National Access Regime: Productivity Commission Draft Report

Submission – Victorian Department of State Development, Business and Innovation

Summary

The Victorian Department of State Development, Business and Innovation (DSDBI) welcomes the opportunity to make a submission to the Productivity Commission's Draft Report in its review of the National Access Regime. The Department's submission focuses on the parts of the review concerning certification of effective access regimes, specifically the application of certification to the energy (electricity and gas) access regimes.

DSDBI supports the Productivity Commission's preliminary view, as expressed in its Draft Report, that the Australian Energy Market Agreement's requirement to certify electricity and gas regimes under the Competition and Consumer Act should be removed.

It would be desirable however to go beyond the Productivity Commission's recommendations and give statutory recognition to the effectiveness of the energy access regimes. This would help to cement the energy regulatory framework and ensure that any residual risk of declaration of energy infrastructure already covered by these regimes is removed.

DSDBI is the Victorian portfolio agency for the energy sector. Victoria, along with all other States and Territories, is a partner in the regulation of the natural gas industry through the National Gas Law and with all States and Territories except Western Australia and the Northern Territory for the electricity industry under the National Electricity Law. This submission is made as a portfolio-specific submission by DSDBI regarding energy (natural gas and electricity) matters only, and should not be read to comment on the implications of the national access regimes outside of these sectors.

1. Background to certification requirement

National Competition Policy, a major reform program of the Council of Australian Governments (COAG) in the 1990s, was developed to open up industry sectors that were previously dominated by predominantly state-owned monopolies. Its legal foundation is the Competition and Consumer Act (CCA), formerly the Trade Practices Act). Under the CCA's national access regime, any person may apply to the National Competition Council (NCC) for declaration of an infrastructure service.

Declaration decisions are made by the relevant Minister on the NCC's recommendation. Declaration allows access seekers to negotiate access with an infrastructure provider. If negotiations fail, declaration gives the Australian Competition and Consumer Commission (ACCC) the power to arbitrate.

However, under Part IIIA, a regime can be certified as being effective for the purposes of the Competition Principles Agreement (CPA), and declaration cannot occur where an access regime that is 'effective' exists. To obtain certification, a relevant state or territory Minister may apply to the NCC. The NCC then assesses the regime against the requirements of the CPA, and makes a recommendation to the relevant Commonwealth Minister, who then decides whether to certify the regime, applying the same factors as the NCC and considering the NCC's recommendation. An access regime needs to be certified for the exemption from declaration to apply. In addition, the exemption ceases if the Commonwealth Minister considers the regime has been substantially modified since declaration.

National energy access regimes may be defined as the regimes under the National Electricity Law (NEL), National Gas Law (NGL), National Electricity Rules (NER) and National Gas Rules (NGR). With the exception of the electricity regime in Western Australian and the Northern Territory, all jurisdictions have applied these regimes. The Australian Energy Market Agreement (AEMA) clauses 13.3 to 13.6 requires of the signatories:

- To take all reasonable measures to ensure that energy access regimes are certified as effective access regimes and remain certified
- To make coordinated and concurrent applications for certification of the current National Electricity Market access regimes by 1 January 2007 and for gas access regimes by 1 July 2007
- That there will be consultation with the NCC on substantial modifications to gas and electricity access regimes.

These provisions were originally included in the AEMA in 2004 as part of a negotiated package of reforms reflecting the circumstances of the time. Since then, and in view of the changing nature of energy sector regulation, the Standing Council on Energy and Resources (SCER) has debated removing the requirement and members have failed to reach an agreement. As such, while certification has never been sought, the requirement remains.

2. Certification requirement is unnecessary and risky for modern energy access regimes

It is instructive to examine the history of energy regulatory governance in Australia since the late 1990s to understand where access to energy infrastructure stands in relation to National Competition Policy. At that time, the National Electricity Code and National Third Party Access Code for Natural Gas Pipeline Systems were the governing frameworks for the electricity and gas industries. Accountability and authority were convoluted under this framework. Changes to the National Electricity Code, in particular, included a Code change process followed by authorisation process and the Codes were also certified access regimes, with substantial changes requiring re-certification.

The process, characterised by frequent ACCC reviews and remittals to the National Electricity Code Authority (NECA), and infrequent certifications lagging behind authorisations, was not only inefficient and duplicative, but it undermined the legitimacy of the primary decision maker, with disenchanted parties often waiting until ACCC review before raising substantive issues. The shortcomings of this regime were a key finding of the COAG Energy Market Review (the 'Parer Review'), which inspired the development of the AEMA and which instructively noted:

> 'Not only is the process time consuming, but the process under which the ACCC is obliged to carry out a separate public consultation process [to the NECA process] and the possibility of substantive changes being introduced or required at a late stage in the process engenders uncertainty and works against the effectiveness of the first consultation process.'[1]

Following the Parer Review, significant structural changes to the regulatory framework were agreed and have been implemented through the AEMA reforms. The industry codes which triggered a need for authorisation by the ACCC were replaced by statutory rules under harmonised national energy legislation. Clear and accountable regulatory governance arrangements have been developed including a single statutory rule-making authority – the Australian Energy Market Commission (AEMC) – and a separate rule enforcer and economic regulator – the Australian Energy Regulator. Both of these bodies conduct their business in pursuit of a single clearly expressed statutory objective targeting economic efficiency in the long term interests of consumers. Further, the SCER, which has absorbed the Ministerial Council on Energy (MCE), has a statutorily recognised role in cooperative decision-making between the Commonwealth and states on energy market policy.

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[1] *Towards a Truly National and Efficient Energy Market*, Council of Australian Governments' Independent Review of Energy Market Directions ('The Parer Review'), December 2002, p.76 at < http://www.ret.gov.au/documents/mce/_documents/finalreport20december200220050602124631.pdf>

Within the NEL and NGL, the regimes for access go beyond the negotiate/arbitrate framework specified in the National Competition Policy Agreement as the baseline for effective regimes. Features of the energy access regimes include direct regulatory oversight of network tariff setting in accordance with the national energy objectives, detailed frameworks for negotiation of connection agreements, and both dispute resolution and access arbitration arrangements applying to facilitate resolution of disagreements. Thus, these regimes have been developed in accordance with principles broadly compatible with the CPA but with further refinements where appropriate to the energy industry.

The regulatory regimes are characterised by an 'open access' framework for electricity transmission, and significant uniformity and standardisation of the terms and conditions of access for gas pipelines and electricity distribution networks. In the electricity sector, the National Electricity Market wholesale market arrangements play a pivotal role in giving access to effective trading arrangements through transmission infrastructure in six jurisdictions, by placing system operation and balancing in the hands of the Australian Energy Market Operator instead of individual transmission companies.

3. The rationale for certification has effectively lapsed

Significantly, when the certification requirement was developed, the national electricity laws had been determined, legislated and administered by the states only, although the Commonwealth was an applying legislator for the Gas Pipelines Access Law due to anticipation of international pipeline developments.

The certification process in Part IIIA of the CCA provides for a State or Territory that is party to the CPA to have a state-based access regime assessed to determine if it is effective for the purposes of the CCA. Various aspects of National Competition Policy were backed by competition payments which played a role for some time in assisting state budgets to adjust to foregone monopoly rents. In the energy sector, certification of the Codes was a condition for such payment.

These arrangements, in short, embodied a bargain struck between the Commonwealth and the states at a particular point in micro-economic reform policy in Australia. However, competition payments ended in 2005-06, and through the Standing Council on Energy and Resources (SCER), the Commonwealth is now an equal partner in all areas of national energy market regulation. Thus, at this point, effective access in the energy sector represents shared policy between the States and the Commonwealth, and not a bargain or transaction between them.

This is reflected in the complementary laws applying the NEL and NGL made in each Parliament, including the Commonwealth Parliament, and administered jointly. Unanimous agreement of the SCER is required for changes to the national laws. As such, certification is

no longer necessary as a gatekeeping mechanism for the Commonwealth in the energy sector.

4. Commitment of regulatory institutions to effective access has increased

Accompanying the move to more robust regulatory institutions has been a fresh impetus for substantive reforms that enhance the actual effectiveness of the energy access regimes.

The AEMC has undertaken several substantive reviews or rule change processes which have been directly relevant to the ability of access seekers to gain access to the monopoly energy transmission and distribution systems. As the Productivity Commission is aware, and has thoroughly investigated in its Electricity Network Regulation Review, there remain significant practical difficulties with apportioning capacity on electricity networks and some gas transmission systems in a way that allows for financial risk management within the physical constraints of the system. These issues are difficult to solve. The AEMC's reviews have included:

- *Congestion Management Review* (2008)[2] dealing with mechanisms for addressing network congestion in the NEM
- *Climate Change Review*[3] (2010) dealing with inter-regional transmission charging and capacity building for reliability standards
- *National Transmission Planner framework* (2008)[4] dealing with improvements to the transparency and coordination of transmission planning nationally
- *Review of National Framework for Electricity Distribution Network Planning and Expansion* (2009)[5] dealing with effective arrangements for connection of distributed generation to distribution systems
- *Review of Demand Side Participation in the National Electricity Market* (three stages 2008 – 2012) also dealing with effective arrangements for connection of distributed generation to distribution systems
- *Transmission Frameworks Review*[6] (2013) dealing with improvements to access rights and generator connection processes.

[2] http://www.aemc.gov.au/market-reviews/completed/congestion-management-review.html

[3] http://www.aemc.gov.au/market-reviews/completed/review-of-energy-market-frameworks-in-light-of-climate-change-policies.html

[4] http://www.aemc.gov.au/market-reviews/completed/national-transmission-planner.html

[5] http://www.aemc.gov.au/market-reviews/completed/review-of-national-framework-for-electricity-distribution-network-planning-and-expansion.html

[6] http://www.aemc.gov.au/market-reviews/completed/transmission-frameworks-review.html

This last review merits special attention. The AEMC has recently developed and proposed further refinement of an 'optional firm access' model of financial transmission rights. These aim to apportion – in a financial sense – a right of generators to dispatch into the market. The absence of such a right is a shortcoming of the 'open access' regime that otherwise prevails. Both a financial transmission rights model and an open access model give generators an effective right of access to the transmission system, but the former has important potential advantages in terms of risk management and, as a result, overall economic efficiency.
It is the AEMC's focus on the economic efficiency-based National Electricity Objective that drives its focus on development of these refinements. It is difficult to see what certification would contribute in a situation where the regulatory institutions are already fully committed to effective access arrangements.

5. Risks of certification

Further, involvement of the NCC through a certification process risks undermining the rule making process administered by the AEMC. The AEMC is an independent statutory authority with specialised expertise in energy market regulation, with rule making following a prescribed process involving the application of clear statutory criteria. The AEMC is also a prolific rule-maker, reflecting the significant changes underway in the energy sector in response to a range of policy challenges. There have been – at the time of writing – 55 versions of the NER since their establishment in 2005, and 16 versions of the NGR since 2008. These rules are complex, technical, and reflect the deep linkages between all aspects of the energy supply chain which make it difficult to deal with 'access' to infrastructure in isolation from broader matters of wholesale market design and system operation. It is also fair to say that with the degree and scope of changes being made to the NER and NGR by the AEMC, frequent re-certification may need to be sought in order to ensure continuing certification of the energy access regimes, thereby creating a second stage to regulatory rule making.

To return to the insights of the Parer Review mentioned previously,the AEMC was created so that rule changes could be processed quickly and efficiently, and in one process so as to give the industry and its investors certainty over the direction of energy rule making. Including the NCC in the rule making process has the capacity to undermine the progress that has been gained by the AEMA reforms by once again creating a second rule maker, implying regulatory duplication and reduced flexibility. As previous experience with the ACCC's authorisation process has shown, the second rule maker may become the primary rule maker quite inadvertently due to strategic behaviour by industry participants.
In a review commissioned by the MCE in 2010, PricewaterhouseCoopers[7] noted that, while the NCC has so far adopted a light-handed approach to the assessment of access regimes,

[7] *Certification of the energy access regimes: review for the Ministerial Council on Energy Standing Committee of Officials*, PriceWaterhouseCoopers consultant report to MCE, November 2010.

there are a number of controversial and complex issue with energy access regimes – electricity in particular – that could be expected to be raised in stakeholder submissions, with potential for the NCC to be drawn into a detailed assessment of complex parts of those regimes and for those matters to be re-litigated during certification processes. While the approach taken by the NCC so far had been light-handed and pragmatic, this was largely determined by decision-makers and culture, and there was nothing to preclude a change in this stance.

Finally, should the NCC engage with the energy regimes in detail, and in so doing decide to make certification of the energy access regimes dependent on changes being made to the NER or NGR, it is unclear what this might mean practically for the AEMC and the rules it administers. The AEMC, as previously mentioned, is a statutory authority which performs its duties according to the national energy objectives and its functions and powers under the NEL and NGL. It is quite unclear whether the AEMC – having decided that a rule is optimal in terms of meeting the national electricity or gas objective – is permitted to change that rule on the basis that the NCC has found it not optimal for the purposes of a similar but different set of criteria as specified in the CPA. There is a risk of a regulatory impasse developing under these circumstances which is detrimental to the operation of the energy governance framework generally.

In summary, DSDBI believes that the current framework for certification of effective access regimes under Part IIIA of the CCA is problematic for energy access regimes specifically. Due to changes in the regulatory framework for energy, there now exists no compelling rationale for the supervisorial role of certification in this sector. At the same time, any move to certify the access regimes would be highly problematic and risk undermining the benefits of the reforms implemented through the AEMA since 2004. There is therefore a case to reform this aspect of the national access regime as it applies to the energy sector.

6. Reform options

As things stand, the energy access regimes are not certified, and the SCER decided in December 2011 not to progress work to certify those regimes in view of the risks previously outlined. Without being certified, there exists in theory an ability for an access seeker to seek declaration of infrastructure, in spite of it being covered by the access regimes under the NEL and NGL. So far, though, no such access seeker has come forward, and DSDBI considers that the risk of any party taking this action is negligible. It is difficult to see how an access seeker could hope to gain a more favourable outcome than they would by seeking access through the well-established processes under the energy laws.

Nevertheless, it would be desirable to put this matter beyond doubt, to ensure that infrastructure owners and access seekers alike have certainty over access arrangements. To do so without compromising the effectiveness of the energy regulatory arrangements, the

effectiveness of the energy access regimes could be statutorily recognised under Part IIIA, reflecting the Commonwealth's adoption and endorsement of these regimes as a party to the AEMA (and the fact that unanimous agreement of the SCER is required to change the laws establishing them).

In order for the Commonwealth to ensure that the access regimes maintain consistency with good competitive regulatory practice in future, the Commonwealth could utilise the NCC in an advisory role in the event of any major changes to the NEL or NGL being proposed and affecting the access regimes. This would be appropriate to the task and allow the relevant Minister to be informed as to implications of changes to these laws when they are raised and debated at the SCER. It is important that the Minister accountable for decisions on access matters under the NEL and NGL be the Minister for Energy and Resources in recognition of the decision making role of the SCER. There appears to be no impediment to the Minister for Energy and Resources seeking this input via the Treasurer or Assistant Treasurer, though it would be more efficient if the Minister for Energy and Resources were empowered to directly seek this input from the NCC.

7. Comments on Productivity Commission Draft Report

Turning now to some comments and questions raised by the Commission in its Issues Paper and Draft Report, DSDBI offers the following comments.

7.1 Productivity Commission suggested options

The Commission states that deemed certification (what we have otherwise referred to as statutory recognition of effectiveness) or exemption from the national access regime would not be appropriate for the following reasons:

- Such an approach could set a precedent for exempting other infrastructure services from the Regime; and
- This would remove the potential for declaration if, in the future, declaration of services provided by electricity and gas networks was expected to have net benefits.

Having rejected this option, the Commission therefore puts forward two options:

1. Removing the requirement in the AEMA for electricity and gas regimes to be certified – the Commission states that this would remove any administrative costs associated with the commitment to certify, and that reforms proposed by the Commission to the certification criterion would make it more likely that state and territory governments would certify their regimes.
2. Re-emphasising the requirement for the states and territories to certify their access regimes.

Statutory recognition of the energy access regimes as a third option

For the reasons outlined above, DSDBI supports introducing provisions into Part IIIA recognising the effectiveness of the energy regimes. Further, DSDBI would like to examine the Productivity Commission's two reasons for rejecting this option.

Firstly, the Commission is concerned about setting a precedent. However, Commonwealth-determined industry-specific access regimes are already exempted from the requirement to be certified. As the Commission notes in Box 2.2, the Commonwealth Government has in the past considered certification of its own regimes unnecessary, presumably feeling that adequate controls are already in place internally to ensure that its access regimes remain effective. The Commonwealth also applies the energy access regimes through the *Australian Energy Market Act 2004* and has a determinative role over these regimes through the SCER. Thus it is arguable that recognition of the effectiveness of the energy regimes follows, rather than establishes, a precedent.

Secondly, the Commission states that declaration may have benefits in the future. It is difficult to see how this could be the case. DSDBI agrees with the AEMC's comment in its submission to the Issues Paper that a declaration application in itself would create confusion, uncertainty, and affect investor confidence. In the event a declaration were granted, Australian Energy Regulator may need to vary its determinations so the access seeker could get access to shared network services on different terms to those granted under the energy access regimes. This would necessitate disentangling shared network investment between two differing access regimes and differing pricing arrangements. This would be complicated and difficult to achieve, and would create regulatory uncertainty.

The alternative options put forward by the Commission would not fully resolve the problems identified here.

Removal of the requirement to certify

DSDBI supports this at a minimum. However, even if the AEMA's certification requirement were removed, the risk of declaration, or a declaration application (even if it is a very low risk) would remain, which for the reasons discussed above, is undesirable, and appears to have no benefits.

In putting this option forward, the Commission makes the problematic assumption that certification of energy access regimes would help serve the purposes of the National Competition Agreement if its administrative costs could be minimised. For the reasons discussed under 'Risks of Certification', certification is unnecessary in relation to energy access regimes, and poses a risk to the effective functioning of the national energy regulatory framework.

Re-emphasising certification

DSDBI strongly opposes this option for the reasons outlined throughout this submission.

7.2 Answers to Draft Report questions

What are the consequences of the potential for declaration of an electricity or gas network if regimes remain uncertified?

As outlined above, while the risk of a declaration or declaration application appears to be negligible, an application would create confusion, uncertainty, and affect investor confidence. Further, if granted, the declaration would be complicated and difficult to implement given the shared nature of services regulated under the energy access regimes, and would create regulatory uncertainty.

What are the costs and benefits associated with certifying the electricity and gas access regimes? How would the proposed reforms outlined in draft recommendation 8.5 affect these costs and benefit?

In relation to energy access regimes, certification is unnecessary and poses significant risks to the effective functioning of the regime, in particular, the AEMC rule making process. By introducing a formal process by which parties including energy providers and access seekers can apply for certification to be revoked, the draft recommendation if anything increases those risks.

Would certification lead to greater consistency between the National Access Regime and the gas and electricity access regimes?

To answer this question we must first address two scenarios:

- In the first, an application for certification is lodged and the NCC takes no issue with the consistency of the energy access regimes with the certification criteria. In this case, the answer is "no", certification does not lead to greater consistency with the national access regime. In the same way, certification adds no value to the energy access regimes, but does impose costs and cannot be held to be of net benefit.

- In the second, an application for certification is lodged and the NCC *does* take issue with the consistency of the energy access regimes with the certification criteria, and recommends that changes be made conditional to certification being granted. In this scenario it is difficult to see what the outcome might be. As noted earlier, it is unclear what the effect a refusal of certification – if any – might have on the energy access regimes themselves, given the AEMC's statutory responsibilities to the national electricity and gas objectives. Such a refusal would however give rise to all the risks previously enumerated around regulatory uncertainty. It may be that no changes are

ultimately made and the regimes remain uncertified, in which case no greater consistency would be achieved. On the other hand changes might be made somehow to suit the NCC's judgment, which would serve to elevate its authority in relation to the AEMC, and give rise to the 'forum shopping' and dual-process risks DSDBI has also outlined.

In either scenario the premise of whether it is inherently desirable to promote consistency with the national access regime must be questioned. It is a rare access seeker who would derive benefits from consistency *per se* across different industry specific access regimes given the major differences in service characteristics between infrastructure industries.[8] What is presumed to be desirable is *consistency with generally good regulatory practice*.

The national access regime may or may not be held to embody generally good regulatory practice, but this is somewhat beside the point when the governance framework for the energy access regimes itself embodies generally good regulatory practice and compels administering institutions, including the AEMC, to pursue enhancements to it. Given the appropriateness of the economic efficiency objectives of the national energy laws, and the demonstrated commitment of the AEMC to enhancing the effectiveness of access in pursuit of this objective, and taking into account the risks associated with certification, it is difficult to see how consistency for its own sake with the national access regime could be of benefit.

What should be guarded against is future divergence of the energy access regimes from generally good regulatory practice with regard to access. DSDBI considers that this is best done by using the SCER as the governing body to ensure this is the case, and providing appropriate advice to that body via the Commonwealth Minister for Energy and Resources. It is in this role that the NCC and other Commonwealth institutions could add value.

[8] The electricity and gas frameworks are an exception to this – having a common set of major access seekers for similar services – and this is why they are dealt with under a common legal framework (and consistency between them is promoted by the AEMA).