL GAS CODE

| Pricing Principles NEC | Pricing Principles –NGC – Productivity Commission |
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| <p>(a) The form of economic regulation to be applied:</p> <p>is to be the prospective CPI minus X form, or some incentive-based variant of the CPI minus X form which is consistent with the other objectives and principles of distribution service pricing, and which takes the form of a revenue cap, a weighted average price cap or a combination of them;</p> <p>must not be changed during a regulatory control period, which must be for at least 5 years.</p> <p>Principles for regulation of distribution service pricing: Prescribed distribution services</p> <p>(b) If the Regulator proposes to amend this form of economic regulation, the Regulator must:</p> <p>(iii) give two years prior notice to the distributor of the new economic regulation arrangements to apply from the commencement of the next regulatory control period; and</p> <p>(iv) publish a description of the process and timetable for re-setting the form of economic regulation at a time which provides all affected parties with adequate notice to prepare for, participate in, and respond to that process, prior to the commencement</p> | <p>In order to provide more specific and operational guidance for setting reference tariffs under the Gas Access Regime, and ensure consistency with the national access regime, s.8.1 of the Gas Code should be replaced with the following:</p> <p>s.8.1 A reference tariff or reference tariff policy should be designed with regard to the overarching objects clause, s.2.24 and the following principles:</p> <p>(a) that reference tariffs should:</p> <p>(i) be set so as to generate expected revenue for a reference service or services that is at least sufficient to meet the efficient costs of providing access to the reference service or services</p> <p>(ii) include a return on investment commensurate with the regulatory and commercial risks involved</p> <p>(b) that reference tariff structures should:</p> <p>(i) allow multi-part pricing and price discrimination when it aids efficiency</p> <p>(ii) not allow a vertically integrated service provider to set terms and conditions that discriminate in favour of its associated businesses in upstream or downstream markets, except to the extent that the cost of providing access to non-associates is higher</p> <p>(c) that reference tariffs should be set so as to provide incentives to reduce costs or otherwise improve productivity.</p> |

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| <p>of the regulatory control period to which that form of economic regulation is to apply.</p> <p>(c) The regulatory regime to be administered by the Regulator must have regard to the need to:</p> <p>(i) provide distributors with incentives and reasonable opportunities to increase efficiency;</p> <p>(ii) create an environment in which generation, energy storage, demand side options and network augmentation options are given due and reasonable consideration;</p> <p>(iii) take account of and be consistent with the allocation of risk between distributors and distribution network users;</p> <p>(iv) provide a fair and reasonable risk-adjusted cash flow rate of return to distributors on efficient investment given efficient operating and maintenance practices where:</p> <ul style="list-style-type: none"> • assets created at any time under a take or pay contract are valued in a manner consistent with the provisions of that contract; • assets in existence and generally in service on a specified date ("sunk assets") are valued at a value determined by the Regulator or consistent with the regulatory asset base established by the relevant Government; • the valuation of assets brought into service after the specified date ("new assets"), and any subsequent revaluation of any sunk or new assets, is to be undertaken on the basis of their deprival value unless the achievement of the other objectives and principles for distribution pricing renders another | <p>s.8.44 The Reference Tariff Policy should, wherever the Relevant Regulator considers appropriate, contain a mechanism (an Incentive Mechanism) that permits the Service Provider to retain all, or any share of, any returns to the Service Provider from the sale of Reference Services in aggregate (not individual Reference Services when there is more than one):</p> <p>s.8.46 The design of an Incentive Mechanism should be consistent with achieving the overall objective of the Gas Access Regime and the pricing principles specified in s.8.1.</p> <p>s.8.6 In view of the manner in which the Rate of Return, Capital Base, Depreciation Schedule and Non Capital Costs may be determined (in each case involving various discretions), a range of values may be attributed to the Total Revenue described in section 8.4. In order to assess whether a value proposed by a Service Provider is within this range the Relevant Regulator may have regard to any financial and operational performance indicators it considers relevant in order to determine whether the level of costs nominated by the Service Provider is within the range of plausible outcomes under section 8.4 that is consistent with the pricing principles contained in section 8.1.</p> <p>To provide greater flexibility for price regulation than that provided by the current building block approach, s.8.5 of the Gas Code should be replaced with the following:</p> <p>s.8.5 A Service Provider can use another method to calculate Total Revenue, provided the Relevant Regulator is satisfied that the proposed method is more likely to meet the overall objective of the Gas</p> |
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| <p>basis more appropriate;</p> <ul style="list-style-type: none"> • benchmark returns to be established by the Regulator are to be consistent with the method of valuation of new assets and revaluation, if any, of existing assets and consistent with achievement of a commercial economic return on efficient investment; <p>(vi) provide reasonable certainty and consistency over time of the outcomes of regulatory processes having regard for:</p> <ul style="list-style-type: none"> • the need to balance the interests of distribution network users and distributors; • the capital intensive nature of the distribution sector, the relatively long lives of distribution assets, and the variable and frequent augmentation of the distribution network; • the need to minimise the economic cost of regulatory actions and uncertainty; and • relevant previous regulatory decisions and expressions of regulatory intent (including those made by previous regulators and Governments). <p>In setting the caps to be applied to each distributor, the Regulator must take into account each distributor's revenue requirements during the regulatory control period, having regard for:</p> <p>(a) the demand growth which the distributor is expected to service;</p> <p>(b) the service standards applicable to the distributor and the performance of the distributor relative to those standards;</p> <p>(c) price stability;</p> <p>(d) the Regulator's reasonable judgment of</p> | <p>Access Regime.</p> <p>8.32 The Depreciation Schedule is the set of depreciation schedules (one of which may correspond to each asset or group of assets that form part of the Covered Pipeline) that is the basis upon which the assets that form part of the Capital Base are to be depreciated for the purposes of satisfying the pricing principles in section 8.1.</p> <p>s.8.33(a) so as to result in the expected Total Revenue attributable to a Service Provider's Reference Services in aggregate (not individual Reference Services when there is more than one) changing over time in a manner that is consistent with the efficient operation and use of the Services (and which may involve a substantial portion of the depreciation taking place in future periods, particularly where the calculation of Total Revenue has assumed significant market growth and the Pipeline has been sized accordingly);</p> <p>s.8.34(d) the expected Total Revenue attributable to a Service Provider's Reference Services in aggregate (not individual Reference Services when there is more than one) should change over the Access Arrangement Period in a manner that is consistent with the efficient operation and use of the Services (and which may involve a substantial portion of the depreciation taking place towards the end of the Access Arrangement Period, particularly where the calculation of Total Revenue has assumed significant market growth and the Pipeline has been sized accordingly).</p> <p>s.8.31 If a Rate of Return is used in determining a Reference Tariff then the method used to calculate the Rate of Return and the values used in applying that method shall in the first instance be proposed by the Service Provider. In</p> |
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| <p>the potential for efficiency gains to be realised by the distributor in expected operating, maintenance and capital costs, taking into account the expected demand growth and applicable service standards;</p> <p>(e) the distributor's weighted average cost of capital applicable to the relevant network service, having regard to the risk adjusted cash flow rate of return required by investors in commercial enterprises facing similar business risks to those faced by the distributor in the provision of that network service;</p> <p>(f) the provision of a fair and reasonable risk-adjusted cash flow rate of return on efficient investment (including sunk assets);</p> <p>(g) the right of the distributor to recover reasonable costs arising from but not limited to:</p> <ul style="list-style-type: none"> • any State and Commonwealth taxes (or State equivalent of Commonwealth taxes) which it has paid in connection with the operation of its distribution business; • charges paid to transmission network service providers and other distributors arising from the provision of distribution services; • payments made to embedded generators for demand side management programs where the Regulator determines that this is appropriate; • compliance with legal requirements and decisions by other regulators which pertain to the operation of its distribution business; <p>(h) any correction factors arising from a previous regulatory control period;</p> <p>(i) any reduction or increase in energy</p> | <p>assessing the Service Provider's proposal the Relevant Regulator must take account of the fact that there is no single correct method to determine a Rate of Return and there is often a range of plausible estimates that could be used in applying a Rate of Return method. The role of the Relevant Regulator is therefore to assess whether the Service Provider's:</p> <p>(a) proposed method has a plausible conceptual basis; and</p> <p>(b) values used in applying the method lie within the range of plausible estimates.</p> <p>The Relevant Regulator must approve the proposed method if (a) is satisfied. The Relevant Regulator must approve the values used in applying a method if (b) is satisfied.</p> <p>s.8.30 If a Rate of Return is used in determining a Reference Tariff then the Rate of Return should provide a return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service (as reflected in the terms and conditions on which the Reference Service is offered and any other risk associated with delivering the Reference Service including that resulting from regulation).</p> |
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| <p>losses in the distribution network;</p> <p>(j) the on-going commercial viability of the distribution industry; and</p> <p>(k) any other relevant financial indicators</p> | |
| <p>Principles for regulation of distribution services pricing: Excluded distribution services.</p> <p>The form of this regulation to be applied is a more “light handed “ approach than that which applies to prescribed distribution prices.</p> | |