



22 February 2007

By email: MCEMarketReform@industry.gov.au

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

Dear MCE Secretariat

2006 Legislative Package: National Electricity Law (NEL)

We refer to the Exposure Draft of the *National Electricity (South Australia) (National Electricity Law – Miscellaneous Amendments) Amendment Bill* (the **Exposure Draft**) and the Ministerial Council of Energy (MCE) Standing Committee of Officials' (SCO) explanatory document, *Electricity amendments and further amendments to the electricity and gas rule-change process* (the **SCO Explanatory Document**), released for consultation on 5 January 2007. The Consumer Action Law Centre (**Consumer Action**) welcomes the release of these documents for consultation and would like to make the following comments in relation to them.

Background: burden of regulation

Consumer Action acknowledges that the significant reform being undertaken to the national energy market through the current consultation and other related consultations has the potential to significantly benefit consumers. A nationally harmonised approach to the economic regulation of energy networks can reduce the potential for regulatory decisions to distort investment incentives and reduce compliance costs, outcomes which will benefit consumers – the ultimate financiers of the service.

Consumer Action is concerned, however, that many industry and government stakeholders are proceeding on the basis that there is currently a significant regulatory or "red-tape" burden that must be removed as part of the reforms. In our view, arguments about the burden of regulation are misplaced. As stated by the Productivity Commission, "an effective functioning modern economy and society depends on regulation".¹ Rather than a simplistic focus on the amount of regulation, we believe that discussions about the level and types of regulation should be based on what is effective in furthering the public interest. Considering this, Consumer Action urges the MCE SCO in its deliberations to focus on developing regulation that

¹ Productivity Commission, *Regulation and its review: 2004-05, annual report series*, October 2005, p 1.

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is in the public interest, rather than merely responding to repeated, self-interested statements about the regulatory burden endured by industry.

NEL amendments

Form of regulation determination

Consumer Action supports the introduction into the NEL of the two forms of regulation (direct controlled network services and negotiated network services) and the associated form of regulation factors which are to be used by the Australian Energy Regulator (**AER**) to determine which form of regulation is to be used.

We seek clarification, however, as to whether a form of regulation decision is to form part of, or is to be separate to, a substantive revenue or pricing determination, in the context of the AER's decision making in relation to distribution businesses. That is, it remains unclear whether the AER is to undertake a two step determination for distribution – the first being a decision relating to process about the form of regulation and the second being the substantive revenue and pricing determination. Noting that a two-step process may contribute to more costly and complex regulatory decisions, we seek a clear analysis of the costs and benefits of a two stage process versus a single decision-making model. We have similar concerns about how the regulator will undertake the control setting methodology decisions.

National electricity objective

Consumer Action broadly supports the amendment of the national electricity market (**NEM**) objective to become the national electricity objective. This amendment correctly identifies that the objective is more appropriately that of the NEL rather than that of the market, as was recommended by the Expert Panel.

We note that the primary focus of the national electricity objective is economic efficiency while its ultimate purpose is expressed in terms of the long-term interests of consumers.² By focusing on economic efficiency, it is our view that this objective, and the associated revenue and pricing principles in section 7A of the Exposure Draft, will in application concentrate on the costs of regulation rather than the benefits. Benefits of regulation can be harder to assess, and care must be taken to ensure that the long-term interests of consumers are not hampered by an approach that focuses on regulatory costs to the detriment of regulatory benefits that ensure a competitive market with concomitant economic efficiencies, and consumer welfare and distributional issues. Past experience with the application of the NEM objective suggests to us that it is being implemented by construing a narrowly defined notion of efficiency. We also note that while pure economic efficiency may contribute to the long term interests of consumers, it does not always do so.

As a general proposition, it is our view that the national electricity objective should be tempered by consideration of the following caveats:³

- In meeting the objective of the national electricity market, all market participants (including governments and regulators) shall have regard to the essential nature of the service, the pecuniary interests of industry, diversity amongst consumers, and long-term environmental sustainability.

² SCO Explanatory Document, p 8.

³ National Consumers Roundtable on Energy, *Charter of Principles for Energy Supply*.

- Energy should be generated, distributed and consumed in a sustainable manner, to meet the needs of consumers whilst affording effective protection of the environment and the prudent use of natural resources. Demand should be minimised and the use of renewable energy maximised to conserve and enhance environmental and social assets.

Fit for purpose decision-making model

Consumer Action strongly supports section 9A of the Exposure Draft which gives effect to the Expert Panel's decision that it is not appropriate for a global presumption to be adopted in favour of the regulator accepting a regulated entity's proposal.⁴ It is our view that such a presumption (known as a "propose-respond" form of regulation) severely limits the regulator's exercise of discretion, potentially putting the interests of service providers ahead of consumers.

We do agree with the Energy Networks Association's criticism that the heading of the section is inappropriate, including the term "propose-respond" which is not a defined legal term.⁵ "Propose-respond" appears to us to be a colloquial term that does not have a clear meaning. We note, however, that rules of statutory interpretation provide that headings of sections do not form part of the legislation.⁶

Amendments to rule making powers

Consumer Action has significant concerns about the proposed amendments to the NEL and NGL rule change process. In our view, some of the amendments may reduce consumers' confidence in the institutional arrangements of the regulatory framework that underpins the national energy market.

We note that the amendments are designed to assist the Australian Energy Market Commission (the **AEMC**) to manage its workload, not to implement better policy. It is our view that AEMC resources need to be boosted by the jurisdictional governments to a level that accurately reflects its role and responsibilities. We do not believe that the proposed amendments will overcome the ultimate problem of a lack of AEMC resourcing.

The requirement for applicants to provide additional minimum content for Rule change requests may impact upon consumer and public interest group participation in the Rule change process. In particular, the requirement to produce an explanation of the costs and benefits of the proposed rule change and potential impacts of the change on those likely to be affected, may be preventative for many organisations. While we strongly support the need for a robust cost-benefit analysis to be undertaken as part of the introduction of any new regulations, it is the proper function of the responsible regulatory agency (the AEMC) to undertake that analysis in a robust and timely way. While stakeholders should be able to contribute to the AEMC's analysis, it is unfair and inappropriate to push this function directly onto rule-change applicants, who may lack the necessary resources to undertake the required level of analysis and, in any case, are not a neutral party in the process.

⁴ Expert Panel on Energy Access Pricing, *Report to the Ministerial Council on Energy*, 17 April 2006, p 90.

⁵ Energy Networks Association, *Submission to Exposure Draft of National Gas Law*, p 13.

⁶ *Acts Interpretation Act 1915* (SA), s 19(2)(a).

We also have considerable concerns about the imposition of an application fee for Rule change requests. We do not think that an application fee is an appropriate way to resource the AEMC. We also believe that a fee of \$1,000 to apply to user or consumer associations or interest groups will be preventative for most, if not all, such interested groups. Moreover, it is our view that the imposition of a fee on a community stakeholder to propose regulatory changes is unprecedented – it offends the basic right of citizens to engage in debate over, and request changes to, laws and regulations.

We note that the SCO Explanatory Document states that the AEMC may waive a fee relating to a particular application where it considers it is in the public interest to do so. If the proposal to charge an application fee proceeds (and we strongly argue it should not), we believe there must be clear and defined procedures applying to when the AEMC can waive such a fee. We note that, in respect of applications for non-merger authorisations, the ACCC can waive the application fee where it would impose an unduly onerous burden on an applicant.⁷ The ACCC states that it will consider all relevant factors, including whether the fee would cause the applicant financial hardship and whether the prospective applicant is a not-for-profit organisation.⁸ We would support similar considerations to be available to the AEMC in assessing fee waiver applications.

We note that pursuant to the SCO Explanatory Document, industry lobby groups may be eligible for the lower rule change fee, as "interest groups". We do not think this is appropriate, and would urge the SCO to ensure that the various fee levels apply to the relevant stakeholders that are intended.

We do support the AEMC being given additional gatekeeper roles to reject Rule change applications where there are no clear or material benefits, or where the same or similar application has been considered. This will prevent unnecessary clogging of the Rule change process, and potential gaming by stakeholders wishing to delay consideration or application of successful Rule changes.

Distribution rules

Consumer Action welcomes the early consultation in relation to the future distribution revenue and pricing Rules. We look forward to providing additional comments on the draft Rules when they are released in the coming months. However, we would like to comment on the following areas discussed in the SCO Explanatory Document.

Side constraints

Consumer Action strongly supports the proposal that the initial distribution pricing Rules include a provision that a distribution business must not increase various aspects of tariff classes in any year by more than a certain amount. We believe that such side constraint rules can effectively limit rapid price rises applying to particular tariffs and particular classes of consumers. Rapid price rises can significantly disadvantage many consumers, who are in many cases juggling increasing prices for a range of household goods and services.

Side constraints can also provide further incentives for distribution businesses to comprehensively assess their pricing proposals at the time of their setting. Without

⁷ Trade Practices Regulations 1974, reg 75.

⁸ See ACCC website: <http://www.accc.gov.au/content/index.phtml/itemId/776286>.

such an incentive, consumers will bear the risk when distributors set tariffs incorrectly at the time of a price determination and subsequently seek to change them. We view any push to remove side constraint rules as another example of an attempt by industry to push risk onto consumers when it is industry that is best placed to manage and bear that risk.

Incentive schemes

Consumer Action strongly supports the initial distribution Rules including the incentive schemes outlined in the SCO Explanatory Document. In particular, we support a service performance incentive scheme and for such a scheme to enable a guaranteed service level (**GSL**) payment to be made to customers who experience network performance below a certain level. In our view, customers who receive poor service should not have to pay the same as customers who receive average or better levels of service.

WACC for distributors

We understand that the initial distribution Rules will provide for a nominal post-tax weighted-average cost of capital (**WACC**) and that, initially, the value of WACC parameters will be left to the discretion of the AER. However, the Rules will also provide for key components of the WACC to be subject to a five-yearly review.

Consumer Action stresses that the regulator must have discretion and flexibility in relation to the setting of the WACC. The value of the WACC has significant effect upon the prices paid by consumers and it is extremely important that regulators balance the interest of distributors and consumers in setting the WACC. We are concerned that a curtailment of the regulator's discretion will hinder the ability of the WACC to reflect market dynamics and realities and could lead to distributors over-recovering to the detriment of consumers. Considering that distribution costs make up 40-50 per cent of a consumer's final bill, the economic regulation of distribution should be able to respond to short term and mild cyclic fluctuations in business conditions, interest rates and economic activity.

Previous consultation on National Gas Law (NGL)

Consumer Action provided a joint submission to the NGL consultation with the Consumer Utilities Advocacy Centre and raised a number of issues around the merits review process and information instruments. The MCE SCO has asked stakeholders not to repeat issues that have already been raised in the previous consultation on the NGL, therefore we simply note here that we continue to believe that those comments are relevant to the current consultation.

We would like to raise the following additional concerns.

Merits review

Division 3A of the Exposure Draft provides that reviewable regulatory decisions are network revenue or pricing determinations (distribution or transmission), AER ring-fencing decisions and other decisions of the AER under the Rules that are prescribed by the Regulations to be a reviewable regulatory decision. We support this, but believe that any interim decisions of the AER in a revenue or pricing determination should not be reviewable. For example, the SCO Explanatory Document suggests that the initial distribution Rules will leave the value of the WACC parameters to the

discretion of the AER (in contrast to the transmission Rules which specify the value of each WACC parameter) – we do not believe that the AER's individual decision in relation to the WACC should be a reviewable decision. This would only draw out the length of any price determination process, adding costs to the process which would be ultimately borne by consumers. We recognise, however, that a WACC decision might be reviewable as part of a review of a revenue determination.

Consumer Action also strongly contests any proposal that would enable draft or final Rule determinations of the AEMC to be reviewable under Division 3A. This would be inappropriate, as the AEMC is effectively a body that makes delegated legislation, being the Rules, and Rule determinations, particularly final ones, are part of that legislative process. It is contrary to the doctrine of separation of powers for the courts to interfere in the making of legislation, unless that legislation is unconstitutional. It is already arguable that the current provisions of the NEL purporting to allow for judicial review of AEMC Rule determinations are invalid as unconstitutional, thus any proposal to extend the even broader recourse of merits review to AEMC Rule determinations would not only be inappropriate but would pose a strong risk of constitutional challenge.

Information gathering powers

Consumer Action strongly supports the provisions relating to improved information gathering powers. The significant information asymmetry between the service providers, the regulators and other interested parties, particular consumers, enables service providers to utilise this imbalance to their advantage at the ultimate cost of consumers. To overcome this market failure, it is essential for a regulator to be able to access information it requires to undertake its activities.

Consumer Action is particularly concerned to enable the regulator to obtain accurate information from regulated businesses' associated service providers. In Victoria, Alinta Asset Management (**AAM**) has commenced litigation against the Essential Services Commission Victoria claiming it is not an associate under the National Gas Code, even though the majority of the regulated business Multinet's functions are undertaken by AAM. Multinet and AAM are actually connected through a complex array of interposed entities. Consumer Action believes that such complex corporate structures can work to evade regulation and stymie the public interest. Such corporate structures and associated legal action effectively prevent the achievement of objectives relating to transparency and accountability in the regulation and delivery of essential services.

Considering this, we support the amendment to the NEL which provides that an associate (in addition to the meaning under the Corporations Law) includes a person or class of persons prescribed by the Regulations to be an associate. We encourage the MCE to actively identify relevant entities and prescribe them as such. Such prescription may assist in preventing costly and complex litigation where the regulator has concerns about the veracity of regulated businesses' information as to costs charged by service providers that may be related to them. We also strongly support section 28 of the exposure Draft in relation to the regulator's general power to obtain information. The exercise of this section together with the threat of strong penalties can provide confidence in the regulator's decision-making, especially where it has concerns about the impact of complex corporate structures.

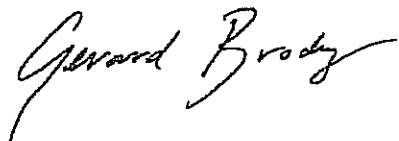
A particular concern in recent price determinations has related to delaying tactics by regulated entities in providing required information. In our view, in cases of delay

caused by regulated entities, stakeholders and the regulator should not be disadvantaged with respect to the amount of time they have to assess proposals. Moreover, the Law or Rules should make it clear what steps the regulator may take when a regulated entity is delaying the progress of a pricing or revenue determination.

Should you have any further questions about this submission, please contact me on 03 9670 5088.

Yours sincerely

CONSUMER ACTION LAW CENTRE

A handwritten signature in black ink, reading "Gerard Brody". The signature is written in a cursive style with a large, stylized 'G' and 'B'.

Gerard Brody
Senior Policy Officer

