

Ministerial Council on Energy
Standing Committee of Officials

Comments on:

**2006 Legislative Package: Gas Legislative Framework and
National Gas Law Exposure Draft**

**2006 Comprehensive Legislative Package: Overview and
Response to Expert Panel on Energy Access Pricing**

**Regulatory Impact Statements on the Form of
Regulation Pricing Principles, Information Disclosure and
Regulatory Decision-making**

Consumer Advocacy Arrangements

by

The Major Energy Users Inc

And

Major Employers Group Tasmania

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Executive Summary

The MEU provides comments on the 2006 Legislative Package in this submission.

The MEU considers that the new national institutions must be adequately funded and resourced to ensure effective and efficient regulatory outcomes “in the long term interests of consumers”.

In particular, given the additional myriad tasks that the AEMC is required to undertake, particularly the extensive functions in the gas pipelines area, given by the MCE and under the new NGL, the number of commissioners should be increased by two, with the essential requirement that the new commissioners have backgrounds from the consumer standpoint. This is essential, to complement the background of the existing commissioners.

The extensive new tasks given to the AEMC included those items contained in the attachment to this submission.

The MEU also provide the following:-

Implementation Definitions and Coverage

- The MEU supports the expeditious implementation of the new national gas pipeline access regime.
- The MEU seeks to ensure that use of the terms “user” and “end user” are applied such that representatives of consumers are not excluded in any material aspect of the Law from being able to represent their interests under the Law.
- The MEU seeks clarification that the new national gas pipeline access regime does not cover upstream gas supplies.

Objective of the NGL: Definition of Natural Gas Service

- The MEU prefers that “gas pipeline services” be substituted for “gas supply services” in the NGL
- The MEU considers that the explanatory note in (b) above (the definition of ‘natural gas service’) to include “major gas users”

Least Costly Form of Regulation

- The MEU recommends that Section 12 of the Exposure Draft be redrafted to include the following:

“The NCC and Minister may determine to grant coverage even if the costs of the more costly form of regulation outweigh the benefits of coverage.”

Forms of Regulation Factors (Section 13)

- The MEU supports the full range of “form of regulation factors” but suggests that to prevent factors (d) and (g) from being neutralised, they must be properly underpinned in the NGL to ensure their effectiveness.

A pipeline can be covered in several parts (Section 14)

- The MEU suggests that should there be an application by a service provider to separate a contiguous pipeline into separable parts, the regulator is empowered to assess the complete system in a holistic manner to ensure that separation is not being used to the detriment of consumers.

National Gas Objective (Section 20)

- The MEU suggests wording changes to describe the objective more accurately.

‘Propose-respond model not to apply unless Rules provide otherwise (Section 24)

- The MEU strongly recommends that policy guidelines be issued to guide the AEMC when making “Rules for where aspects of a regulatory decision are closer to a ‘propose-respond model’.”

Timely provision of information

- The MEU suggests that the Law incorporate clear directions if the regulator is unable to complete its review in a sensible time frame by actions of the service provider

AEMC must consult with the AER and NCC (Section 137)

- The MEU considers that under Section 137, the AEMC must also consult with consumers.

Service Provider must give undertaking not to engage in price discrimination (Section 141)

- The MEU seeks further clarification concerning Section 141 (not to engage in price discrimination).

Merits Review

- The MEU strongly recommends that Section 291 (1) (indemnity costs) be deleted.

The making of Rules

- MEU suggests that this section include a clear statement that in making Rules, the AEMC must recognise the responsibility of MCE to determine policy directions and that the AER must retain sufficient key powers of discretion to be able to properly carry out its responsibilities

Planning and Reliability

- MEU suggests that the Gas Law incorporate similar bodies as used in the electricity supply arrangements for long term planning and system reliability.

2006 Legislative Package: Gas

- The MEU supports the proposed new gas regime and also consistency with the electricity regime where possible.

2006 Legislative Package: Electricity

- The MEU urges the MCE to maintain its policy commitment and oversight of the new national regime, including the performance of the new institutions established.

Consumer Advocacy

- The MEU is concerned with proposed amendments to the Consumer Advocacy arrangements.

Timelines

- The MEU strongly suggests that the timelines be extended from the 6 months allowed to the 13 months suggested by the AEMC in the Electricity Transmission Rules, and that a failure to comply with a final determination can expose the regulated business to the imposition of an access arrangement by the regulator using the “Further final determination” step.

Revenue and Pricing

- The MEU recommends that the MCE either require AEMC to change the approach it uses for negotiated services in electricity transmission, or sets some Rules on which arbitration of regulated assets must be based.

Form of Regulation

- The MEU considers that whilst adequate for descriptive purposes it is essential that the MCE set a clear and unequivocal quantitative basis for the allocation of a regulatory approach to the services provided by monopoly energy supply side entities.
- The MEU considers that option 3 - adopting the Expert Panel recommendations without price monitoring lighter-handed form of regulation - delivers most benefits and lesser costs to consumers when compared to Option 2 (control, negotiate/arbitrate, price monitoring and no regulation). Option 1 - status quo - is not realistic, as there is a need for consistency between gas and electricity regimes.
- The MEU is of the view that the AER alone should decide whether an element of the service provider’s assets are contestable or subject to negotiate/arbitrate regulation. This decision must not be left to a commercial arbitrator to decide on. Therefore the Law should specifically require the AER to decide on this issue rather than leave it to the AEMC to decide.

Pricing Principles

- The MEU suggests that the MCE recognise that incentivising investment further than it already is, will cause unnecessary costs to consumers if there is no evidence that such further incentive is required. In other words, if the need is not there, then further incentives should not be provided.
- Accordingly, the MEU supports Option 2, but with an important proviso that the unbalanced weighting in the NEL pricing principles that favour network service providers be redressed and the primacy of the NEL objective “...in the long term interests of consumers” be restored through appropriate legislation. Unless, this is accepted, the MEU’s default position is Option 1

Information Disclosure

- The MEU sees that the provision of information is a tool used by regulated businesses to game a regulatory review. This therefore requires the law and the Rules to be specific and expansive rather than constraining of the powers of the regulator to get the information it needs.
- The MEU strongly supports Option 4

Regulatory Decision - Making Covering Regulated Network Entities

- The MEU supports Option 3, and strongly considers that allowing option 4 will be to the detriment of consumers in that the regulated business will seek to use the approach that best serves their needs to maximise revenue

Consumer Advocacy Arrangements: Having regard to all, but a focus on some. - Is it sophistry?

- The MEU supports effective consumer advocacy arrangements but is opposed to arrangements that discriminate in favour of particular classes of consumers. This is inconsistent with the NEL and NGL objectives (“interests of consumers” per se) and the competitive neutrality principles underpinning the National Competition Policy Framework.

I 2006 Legislative Package: Gas Legislative Framework and National Gas Law Exposure Draft: MEU Comments

1. Implementation Definitions and Coverage

The MEU notes that the new gas regime will give functions and powers to the AEMC and that the intention is to have the new NGL and NGR in place by 1 July 2007. **This is supported, as it is important that the move to a national regime be implemented expeditiously.**

It is important that the new NGL reflects that the term “user” includes a consumer of natural gas who uses a third party (such as a retailer) to enter into contacts with a service provider. The term should also be expanded to incorporate a representative of an actual consumer (or prospective consumer) of natural gas (e.g. the Major Energy Users) so that the representative can be involved in representing a number of users who have expressed a common view regarding issues impacting users and prospective users.

As the draft currently stands the term “user” does not incorporate an actual consumer of natural gas even though it effectively pays for the service but indirectly through a third party (retailer). The term “end user” is incorporated in the draft but there is a concern that in the detail of the Law, differing uses of these two terms might inadvertently exclude consumers who do not have a direct contract with a service provider. This change would reflect the interests of all consumers of natural gas and allow them to be involved in issues where they might be precluded if the current tighter definition is used.

The objective of the Gas Law is to ensure that the law acts “in the long term interests of consumers”, but if consumers are not specifically recognised in the Law as users of the service, then they might have no say and have to rely on others to represent their interests. The experience of consumers is that no one party of the supply side has acted in the interests of consumers, thus requiring them to represent their own interests.

The suggested change allows for a body representative of a number of consumers to act for the consumers they represent.

The new legislative framework proposed by the MCE will replace the existing gas access regime. It is not clear, however, that the new legislative framework is intended to cover the whole gas chain i.e. upstream, mid-stream and downstream sectors. Indeed, the Exposure

Draft of the National Gas Law (3/11/2006) sets out under Section 2, the main purpose of the Law as to:-

- “(a) enable persons to get access to pipeline services provided by means of covered pipelines or international pipelines to which price regulation exemptions apply, and to regulate how that access is given; and*
- (b) regulate the provision of pipeline services provided by means of –*
 - (i) covered pipelines (including, in some cases regulation of the revenues earned from the provision of, or prices for, pipeline services);*
 - (ii) international pipelines to which price regulations apply; and*
- (c) resolve disputes about access to pipeline services provided by means of covered pipelines or international pipelines to which price regulation exemptions apply; and*
- (d) impose a number of overriding duties on service providers relating to the provision of pipeline services by means of covered pipelines or international pipelines to which price regulation exemptions apply; and*
- (e) Provide for exemptions from the requirements of this Law for certain proposed greenfields pipelines.”*

In other words, the proposed National Gas Law is intended to apply to pipeline services as defined in Part 1.1 Section 2 and does not apply to “upstream gas supply services”. It would seem, therefore, that the explanatory statement relating to the objective of the NGL (in the Overview and Response to Expert Panel on Energy Access Pricing, page 10) is (unintentionally) incorrect, viz.:

“The objective refers to ‘efficient investment in, and efficient operation and use of natural gas services’. These services include upstream gas supply and pipeline haulage and interconnection services”.

Whilst alignment between the objectives of the gas and electricity regimes is seen by the MCE as an important foundation for the regimes, it must be clear that the current gas access regime does not cover gas services “throughout the supply chain”. It would, also, be inconsistent to seek to apply economic regulation (through the NGL) to upstream gas supply services, as this issue was never debated nor canvassed in the various reviews, inquiries and decision-making by the MCE leading to the present NGL Exposure Draft. **It is important that the issue of ‘coverage’ of upstream gas supplies be clarified to avoid creating uncertainty with respect to the new gas pipeline access regime.**

- The MEU supports the expeditious implementation of the new national gas pipeline access regime.
- The MEU seeks to ensure that use of the terms “user” and “end user” are applied such that representatives of consumers are not excluded in any material aspect of the Law from being able to represent their interests under the Law.
- The MEU seeks clarification that the new national gas pipeline access regime does not cover upstream gas supplies.

2. Objective of the NGL: Definition of Natural Gas Service

The definition of “natural gas service” is stated in the NGL Exposure Draft as meaning-

- “ (a) a pipeline service; or*
- (b) the supply of natural gas (note: Natural gas may be supplied by producers, wholesalers or retailers of natural gas); or*
- (c) a service ancillary to the service described in paragraph (b)”.*

Because of its wide definition (i.e. pipeline service as well as gas supply service) it would be preferable (and more accurate) to substitute “gas pipeline services” for “gas supply services” in the objective clause of the NGL.

In addition, it would be useful (and more accurate) to expand the explanatory note in (b) above to include “major gas users” as under the proposed Bulletin Board and Short Term Trading Market for gas (as agreed by the MCE), it is envisaged that major industrial gas users (and even gas fired power generators) would be able to trade (and supply) gas.

- The MEU prefers that “gas pipeline services” be substituted for “gas supply services” in the NGL
- The MEU considers that the explanatory note in (b) above (the definition of ‘natural gas service’) to include “major gas users”

3. Least Costly Form of Regulation

The Exposure Draft states:-

“12. Least costly form of regulation to be considered in giving effect to pipeline coverage criteria

For the purpose of this Law, if, in giving effect to the pipeline coverage criteria, the NCC or a relevant Minister has regard to the costs that may be incurred by a service provider in providing pipeline services, the NCC or the relevant Minister must give effect to the criteria on the basis that the least costly form of regulation should apply to the services provided by means of the pipeline.”

However, we strongly agree with the explanatory statement (page 6) that:-

“The availability of a light-handed form of regulation in addition to the control form of regulation makes the NCC and the relevant Minister’s task of assessing the cost to the service provider of giving effect to the coverage criteria (and in particular criterion (d)) more complex. The costs to the service provider of these different options may vary significantly”.

Accordingly, we are unable to reconcile or understand, how given those reservations, that the explanatory statement could go on to state that (page 6):-

“Section 12 ensures that the NCC and Minister may determine to grant coverage even if the costs of the more costly form of regulation outweigh the benefits of coverage”.

And further, how the foregoing statement is reconciled or even consistent with a bold statement that:-

“The purpose of section 12 is to guarantee the benefits of introducing a light-handed form of regulation”

As we read section 12, there is **no** assurance that Coverage will ever be determined by the NCC or the Minister, so long as, under the section,

“the NCC or the relevant Minister must give effect to the criteria on the basis that the least costly form of regulation should apply to the services provided by means of the pipeline”.

To make it clearly understood in plain English, the MEU recommends that Section 12 include the following intent:-

“The NCC and Minister may determine to grant coverage even if the costs of the more costly form of regulation outweigh the benefits of coverage”.

- The MEU recommends that Section 12 of the Exposure Draft be redrafted to include the following:

“The NCC and Minister may determine to grant coverage even if the costs of the more costly form of regulation outweigh the benefits of coverage.”

4. Forms of Regulation Factors (Section 13)

The MEU supports the full range of ‘form of regulation factors’.

It is noted that factors (d) (countervailing power by a user) and (g) (adequate information to enable a user to negotiate) can be easily neutralised (or circumvented) by network service providers through strategic ‘negotiations’ and dissembling (e.g. delaying tactics, insufficient and/or incorrect information provision, hiding behind contracted operators, buck-passing). If this occurs (noting that these activities have been used by service providers in the past) then the other factors can have their impact reduced. The Law should be made much more clear that activities by the service provider cannot lead to the impact of the other factors (a), (b), (c), (e) and (f) being diluted.

Most importantly, there must be some approach and/or provision included in the NGL to ensure that (d) and (g) especially are rendered effective.

- The MEU supports the full range of “form of regulation factors” but suggests that to prevent factors (d) and (g) from being neutralised, they must be properly and fully underpinned in the NGL to ensure their effectiveness.

5. A pipeline can be covered in several parts (Section 14)

The MEU recognises that a pipeline might be appropriately covered in several parts with each element covered under a separate access agreement. That this approach might be needed at times is conceded but equally it must be also recognised that separating what is essentially one

service into multiple parts can provide the service provider with an ability to secure increased revenue and an ability to constrain access to third parties.

It is suggested that should there be a request for separation, that the regulator has the ability to review the pipeline system in its entirety to ensure there has been no attempt of the service provider to “double dip” or to use the process to modify access and so increase the costs to a user or consumer. This is a very important issue for consumers.

- The MEU suggests that should there be an application by a service provider to separate a contiguous pipeline into separable parts, the regulator is empowered to assess the complete system in a holistic manner to ensure that separation is not being used to the detriment of consumers.

6. National Gas Objective (Section 20)

Our earlier comments suggested that it will be more accurate to describe the objective as it applies to the use of natural gas **pipeline** services, rather than natural gas services. The explanatory statement that the objective applies to services that “**include** pipeline haulage and interconnection services (page 8)” suggests that other parts of the gas chain are caught up in the NGL.

In the explanatory notes it is quite clear that the services included under the Law are those which are pipeline haulage and interconnection services, and that the wider definition includes for integration with non-economic distribution and retail functions. The explanatory notes make no reference to producers of natural gas being incorporated into this Law.

Producers of natural gas are also users of pipeline services and the objective should recognise explicitly that producers of gas (as users of gas pipelines) have interests in efficient investment in, and efficient operation and use of pipeline services.

If it is intended that producers of gas are also users of gas pipelines then this should be made explicit.

- The MEU suggests wording changes to describe the objective more accurately.

7. **'Propose-respond model not to apply unless Rules provide otherwise (Section 24)**

The MEU strongly supports section 24, which gives effect to the Expert Panel's conclusion that the NGL should not embody a prescription in favour of accepting a regulated entity's proposal. Consumers are concerned that such a prescription would, over time, lead to a consistent upward bias in rates of return accruing to the network service provider.

However, Section 24 does not set out criteria or principles to guide the AEMC in its discretion

"... to make Rules for where aspects of a regulatory decision are closer to a 'propose-respond model ...".

Experience to date with respect to the exercise by AEMC of its powers in making Rules regarding electricity transmission revenue and pricing strongly suggests that consumers need the protection of some policy guidelines covering the discretion for the AEMC to act in this area. For example, the AEMC has seen fit to specify the key parameters (at the high end of the possible range) for the CAPM formula used in development of the WACC into the Transmission Revenue Rule. This approach by the AEMC has had the result, for the Electricity Rules, of taking an overly prescriptive approach and (disconcertingly) taking away the discretion of the AER to exercise its regulatory functions.

There is considerable disquiet over the discretionary powers that have been assumed already by the AEMC (and could be further exercised in the future) as demonstrated by its review of electricity transmission revenue and pricing reviews. **To ensure that the prerogatives for defining policy which should lie with the MCE are not assumed by the AEMC, we strongly recommend that the MCE defines the extent of the discretion which the AEMC can exercise.**

This issue is also referenced in Part 2.1 where the Law defines the responsibilities of the various entities established to administer the Gas Law. Simply put the AEMC is to set the Rules and the AER is apply them. Implicit in this segregation of responsibilities is that AER is to take a holistic view of the provision of the service and to set the revenue. If the Rules are written in such a way that precludes the AER from making holistic assessments because the Rules are too prescriptive or include judgements which should be left for the regulator to make, then the AER is not able to comply with the need to ensure its decisions match the requirements of the Law and its Objective.

- The MEU strongly recommends that policy guidelines be issued to guide the AEMC when making “Rules for where aspects of a regulatory decision are closer to a ‘propose-respond model’.”

8. Timely provision of information

An issue which has consistently created dissent and delayed the issue of decisions on Access Arrangements, is the timely provision of information. The draft Law provides adequate powers to access information necessary for the regulator to undertake its review processes, yet consumers have seen that consistently service providers use delaying tactics in the release of the requested information. This has the inevitable result of constraining the time the regulator and other Interested Parties have in assessing the information needed for a sound regulatory review. This use of delay prevents the regulator from completing its review in a reasonable and sensible time frame.

- The MEU suggests that the Law incorporate clear directions if the regulator is unable to complete its review in a sensible time frame by actions of the service provider

9. AEMC must consult with the AER and NCC (Section 137)

This clause gives powers to the AEMC to direct whether light regulation should apply. An applicant service provider performance must be a party to an application for light regulation. Section 137 requires that the AEMC, in the making of the decision, must consult with the NCC and AER. It is users and consumers which will be impacted by the decision yet there is no direction that they be consulted.

Why should the AEMC not consult with non-regulatory stakeholders to obtain most up to date information, bearing in mind that the NCC coverage processes and information available at the time of an application

may be dated. Consumers are affected and should be given the option to be consulted.

- The MEU considers that under Section 137, the AEMC must also consult with consumers.

10. Service Provider must give undertaking not to engage in price discrimination (Section 141)

Section 141 places conditions on a service provider under Light Regulation not to discriminate between users of the service:

“unless that price discrimination –

- (a) is conducive to efficient service provision; or*
- (b) can be justified on some other rational economic basis”*

This condition, whilst supported in principle, has little power and is most unlikely to be effective. There is a need to define

- Who assesses the criteria?
- How are the criteria to be assessed?
- How is transgression to be identified and sustained
- Even what it means.

- The MEU seeks further clarification concerning Section 141 (not to engage in price discrimination).

11. Merits Review

Part 6.5 (Merits Review) is a substantial improvement in setting out the processes and limits of merits review. In particular, the explicit recognition of users, prospective users and consumer organisations to appeal and intervene is welcomed. **However, Section 291(1) (Amount of costs) unfortunately negates all the positive changes, viz.**

“(1)If the Tribunal makes an order for costs in a review, the Tribunal must, unless there are exceptional circumstances fix the amount payable by a party to the review on an indemnity basis” (our underlining)

The presumption that indemnity costs are to be awarded by the ACT unless exceptional circumstances exist will make it unlikely for any individual user, prospective user, or consumer organisation to appeal or intervene because the potential costs are simply likely to be prohibitive! **Thus there is a stark inconsistency in Part 6.5. On the one hand, it seeks, inter alia, to recognise the important interests and role of users, prospective users and consumer organisations in merits review, whilst**

on the other, it makes it almost unlikely that these organisations would seek to participate through the presumption that indemnity costs are to be awarded by the ACT.

We seek a reconsideration of the appropriateness of Section 291(1).and strongly recommend that it be deleted.

- The MEU strongly recommends that Section 291 (1) (indemnity costs) be deleted.

12. The making of Rules

The principle espoused in Chapter 7 is fully supported, in that the AEMC is only to make Rules if these are requested by other Parties.

As noted in point 7 above, consumers have noted that the AEMC has made Rules which have:-

- removed from the regulator (AER) some key discretionary powers which are needed to ensure there is a balance between competing elements in any review it undertakes
- usurped from the MCE policy making forum decisions that impact on the energy markets

- MEU suggests that this section include a clear statement that in making Rules, the AEMC must recognise the responsibility of MCE to determine policy directions and that the AER must retain sufficient key powers of discretion to be able to properly carryout it responsibilities

13. Planning and Reliability

In the Electricity Market there is a function incorporated within the AEMC which addresses the overall reliability of the Electricity Supply Arrangements. Further, the ERIG is in the final stages of completing a review of electricity transmission.

MEU considers that there is a need for there to be equivalent roles in the gas supply arrangements to those in place and proposed for the electricity market.

MEU sees that a national planning body for gas supply would identify the needs for medium to long term needs in gas demand and how these might be best met.

Similarly there is a need to ensure that there is consistency between gas supplies (particularly in the interconnected system which already encompasses SA, Victoria, Tasmania, ACT and NSW (and shortly will include Queensland when a treated gas pipeline connects Ballera to Moomba. The matters that this “reliability panel” would address are gas standards (e.g. calorific content, pressure variability) which might be used to prevent or minimise the ability of the gas system to meet the needs of consumers.

- MEU suggests that the Gas Law incorporate similar bodies as used in the electricity supply arrangements for long term planning and system reliability.

II 2006 Comprehensive Legislative Package: Overview and Response to Expert Panel on Energy Access Pricing

1. 2006 Legislative Package: Gas

The proposed new gas regime, as set out in the 2006 Legislative Package, is supported, except as noted in the foregoing section. Consistency of approach with the electricity regime is also supported, with the National Gas Law (NGL) to be supplemented by the National Gas Rules (NGR).

The MCE Expert Panel Review on Energy Access Pricing is to be commended, over-riding as it does, much of the unbalanced Productivity Commission Review of the Gas Access Regime.

- The MEU generally supports the proposed new gas regime and also consistency with the electricity regime, where possible.

2. 2006 Legislative Package: Electricity

The Legislative Package with respect to electricity will amend the National Electricity Law (NEL) to implement the changes resulting from the Expert Panel Review, the transfer of distribution economic regulation to the AER, and the MCE decision on merits review. These changes are supported.

However, it is worth pointing out that the transfer of economic regulation powers to the national institutions - e.g. AEMC and AER - needs continued MCE commitment and oversight. There is very significant disquiet as to the efficiency and balance of AEMC proposed rulings, and concerns with the adequacy of appropriate resourcing of both the AEMC and the AER. These issues are expanded upon later in this submission.

- The MEU urges the MCE to maintain its policy commitment and oversight of the new national regime including the performance of the new institutions established.

3. Consumer Advocacy

There is support for the MCE policy objective of strengthening the consumer advocacy arrangements to apply in both the gas and electricity regimes. However, there is considerable disquiet with the amendments to the Australian Energy Market Commission Establishment Act 2004, as the MEU considers that they are a backward step in consumer advocacy arrangements. Concerns with the proposed amendments are expanded upon later in this submission.

- The MEU is concerned with proposed amendments to the Consumer Advocacy arrangements.

4. MCE Response to Expert Panel

We support the incorporation, into the NGL and NEL amendments, of key recommendations of the Expert Panel, in particular the development of a common legislative framework for gas and electricity access pricing, especially with respect to:-

- Objectives of the regime
- Scope and form of regulation
- Regulatory procedures
- Revenue and Pricing Principles
- Information disclosure
- Review of decision making.

Our comments on the above issues follow.

1. Objectives of the regime

We have supported, from the outset, insertion of a common objects clause in both the NEL and NGL, and, in particular, the objects clause for the NGL and the NEL.

For the NGL, the objects clause is:-

“The objective of this law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.”

For the NEL, the objects clause is:-

“The objective of this law is to promote efficient investment in, and efficient operation and use of, electricity services, for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and reliability, safety and security of the national electricity system.”

We agree with the explanatory sentiment expressed in the MCE SCO paper (Page 10):-

“The objective refers to “efficient investment in, and efficient operation and use of, natural gas services.” These services include upstream gas supply and pipeline haulage and interconnection services. The intention is that the application of the objective will involve an assessment of the interests of end-use consumers at multiple levels in the supply chain, not only at the point of final supply, thereby encouraging competition throughout the supply chain. The objective emphasises the adoption of a long-term perspective with respect to consumer interests, and that a critical factor in such long-term perspective is the impact of decisions on investment in gas infrastructure and services.”

Reflecting the fact that the objects clause is drafted as an objective of the law, rather than as an objective of the market (as was previously the case in the NEL) it is noted that:-

“Just as the AEMC must test Rule changes against the objective of the law when making Rules, the regulator must perform its functions in a manner that will or is likely to contribute to achieving the objective of the law. The objectives clause therefore is a point of congruence between policy-makers/law makers (MCE), the Rule-maker (AEMC) and the regulator (AER).”

5. Forms of Regulation

We strongly agree with the Expert Panel’s proposition with respect to the potential for the misuse of market power and the potential efficiency loss arising. Thus the Expert Panel recommended that the NEL and NGL contain common provisions that require the AEMC, in making Rules that apply the available forms of regulation, to have regard to the presence and extent of market power possessed, and the likelihood of its misuse, by the owners, operators or controllers of the transmission and distribution facilities by which those services provided are to be subject to regulation. **The NEL and NGL should direct the AEMC to have regard to those specific factors which give rise to the identified detriments when making the Rules about the form of regulation to be applied in each instance.**

The MCE has accepted the Expert Panel’s recommendation that a price monitoring option (without arbitration) be further investigated by the

AEMC with a view to developing a draft Rule. The proposed investigation is welcomed. **However, the disquiet with the conduct to date of the AEMC when it conducted the recent electricity transmission revenue review, raises a number of concerns about the balance of its approach to its decision making. There is also disquiet with the proposal to empower the AEMC to determine whether there is a net benefit in the pipeline being subject to access arrangement regulation or the light handed regime, for similar reasons.**

Overall, the AEMC is being empowered to conduct many tasks:-

1. Price monitoring (without arbitration) draft Rule.
2. Apply a net benefits test on pipelines to determine whether to regulate via access arrangement regulation or light regulation.
3. Make further rules about the circumstances in which certain individual services provided by a covered pipeline that requires an access arrangement should be controlled.
4. Rule on applications for a 15 year price regulation for international greenfields pipelines.

To undertake these tasks effectively and efficiently, the AEMC needs to be well-resourced and have requisite staff and commissioners that have relevant expertise.

We consider that the number of commissioners needs to be increased to enable the AEMC to undertake its rule-making responsibilities. The make-up of the commission is critical, with strong governance arrangements and even stronger ring-fencing to avoid any perceptions of potential conflicts of interest.

It may also be necessary to require the AEMC to abide by the same framework as that proposed by the Expert Panel (and endorsed by MCE – see page 18 of MCE response to Expert Panel report) for the AER, viz:-

“It is important that the framework within which the AER will undertake its economic regulation provides it with clear powers and guidance to make efficient decisions from the perspective of society as a whole. The AER’s powers need to be clear, its scope of discretions set out, and the timeliness and transparency of its processes guaranteed. The AER must be accountable for its decisions and the opportunity must be provided to regulated service providers for the correction of potential regulatory error through review mechanisms.

The regulatory framework must take into account the risks and consequences of over-and under- investment in transmission and distribution infrastructure. A regulatory environment that is conducive to desirable investments being made in a timely way is important. This means not only

appropriate returns in the short term, but also means that potential investors can be confident that sound and substantial long-term investment decisions can be based on a well-understood and consistent regulatory regime and not rendered loss-making by subsequent regulatory intervention."

6. Models of AER decision-making

The MCE is correct in accepting the Expert Panel's Conclusion with respect to the unbalanced Productivity Commissions propose-respond model and formulation.

However, there is considerable disquiet over the AEMC's interpretation of the Panel's recommendation that:

"the AEMC have regard to the analysis of the issues related to propose-respond and receive-determine models in (their) report, the Panel's conclusions and the MCE's response in further developing its draft National Electricity Rule and any review of Chapter 8 of the Gas Code"

The AEMC's draft rule on electricity transmission revenue which takes an excessively prescriptive and unbalanced approach raises significant concerns over how it would deal with the development of Rules relating to the issues covered under Section 8 of the Gas Code.

MEU is firmly of the opinion that there was a tendency in the development by the AEMC of the Electricity Transmission Rules to determine policy issues that might have been more appropriately left to the MCE, and to remove sensible discretionary powers of the AER – these extensions of this AEMC decision making was driven by the AEMC's unproven assumption that TNSPs required more incentive to invest than was the case under the current form of Rules. The outcome of the AEMC approach has been an increased cost to consumers and a significant reduction in the discretion available to the AER. This is a very poor outcome from a new national institution. It creates significant uncertainty about the rules making regime for consumers.

7. Timelines

The MEU notes that the MCE has accepted the Expert Panel recommendation that there should be a mandated 6 month period for the AER to determine an access arrangement. MEU would advise that this period is significantly an under estimate based on a decade of experience in being involved in every access arrangement review. It is quite obvious that regulated businesses use constrained timelines to their advantage, most commonly using up time to provide information and so putting the

regulator under extreme pressure. A classic example of this was the review by SAIPAR of the Envestra gas distribution determination which required over four years to reach a final determination.

Further, we note that the MCE has accepted the PC suggestion that the AER is entitled to only once extend the time for reaching a determination, and that this extension cannot exceed 2 months. The MEU again from its extensive exposure to a decade of regulatory reviews considers that this places an unreasonable pressure on the regulator, and provides the regulated business with another avenue to “game” the regulatory process. We do note that the proposed process does exclude delays in others taking action, but there is no constraint provided on how long or frequently the other parties may delay the process. This inequality acts to the detriment of consumers.

The MCE has accepted the PC recommendation that the “Further Final Decision” process should be deleted, and that the existing arrangement stands until there is a new complying agreement set. The MCE notes that any over or under payments will be adjusted with interest applying. The MEU notes two concerns in this

1. Unless the interest on over payments by consumers to the regulated business is set well above the prevailing cost of cash, then this is no penalty on the business
2. There are issues in an access arrangement that are not price related. Allowing the regulated business to continue with the current access arrangement could well disadvantage new and existing users by not having the new arrangement in place. There is no penalty on the regulated business for these circumstances.

- The MEU strongly suggests that the timelines be extended from the 6 months allowed to the 13 months suggested by the AEMC in the Electricity Transmission Rules, and that a failure to comply with a final determination can expose the regulated business to the imposition of an access arrangement by the regulator using the “Further final determination” step.

8. Revenue and Pricing

The MEU notes that the MCE has stipulated the basis under which a review by the AER must comply, and that these were the recommendations of the Expert Panel. The MEU supports this inclusion. However, the MEU draws the attention of the MCE to the recent decision of the AEMC for transmission revenue and pricing. In this decision, the AEMC decided that elements that were normally included in the determination were to be excised and revenue was to be determined on a negotiated basis, with the negotiation outcome being subject to commercial arbitration. The AEMC has followed this path as it sees that this reduction in the amount of regulation will provide an incentive to TNSPs.

The MCE has decided that the application of the Rules as they apply to the AER will not be a requirement for use in arbitration, mediation, conciliation or expert determination. As the AEMC has already extended a significant element of the Electricity Rules to be subject to these excluded services, the MEU suggests that the MCE either give some direction to such private dispute resolution or require the MCE to delete reference of disputes to commercial arbitration for elements of the regulated assets.

- The MEU recommends that the MCE either require AEMC to change the approach it uses for negotiated services in electricity transmission, or sets some Rules on which arbitration of regulated assets must be based.

We agree with the MCE's acceptance of the Expert Panel's recommendation on the use of a Total Factor Productivity (TFP) approach. Again, the AEMC is assuming more functions by being tasked with developing rules that address a range of issues, including the use of TFP as a regulatory tool.

III Regulatory Impact Statements on the Form of Regulation Pricing Principles, Information Disclosure and Regulatory Decision-making

1. Introduction

The MEU welcomes the use of Regulatory Impact Statements to assist in assessing the regulatory impacts of the proposed legislative changes to the existing gas and electricity access regimes proposed by the MCE.

There have been a number of reviews that have been used to inform the MCE. These included the Productivity Commission's Review of the National Gas Access Regime and the Expert Panel Review of Electricity and Gas Access Pricing - it has been observed that the MCE has heavily relied on these two through much of its assessment of the new NGL. Additionally, the MCE has referred to the work of the AEMC in relation to electricity transmission revenue and pricing. The rigour and qualitative differences with which these first two reviews were undertaken needs a brief comment.

The first review - The Productivity Commission Review - lacked analytical rigour and balance, and many of its key conclusions were not evidence-based. For example, the Productivity Commission was challenged to provide the evidence that investment had been distorted or deterred, but consistently failed to oblige. It should be on the public record that this review was carried out over an extended period of over a year, many rounds of public submissions and stakeholder consultations and discussions held, and significant costs incurred by stakeholders and taxpayers. But in the end, it did not provide a balanced report.

The second review - The Expert Panel Review - had to be carried out, in order that more balance be made to the Productivity Commission conclusions and recommendations. This review took some six months and would have incurred substantially lower costs to stakeholders and taxpayers. The Panel's conclusions and recommendations were more informed, balanced and analytically rigorous.

The third review- the AEMC determination on transmission revenue and pricing - has also be criticised in the submission. As with the PC review the AEMC accepted prima facie that there was a need for increased incentives on TNSPs to invest, yet despite this fundamental assumption being questioned and evidence being provided that increased rewards and

less risk was not needed, the AEMC has effectively provided TNSPs with increased revenue, decreased risks and a constrained AER.

Regulatory Impact Statements are, therefore, very important to assist in assessing the regulatory impacts of proposed legislation. It is a pity that Review Impact Statements are not part of this process, as we would have been spared the costs of inappropriate and unbalanced reviews. The transactions costs and the social costs of poor reviews can be significant.

2. Form of Regulation

In its introduction, the MCE observes that there is a shortage of regulatory oversight options used for both electricity and gas regulation. Whilst this principle is accepted in general, it should be noted that the purpose of regulation is to replicate commercial pressures onto a monopoly business. With this in mind, there is a fundamental concern that in an endeavour to “ease the pain” of regulation, there is a trend away from certainty in ensuring that regulatory businesses are not capturing monopoly rents. In the attempt to provide greater flexibility and less imposition on regulated businesses, there is the real concern that the additional benefits accrued by regulated businesses may well exceed the cost of stronger regulation.

The MCE attempts to identify and set varying degrees of regulation to reflect supposed levels of market power, yet there is no attempt to quantify at what level of market power should the different styles of regulation be used. The entire analytical process is intuitive, and the MCE should attempt to set guidelines based on analysis rather than leave the decisions to be assessed purely on a qualitative basis. There are tools for identifying quantitative bases for market power and the Law should require these to be used by those tasked with the responsibility of allocating different regulatory approaches to the differing levels of market power and the ability to garner monopoly rents.

The Expert Panel provided a basis for assessing which form of regulation should apply:-

- *Barriers to entry into the market;*
- *Network externalities, or interdependencies between competing network services;*
- *Countervailing market power (i.e. market power possessed by users of network services);*
- *Substitution possibilities (including demand elasticity);*
- *Information asymmetry; and*
- *Any other factors considered relevant.*

What is totally absent from these qualitative assessments is the need to ensure that there is the requirement to undertake assessments on these bases using quantitative analyses. Consumers have consistently seen regulators assess, on a qualitative basis, the degree of competition that is assumed to apply. At its most simple, there has been an acceptance that even one might make for competition, provided this is supported by qualitative discussion as to why there might be underlying competition from minority influences.

A decision based on qualitative assessments is always subject to review depending on the aspect of the viewer and therefore uncertainty is created. A decision based on quantitative criteria can only be disputed if the mathematics is wrong or the set point between options is incorrect. Certainly there is less avenue for dispute when quantitative analysis is used

The RIS only addresses qualitatively the degree of competition and the extent of the market power held. Whilst this is acceptable for the purposes of a descriptive analysis, it is totally inadequate for the actual setting of the regulatory approach.

The qualitative analysis undertaken by MCE implies that regulatory certainty is enhanced by the implementation of a “common market power test” for both gas and electricity and MEU would concur, providing that the test has a quantitative basis.

- The MEU considers that whilst adequate for descriptive purposes it is essential that the MCE set a clear and unequivocal quantitative basis for the allocation of a regulatory approach to the services provided by monopoly energy supply side entities.

It goes without saying that the MEU has strong reservations to price monitoring, particularly after assessing the ACT decision on Sydney Airport. The Productivity Commission’s price monitoring recommendation is, as noted by the NCC and the Expert Panel unlikely to be capable of certification as an effective access regime under the Trade Practices Act 1974, in the absence of a requirement for negotiation and enforceable arbitration. A price monitoring form of regulation cannot substitute for a negotiate/arbitrate form of regulation, and at best, as the NCC correctly points out, it “can only supplement it” (Page 23).

The MEU agrees that a stand alone price monitoring regime achieves no benefits for access seekers that are not present under a negotiate/arbitrate regime that includes statutory information gathering powers (Page 24).

The benefits of Option 3 are as stated in the RIS; a standalone price monitoring regime, without negotiate/arbitrate provisions is a toothless regime, as the threat of re-regulation or a negotiated settlement may not eventuate. In any case, the horse would have bolted before the stable door is shut! Empirical evidence provided by the ACT's decision on Sydney Airport and the Productivity Commission's subsequent 'review' of price monitoring of airports, demonstrate how consumer interests may be adversely affected over extended periods of time, with the threat of re-regulation merely that - a threat! A stand alone price monitoring regime simply adds to transactions costs without delivering any real benefits to consumers, or economically efficient outcomes. All consumers get is transparency in demonstrating that price gouging is occurring.

- The MEU considers that option 3 - adopting the Expert Panel recommendations without price monitoring lighter-handed form of regulation - delivers most benefits and lesser costs to consumers when compared to Option 2 (control, negotiate/arbitrate, price monitoring and no regulation). Option 1 - status quo - is not realistic, as there is a need for consistency between gas and electricity regimes.

One issue that arose in the relation to the AEMC decision on transmission revenue and pricing, was the point at which there is assumed to be contestability, and therefore no regulation. As an example, in the discussion on this issue during the transmission revenue and pricing review, the AEMC pointed out that connection assets might be in some cases a contestable service and others be a regulated service which they then saw as being subject to negotiate/arbitrate regulation under the Rules. They state that the arbitration would be carried by a commercial entity rather than by the AER. This then raised the issue as to whether it is a decision of the AER or the commercial arbitrator if the extension is contestable or not.

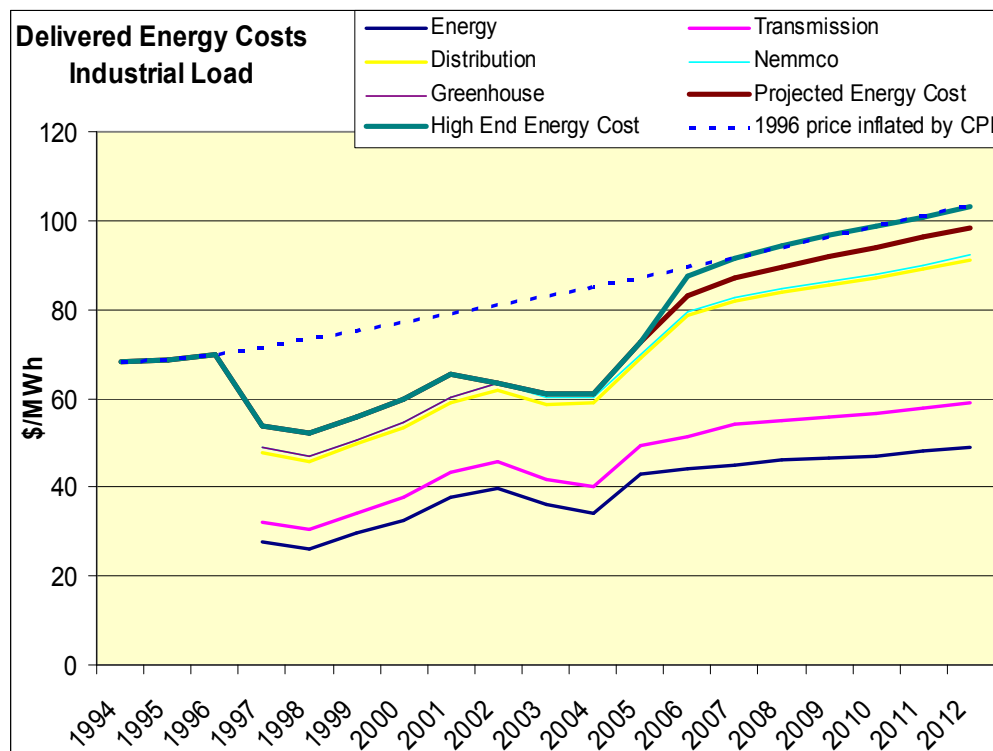
- The MEU is of the view that the AER alone should decide whether an element of the service provider's assets are contestable or subject to negotiate/arbitrate regulation. This decision must not be left to a commercial arbitrator to decide on. Therefore the Law should specifically require the AER to decide on this issue rather than leave it to the AEMC to decide.

3. Pricing Principles

It is important to put issues such as this into context. In the recent ERIG discussion papers on the electricity market MEU provided some context to the electricity market as seen by consumers. In its submission MEU noted that:-

It has been seen that Australia's cost of energy is increasing in relative terms (compared to its trading partners and competitors) and that what was once seen as a competitive advantage is slowly being eroded as increasing profits being garnered by energy supply side entities have led to an increase in delivered energy costs.

The following graph (based on contracted prices) shows the changes in the cost of electricity for an industrial load in NSW. This graph can be replicated for other regions in the NEM showing similar trends.

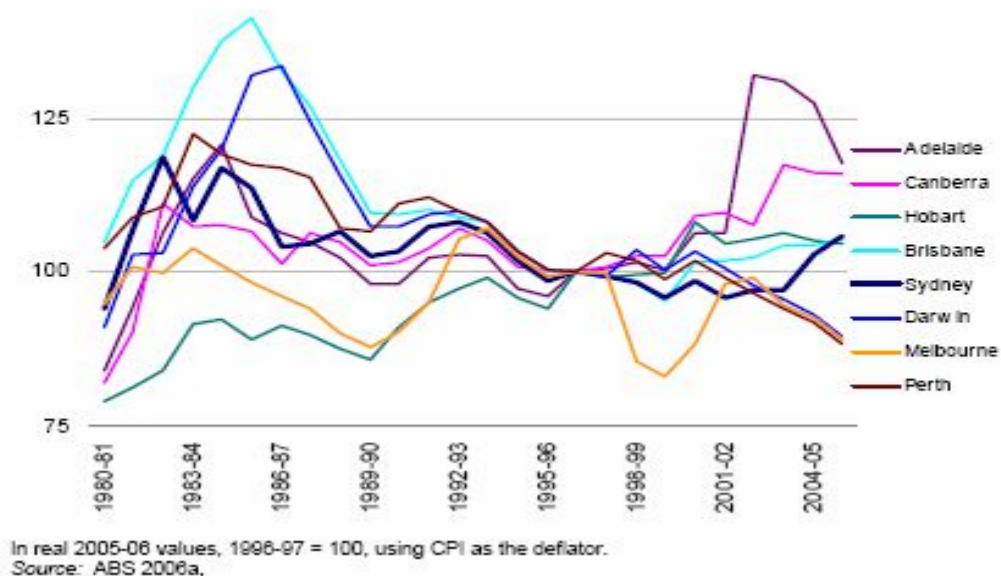


Source: EMRF based on actual data from consumer members

This graph shows that, by and large, the economic benefits to consumers of the deregulation processes in the 1990s have been taken by the supply side entities and governments. On a holistic basis this demonstrates that there must be problems occurring in the energy markets if this is the extent of the loss to consumers of the deregulation processes which were initially started to deliver better outcomes for consumers.

This observation is confirmed by ERIG itself in figure 2 in the reports.

... 2 Retail electricity price indexes by capital city (1980-81 to 2004-05)



ERIG comments (page 29) that

“In the period since the early 1990s when reform began, retail electricity price increases have generally been at rates slightly lower than the inflation rate as measured by the all groups CPI – particularly in Victoria, where real retail prices have fallen at a rate of 1 per cent a year. In South Australia average retail prices jumped 24 per cent in 2002-03, associated with the removal of historical and regulated tariffs at a time when significant new investment in generation was required. Real prices have since fallen as competition has increased. It is also worth noting that retail prices include payments for network investments, which have been substantial in some jurisdictions in recent years, as well as the wholesale and retailing cost of energy.”

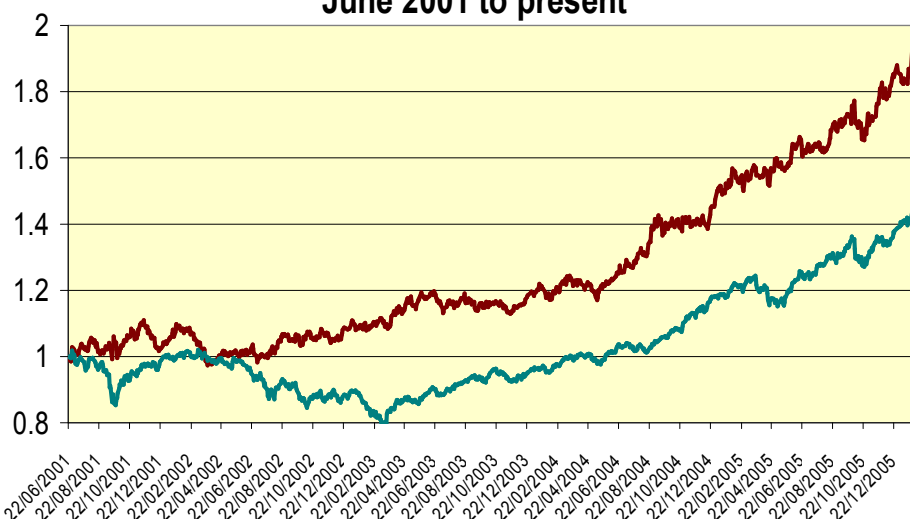
This summary of the actuality of price movements is disingenuous to say the least (some might say misleading!). Excluding Darwin and Perth which are not in the NEM and therefore have been subject to drivers other than those extant in the NEM, the only fall in prices was in Melbourne. On a volume weighted basis, prices in the NEM have risen in real terms, at the same time when the disaggregation was to deliver lower prices to consumers from the released productivity increases. The report’s view is that these increases probably arise from the increased investment in networks. This might account for some of the rise, but this should have been more than offset by increased productivity released by disaggregation and competition. In fact the ERIG report demonstrates that these productivity increases have occurred but the benefits have not gone to consumers as the graphs show. So where have they gone? ERIG doesn’t say but only acknowledges their existence.

Effectively what consumers are seeing is that the benefits to consumers of deregulation are being eroded and that others are getting the benefit. In one of its submissions to AEMC on transmission revenue the MEU provided evidence that the regulated utilities are outperforming the market average returns. Thus at a high level, it can be demonstrated that regulated businesses (gas pipelines and electricity transport) are more profitable than the average business as measured by the ASX 200.

In its submission to the AEMC on the proposed draft Revenue Rule, MEU stated that

“The MEU has examined the outcomes of the regulatory reviews to date, in order to identify if there is a commercial reason why the regulated businesses might not be investing. The review shows that (profit maximising) regulated businesses have every reason to invest as their profitability is greater than the market average. The following graph shows the Utilities sector share performance compared to the share average as defined by the ASX 200.

Movement of Utilities index (red) relative to ASX 200 (blue), June 2001 to present



Source: Commonwealth Securities

The ASX 200 is recognised to be particularly buoyant in the past 2-3 years as a direct result of the “China resources” boom. This should not have impacted on the Utilities index yet despite the China boom, the Utilities index has significantly outperformed the market average overall, but particularly even during the China boom period. This shows that the companies within the Utilities index are seen as extremely profitable businesses, relative to risk.

A review of the companies comprising the index shows that DUET, Hastings, Alinta, AGL, APT, Envestra, GasNet, SPI AusNet, Spark Infrastructure are all in the index and between them, they comprise over 90% of the index capitalization – supporting the following assessment.

Analyzing the figures provided by Commonwealth Securities (CommSec) shows that the ASX 200 demonstrates that the market risk premium (MRP) for the sector for the past five years is at about the long term average of 6.05%, rising from an MRP of between 3-4% observed for the past 30 years¹. CommSec has calculated an equity beta for this sector² at 1.08, again about the mean for the long term market average.

In comparison, analyzing the figures provided by CommSec shows that the Utilities index demonstrates an MRP of 11% for the sector for the past five years. This is despite the fact that regulators have been setting an MRP of 6% in all regulatory decisions made during the same period, as well as for the five years before. CommSec has calculated an equity beta for this sector at 0.31, less than one third of the value used in all regulatory decisions up to late 2004.

It is the outcome of actions by the regulators of providing an MRP and equity beta well in excess of appropriate amounts which has produced the massive out performance of the Utilities sector. In other words, regulators have been incentivising businesses to invest.

Based on the relatively high rewards provided by the regulators to companies within the sector, there is little doubt that with such rewards being available, the Utilities sector has had every profit incentive to invest.”

Thus it is against this demonstrable backdrop that the MCE should be making assessments as to the most appropriate approach to set pricing principles for regulated businesses.

The MCE notes that regulatory reviews take place every five years, and this is seen as the base timeframe for regulatory reviews, In fact the Electricity and gas Rules allow a regulated business to apply for longer terms than five years. This discretion is exclusively the province of the regulated business and has been used by them to implement longer regulatory periods. Unless this discretion available to the regulated business is constrained then MEU would counsel the MCE not to carryout

¹ See assessments by Prof R R Officer

² See appendix 1 which provides a listing of equity betas and sector and subsector dividend yields for each market sector. This data was sourced from Commonwealth Securities.

all of its assessments assuming that the five year period is a regulated requirement.

The MCE notes a concern that some stakeholders have about the pricing principles included in the NER, which provide for there them to deliver:-

- *an efficient and cost-effective regulatory environment*
- *an incentive based regulatory regime which provides an equitable allocation between network businesses and network users, and provides, on a prospective basis, a sustainable commercial revenue stream which includes a fair and reasonable rate of return to efficient investment*
- *prevention of monopoly rent extraction*
- *an environment which fosters an efficient level of investment in the networks, and upstream and downstream of the networks*
- *an environment which fosters efficient operating practices, and use of existing infrastructure*
- *reasonable regulatory accountability through transparency and public disclosure of regulatory processes*
- *reasonable certainty and consistency over time*

The concern raised is that it provides considerable discretion to the AER due to the principles having conflicting outcomes. That there are conflicting aims of the principles is inevitable, as is the potential for businesses to seek enhanced returns and consumers to seek to pay less. Regulation is at best a surrogate for competition, and competition has always had conflicting aims dependent of the aspect of the beholder. What has been seen as a benefit to the regulator is the ability to take a holistic view of the review. The AEMC in its recent review of transmission pricing has removed some of this discretion.

Over the past decade of energy regulation, the overwhelming preponderance of appeals against regulatory decisions have been by regulated entities. That this has been the case is quite obvious. As noted in section I above on merits appeals, consumers have little incentive to appeal against a regulatory decision, mainly due to the costs and the likely benefit that they might achieve. Contrast this to the incentive on a regulated business, the cost of an appeal when assessed against the reward for achieving even a small benefit is relatively modest.

The MEU is strongly of the view that discretion for the regulator able to balance the many competing matters in a review is by far preferable to constraining the regulator. The drive to reduce regulatory uncertainty that sat behind the AEMC decision to increase the incentive to invest has acted to the detriment of consumers as has been detailed in consumer responses to the AEMC review on transmission revenue and pricing. Consumers have a concern that the AEMC approach will be used in further AEMC assessments and continue this trend to benefit

businesses under the guise of incentivising investment, to the further detriment of consumers.

- The MEU suggests that the MCE recognise that incentivising investment further than it already is, will cause unnecessary costs to consumers if there is no evidence that such further incentive is required. In other words, if the need is not there, then further incentives should not be provided.

The MEU has reviewed the 3 options for pricing principles canvassed, including the likely costs and benefits of each option.

From the Major Energy Users' perspective, the development of a common set of objectives and pricing principles for electricity and gas pipelines is a key benefit and minimises regulatory costs and risks.

In addition, the Expert Panel's insertion of additional provisions which address the risk of over and under investment in network infrastructure is also a useful benefit.

Furthermore, the addition of incentives to promote allocative, dynamic and productive efficiency, contain a greater potential for long term benefits for major energy users.

These benefits, overall, would appear to outweigh the costs of moving from the status quo.

However, the MEU is considerably disturbed by recent legal advice by the Australian Government Solicitor on the AEMC's proposed electricity transmission revenue rules (Advice to Tom Motherwell, Department of Industry, Tourism and Resources, 'Assessment of expenditure forecasts, 10 October 2006).

In particular, we note:-

"Role of the NEL objective and pricing principles

49. Relevantly, after the proposed NEL amendments, both the Expert Panel pricing principles and the new objective of the NEL may be relevant in assisting the AER resolve conflicts between the factors in the proposed Rule. This would follow from the logic in Michael where conflicts within list of factors in particular provisions (such as determination of an initial

capital base in ss. 8.10 and 8.11 of the Gas Code) needed to be resolved by reference to objectives outside of those provisions (that is the reference tariff principles in s. 8.1). Similarly 'guidance in the exercise of discretion to resolve conflict within s. 8.1 will be provided from outside that provision', that is in s. 2.24 of the Gas Code (see [136]). On the other hand, a court or tribunal may find that the evidentiary factors in the proposed Rule are so comprehensive and different to the policy based considerations in ss. 8.1. 8.10 and 8.11 of the Gas Code that there is little room for broader principles to provide any further guidance.

50. *Section 16 of the NEL will continue to require the AER to carry out its economic regulatory functions in a manner which will, or is likely to, contribute to the achievement of the NEL objective. The new NEL objective will provide that: The objective of this law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.*
51. *The AER will also be required by the NEL to take into account the following pricing principles when exercising a discretion in making a network revenue or pricing determination:*
- (1) provide a reasonable opportunity for a network operator to recover at least the efficient costs of providing services that are the subject of the network pricing determination and complying with a regulatory obligation; and*
 - (2) provide effective incentives to a network operator to promote economic efficiency in the provision by it of services that are the subject of a network pricing determination, including:*
 - (i) the making of efficient investments in the network owned, controlled or operated by it and used to provide services that are the subject of a network pricing determination;*
 - (ii) the efficient provision by it of services that are the subject of a network pricing determination; and*
 - (iii) the making of efficient use of existing assets and proposed new assets that are, or are to be, used to provide services that are the subject of a network pricing determination;*
 - (3) make allowance for the value of assets forming part of a network owned, controlled or operated by a network operator, and the value of proposed new assets to form part of that network, that are, or are to be,*

used to provide services that are the subject of a network pricing determination;

(4) have regard to any valuation of assets forming part of a transmission or distribution system owned, controlled or operated by a network operator applied in any relevant determination or decision; and

(5) have regard to the economic costs and risks of:

(i) the potential for under-investment and over-investment in assets by the network operator; and

(ii) the potential for under-utilisation and over-utilisation of the capacity of assets forming part of a distribution or transmission system, and the capacity of proposed new assets.

52. *The NEL objective and the pricing principles may influence the resolution of uncertainty with regard to a service provider's estimates. We note that these in turn also contain competing objectives and considerations. However, generally the pricing principles place considerable weight on protecting the interests of service providers. The pricing principles in particular would therefore favour the view that a broad range of proposals from a service provider will be within the bounds of a reasonable estimate.*

Conclusion on interpreting what will be a 'reasonable estimate'

53. *The reasonable estimate decision framework based on the twelve factors does enable the AER to reject total forecasts which are not based upon reason, or exceed the limits prescribed by reason, after critically analysing all the evidence. However, the use of the 'reasonable estimate' test, uncertainty in forecasting, the existing case law in Gasnet and Telstra and the role of the pricing principles in resolving conflict, will result in the AER being required to accept a range of forecasts higher than those it would determine as the most appropriate or best estimate."*

Against this background, whilst we support Option 2 (harmonising pricing principles for both gas and electricity transmission and distribution services) we are considerably concerned with the Australian Government Solicitor's advice that the current NEL pricing principles favour network service providers and would outweigh the NEL objectives.

Again, we remind the MCE that the Productivity Commission Review of the National Gas Access Regime and the Expert Panel did not establish nor make any finding that investment in network infrastructure had been deterred as a result of economic regulation. In fact, the Expert Panel,

correctly in our view, sought to make the balanced point that over-and under-investment could happen.

- Accordingly the MEU supports Option 2, but with an important proviso that the unbalanced weighting in the NEL pricing principles that favour network service providers be redressed and the primacy of the NEL objective “.....in the long term interests of consumers” be restored through appropriate legislation. Unless, this is accepted, the MEU’s default position in Option 1.

4. Information Disclosure

Major energy users have consistently sought to have adequate information disclosures during access arrangements reviews, ever since the advent of regulatory pricing reviews in electricity and gas pipeline transmission and distribution services more than a decade ago. The purpose behind adequate information disclosure is to ensure transparency, certainty and consistency in the regulatory reviews and the greater likelihood of obtaining efficient and effective regulatory outcomes. This recognises the considerable asymmetry between service providers on the one hand and on the other, regulatory consumers and other stakeholders.

It has been noted that regulated energy businesses have used the provision and release of information as a tool to gain the maximum benefit for their enterprise. Because of this approach the regulator and Interested Parties have been constrained by this approach, and as a result there have been concerns that inefficient regulatory outcomes may have resulted. The MEU sees that in the provision of information the regulated business has control of the review and if there is an inappropriate outcome of a review then the business must accept a large portion of the blame. What does happen is that the businesses complain and policy makers accept the complaints prima facie, without having the benefit of the gaming carried out by regulated businesses. As a starting point, MEU would adjure the MCE to accept the basic premise that a regulated business will seek to maximise its profitability wherever it can, and if this means gaming the system, it will.

- The MEU sees that the provision of information is a tool used by regulated businesses to game a regulatory review. This therefore requires the law and the Rules to be specific and expansive rather than constraining of the powers of the regulator to get the information it needs.

Poor regulation can result in over and under investment in networks, as well as poor pricing outcomes through delivery of monopoly rents. Inadequate pricing outcomes can also be the result.

However, transparent and adequate availability of information can minimise regulatory error, and provide certainty and clarity, which is in the best interests of consumers, producers and network owners.

With approximately \$44 billion in electricity and gas pipeline infrastructure and with over \$33 billion in capital and current expenditure over a 5 year regulatory cycle, the costs of regulatory error can be very significant.

Regulatory error also impacts even more significantly on the competitiveness of upstream and downstream investments which are very substantially larger in size than the network businesses. Therefore, social costs can be very high.

Over the past 10 years' experience with access arrangements reviews, an adequate information disclosure has been a significant problem at every regulatory review. These problems include:-

1. Insufficient disclosure
2. Errors and emissions
3. Delays in information disclosure
4. Claims of commercial in-confidence
5. Lack of certainty concerning regulators' powers to access or require information to be kept and/or made available (even on a confidential basis)

More recently, the use of trust vehicles and other corporate structures have also tended to prevent regulators more penetrating of corporate veils to ensure that related and non-related party contracts and arrangements are robust, fair, efficient and are at arms-length. The need is also more urgent, as many network businesses are now structured by financial engineers. Consumers consider that regulatory reviews need to deliver efficient and fair outcomes. But they also hold to the need to ensure the following principles are adhered to: certainty, consistency and transparency. These principles are more likely to be achieved with adequate information disclosures, underpinned by sufficient powers to enable regulators to require the collection, presentation and reporting of relevant information.

MEU notes that the regulated businesses seek to have minimal oversight of their activities and point to the costs of addressing the needs of the regulator. Equally, regulated businesses are prepared to expend large sums in seeking to have regulatory decisions overturned. Thus on the one hand they object to the costs of regulatory interference but on the other they are prepared to expend big to get even modest improvements in revenue. This dichotomy of views can be extended into the provision of information.

Given the most accurate and useful information the regulator can reduce regulatory risk to the business and provide a fair and reasonable outcome for allowing a business to benefit from its monopoly position. This is the balance that a monopoly business has to accept – the ability to have no competition for the requirement of being regulated. No competition brings significant benefits but the downside is proving that the monopoly position is not being abused.

The regulated business complains at having to provide too much information which the regulator considers relevant, yet it is within the power of the business to provide all of the information necessary to prove that it is not abusing its monopoly position. If the business refuses to provide the information necessary for the regulator to properly assess the access arrangement then the regulated business is not really in the position to complain of regulatory risk.

There is no doubt that given all the needed relevant information the regulator is best positioned to deliver a decision which is balanced and equitable. If the business fails to provide the b]needed information either the regulator makes a decision based on insufficient data or it must have the power to obtain the information in any way it must. The regulator will only use its powers if the business fails to provide the information.

On this basis the MEU asks why should the regulator's powers for obtaining information be constrained if the regulated business elects not to provide it?

Accordingly, the MEU strongly supports the Expert Panel's recommendation for improved information disclosures and considers that **Option 4** would meet the objectives of consumers. With the AEMC's recent final decision on electricity transmission revenue not to require an ex-post review of expenditures, to allow an automatic rolling in of past expenditure and not to allow for the optimisation of the Regulatory Asset Base, the issue of adequate information disclosure, from a consumer viewpoint, becomes even more critical.

It would be expected that regulated businesses would protest against adequate information disclosures – costs, intrusion, unnecessary, etc. As noted above it is the interests of the business to seek constraint on the information collection powers of the regulator. However, any light-handed approach to regulation (an approach taken by the AEMC in its recent transmission revenue decision) must be accompanied by adequate information disclosure.

The costs of under-and over-investments and/or inefficient pricing (e.g. monopoly pricing) and the adverse impact on upstream and downstream investments, very significantly outweigh the costs likely to be incurred by network service providers.

Options 1 and 2 are not realistic, as the recent reviews have demonstrated a need for a consistent framework for electricity and gas pipelines and a need for improved information and knowledge available to regulators to make efficient decisions.

Option 3 is ineffective, given that new corporate structures and financial engineering of network businesses means that regulators must have access to related and non-related party contractual arrangements to ensure they are efficient and are at arms-length.

- The MEU strongly supports Option 4

5. Regulatory Decision – Making Covering Regulated Network Entities

The MEU considers that Option 4 will not achieve consumers’ objectives for certainty, consistency, transparency and efficiency. It will also result in a “propose respond” framework, which will lead to an upward bias in raising costs to consumers.

Option 4 (at least the key elements) is, in effect, applied already by the AEMC in its electricity transmission revenue and pricing reviews. In its revenue decision, the AEMC has reduced considerably the discretion that could be exercised by the AER (e.g. automatic rolling in of past expenditure to the RAB and no optimisation of the RAB) and at the same time prescribed the WACC parameters at the high end of prevailing rates.

In contrast to its prescriptive approach on revenue, the AEMC's draft determination on pricing provides a great deal of flexibility to TNSPs (e.g. cost allocations on the basis of having to lie between the very wide range of stand-alone and avoided costs, and pricing based on its own methodology). These reviews have caused a great deal of concerns to major energy users as they will, without any doubt, substantially raise network costs to consumers.

Option 4 does not enable more efficient regulatory decisions nor does it balance the interests of consumers and network owners. Varying regulatory discretion – as allowed under option 4 and as practical by the AEMC – provides uncertainty, inconsistency and lack of transparency, from the consumer viewpoint. There have been consultations with the AEMC, but unbalanced decisions have been maintained.

It is also necessary to examine the principle that the AEMC saw as essential to the regulatory regime in that certainty for the regulated business is a precursor to reducing regulatory risk. By being explicit the AEMC sees this as reducing regulatory risk. Equally the MCE has commented that certainty for the regulated business is supportive of ensuring adequate investment. This same principle applies to consumers – they also need certainty so that they can confidently invest as well.

The MCE has addressed this RIS purely from the viewpoint of the regulated business. It has failed to include in its RIS summary of impacts any reference to the needs of consumers other than the extraction of monopoly rents. While this is certainly a concern for consumers, so is the need for certainty which underpins investments made by consumers. If input costs and arrangements can be modified to suit the desires of the regulated business and potentially be to the detriment of consumers, then the MCE has failed to address the focus of the objectives.

The MEU considers Option 3 to be the fairest option available. This provides certainty for both the regulated business and for consumers, and is therefore a fair balance between the needs of both. To allow certainty for one party, but to preclude certainty for the other, is neither equitable nor in the interests of encouraging needed investment, whether this is by the regulated business or by a consumer. .

There has never been any empirical evidence provided in all of the reviews referred to in the RIS paper to suggest that efficient investment has been deterred by defining the basic regulatory approach, that there has been regulatory uncertainty discouraging investments, or that by defining the approach that a regulated monopoly must use in the regulatory process will result in less investment.

On the contrary, regulators have pointed to their overwhelmingly positive treatment of capital expenditure requests from network owners at regulatory reviews.

Accordingly, the MEU is strongly opposed to Option 4 and considers that Option 3 provides a fairer approach from the consumer standpoint when addressing both the desires of the regulated business and the needs of consumers for certainty.

Consumers have first hand experience that option 4 will be to their detriment and therefore have little confidence that Option 4 will, in practice, provide a balanced approach and outcome.

- The MEU supports Option 3, and strongly considers that allowing option 4 will be to the detriment of consumers in that the regulated business will seek to use the approach that best serves their needs to maximise revenue

IV Consumer Advocacy Arrangements

The MEU has supported the concept of a well-funded and effective consumer advocacy body to fund energy and related projects and research identified by consumer advocates and other stakeholders that are in the interests of consumers. In particular, the MEU has strongly supported the progressive moves to improved governance arrangements of the Advocacy Panel and the need for accountability of grant recipients.

The legislative changes proposed by the MCE are strongly supported, in particular:-

- funding for both gas and electricity
- improved governance arrangements, including the issues of conflicts of interest

The MEU has, however, strong reservations with respect to the following:-

1. The Panel's Functions:

We consider that functions (b) and (c) should be the primary focus of the Panel, with (a) (the identification of areas of research.....) having a lower priority ranking. There are strong concerns that the Panel, which is likely to have less expertise in energy issues and the advocacy needed to address these issues further, will give primacy to itself and dominate resources and exceed its primary function viz. funding consumer advocacy projects and research. There is a concern that limited funds will be diverted to fund the Panel's 'projects'.

In this regard we would encourage that there be a specific requirement on the Panel, that it meet with bona fide energy advocates on a regular basis in order for the Panel to:-

- Be informed of those issues seen by consumer advocates experienced in energy matters as requiring attention.
- Use this exchange of information to develop a funding strategy which will provide adequate resources to address the most important issues
- Review the outcomes of advocacy funded by the Panel, to provide guidance as to the performance of the advocates and of the advocacy carried out. In this regard, the Panel would need to develop sound guidelines to assess the outcomes of the advocacy funded by it.

One of the major concerns advocates had with the original Panel structure, was that the Panel considered itself to be aware of those issues that needed attention in the energy market. Using this assumed knowledge, the panel made decisions on funding which were not supportive of the primary needs of consumers, and it failed to ensure there was a review of the advocacy funded to ensure the outcomes expected of the funding were being delivered..

2. The Number of Panel Members and Secretariat:

Funding is limited, and it is surprising that the Panel is to be expanded (from the current 4 to 5) as well as having An Executive Director and a Secretariat. The AEMC, with a considerably larger workload has 3 Commissioners. Already the AP has used some 20-30% of its annual funding to reimburse Panel Members and provide a single part time executive officer. To increase the size of the Panel and staffing will only amplify this mis-allocation of funds towards management and administration of the funding arrangements at the expense of funding advocacy in the energy markets which is the focus of the funds.

Even the AEMC, with its vast remit, has only 3 Commissioners (2 of whom are part-time commissioners). Again, the concern is a self-perpetuating Panel that will, over time, grow its remit and functions, defeating the whole purpose of its role which is: funding consumer advocacy projects to be executed by competent advocates experienced in energy matters.

3. Having regard to all, but a focus on some - Is it sophistry?:

The proposed function of the Panel should be clearly stated – its role is to fund consumer advocacy projects without discrimination as to the size of the consumers that are to benefit from the advocacy. The funding for the current Panel is largely funded by major electricity users and there should be no discrimination against those who are essentially the primary financial contributors.

To put this into context, in Tasmania for instance, over 60% of all electricity purchased and consumed is by fewer than 10 enterprises, implying that over 60% of the AP funding in Tasmania is from these few companies. Analysis of electricity usage in other jurisdictions follows this pattern, but perhaps less starkly. In gas consumption, this trend applies more strongly, with the bulk of gas being used by large enterprises.

There is an unreasonable and uninformed perception that large business should provide for its own advocacy in the area of energy provision. But as the bulk of the funding for the Advocacy Panel comes from large energy consumers, to make any statement with regard to funding allocation, will be inequitable.

The MEU and its associates have been involved in advocating on energy issues for over a decade. Drawing from this experience we can state without equivocation that the overwhelming number of issues faced in advocacy in the energy area, equally affect small, medium and large consumers. To stipulate that there be a bias in funding will be to the detriment of all consumers. Experience has shown that when representatives of small energy consumers become involved in energy advocacy, they tend to work with, and use the resources of those other advocates experienced in energy matters, regardless of notional representation.

In the specific case of MEU, most of our members are regionally based (Whyalla, Port Pirie, Mt Gambier, Westernport, Port Kembla, Newcastle, inland NSW and Queensland, and the north and west coasts of Tasmania). Because of the dependence these regionally based companies have on locally based employees and small businesses, the MEU is required to ensure that any activity it undertakes must support the needs of small consumers, and must not act to their detriment.

The NEL objective concerns

“...the long term interests of consumers ...”.

It does not specify any priority as to different classes of consumers. It is therefore, unnecessary that the functions of the Panel include the words

“have regard for all energy users with a focus on small and medium consumers” (Clause 30).

In fact the inclusion of this clause may well act to the detriment of the very classes of consumers it purports to aid. We are of the view that the Panel should be left to decide what it considers will best benefit energy consumers as a group, without the addition of this inappropriate clause.

- The MEU supports effective consumer advocacy arrangements but is opposed to arrangements that discriminate in favour of particular classes of consumers. This is inconsistent with the:-
 - NEL and NGL objectives (“interests of consumers” per se)
 - Competitive neutrality principles underpinning the National Competition Policy Framework
 - Actual source of funding.

Attachment 1

Major Additional Tasks for AEMC

1. May apply to AEMC for a light regulation determination in relation to pipeline services
2. MCE may issue a statement of policy principles in relation to any matters that are relevant to the exercise and performance by the AEMC of its functions and powers (Section 22).
3. The AEMC has discretion to make Rules for where aspects of a regulatory decision is closer to a 'propose-respond model' (Section 24).
4. AEMC assumes similar functions to the National Gas Pipelines Advisory Committee, and Code Registrar under the GPAL.
5. AEMC may make a Rule providing for the application of TFP as a regulatory econ-methodology to assist the AER in applying or analysing the application of the building blocks approach by the AER (Section 70 (2)).
6. MCE may give written direction to conduct reviews (Section 74) into any matter relating to:
 - a market for gas
 - access to pipelines or services provided by means of pipelines
 - the NGR or the operation and effectiveness of the NGR
 - into the effectiveness of competition in retail gas markets.

Attachment 2

Major Energy Users Inc and MEG

The Major Energy Users (MEU) and the Major Employers Group Tasmania (MEG) comprise some 30 major energy using companies in NSW, Victoria, SA, Tasmania and Queensland. In particular, the submission represents the views of the Energy Markets Reform Forum (NSW), Energy Consumers Coalition of South Australia, Energy Users Coalition of Victoria and Major Employers Group Tasmania.

Analysis of the electricity usage by the members of MEU and MEG shows that between them they consume about 7% of the electricity generated in the NEM, and an even higher percentage of the gas used in eastern Australia. Many of the members are located in regional parts of Australia, some distance from the regional centres. As such they are highly dependent on the gas and electricity transmission networks to deliver the energy essential to their operations. Being regionally located, the members have an obligation to represent the views of their local suppliers and of the regionally based workforce on which the companies are dependent. With this in mind, the members require their views to not only represent the views of large energy users but also those of smaller energy consumers located near to their regional operations.

The companies represented by the MEU and MEG (and their suppliers) have identified that they have an interest in the **cost** of the energy network services as this comprise a large cost element in their electricity and gas bills.

Electricity and gas supplies are essential sources of energy required by each member company in order to maintain operations, and a failure in the supply of electricity or gas effectively will cause every business affected to cease production. Thus the **reliable supply** of electricity and gas is an essential element of each member's business operations.

With the introduction of highly sensitive equipment required to maintain operations at the highest level of productivity, the **quality** of energy supplies has become increasingly important with the focus on the performance of the distribution businesses because they control the quality of electricity and gas delivered. Variation of electricity voltage (especially voltage sags, momentary interruptions, and transients) and gas pressure by even small amounts now has the ability to shut down critical elements of many production processes. Thus member companies have become increasingly more dependent on the quality of electricity and gas services supplied.

Each of the businesses represented here has invested considerable capital in establishing their operations and in order that they can recover the capital costs invested, long-term **sustainability** of energy supplies is required. If sustainable supplies of energy are not available into the future these investments will have little value.

Accordingly, MEU and MEG are keen to address the issues that impact on the **cost, reliability, quality** and the long term **sustainability** of their gas and electricity supplies.

The members of MEU have been involved in nearly every major economic regulatory review (both gas and electricity) since deregulation of the energy markets commenced in 1996, as well as participating in the drafting of the electricity and the gas access regulatory regimes. As a result, they have accumulated a wealth of knowledge of the relevant regulatory and legislative processes, and in particular observed and experienced a number of perverse outcomes resulting from the application of the rules and regulations over the past decade.