



ENERGY MARKET GOVERNANCE REVIEW

Response to Issues Paper
30 April 2015

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1. EXECUTIVE SUMMARY

The Energy Networks Association (ENA) welcomes the opportunity to respond to the COAG Energy Council expert panel's Issues Paper *Review of Governance Arrangements for Australian Energy Markets*. This review is critical to the ongoing strength and resilience of energy markets over the next decades, and safeguarding the delivery of outcomes in the long-term interests of network customers.

ENA considers that energy market governance arrangements are broadly fundamentally sound, and superior to those prevailing across other infrastructure sectors in Australia such as water, telecommunications and rail. Internationally, the Australian institutional and regulatory framework for energy has been well-regarded, benefiting from transparent and independent institutions; generally strong evidence-based economic regulation without political influence; and a separate rule-making authority in the form of the Australian Energy Market Commission. With some interruptions, Australia has maintained broad policy support across successive governments for competitive markets, prudent deregulation, and private capital investment that relies on a clear expectation of the recovery of current and past investments, regulatory stability and predictability as well as low levels of sovereign risk.

Regulatory stability and predictability affecting cost recovery issues is of critical importance in a capital intensive industry where the cost of finance is usually responsible for 50 to 70 per cent of the network charge. The predictability and transparency of these current arrangements has underpinned financing with low-cost private sector capital, resulting in lower network charges and final energy prices for consumers. Investors evaluate not only industry risks but regulatory risk in the energy network sector, which frequently invests in assets with 50 year lives, in circumstances where an investment may only become cash-flow positive twenty years or more after the initial investment.

Separation of rule making and economic regulatory functions, in particular, provides for transparency and predictability around the long-term development of the regulatory framework supporting the least cost-financing of assets delivering essential network services to customers. The importance of this predictable rules-based environment will only increase as current, and potentially future, governments seek greater private sector involvement in network management and investment.

Whilst there are significant strengths in the existing institutional framework, there are also clear reform opportunities for the review to consider that would strongly enhance current arrangements and lock in the benefits discussed above. These include:

- » Establishing a clearer and prioritised set of agreed reforms and implementation plans across the Energy Council's activities;
- » Providing the AEMC with the unequivocal mandate, and accountability to lead energy market and regulatory design;
- » Providing a standardised mechanism and avenue for assessing proposed Federal, State and Territory policy interventions against the long-term interests of consumers;
- » Changes to streamline and enhance the responsiveness of the rule change process to Energy Council priorities, including addressing delays in rule change commencements, and efficiently manage 'superseded' rule changes;
- » Promoting strategic market and regulatory design issues, such as the introduction of contestability in existing monopoly energy services, being addressed by an agency independent of the AER; and
- » Introduction of low cost 'error correction' steps in regulatory determination processes, and increased procedural accountability and transparency around expert evidence relied upon by the AER in its decision-making.

This response outlines ENA's recommendations and also responds to the specifically posed questions for consultation contained in the Issues Paper (see [Appendix A](#)). ENA looks forward to actively participating in the further consultation steps occurring through the review process.

2. BACKGROUND

The Energy Networks Association (ENA) is the peak national body representing gas distribution and electricity transmission and distribution businesses throughout Australia.

Energy networks are the lower pressure gas pipes and low, medium and high voltage electricity lines that transmit and distribute gas and electricity from energy transmission

systems directly to the doorsteps of energy customers. Twenty-five electricity and gas network companies are members of ENA, providing governments, policy-makers and the community with a single point of reference for major energy network issues in Australia.

3. INSTITUTIONAL COORDINATION

As noted above, the ENA considers that the national energy institutional structure is broadly sound. The establishment of national institutions over the past decade and efforts to increase the national consistency and harmonisation of energy policy and regulation have been essential to minimising distortions in an energy market in which physical flows, service providers and sources of capital funding span multiple jurisdictions.

Within this national framework, it is important the COAG Energy Council effectively leads strategic energy market reform and policy decision-making.

ENA considers that the Energy Council and its associated institutions can be most effective in two main areas:

- » achieving consensus in national energy policy and regulation given the split responsibilities between Commonwealth, State and Territory governments; and
- » program oversight, including monitoring progress, evaluating the consistency of outcomes with objectives, and resolving road-blocks.

Challenges to achieving coordinated reform outcomes

While recognising what has been achieved to date, there is clear evidence of the need for improvement in institutional coordination under the oversight of the COAG Energy Council, including:

- » **A broad and disparate energy reform work program which has progressed in a patchy manner, or in some area has been compromised or stalled in some jurisdictions.**

For example, the National Energy Consumer Framework has been varied substantially by implementing jurisdictions, delayed substantially in some jurisdictions or not implemented at all.

- » **National agencies have initiated parallel, overlapping reviews on topical issues due to lack of role clarity or the need for coordination.**

For example, the AER's review of the Regulation of Innovative Energy Sellers and the Energy Market Reform Working Group's review of New Products and Services, together with the Energy Council's separate 'regulatory stress-testing' review process all address highly inter-related issues.

- » **Delayed interactions between the Council and the AEMC's rule-making have hindered timely reform.**
- » **The timely implementation of some recent Energy Council decisions has suffered from sequencing and co-ordination issues.**

An example of these two challenges are the implementation of Power of Choice recommendations relating to the development of effective and integrated regulatory, technical and market frameworks for competition in metering services.

The ENA recognises that these challenges are exacerbated by the dynamic market environment. A range of other review processes and parties have similarly recognised the challenges in this area, with the Productivity Commission recommending that the Council:

*"reform its process and decision making so that critical policy reviews... and their implementation occur in a timely manner."*¹

Options to improve on reform coordination and delivery

In 2014, the Australian Government made formal commitments to enhance opportunities for stakeholder engagement in Ministerial decision-making processes, and the recent changes to format of meetings of the Energy Council are welcome. With other energy stakeholders, ENA has sought to contribute constructively in the new forum provided.

To build on these measures, ENA suggests some further initiatives which may improve the effectiveness of institutional coordination under the Council's oversight:

¹ Productivity Commission *Review of electricity network regulatory frameworks*, April 2013, p.43

- the COAG Energy Council should release an annual **Statement of Priorities in Energy Reform**, to provide an integrated, strategic focus to the work program which is shared by all governments. This standardized annual process could include submission of Draft Priorities by the AEMC;
- the COAG Energy Council should receive, and publish, an independent assessment of reform progress. The AEMC could submit an **Annual Report on Energy Reform Progress**, including a 'traffic light' format, assessing the progress by Commonwealth, State and Territory jurisdictions against priority elements of the Council's work program;
- building on recent enhancements, the COAG Energy Council could improve engagement by: **releasing the agenda for the forthcoming meeting and inviting focused submissions** on all major upcoming issues for decision. This type of engagement can assist in better decision-making around the optimum sequencing and implementation of related reform measures; and
- to intensify reform program management and allow timely intervention on roadblocks, the COAG Energy Council should either **meet more frequently than twice each year or delegate greater decision making and monitoring roles to officials**, such as the Energy Markets Reform Working Group (EMRWG). If delegation of functions is proposed, the transparency and engagement steps proposed above should also be applied.

Recommendations

1. Preparation of a *Statement of Priorities in Energy Reform* by CoAG on advice of AEMC to provide an integrated, strategic reform focus.
2. An *Annual Report on Energy Reform Progress* on delivery against core priorities.
3. Increased frequency of Energy Council meetings and greater transparency surrounding core agenda items.

4. ENERGY MARKET AND REGULATORY DESIGN

In addition to the coordination issues previously discussed, it is apparent that particular challenges are arising due to the rapid changes in the external energy market environment, including developments in the cost and capabilities of technologies such as distributed energy resources and home automation, an increasingly diverse use of the energy network and the emergence of new markets.

It will be important to ensure clearly defined responsibilities for energy market and regulatory design, given their implications for the long-term interest of consumers. Consumer outcomes will be directly impacted, for instance, by:

- » the extent to which new regulatory and market frameworks remove barriers to innovation in both new markets and in regulated services;
- » the extent to which Australia maintains investor confidence through regulatory predictability and confidence around investment cost recovery, which is essential in an industry that remains capital intensive under all future scenarios; and
- » whether reform proposals are sufficiently scoped and defined to enable them to be evaluated based on their net benefits to the long-term interests of consumers, before their implementation.

Issues in coherency of market and regulatory measures and design

The 'disruption' in traditional energy supply chains will require policy and regulatory reforms that harness, and stimulate innovation. These trends are not only disrupting the business model of energy networks and other service providers – they are challenging policy and rule-making institutions like the AEMC and the COAG Energy Council itself, the Australian Energy Regulator and Australian Energy Market Operator.

A number of areas for improvement in energy market and regulatory design are evident.

There has been a tendency for governments to introduce policy measures which directly impact on competitive markets or network efficiency, without prior assessment of cost-benefit analysis of potential unintended consequences. Key examples include:

- » Disparate State and Federal energy efficiency programs, which are not evaluated in terms of their cumulative effect or economic value in an oversupplied market;
- » A diverse range of solar technology incentives were introduced through State and Federal Governments without adequate evaluation of their cumulative impact, or how schemes may have been targeted to provide other benefits to energy consumers, for instance by deferring network augmentation.

It is also concerning that fundamental market and regulatory design issues are increasingly being addressed in a disparate, rather than integrated manner, across the energy institutions. In some cases, this has been deliberate and in some cases, it appears accidental or reactive, as illustrated below:

- » In the case of metering reform, the AEMC has deliberately determined to defer the resolution of key elements of the new regime to the AER and AEMO. The new regime introduces the choice of service provider for some customers of metering services (i.e. retailers) while removing it from others (i.e. networks). The net benefits - or costs - to consumers will depend entirely on the competition and commercial relationships shaped by the new framework, including the extent of standardisation and interoperability. However, fundamental issues impacting on the workability of the new regime have not been confronted by the AEMC in its Draft Decision, but deferred to AER (in the case of exit fees and ring-fencing); and AEMO (in the case of a minimum service specification and Shared Market Protocol). This puts both the AEMC, and their stakeholders, in a position where they cannot meaningfully assess whether the proposed reform is in the long-term interest of consumers, because the nature of the reform itself has not been sufficiently defined.
- » The integration issues in relation to metering policy reform have been exacerbated by the fact that AEMO was separately commissioned by the COAG Energy Council to provide advice to it on the issues of Minimum Service Specifications and Shared Market Protocols. It seems highly impractical for AEMO to provide such advice to the Council, which meets twice per year, rather than advising the AEMC directly at a time when it is attempting to fundamentally redesign electricity metering frameworks in Australia.

- » The AER recently sought to consult on the introduction of contestability in load control in its Framework and Approach consultation for the Queensland distribution regulatory process.² It is recognised that this is a topical issue and the AER's intention was to ensure its regulatory approach remained current. However, the introduction of contestability in integrated network services is clearly a substantial issue of national significance. It appears beyond the appropriate scope of a Framework and Approach consultation by the regulator to rigorously consider the potential costs and benefits to consumers and the wider implications and precedent value. It would be better for such an assessment to have been undertaken by a body with responsibilities for energy market and regulatory design, such as the AEMC.

- » As noted above, there have also been instances where overlapping reviews are initiated by national institutions in an uncoordinated manner, such as the fundamental overlap in the AER's review of the regulation of innovative business models and alternative energy sellers and the EMRWG's review of new products and services in the energy market.

Reform options

ENA proposes the following initiatives to enhance energy market and regulatory design processes to ensure demonstrable benefits to consumers.

- » **AEMC should have the unequivocal mandate, and accountability to lead energy market and regulatory design.** The AEMC should provide the leadership in the area of market and regulatory design, and have the clear capacity to directly seek and receive regulatory and technical advice from AER and AEMO. It is envisaged that the AEMC under this approach would more clearly represent the primary instrument or 'funnel' through which higher level Energy Council energy policy reform decisions would be planned, sequenced and executed. It should have the accountability for confronting fundamental market and regulatory design issues in proposed rule changes, sufficient to allow the evaluation of whether proposed changes are in the long-term interest of consumers.

² AER *Final Framework and Approach for Energex and Ergon Energy* (2014), p.26-27

» **COAG Energy Council should agree to provide a standardised role for the AEMC in assessing individual Federal, State and Territory policy interventions which may impact on energy markets or network efficiency.**

While recognising the strategic policy leadership role of governments, the AEMC could provide advice on the consistency of individual proposed Federal, State and Territory energy policy measures with the national energy objectives. This would seek to ensure that individual jurisdictional energy policy measures interact with existing national energy policy settings in a coherent and coordinated way, with their implications for broader outcomes in the National Electricity Market fully assessed upfront.³

» **Significant market and regulatory design issues, such as the introduction of contestability in existing monopoly energy services, should be rigorously evaluated and resolved by an agency independent of the economic regulator.**

A managed process should apply for evaluating strategic, nationally significant issues in the scope of regulation. This role could be undertaken by the AEMC or, a new body such as that recommended by the Harper Review of Competition Policy (i.e. the proposed Australian Council for Competition Policy). It may be appropriate as part of this reform to consider amending the *National Electricity Rules* to explicitly limit the extent to which the AER should assess the scope of regulation as part of its regulatory processes

The last proposal above is consistent with recent comments by the Harper review and the Monash Business Policy Forum on the separation of competition functions from market functions, defining the scope of core regulated services, and defining the boundaries of unregulated and contestable markets.⁴ Under current electricity arrangements the same body (the AER) both carries out the primary regulatory functions, and defines the scope of this function.

In regulatory design terms, this dual function has the potential to lead to perverse organisational incentives, in particular, to retain intrusive regulatory controls even where strong contestability is emerging and feasible. It is noted that in respect of gas, this functional separation exists, with

³ Senate Environment and Communications Reference Committee *Interim Report – Performance and management of electricity network companies*, April 2015, Recommendation 10, p.xiv

⁴ Competition Policy Review: Final Report, March 2015, p. 448-449 and Monash Business Forum, *Rationalising rustic regulators*, July 2014.

the National Competition Council undertaking the role of assessing 'what should be regulated?'.⁵

Finally, as positively recognised by the conduct of the current Panel's review, the operation of the energy market governance system should be subject to regular review to ensure it remains relevant and appropriate to the market and policy challenges as these evolve, recognising as well the need for overall stability and predictability in arrangements that underpin long-lived network and other investment.

Recommendations

4. The AEMC should be given the unequivocal mandate, and accountability to lead energy market and regulatory design.

5. The COAG Energy Council should agree to provide a standardised role for the AEMC in assessing Federal, State and Territory policy interventions which may impact on energy markets or network efficiency.

6. Significant market and regulatory design issues, such as the introduction of contestability in existing monopoly energy services, should be rigorously evaluated and by an agency independent of the economic regulator.

7. Each energy market institution (AEMC, AER, AEMO and ECA) and the overall governance framework should be subject to an independent and public review by the Energy Council at minimum each 10 years.

5. AUSTRALIAN ENERGY MARKET COMMISSION

Role of the AEMC

ENA strongly supports the role of an independent rule-making and market development body as envisaged in the *Australian Energy Market Agreement*.

The establishment of the Australian Energy Market Commission represents a crucial step in the maturing of Australian energy market arrangements and a pragmatic and effective recognition of the shared challenge of implementing energy reform in the context of the intersection of national and state responsibilities over energy policy issues.

This point was recently reinforced by Professor Stephen King and former ACCC Commissioner Mr Joe Dimasi, who authored a report for the Monash Business Policy Forum

titled *Rationalising rustic regulators*.⁵ This report examined the optimum design, based on their direct and extensive experience of the roles and functions of a diverse range of regulatory bodies operating across the Australian infrastructure and business sectors.

Interestingly, while their preferred institutional framework features a single national utility regulator, they do not support this body also having rule making functions. Rather, they propose a 'National Markets Commission', to carry out functions essentially analogous to the existing AEMC, but on a national utility sector wide basis. The paper highlights a key benefit of this approach as being coordination in market creation and rule-making functions where shared federal-state responsibilities exist.⁶

Value of separate rule-making body

The transparency, predictability and stability which the presence of an independent energy rule-making body provides to the energy market deliver strong benefits to consumers.

The independence of this body provides an important signal to current and future investors in long-lived network infrastructure that the Australian regulatory environment will develop in a predictable manner based on high quality evidence-based independent decision-making. This confidence, which is routinely cited in debt and equity advisory reports covering the sector, provides the essential underpinning for networks capacity to efficiently finance and make investment in long-lived network infrastructure, featuring asset lives typically in excess of 30-40 years.

This capacity to efficiently finance long-term capital through investor confidence in the transparent, predictable and evidence-based evolution of access and pricing rules provides a direct benefit to consumers, lowering consumer bills and ensuring continuing investment in infrastructure necessary to maintain and upgrade network service levels.

It is notable that the energy network sector contains some of the most significant levels of private sector participation in infrastructure financing across any comparable utility sector. Commitment to transparent rule-making and market development through a dedicated independent centralised body has been a key element in the facilitation of this extensive reliance on private sector capital in the delivery of

network services. Attracting private sector capital to these other utility sectors has tended to be constrained by the absence of a clear, independent rule-making process, and relied to a far greater extent on bespoke individually negotiated regulatory or commercial contractual arrangements (such as those underpinning the National Broadband Network or a number of desalination plants).

Recently, a number of parties have argued that the functions of the AER and the AEMC could be combined into a single body.⁷ ENA considers this proposal fails to recognise the critical separation in roles between setting economic regulatory rules, and administering and enforcing these rules.

The primary drivers for the proposal appears to be unreasonable delays in the rule-making process administered by the AEMC or as a means of addressing a claimed lack of sufficient independence of the AEMC from State Governments. If either of these propositions were accepted by the review, ENA considers these issues would be best addressed more directly, with some possible suggestions discussed in this submission.

Combining rule-making and economic regulation would not promote the long-term interests of consumers. Such a combination would:

- » Unnecessarily undermine the predictability and stability of the regulatory framework in energy, raising regulatory risk for current and future network investors;
- » Add an additional distinct function to the economic regulator, distracting it from its primary (and already sufficiently onerous) role in independently applying and enforcing energy market rules;
- » Return energy market governance arrangements to failed past models of the past (prior to establishment of the AEMC the ACCC effectively acted as both a final rule-maker and regulator in respect of electricity transmission network businesses, under the auspices of the National Electricity Code Administrator model).

Combining the roles of rule-making and economic regulation would also create fundamental conflicts of interest. For example, in its *Electricity Network Regulatory Frameworks Inquiry* report, the Productivity Commission concluded that combining the AER and the AEMC:

⁵ Monash Business Forum, *Rationalising rustic regulators*, July 2014, p.28

⁶ Monash Business Forum, *Rationalising rustic regulators*, July 2014, p.23

⁷ See Dissenting Report from the Australian Greens, in Senate Environment and Communications Reference Committee *Interim Report – Performance and management of electricity network companies*, April 2015

...raises potential conflicts of interest for the rule makers in the merged agency. For instance, they may be influenced to make rules that ease the task of the regulators in the agency, rather than being beneficial for the wider community. Concerns about coordination and overlap in the activities of the AEMC and the AER might be better addressed under the 2009 Memorandum of Understanding between the ACCC, the AEMC and the AER.⁸

Some proponents of consolidating the rule-making function in the economic regulator have suggested that the AEMC/AER model is unique in international circumstances. While the AEMC itself may be relatively unique, it is certainly common to separate rule-making (frequently in the form of legislation passed by Parliaments) from the regulator administering those rules.

ENA reiterates that the institutional separation of the role of rule-maker from economic regulator and rule enforcement body is a well-recognised strength of the Australian regime and regarded highly by investors.

Improving the rule making process

The rule change process administered by the AEMC represents an important mechanism for reviewing, testing and improving regulatory frameworks and practice. This is a transparent process that takes into account the views of all stakeholders. In making its decision, the AEMC is required to consider whether the proposed rule change is likely to promote the National Electricity or Gas Objective and can make a more preferable rule, if considered necessary, providing flexibility to shape the rule change to address issues raised or findings of alternative superior approaches arising through the rule consultation process.

ENA considers that the existence of an open rule making mechanism, focused on the long term interests of consumers, and independently assessed by one independent body represents a foundation of strength in energy market governance arrangements that should be recognised and valued.

The open and reactive nature the current rule change process does inevitably impose planning, coordination and resourcing challenges for both the AEMC and other stakeholders. Many of these were considered carefully in the design of the rule change arrangements, and the establishment and resourcing of the AEMC.

⁸ Productivity Commission *Review of electricity network regulatory frameworks*, April 2013, p.780

ENA considers that all stakeholders experience with the rule making process to date has allowed the identification of some pragmatic and positive refinements to the rule change process that would improve the timeliness, efficiency, responsiveness and quality of the rule change process.

Several areas of widely acknowledged difficulties with the existing rule change process include:

- » **Lengthy delays in some rule change proposals moving from the initial lodgment to the commencement of active assessment stages.** For example, taking forward of the Demand Management Incentive Scheme rule change proposal;
- » **Delays arising from the AEMC being unable to initiate its own rule changes, even where it has been asked to identify rule changes to address specific issues by the COAG Energy Council.** For example, recommended rule changes arising from the AEMC's comprehensive Power of Choice review relating to regulation of third parties and load control); and
- » **Lack of coordination arising where rule changes are unable to be dismissed or suspended by proponents on the basis that prior rule changes or intervening policy changes make them no longer relevant or appropriate.** An example of this is the current electricity rule change focused on aligning network and retail tariffs. The basis for this rule change has been effectively superseded by a more comprehensive electricity distribution rule change which has been finalised over the past year. Even while service providers struggle to comply with the recently made rule change in challenging timeframes, they and the AEMC are forced to deal with the distraction of the outstanding rule change which is in direct conflict with the new regime. The inability to discontinue a rule change process in these circumstances promotes wasted resources, and regulatory uncertainty.

In each of these cases, ENA considers that relatively modest targeted amendments to the existing rule change process in the National Electricity and Gas laws would significantly improve the smooth flow and responsiveness of the rule change process, enhancing regulatory certainty and improving outcomes for all stakeholders. ENA also considers a modest expansion to the number of Commissioners would also assist in allowing more rapid and full assessment of lodged rule change proposals and requested reviews.

Recommendation

8. Maximum periods should be defined in legislation covering the lodgment of a rule change and the formal commencement of an associated rule change assessment
9. The AEMC should have the power to initiate a rule proposal consistent with the specific recommendations of an Energy Council commissioned AEMC review even in the absence of a draft proposed rule change.
10. The AEMC should be provided with the power to recommend to the CoAG Energy Council, for out of session approval within four weeks, the withdrawal or suspension of a CoAG proposed rule change.
11. Increase number of commissioners by two, with appointments to be made by the Commonwealth

6. AUSTRALIAN ENERGY REGULATOR

When considering the structure, scope and role of the Australian Energy Regulator, a key objective must be ensuring an independent, effective and credible regulatory body with the resources to carry out its functions and apply best practice regulatory approaches.

A strong, credible and effective energy regulator promotes the long-term interests of consumers by promoting efficient pricing and investment outcomes, lowering regulatory risk, and facilitating the efficient financing of long-lived sunk network infrastructure serving current and future consumers. Network investors and current and future consumers share a strong common interest in an economic regulatory body that is adequately resourced for its tasks, credible, capable and which is genuinely independent from political influence.

The establishment of the AER in 2005 was an essential step towards a more consistent, nationally-focused decision-making in the network sector. The ENA continues to support the role of the AER in the economic regulation of electricity and gas transmission and distribution networks and enforcing of the Rules for the National Electricity Market (NEM). ENA has also recommended the extension of the AER's network regulatory functions to electricity and gas networks in Northern Territory and Western Australia.

Notwithstanding this strong support, on a number of occasions since its establishment, ENA has expressed concerns over aspects of the governance, performance and

capabilities of the AER. In this submission, the ENA proposes a significant set of reforms to the AER to enhance its capacity to carry out its economic regulatory functions.

Since 2012 a number of reforms were implemented to reinforce the AER's role as a single national energy regulator. As a result of these reforms:

- » The AER appears to enjoy more control over its budget and publishes Annual Reports separate from the ACCC;
- » In late 2012, the AER was allocated additional funding of \$23m over four years;
- » The part-time state nominated board member was converted to full-time status; and
- » The AER has established an internal technical advisory group, with an emphasis of accessing stronger technical and engineering capabilities to inform its decisions

The ENA considers that these were initial positive steps, and that this current review is an opportunity to build on these steps.

Basis for views provided

The *Issues Paper* seeks commentary from stakeholders on the performance of the AER of its functions and roles.

The AER carries out one of the most challenging roles in Australia's energy markets. Under any scheme of monopoly infrastructure regulation, regulators face complex challenges. Regulators must make difficult judgements about such uncertainties as future costs, demand and investment requirements with significant short and long-term consequences for energy consumers and regulated firms. These decisions will inevitably attract criticism, fair and unfair.

ENA particularly welcomes the ongoing commitment of the AER at a officer, senior executive and Commissioner level to engage with the network sector on strategic regulatory issues. This engagement was intensive through the recent *Better Regulation* guideline development process.

While the ENA provides views and recommendations on how AER performance and operation could be enhanced, this should not be interpreted as a criticism of AER staff (either individually or collectively) or its leadership as they execute their difficult legislative and regulatory tasks within a challenging range of constraints.

Rather, in commenting on AER performance over time, ENA has sought to rely on objective measures of performance, identify any underlying governance issues that could be the cause of any underperformance, and link these to clear and practical recommendations for change.

Recommendations for improvement

Governance and accountability

The AER Board consists of three full-time members, one of which is required to be a commissioner of the ACCC. The AER's Board is appropriately independent and skilled. There would be a benefit, however, in increasing the number and mix of expertise applied to each regulatory decision to fully exploit the Commission structure to challenge and test developing AER staff positions.

An increase in the number of Commissioners would provide recognition of the growing scope and role of the AER since its commencement in 2005, and recognise the growing responsibilities it is likely to assume over the next few years (with potential assumption of network regulatory functions across WA and Northern Territory being examples).

The AER Board made decisions approving approximately \$69 billion⁹ of network revenues for the current regulatory cycle. The ENA observes that in 2013-14, one in five Board meetings had only two Board members present.¹⁰ The ENA considers that two independent decision-makers are insufficient to make revenue determinations routinely relating to allowable revenues exceeding \$2 billion, which affect every household and business within the NEM. In this regard, ENA notes that the just completed Senate Environment and Communications References Committee into the Performance and management of electricity network companies recently made a similar recommendation to increase the total number of Commissioners.¹¹

As noted, the AER as part of a recent package of CoAG Energy Council reforms the Energy Council now develops a *Statement of expectations* for the AER on an annual basis, and this statement is effectively responded to by a matching AER *Statement of Intent*, which outlines the expected work program and priorities of the body.

⁹ AER *State of the Energy Market 2014*, p.71 and p.113

¹⁰ AER *Annual report 2013-14*, p.10

¹¹ Senate Environment and Communications Reference Committee *Interim Report – Performance and management of electricity network companies*, April 2015, Recommendation 14, p.xv

The clear specification of expectations and plans increases transparency and accountability. In this regard, however, there is more that can be done. In particular, the setting of expectations for a significant regulatory body such as the AER should routinely include an opportunity for stakeholder comment and input.

Recommendation

12. There should be an increase in the number of Commissioners to enable more comprehensive and critical assessment of proposed AER decisions and a higher minimum quorum for decision-making.

13. Public consultation should occur both on COAG Energy Council's statement of expectations and AER's corresponding Statement of Intent, rather than this being a closed process between the COAG Energy Council and AER.

Regulatory decision-making

A significant concern of ENA members has been that individual determinations made by AER do not consistently apply rigour and sound evidence to reach a reasonable decision.

This assessment is based on evidence from past merits-based appeals, AER stakeholder surveys and examples from the most recent round of determination and guideline processes.

While no regulator can entirely avoid error in conducting complex multifaceted access pricing determinations, the record of findings by the Australian Competition Tribunal relating to AER decisions makes clear that AER decisions have at time been affected by material and avoidable regulatory errors with potentially significant consequences for the long-term interests of consumers, and network infrastructure investors.

These errors have been documented in Australian Competition Tribunal rulings, and commented on in the Expert Panel Review of Limited Merits Review. In a number of cases these errors appear to be based on a lack of expertise or rigour in core regulatory judgements. Examples of this included:

- **Reaching an estimate which is used to calculate an important benchmark of expected tax liability of a network erroneously.**

In this example the AER reached its 'estimate' by averaging one valid estimate based on market data, with another value that represented a

conceptual upper-bound value. This is analogous to taking an actual measurement of the temperature of a pot of water of 50 degrees, observing it is not boiling, and therefore arguing that the best measure of temperature is an average of 50 degrees and 99 degrees.

The Tribunal noted in this regard:

... The AER, recognising that this was an upper bound on the value of theta for the relevant period, decided to be "conservative" by adjusting the figure downwards. As explained, it did so by averaging 0.81 with the lower figure of 0.67 that Handley and Maheswaran (2008) estimated for the period 1988-2000. But this simple averaging adjustment has no logic to it and fails to accord each Handley and Maheswaran (2008) estimate its correct interpretation as an upper bound applying to a period.¹²

- **Reliance by the AER on the assumed yield of a hypothecated Australian Pipeline Trust bond, despite that bond not yet being in existence in the time period which the estimate was made within.**

That is, the *assumed* bond yield (hypothecated by AER modelling) of a 'phantom' bond which did not exist during the relevant sampling period was assumed to have significant information value on the actual prevailing conditions in the market for debt.

In relation to this approach the Tribunal commented:

In the Tribunal's opinion this arbitrary approach by the AER should be rejected. A regulator should not make subjective assessments of key inputs into a formula simply because it likes the feel of them. Even assuming for the moment that inclusion of the APT bond was acceptable, we would have thought that accountability demanded a careful and objective justification for the weight to be assigned to it. At the hearing, the AER conceded that it had carried out no form of sensitivity analysis

of what the most appropriate weight should be—it simply fed the chosen value into the formula.¹³

These examples, defended by the AER up to a merits review proceeding, represent clear logical and analytical errors, rather than matters for judgement on which reasonable minds might differ.

The outcome of the 2014 stakeholder survey also indicates declines on metrics such as 'Independence in decision-making', and 'Decisions based on evidence and robust analysis' when compared to the 2011 results.¹⁴

ENA would also highlight two recent direct examples of poor regulatory practice and decision-processes.

Improving mechanisms to address potential regulatory error

The network sector strongly supports the use and further development of robust benchmarking as one of a set of key tools in economic regulation. Benchmarking is a valuable tool for corporate management and continuous improvement at a firm and industry level.

In its November 2014 draft determinations, however, the AER did not apply benchmarking in a robust manner. It instead set 'top-down' operating allowances based on inappropriate and deterministic use of its benchmarking analysis, which in itself was developed without appropriate validation and consultation in a manner that compromises procedural fairness.

This is despite substantial evidence having been presented to the AER putting in question the robustness of the inputs and outputs of the AER's benchmarking analysis and is in contrary to the cautionary guidance provided by the Australian Energy Market Commission and the Productivity Commission which expected benchmarking to be used as a diagnostic tool in the regulatory process, at least until robust data and methodologies were available.

As an example of the impact of this lack of rigour in regulatory decision-making, the benchmarking model adopted by the AER implied efficient operating expenditure for the regional electricity distribution network company Essential Energy which was implausible without impacting on service outcomes, reliability or safety. After excluding vegetation management costs (which are generally outsourced through competitive contracting) the benchmarking model implied that Essential Energy could

¹² Application by Energex Limited (No 2) [2010] ACompT 7 [95]

¹³ Application by United Energy Distribution Pty Limited [2012] ACompT 1 [449]

¹⁴ See AER *Annual Report 2013-14*, September 2014, Part 4, p.57-71

operate with operating funding which could only support a workforce of about 10 per cent of the current staffing. Further, it would have left Essential Energy operating with less operating expenditure than the largely urban-based Endeavour Energy, despite having a network over 5.5 times the line length.

The capacity to address clear errors in a regulatory proceeding using an informal internal review mechanism may be of significant assistance in avoiding the risks and costs of regulatory error, improving final decisions, and avoiding costly legal appeals. Such a mechanism has precedent across a range of different international regulatory regimes, as noted in the recent AER-ACCC working paper *International Insights for the Better Economic Regulation of Infrastructure*.¹⁵

At an industry level, the inappropriately deterministic application of benchmarking to set cost benchmarks has the potential to undermine the future credibility benchmarking techniques. ENA is strongly supportive of the use of benchmarking as a regulatory tool and seeks to work with the AER on a collaborative basis to increase the quality and robustness of underlying benchmarking data. In this regard, ENA has recommended that independent peer review of AER benchmarking. This recommendation is also consistent with recent recommendations of the Productivity Commission.¹⁶

Facilitating transparent and evidence-led regulatory outcomes

A further issue is that on a number of occasions the AER has failed to afford sufficient time for consultation on major new expert reports and critical evidence that it used to inform its regulatory decisions.

Apart from the methodological issues discussed with the AER's benchmarking analysis described above, in its draft determinations for NSW and ACT electricity distribution businesses from November 2014 the AER relied upon the annual benchmarking report which was not released in accordance with the *National Electricity Rules* and did not undergo the required consultation and scrutiny envisaged under the Rules.

Under the AEMC's *Economic regulation of network service providers* rule change process completed in 2012, the AER was tasked with preparing an annual benchmarking report to be released by September 2014. The requirement to

produce the report was codified in NER 6.27 (d), and was intended to allow separate consultation prior to the first network pricing determinations.

The AER - the designated rule enforcement body - breached this Rule requirement, however, and released the annual benchmarking report around two months later, releasing the report at the same time as a release of its substantive draft decisions affecting NSW, ACT and Tasmanian electricity distribution and transmission networks. This outcome had the effect of frustrating the deliberate policy intent of the AEMC *Economic regulation of network service providers* rule change to:

- » provide all stakeholders with a timely and transparent benchmarking information prior to the AER's scheduled draft decisions;
- » provide an adequate and full consultation process around the preparation and finalisation of the AER's annual benchmarking report;
- » clearly separate the findings and methodology annual benchmarking report in time from the application of that evidence to individual network determinations.

These impacts were then compounded by the concurrent release of specific and different economic benchmarking evidence applying different approaches and methodologies, which were primarily relied upon by the AER in setting forward operating network expenditure allowances in respect of NSW electricity distribution businesses. These additional materials had not been subject to any prior consultation in accordance with the AEMC's defined process for conduct of the annual benchmarking report.

Thus consumers or other stakeholders wishing to understand the AER's proposed approach to economic benchmarking were required to assimilate simultaneously two documents, the first an annual benchmarking report intended by the AEMC to provide a regular transparent insight into benchmarking findings and approaches, and a second set of review-specific and highly technical benchmarking models and materials prepared for the AER by external consultants Economic Insights specifically for the current network determinations.

Similar process failure issues arose in relation of the finalisation of the AER's *Rate of Return Guideline*.

Consultation on the guideline commenced approximately 12 months prior to the guideline's finalisation. At the draft guideline stage, however, the AER indicated that it had not

¹⁵ AER-ACCC Working Paper *International Insights for the Better Economic Regulation of Infrastructure*, March 2015, p.106

¹⁶ Productivity Commission *Review of electricity network regulatory frameworks*, April 2013, p.31

undertaken planned empirical work on one of the major input parameters of the Capital Asset Pricing Model, the model it indicated would serve as its 'foundation' or default model.

As a consequence of this, the AER was able to release a short consultation paper relating to equity beta in October 2013, one of the most influential WACC parameters, only around a month prior to the release of its final guideline. The telescoping of consultation on this major identified parameter to a single step consultation of around two business weeks out of a year long process represented a significant process and planning deficiency.

Recommendations

14. Introduction of informal 'no-fault' error correction opportunities in major network determination processes.

15. AER should, as standard practice, obtain and publish independent expert peer review of the benchmarking methodology, models and data choices.

16. There should be an obligation to disclose and consult on any new expert reports or external sourced evidence the AER proposes to rely on at any stage of the determination process, including prior to the final determination.

Skills and experience

A potential reason for AER experiencing difficulties in relation to external stakeholders' assessments of its technical capability may relate to the availability of specialist staff to the AER and the impact of such on the quality of its decision-making.

There is an ongoing concern amongst regulated network firms about a relative lack of stability and continuity within the AER 'regulatory reset' teams even within the duration of a single regulatory determination process, which typically takes approximately 18 months.

The AER's 2014 stakeholder survey shows the metric of 'Industry experience' was rated as poor, which is concerning for an industry-specific regulatory body. It is also surprising given that it would be expected a regulator would be observed by stakeholders to have become more experienced and skilled over time, having performed its functions for ten years. This is the trend observed in comparable stakeholder surveys taken over extended time periods, such as that released by the NSW Independent Pricing and Regulatory Tribunal.¹⁷

¹⁷ [IPART Stakeholder Survey 2013](#)

The fact that the AER continues to rely significantly on external consultants also suggests that it may not yet have sufficient in-house expertise. The ENA, however, recognises the AER's recent efforts to increase the use of in-house technical expertise (including engineering capabilities) with a small team in order to strengthen technically focused engagement with regulated businesses.

ENA considers that further scope exists to improve the technical expertise available to the AER, beyond initiatives which the AER has taken itself to date. One form that may be worth exploration is the opportunity for periodic secondments from industry.

Recommendation

17. The AER should explore obtaining increased access to specialist industry expertise through secondment arrangements with the industry.

Funding adequacy and efficiency

The scope of the AER's responsibilities has expanded significantly, including new requirements on the AER to develop and review various guidelines, as well as to produce annual benchmarking reports.

These new requirements add to the resourcing pressures that have been identified in the past by stakeholders, including industry and consumer groups. Future resourcing will also be impacted by any planned assumption of regulatory functions associated with transferal of network regulatory functions from existing Western Australian and Northern Territory regulatory bodies to the AER. Conversely, however, the AER's resourcing should also be expected to fall commensurately over time as it adopts more light-handed regulatory techniques as competition in the energy sector increases. The AER should be expected to streamline its regulatory impost on service providers and ultimately end users.

The ENA notes that in late 2012 the AER was allocated additional funding of \$23 million over four years representing around a 20 per cent increase in funding above prior levels.¹⁸

¹⁸ Productivity Commission *Review of electricity network regulatory frameworks*, April 2013, p.771

Recommendation

18. A review of the adequacy of AER funding should take into account its expanded functions.

To the extent that the Panel finds that accountability, capability and performance issues will be addressed by additional funding, more resources should be given to the AER.

Given likely continued constrained resources, the AER should be required to undertake and release clearer cost-benefit assessments prior to introducing major new initiatives. There are specific concerns, for example, about information-intensive requirements that the AER has imposed on network businesses to assess their regulatory proposals.

For example, the AER has previously failed to complete cost-benefit assessments prior to requiring multi-year backcasting and sign off on Regulatory Information Notice data requirements. These requirements were excessive in a number of areas and required significant resources from both the AER and network businesses. As an example of unnecessary regulatory burden, the AER required network businesses to estimate the number of maintenance spans, and average number of trees per span as part of the RIN data collection process.

The issue of limited regulatory resources is a common concern across both the Australian and international regulatory landscape. ENA notes that one innovative approach initiated by the UK energy regulator Ofgem is the regular proposal of a 'Simplification Plan', under which Ofgem and its stakeholders identify opportunities to streamline, remove or reduce the cost of regulatory obligations that are assessed as no longer being cost-effective or proportionate to the original regulatory issue. This approach would be consistent with the policy objectives of the Commonwealth Government's current red tape reduction program and associated Parliamentary 'repeal day'.

Recommendation

19. Given likely continued constrained resources over the medium term, the AER should be required to undertake clearer cost-benefit assessments prior to introducing major new initiatives.

20. The AER should consider implementation of a regulatory 'Simplification Initiative' to identify opportunities to remove or reduce the cost of regulatory obligations on regulated firms and their customers.

Independence from ACCC

The ENA has argued in the past that the status of the AER as a constituent part of the ACCC has a number of disadvantages. One is that the ACCC's major roles have a reactive enforcement character and are focused on consumer protection goals. These objectives are distinct from a forward-looking medium term focus decision-making that is applied by the AER. This point was recently reiterated by the Monash Business Policy Forum *Rationalising rustic regulators*, and publicly by the former Chair of the ACCC, Graeme Samuels.¹⁹

A further concern expressed has been that the current AER-ACCC link has affected the AER's ability to direct the resourcing and capacity so that it can effectively perform its functions. This concern was also recognised in the *Review of the Limited Merits Review Regime* process, where the expert panel suggested the following in relation to the AER-ACCC link:

"...the AER Chair and members are constrained in their ability to independently direct the development and utilisation of the organisational expertise and capabilities that are required for the effective performance of its role".

It is not clear whether the 2012 reforms to the governance of the AER have addressed these concerns. For example, the 2014 stakeholder survey indicates that the metric of 'leadership' did not improve when compared to 2011 survey outcomes. In addition, it is ENA's understanding that all AER staff continue to be employees of the ACCC and therefore accountable to that body.

ENA recognises that the recently completed Harper Committee review of competition policy made a series of recommendations that relate to the future structure and functions of the ACCC and a proposed single national access and pricing regulator, which would include the AER.

While supporting in principle the separation of the AER from the ACCC, ENA does not consider that large scale structural changes are the current priority. Rather, the tailored recommendations contained in this submission are considered to be more likely to effectively target performance improvements.

¹⁹ Monash Business Forum, *Rationalising rustic regulators*, July 2014 and '[Harper makes case for competition overhaul: experts react](#)', 1 April 2015, The conversation.

Recommendation

21. In principle ENA supports the separation of the AER from the ACCC, however, this is a lower priority than other identified reform measures

7. AUSTRALIAN ENERGY MARKET OPERATOR

The ENA does not have any significant issues with how the AEMO performs its core functions, which is generally focused on gas and electricity market operation functions and related advice.

However, the ENA is significantly concerned with the AEMO's increasing involvement in a range of policy issues.

For instance, AEMO has been undertaking work at the request of the COAG Energy Council on an increasing range of policy issues, including for instance:

- » a 100% Renewables Study;
- » the Development of a Gas Supply Hub at Wallumbilla,
- » development of a Rule Change proposal to introduce a Demand Response Mechanism in the National Electricity Market.

As noted above, the ENA supports a clarification of industry roles in relation to energy market and regulatory design. The market operator should not generally be a primary provider of advice on energy policy and the economic regulatory framework as it has a separate, distinct role. In particular, the market operator should not duplicate roles assigned to the AEMC in its market development capacity. The industry is also concerned that AEMO's wider activities, including advice to governments may come at the expense of core responsibilities for which it was funded by industry participants.

The ENA notes that AEMO initiated a review of its own governance arrangements in 2013. The review sought to address a commitment that this would be reviewed within three years of its operation.

One issue raised in the review was whether there is a need for flexibility within AEMO's charter to allow AEMO to undertake (and raise working capital for) a broader set of "closely defined" activities consistent with its 'Vision' and 'Mission Statement' but which "would otherwise currently be considered as out of scope and not taken any further."

AEMO did not specify what activities it considered might fit within this definition, or how they would fit with its statutory functions. ENA does not support a wider charter being provided to AEMO, as it risks compromise the existing division of mandates between the three market bodies.

Instead, the ENA considers that there needs to be clear delineation between the roles of the AEMO and other policy-making and regulatory bodies. The recent practice has seen lack of coordination and overlap of energy market bodies' activities. As noted above, the AEMC has progressed determinative rule changes in metering, while the AEMO has been separately commissioned to provide recommendatory advice directly to the COAG Energy Council on the Minimum Functional Specification and Shared Market Protocol.

Recommendation

22. Objects within the AEMO's Constitution should be clarified.

Further, the ENA observes that the existing membership structure of the AEMO (60% government: 40% industry) is inconsistent with increasing trends to government divestment of energy industry ownership and with international practice. For example, all US market operators are 100 per cent industry owned. In this regard, the ENA support changes to AEMO's ownership arrangements that would see 100 per cent industry ownership or majority ownership of AEMO.

With ownership addressed, there are further steps that can be made to enhance the AEMO's governance arrangements.

The specific recommendations include:

- » streamlining the process for appointment of Directors so that it is consistent with corporate practice;
- » aligning Independence requirements with the ASX framework; and
- » relaxing restrictions on Directors terms

Recommendation

23. The current governance structure should be transitioned to industry ownership or majority ownership of the AEMO, consistent with long-term trends to reduce government's role in operational energy market activities and make transparent its regulatory measures.

24. Corporate governance improvements should achieve improved accountability for the strategic and operational activities of the organisation and approval of its annual budget. With ownership addressed, a further step will be to enhance governance arrangements:

- » normalise appointment of Directors in accordance with corporate practice;
- » align independence requirements with the ASX framework; and
- » relax restrictions on Directors terms (e.g. through permitting more than two terms of three years – rather than extending the term length).

APPENDIX A – RESPONSE TO ISSUES PAPER QUESTIONS

Issues Paper question	ENA Response	Relevant section of ENA submission
<p>1. <i>How has (or how do you consider) the Energy Council's performance tracked over time? What factors do you think are contributing to this?</i></p>	<p>The Energy Council has performed most strongly in the past when it has focused through regular meetings in a collegiate manner on a shared common vision around a smaller number of carefully prioritised and sequenced reforms.</p> <p>Since the completion of a major series of Law and Rule reforms in 2008-09, the Council has pursued a large number of individual initiatives and met less frequently. There are opportunities to enhance the coordination and strategic leadership of the policy reform process.</p>	<p>Section 3.</p>
<p>2. <i>Should the Panel be contemplating alternatives to the COAG council process for the tasks of leading energy market policy developments? Does the AEMA remain fit for purpose?</i></p>	<p>Whilst strategic policy decision-making should always reside with the Energy Council, there is a case for the Council to provide to the AEMC an unequivocal mandate to lead market and regulatory design issues, as well as provide advice to the Council on the impact of proposed Commonwealth and State policy interventions on the long-term interests of electricity and gas consumers (i.e. the National Energy Law objectives).</p> <p>ENA considers the <i>Australian Energy Market Agreement</i> (AEMA) remains broadly fit for purpose, while recognising that movement to stronger national frameworks for reliability matters and energy consumer protection are desirable to promote reliability outcomes that better reflect customer's valuation of the service, lower regulatory compliance costs, and reduced barriers to competition and innovation.</p>	<p>Sections 3 and 4, Recommendations 4-5.</p>

<p>3. <i>What are the strengths and weaknesses of the Energy Council's decision making arrangements? Are there examples of specific situations where lack of timeliness, or the need to achieve consensus, has adversely affected market outcomes?</i></p>	<p>This issue is a primary focus of ENA's submission, and is discussed in detail in Section 3 of the response.</p>	<p>Sections 3 and 4, Recommendations 1-6.</p>
<p>4. <i>How relevant is the Energy Council's agenda to contemporary market challenges? How accessible, flexible and transparent is this work program? In what ways might the agenda be improved?</i></p>	<p>The Energy Council's agenda currently encompasses a wide range of high and low priority issues, reflecting both past policy perspectives, and consideration of more contemporary market issues. This highlights the need for clarity over what precisely is on the active agenda of the Council, and how this will be practically progressed in a manner that is genuinely coordinated between COAG Energy Council and the energy market institutions.</p> <p>The Energy Council's current agenda includes, for example, consideration of impacts of changing demand, technologies and competitive forces on regulation of network, and also the consumer protection implications of new products and services in energy. These are valuable and high priority issues for strategic assessment and review.</p> <p>The agenda could be improved by being prioritised, by an increased role in market and regulatory policy design being given to the AEMC to address coordination issues, and by steps to increase transparency around the contents, next steps, timing and sequencing of the work program.</p>	<p>Sections 3 and 4, Recommendations 1-3.</p>
<p>5. <i>Should the Energy Council meet more regularly or delegate more roles to officials? What suggestions can stakeholders offer to improve efficiency, timeliness and accountability of Energy Council processes, including those of SCO and its key working groups?</i></p>	<p>The frequency of COAG Energy Council meetings should be increased to ensure that the requirement for Ministerial approval for reform initiatives does not unintentionally become a 'choke point', and to enable Ministers to collegially examine and discuss the performance of the overall energy market on a more regular basis. Over time, ENA considers this would assist in ensuring energy market reforms are developed with a shared common vision of outcomes sought.</p> <p>The ENA makes a number of other specific recommendations to improve the policy coordination, efficiency and timeliness of Energy Council and associated senior officials processes.</p>	<p>Sections 3 and 4, Recommendations 1-3.</p>

<p>6. <i>Does the Energy Council provide adequate policy oversight of its three market institutions? Can this be improved?</i></p>	<p>There needs to be a stronger approach to the oversight of an integrated energy policy reform program. ENA recommends that this occur through improved policy coordination, including a strengthened role for the AEMC in leading market and regulatory design issues, improved market consultation, transparency and accountability around setting goals and priorities for each of the energy institutions.</p>	<p>Sections 3 and 4, Recommendations 1-7.</p>
<p>7. <i>What should be the Energy Council's role in areas outside its direct policy remit, including financial markets, sustainability and climate change issues and social policy? What role should it take in engaging with non-interconnected states like the Northern Territory and Western Australia? What role should it take in areas beyond its AEMA coverage, such as retail price regulation and technical and safety matters? What practical barriers might need to be addressed in it taking on such roles?</i></p>	<p>Generally, ENA considers that the Energy Council has appropriately adopted the view that its decisions and proposed reforms should taken into account developments outside of its direct policy remit, but not seek to promote policy and regulatory outcomes that go beyond the objectives set out in the <i>Australian Energy Market Agreement</i> and the objectives of the National Electricity and Gas Laws.</p> <p>The Energy Council should take a role of positively engaging with non-interconnected states like the Northern Territory and Western Australia consistent with the objectives of the AEMA to strengthen the national character of governance of energy reforms and streamline and improve the quality of economic regulation. (See Clause 2.1 (b) (i-ii)).</p>	
<p>8. <i>How has (or how do you consider) the AER's performance tracked over time? What factors do you think are contributing to this?</i></p>	<p>This issue is a primary focus of Section 6 of ENA's response and discussed in detail there.</p>	<p>Section 6, Recommendation 12-21.</p>
<p>9. <i>Does the concept of a national energy regulator, separate from the rule maker and jurisdictional governments, remain relevant in today's market? Should the Panel be considering alternative models?</i></p>	<p>Yes, ENA considers the principle of separation of the rule-making body from the economic regulator tasked with applying and enforcing the rules is a critical feature of today's energy market.</p> <p>This issue is a primary focus of Section 5 of ENA's response and discussed in detail there.</p>	<p>Section 5.</p>
<p>10. <i>Do you consider there are any issues in relation to the performance of the AER's functions? To what extent are your views on the performance of the AER due to its institutional arrangements, resourcing, the prescriptive rules environment, or other factors? To what extent does the AER's governance contribute to how it exercises its regulatory tasks, including its approach to enforcement?</i></p>	<p>This issue is a primary focus of Section 6 of ENA's response and discussed in detail there.</p>	<p>Section 6, Recommendation 12-21.</p>

<p>11. <i>To what extent does the AER's current three member structure, and the split between Commonwealth and state membership, affect its capabilities? Are there alternative oversight models the Panel should consider, for example a board structure or additional members?</i></p>	<p>ENA supports an expansion in the number of Commissioners to reflect the growing complexity and accrued responsibilities of the AER. ENA supports an AER governance model which sees AER staff work to an independent Board which has the skills and opportunity to review, critique and shape AER decisions.</p>	<p>Section 6, Recommendation 12.</p>
<p>12. <i>The Panel notes a number of stakeholders have expressed a view that the AER should be separate from the ACCC. Is this a sovereignty issue or is there a systemic problem in performance of the AER? If the latter, what evidence is there of a problem that such changes would address, or alternatively what are the pros and cons to be weighed up in considering the merits of such a change? Do these assessments change with different models for a separate regulator, for example a standalone but otherwise unchanged AER, or combined with other monopoly network regulators as proposed in the Harper Review?</i></p>	<p>ENA's response addresses this matter in Section 6.</p>	<p>Section 6, Recommendation 21</p>
<p>13. <i>Noting the importance of maintaining independence, what are the opportunities to improve the oversight of the AER by the Energy Council, or individual jurisdictions?</i></p> <p><i>How should the Panel consider the potential conflicts which arise from individual jurisdictions (and thereby an element of the Energy Council) holding assets regulated by the AER?</i></p>	<p>ENA considers there are several opportunities to improve the oversight of the AER and have outlined these in Section 6.</p> <p>Potential conflicts are currently managed through the separation of the Energy Council from the function of economic regulatory decision-making made under the National Electricity and Gas Law and Rules. Merits based appointment for fixed terms on the part of Commissioners provides another critical means of managing any potential conflict. A further protection provided is that the AER is tasked with applying a single set of economic regulatory rules regardless of the ownership status of the individual network. This provides for outcomes that are competitively neutral and guided by the National Electricity and Gas objectives and revenue and pricing principles.</p> <p>ENA considers any analysis of this issue proceed on the basis of clearly establishing that these potential conflicts exist, with reference to the empirical record of AER decisions. Any parties claiming that the AER has not discharged its Law and Rule obligations in an independent manner</p>	<p>Section 6, Recommendation 12-21.</p>

	<p>should be requested to provide clear evidence of this.</p> <p>Maintenance of regulatory accountability through access to merits based review is critical to promoting high quality performance. The AER facing a number of unfavourable independent findings in relation to some of its regulatory determinations in merits-based reviews has in the past been essentially interpreted by the Energy Council and AEMC as a reason to tighten review mechanisms and provide the AER with greater discretion. This is the opposite of what would be expected to occur in a non-bureaucratic or market context.</p>	
<p>14. <i>Do you consider the AER is adequately resourced? Should the AER be funded by market participants or cost recovery, rather than being funded through the Commonwealth budget?</i></p>	<p>The AER has assumed a range of additional functions and responsibilities since its inception, and may acquire new functions as a result of future decisions by State or Territory governments. A primary issue for analysis by the Expert Panel should be around whether existing resources are appropriate for its functions.</p> <p>To the extent that any identified accountability, capability and performance issues will be addressed by additional funding, ENA supports more resources being provided to the AER</p> <p>Given likely continued constrained resources on the AER this places even greater emphasis on the need to undertake clear cost-benefit assessments prior to introducing major new regulatory initiatives.</p>	<p>Section 6, Recommendations 18-20.</p>
<p>15. <i>Should the AER's role be expanded or reduced in any areas, particularly in relation to its market monitoring functions?</i></p>	<p>ENA supports the AER's market monitoring functions and has no comment on this matter.</p>	
<p>16. <i>How could the relationship between the AER and the other two market institutions (AEMC and AEMO) be improved? Should the AER be given increased capacity to help develop expedited rule changes, or an increased role in reviews or policy advice?</i></p>	<p>Relationships between each market institution could be improved by clearer delineation of roles and functions, including by the strengthening of the AEMC as a lead market and regulatory design body.</p>	<p>Section 4, Recommendations 4 and 6.</p>
<p>17. <i>Should the AER have an expanded role in regulating state specific functions outside national frameworks? What are the opportunities to improve interaction with state technical, safety or economic regulators within the national market, and with</i></p>	<p>ENA considers that the AER should have a limited role in regulating state-specific functions outside of national framework. Any role in this area should only be assumed as part of an agreed transition to national arrangements consistent with the <i>Australian Energy Market Agreement</i></p>	

<p><i>Northern Territory and Western Australian counterparts?</i></p>	<p>objectives of strengthening the national character of governance of energy markets, and improving the quality and efficiency of regulatory arrangements. The AER assuming state specific functions under bespoke jurisdictional regimes risks diverting it from its core competencies and control objective of applying high quality national economic regulatory frameworks in the long-term interests of consumers.</p> <p>ENA considers there are opportunities to improve the integration of state technical and safety regulators, to ensure AER economic regulatory decisions align with the relevant obligations applying to each energy network. The benefit of this is a reduction of areas of factual dispute in revenue determination processes and the better integration of safety and technical obligations into current network prices.</p>	
<p><i>18. Are there opportunities to improve confidence in regulatory outcomes, for example through improved communication or performance and accountability measures?</i></p>	<p>ENA consider there are a range of opportunities to improve confidence in regulatory outcomes, including establishment of low cost internal AER 'error correction' mechanisms, independent peer reviewing of critical AER benchmarking approaches and methodologies, and greater consultation between market participants and the AER in setting AER goals, and performance measures.</p>	<p>Section 6, Recommendations 14-17.</p>
<p>AEMC</p>		
<p><i>19. How has (or how do you consider) the AEMC's performance tracked over time? What factors do you think are contributing to this?</i></p>	<p>ENA considers the AEMC has performed strongly in its core rule making and market development functions, including in developing comprehensive reform packages across several key energy issues. ENA considers that the AEMC's performance has generally improved over time as it moved from its establishment phase to mature operation phase, and was able to build its internal corporate resources and capabilities. Critical to its performance is its independence from day to day political decision-making, the internal separation between the Commission and its staff, a focus on long-term reform outcomes for consumers, its commitment to open, transparent evidence based processes, and the ability to recruit and second highly qualified staff.</p>	<p>See Section 5.</p>

<p>20. <i>To what extent does the AEMC's statutory rule making process remain appropriate in today's market? Should the Panel be considering, for example, returning this role to jurisdictions or to the Energy Council?</i></p>	<p>A clear statutory rule-making function which is separate to individual jurisdictional decision-making is a lynchpin of a transparent and effective rules-based framework that is responsive to changing market and competitive developments.</p> <p>Returning this function to jurisdictions or the Energy Council would be likely to result in a less independent, flexible, transparent and predictable rule change process. One reason for this is that the rule-change process would be likely to become subject to an effective 'veto' from any jurisdictions not supporting a particular rule change. Over time, this would be likely to promote greater divergence in network regulation, the reintroduction of effective jurisdictional level regulation. This would raise barriers to efficient investment, and likely increase costs to consumers through increased regulatory risk to market participants and reduced competition. These outcomes would undermine the objectives of the <i>Australian Energy Market Agreement</i>.</p>	<p>Section 5, Recommendations 8-11.</p>
<p>21. <i>Do you consider there are any issues in relation to the performance of the AEMC's functions? To what extent are your views on the performance of the AEMC due to its institutional arrangements, resourcing, the process requirements for rule making, or other factors? To what extent does the AEMC's governance contribute to how it exercises its statutory rule making and market development function? To what extent do you consider the AEMC's rule making processes are achieving the national energy objectives of serving the long term interest of consumers? To what extent are your views a function of its institutional arrangements, the legislative framework it operates in, resourcing, or other factors?</i></p>	<p>To the extent that the network sector has identified any performance difficulties for the AEMC, these appear to largely arise from resource constraints, the open nature of the rule change process (which is a strength of the regime) and the need for better coordination or task allocation between AEMC and COAG Energy Council and AEMO.</p> <p>A significant issue has been the AEMC's delayed progression of a number of rule changes. The reasons for this appear to be a combination of inadequate resourcing, the 'lumpiness' of some large and highly integrated reform packages (such as Power of Choice), the need for AEMC to receive a fully developed rule proposal from COAG Energy Council to progress rule changes proposed in AEMC reviews, and the 'openness' of the rule change process itself to third party rule changes.</p> <p>The AEMC's governance is, appropriately, highly influential of its ability to progress its rule change and market development functions. It is important to recognizing the strength and predictability that governance structure has brought to rule-making functions, compared</p>	<p>Section 5, Recommendations 8-11.</p>

	to prior models such as National Electricity Code Administrator (NECA) and National Gas Pipeline Advisory Committee (NGPAC).	
<p>22. <i>To what extent do you consider it is important to have an independent market development role within the AEMC? To what extent do you consider the AEMC's market development role 'outsources or augments' the policy responsibilities of the Energy Council? Does the market development role of the AEMC 'outsource or augment' the technical input to policy provided by the AEMO and AER? Are there alternative recommendations the Panel could pursue to improve collaboration in market development, and/or policy oversight by the Energy Council? To what extent is it important to clearly define the scope of the AEMC's 'market development' role, and the demarcation between the Energy Council and other institutions?</i></p>	<p>ENA considers the AEMC should continue to provide an independent market development role, and that this should be augmented by providing the body with a leadership role in the coordination of market and regulatory policy advice to the Energy Council.</p> <p>Industry considers the AEMC having a market development role and an informed strategic view on current and future energy markets to be critical to its capacity to carry out its review and rule-making function.</p> <p>ENA has developed a range of suggestions, options and recommendations directly addressing these matters.</p>	<p>See Section 4 and 5, Recommendations 4-6.</p>
<p>23. <i>To what extent of does the AEMC's commissioner structure, and the split between Commonwealth and State and Territories membership, affect its capabilities and approach to its rule making and market development tasks? Are there alternative oversight models the Panel should consider, for example a board structure or additional commissioners?</i></p>	<p>A Commission structure with fixed period appointments on a skills basis is an appropriate structure to foster high quality and independent regulatory and market development decision-making and advice.</p> <p>ENA considers this approach provides a model to other infrastructure sectors in how transparent, evidence-based and predictable regulatory rule-making can underpin significant long-term private sector capital involvement in utility infrastructure.</p> <p>In ENA's experience Commissioner's have consistently approached market issues on their merit and based on the legislative framework objective of promoting the long-term interests of consumers. This is the case for individual rule determinations that have not been supported by networks.</p> <p>Provision of additional Commissioners (2 full time, nominated by the Commonwealth) could help address issues of the breadth and depth of AEMC workload, and any expressed concerns regarding State/Territory involvement in selection of AEMC Commissioners.</p> <p>These issues are discussed further in ENA's response.</p>	<p>Section 5 and Section 6, Recommendation 4, 5, 6 and 11.</p>

<p>24. <i>Do you consider the AEMC is adequately resourced to undertake its roles? Should the AEMC be funded by market participants or cost recovery, rather than being reliant on budget from the States and Territories? Does it have the right skills base to undertake its functions, particularly across the spectrum of electricity, gas and retail sectors?</i></p>	<p>It would appear at times that delays in the simultaneous progression of multiple rule changes may in part have arisen from resourcing constraints, rather than AEMC decisions on sequencing. This is the only clear insight into resource adequacy available to ENA</p> <p>AEMC appears to have the capacity to attract and retain highly professional skilled staff. In the past this has been supplemented by secondment arrangements and the increased used of these arrangements (recognising and managing any conflicts appropriately) is supported.</p>	<p>Section 5.</p>
<p>25. <i>What are the opportunities to improve the timeliness of rule change assessments? For example, should there be a faster track for rules which arise out of reviews by the AEMC or other reputable bodies, or should the AEMC be able to progress less well refined rule proposals from the Energy Council or market participants or have some flexibility to initiate its own rule change proposals? What other opportunities are there to improve the accessibility, transparency, and rigour of the AEMC's processes?</i></p>	<p>ENA supports a specific 'fast track' path under which delays to commencing the rule change are avoided for rule changes initiated by COAG EC.</p> <p>It is critical, however, that such fast track processes still enable sufficient and transparent consultation with market participants affected by the rule change, and as such ENA considers any revised process should avoid delays to the commencement of the process and potentially shorten but not eliminate consultation steps in the process</p> <p>The AEMC should have the power to receive a policy direction from COAG EC to pursue a rule proposal even in the absence of a draft proposed alternative rule. This option would reduce duplication and double handling of an issue under which COAG EC prepares a fully detailed rule change, which is then required to be refined to take account of issues arising under closer analysis and consultation.</p>	<p>Section 5, Recommendation 8-11</p>
<p>26. <i>Should the AEMC be given an increased gas market reporting role, in a similar manner to its electricity price reporting?</i></p>	<p>ENA has no view on this issue and in particular is not aware of the specific problem which would be addressed by this measure.</p>	

AEMO		
<p>27. <i>How has (or how do you consider) the AEMO's performance tracked over time? What factors do you think are contributing to this?</i></p>	<p>The industry does not have any significant concerns with how AEMO performs its core functions over time.</p> <p>Network businesses are concerned that AEMO's performance has been increasingly affected by its involvement in a range of policy and regulatory issues, in which its expertise is limited compared to bodies such as the AEMC and AER.</p>	<p>Section 7.</p>
<p>28. <i>To what extent does AEMO's role as an independent national energy market operator and planner continue to remain relevant to delivering a more integrated, secure and cost effective national energy supply in today's market? What is your assessment of AEMO's leading strengths and shortcomings on delivering on those outcomes?</i></p>	<p>AEMO original intended role as responsive, efficient, provider of market operator services remains relevant. Its strengths are the delivery of efficient and relevant market making and supporting services.</p> <p>Shortcomings identifiable in AEMO's work mostly relate to where they have undertaken work out of their intended scope and core area of expertise.</p>	<p>Section 7.</p>
<p>29. <i>Do you consider there are any issues in relation to the performance of the AEMO's functions? To what extent are your views on the performance of the AEMO due to its institutional arrangements, resourcing, the requirements in the rules, or other factors? To what extent does the AEMO's governance contribute to how it operates as the market operator?</i></p>	<p>ENA's response provides detailed comments on these issues.</p>	<p>Section 7, Recommendations 22-24.</p>
<p>30. <i>To what extent does AEMO's ownership and governance structure affect the quality of its outcomes? What are the implications for AEMO of having a 60 per cent government shareholding? What are the implications of 40 per cent ownership by industry? Should this be changed – what is the right level and mechanism for encouraging accountability to the Energy Council?</i></p>	<p>Current ownership arrangements should be changed to industry ownership or majority ownership of the AEMO, consistent with long-term trends to reduce government's role in operational energy market activities and make transparent its regulatory measures.</p> <p>ENA would query the objective of encouraging accountability to the Energy Council as a guide to assessing issues of ownership. A market operator should be accountable to the market it serves, in this case, to market participants.</p>	<p>Section 7, Recommendations 22-24.</p>
<p>31. <i>Are there other matters to consider in terms of the influence of governments on AEMO, including the ability to task AEMO with projects, and the ability to influence board appointments? To what extent should the Panel be considering alternatives to the current AEMO structure, that is, a Corporations Act company with</i></p>	<p>As discussed in ENA's response, the ability of CoAG to task AEMO with projects is appropriate in some circumstances, but issues of delay and duplication have arisen in practice in this area due to poor coordination and sequencing of reform work programs.</p> <p>ENA has made a number of recommendations, including a refocusing</p>	<p>Section 7, Recommendations 22-24.</p>

<i>a Board to oversee activities?</i>	of AEMO on its core functions, movement to industry ownership, and the adoption of more standardised ASX/Corporations Law protocols for AEMC Board governance.	
32. <i>To what extent do AEMO's different roles in the national market, including its responsibility for different gas trading hub designs but not the wider gas market, and having a combination transmission planner/procurer role only in Victoria, affect its ability to deliver better national market outcomes? Is there a case for expanding or reducing AEMO's role in any areas?</i>	ENA has no view on this issue and considers individual market participants are better placed to provide comments in this area.	
33. <i>Does AEMO have sufficient financial, human and technical resources to undertake its roles? If not, what are the key areas for improvement in the way it sets fees and manages its resources?</i>	ENA considers that AEMO has sufficient resources to undertake its core market operation and facilitation role. AEMO does not have the resources and capability to provide high quality advice outside of its core area of expertise, resulting in a risk of poor advice to governments, policy makers and other energy institutions if it fails to focus on its primary role.	
34. <i>What opportunities are there for AEMO to improve market operation data, confidence in market outcomes, and its stakeholder engagement processes?</i>	ENA has no comment on this issue.	
35. <i>What should AEMO's role be in market development? How might its current contribution be improved? Are there ways to improve its procedure development processes? Should it be given more specific roles in supporting regulatory processes?</i>	Consistent with previous comments, ENA considers the AEMC should be given responsibilities for market development and regulatory design advice. ENA considers direct participation of AEMO in the regulatory process is outside of its core area of responsibilities and expertise under the Australian Energy Market Agreement. Parties and AER should have the capacity to draw upon transparent and published AEMO's independent forecasts and data.	Section 7.
36. <i>What are the opportunities to improve the way AEMO engages with the Energy Council and the other two institutions? Is there a role that AEMO should play in non-NEM jurisdictions, or in markets outside its direct remit such as financial markets?</i>	ENA addresses possible improvements in the coordination of energy market institutions integrated work with the Energy Council in detail in its response.	Section 4, Recommendations 4-6.

<p>37. <i>What are the opportunities to improve the quality and relevance of AEMO's planning and forecasting roles, including mechanisms to improve the value adding AEMO can deliver on its existing market information sets?</i></p>	<p>ENA has no comment on this issue.</p>	
<p>Energy market - relationships and related issues</p>		
<p>38. <i>How positive or negative do you perceive the communication channels between the Energy Council, AEMO, the AEMC, and AER to be? What are the opportunities to enhance the way these institutions interact with each other?</i></p>	<p>ENA considers there are opportunities to enhance the coordination and communication channels between key energy policy and market institutions. ENA considers this can best occur by providing an enhanced role for the AEMC in the coordination and integration of market, technical and regulatory policy advice.</p> <p>ENA addresses the detailed potential improvements in the coordination of the integrated work of energy market institutions with that of the Energy Council in detail in its response.</p>	<p>Section 4, Recommendations 4-6.</p>
<p>39. <i>To what extent do the roles and responsibilities of the different institutions as laid out in the AEMA consistent with the establishing legislation?</i></p>	<p>The issues in relation to institutional roles and responsibilities have arisen over time out of developing practice, rather than having a legislative basis.</p>	<p>Section 4, Recommendation 7.</p>
<p>40. <i>Does the broad division of mandates between these institutions remain appropriate? Are there relevant international models of alternatives the Panel should be considering?</i></p>	<p>Yes, the broad division does remain appropriate, however, ENA recommends that in recognition of the importance of a strengthened focus on coordinated policy development and independent assessment of proposed market interventions from State/Territory governments, that a rebalancing of policy coordination and market and regulatory design responsibilities towards the AEMC should be considered. It is recognized that this would require additional resourcing to be considered.</p>	<p>Section 4, Recommendations 4-6.</p>
<p>41. <i>What are the opportunities to enhance the way these institutions interact with stakeholders and the broader community?</i></p>	<p>Each of the three market institutions should prepare and consult on their statement of corporate intent/strategic plans, and their performance measures</p> <p>Ideally this should occur in a coordinated fashion, and take into account a COAG EC approved 'road map' document which is itself subject to public consultation and industry feedback mechanisms.</p>	<p>Section 3, Recommendation 1-3.</p>

<p>42. <i>What are the opportunities to improve the extent and consistency of responsibilities and roles by individual jurisdictions under these energy market governance arrangements?</i></p>	<p>The most practical opportunities to improving the consistency and extent of responsibilities and roles would appear to be better prioritisation by COAG Energy Council on reforms areas, coordination of market and policy reforms, including escalation and effective resolution of areas of difference where possible. Market and policy reforms developed with close attention to the implementation across different markets with different pre-existing conditions, and attention to realistic transition pathways allowing for the securing of credible political commitments to transitioning to more consistent national outcomes are two other important factors.</p>	<p>Section 3 and Section 4, Recommendations 1-3.</p>
<p>43. <i>What are the opportunities to improve integration between energy market, efficiency and sustainability agendas?</i></p>	<p>ENA considers that it is the appropriate role of broader government energy policy frameworks to integrate energy market, efficiency and sustainability agendas. ENA has considers that that better integration could be achieved by the provision of a specific additional function to the AEMC to assess proposed policy interventions with significant impacts on the capacity of energy markets to deliver outcomes consistent with the NEO and NGO.</p>	<p>Section 4, Recommendation 5.</p>
<p>44. <i>What are the opportunities to improve the governance of energy financial markets? Would a NEM Resilience Council be useful in any future governance arrangements in the NEM? What role, if any, should ASIC play in regulating electricity companies who hold financial services licenses to allow them to trade in electricity derivatives?</i></p>	<p>ENA has no comment on this issue.</p>	
<p>45. <i>What are the opportunities to improve consumer engagement in energy market governance, particularly given the recent creation of ECA by the Energy Council?</i></p>	<p>ENA welcomes the recent creation of Energy Consumers Australia to provide a focal point for energy consumer voices in energy market and rule change, and regulatory determination processes. Due to the limited time it has been operational, ENA considers it would be best to include a substantive review of ECA activities and additional steps that might be taken in this area in the next review of energy market institutions.</p>	<p>Section 4, Recommendation 7.</p>

46. *There exists a range of energy market issues outside of the remit of energy ministers. Are there any issues in how this impacts the governance of the Australian Energy Market?*

The ENA is unclear on the nature of issues being referred to in this question, but would be pleased to explore this specific question in further detail scheduled discussions with the Panel.