# 21 Governance

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| Key points |
| * Governance of the National Electricity Market (NEM) and its institutions is critical to achieving the National Electricity Objective through efficient electricity network regulation. It particularly affects network revenue and price determinations, network planning, and the speed of reform. * Participants (and stakeholders) have concerns about aspects of the governance of the Australian Energy Regulator (AER), currently located within, and resourced through, the Australian Competition and Consumer Commission (ACCC). * AER surveys indicate that stakeholders do not appear to have a high level of confidence and trust in the regulator, and that their ratings of the regulator’s performance and reputation have declined in recent years. * Some participants question whether the AER has sufficient resourcing, specialist expertise and capacity to fulfil its current and growing obligations, However, there is no publicly available information to assess these matters. * Two immediate measures to improve the AER’s governance, while retaining the regulator within the ACCC, are to: * undertake an independent review of the AER’s resourcing and capacity * give the AER more control over its budget and resources, and make it more accountable (such as through a separate annual report) for how it manages those resources. * A more far-reaching option would be to remove the AER from the ACCC and establish it as a separate independent entity — with full or partial funding from an industry (or NEM) levy. This raises complex issues upon which further input from participants is sought. * The participation of consumers (such as households, small businesses and major industry users) in NEM policy, regulatory, rule-making and review processes is fragmented. There would be merit in a single consumer body having adequate public funding, and with expertise in economic regulation and energy markets. This body could participate in NEM processes and in negotiating settlements with network businesses. * The powers of the South Australian Minister and the Australian Energy Market Commission should be amended to fast-track Rule changes proposed by appropriately undertaken reviews and agreed to by the Standing Council on Energy and Resources. This would hasten reform and reduce costs for, and consultation burdens, on stakeholders, while still providing appropriate checks and balances. |
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The governance of the National Electricity Market (NEM) and its institutions is critical to the:

* achievement of the National Electricity Objective (NEO)
* efficiency of current electricity network regulation, particularly in relation to making network revenue and price determinations, and network planning
* the pace of regulatory reform.

The governance of the NEM refers to the overarching policy and legal framework that sets out its objectives, regulates its operation, establishes and assigns functions to institutions, and sets out processes for its review and amendment. At the institutional level, governance is more narrowly concerned with how each relevant institution undertakes its functions including:

* how it is led
* how it interprets its objectives
* how it structures itself
* what priorities it sets for itself
* what analytical and technical approaches it adopts
* what internal corporate culture and values it promotes
* what staff competencies it seeks and rewards
* how it engages with stakeholders
* how it monitors the performance of its functions
* how and what it reports to governments and other stakeholders
* how it exercises any discretion
* whether it has processes for continuous improvement and change.

This chapter focuses on three areas of governance relating to electricity network regulation.

* The Commission has made recommendations in this report that will increase the regulatory responsibilities of the Australian Energy Regulator (AER). However, participants have raised concerns about how the AER manages its current functions, which has implications for its capacity to absorb new functions (section 21.1).
* The NEO is to promote efficient investment in, and efficient operation and use of, electricity services for the ‘long term interests of consumers’. Participants have expressed concern about the poor engagement of consumer representatives in relation to electricity network regulation (section 21.2).
* The chapter concludes at section 21.3 by considering how the Commission’s recommendations in this report, along with those arising from reviews outside of the Australian Energy Market (AEMC), might best be implemented under the current NEM policy and legal framework, and whether that framework lends itself efficiently to this task.

## 21.1 Governance of the Australian Energy Regulator

The AER is the national regulator of the wholesale electricity and gas markets. It was established in July 2005 as a statutory body under then *Trade Practices Act 1974* (now the *Competition and Consumer Act 2010).* It is funded by the Australian Government, with staff, resources and facilities provided by the Australian Competition and Consumer Commission (ACCC). The AER has three ‘members’ — two state members (including the chair) nominated by the Standing Council on Energy and Resources (SCER) and a Commonwealth nominated member who is required to be an ACCC commissioner. The Commission understands that it has around 140 staff, which accounts for 17 per cent of all ACCC staff.[[1]](#footnote-1) The structure of the AER — including its links with the ACCC, the SCER, and two external review bodies — is set out in figure 21.1.

The AER’s functions in relation to the NEM include:

* the economic regulation of electricity transmission and distribution network providers (including making revenue and price determinations)
* monitoring the wholesale electricity market to ensure compliance with the National Electricity Law, Regulations and Rules, investigating any breaches, and taking enforcement action where necessary
* preparing and publishing reports such as on the financial and operational performance of network service providers.

The AER was originally conceived by the Parer Review Panel in 2002 as an ‘independent’, ‘separate energy sector-specific agency’ (Parer et al. 2002, pp. 84, 86).

Figure 21.1 Structure of the Australian Energy Regulator

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| Structure of the Australian Energy Regulator. This figure shows the organisational structure of the Australian Energy Regulator and its relationship with the ACCC. |

*Data sources*: ACCC and AER (2011); AER (2012k); SCER (2011c).

Nevertheless, the Ministerial Council on Energy (MCE) subsequently decided that, while the AER would be a ‘separate legal entity’, it would be a ‘constituent part’ of the ACCC (MCE 2003b, p. 5; MCE Standing Committee of Officials 2004a, p. 2).

When the AER was established, the inaugural chair, Steve Edwell, considered that the ‘legal construct’ of the AER as a ‘separate legal entity’, and its incorporation into the ACCC, would not affect the regulator’s independence :

… the AER’s legislation is unequivocal in terms of its independence and the AER will be responsible for making decisions on energy regulatory matters independently of the ACCC. The AER will have its own dedicated staff and other necessary resources and identity separate from the Commission. (Edwell 2005, p. 5)

### Areas of concern

The establishment of the AER in 2005 was an essential step in creating a nationally consistent approach to the regulation of the energy sector, particularly of electricity networks. The benefits of having a national energy regulator were expressed by Edwell as follows:

Simply put, the key principle behind the establishment of the Australian Energy Regulator was that a national energy market needs a national energy regulator. Different approaches to regulating utilities across jurisdictions distort investment decisions and create unnecessary costs and barriers for utilities operating jurisdictional boundaries.

Despite the fact that gas and electricity has been traded across borders for some time now, giving rise to a national market in both sectors, there are still a dozen or so state and territory energy regulators. The AER will, over the next few years, replace jurisdictional regulators and become a “one stop shop” regulator for the energy sector on a national basis.

A single and independent regulator will reduce regulatory costs and uncertainty to business and allow both gas and electricity markets to develop along, as much as possible, a consistent regulatory framework. (Edwell 2005, p. 2)

However, seven years on, participants in this inquiry and in other reviews have raised concerns — some inter-linked — about the governance of the AER. In assessing these concerns, the Commission has drawn on several core principles, which it considers to apply to ‘good governance’ (box 21.1).

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| Box 21.1 The Commission’s principles of good governance |
| During the Commission’s work in regulatory benchmarking, and in other areas, a number of principles and leading practices have emerged that are relevant to ensuring the good governance of a regulator. These principles are that the regulator:   * has ‘sound’ objectives, such as to maximise community wellbeing or economic efficiency, which are prioritised where they conflict * is independent and impartial in that its decisions and actions are not subject to the influence of any one stakeholder or group of stakeholders (including governments) * has effective and strong leadership * has a board of directors appointed on the basis of their independence, expertise and skills * has staff with appropriate expertise and skills * has adequate funding to fulfil its functions * applies rigour and sound evidence in making decisions and taking actions * keeps up to date with, and where appropriate, adopts international regulatory best practices and innovations, which improve the efficiency and effectiveness of regulation * consults with the wider community in making decisions and taking actions * has the trust and confidence of all its stakeholders * is transparent about its decisions and actions * is timely in its decisions and actions * is accountable to others for its decisions and actions * uses its resources efficiently to achieve its objectives * is subject to periodical independent reviews of its capability and performance. |
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#### Stakeholders’ confidence and trust

Many stakeholders currently have poor perceptions of the AER. The limited merits review panel recently said:

As a relatively young organisation, created in conjunction with a re-allocation of powers between States and the Commonwealth, the AER does not appear, on the basis of evidence given to the Panel, yet to enjoy a high degree of confidence and trust among many stakeholders. (Yarrow et al. 2012b, p. 47)

According to the 2011 Australian Energy Regulator Stakeholder Survey (figure 21.2), stakeholders’ positive views about the AER have declined since 2008 in relation to:

* all 12 performance indicators, with ‘professionalism, ‘quality of outputs’ and ‘analytical/intellectual capacity’ experiencing the largest declines of all the indicators
* all seven indicators of reputation, particularly in relation to the AER being ‘credible’, ‘reliable’ and ‘independent’
* four of five indicators of communication processes and materials, particularly in relation to the ‘relevance’ and the ‘quality’ of the AER’s information.

The trends in the survey results are disturbing. When the survey was first undertaken, the AER was still a relatively new agency and likely to have faced teething problems. It might be reasonable to expect that the longer the AER operated, the more experienced it would have become in managing its functions and, thus, the more positive would have been the views of stakeholders. However, as the Energy Networks Association noted, ‘... the opposite seems to have occurred’ (sub. 40, p. 4).

The Commission has received other, largely confidential, evidence of poor stakeholder confidence and trust, which corroborates the Australian Energy Regulator Stakeholder Survey’s findings.

* Under the National Electricity Rules, the AER is responsible for acting as a neutral arbitrator and for making unbiased and objective determinations in the ‘long term interests of consumers’. However, some consumer groups believe that the AER should, and does, act as their ‘proxy’ in the determination process (Consumer Action Law Centre sub. 5, p. 2). Such views might colour other stakeholders’ perceptions of the AER’s independence, even though the regulator has asserted that it does not act in the interests of any particular party (AER 2012l, p. 7).
* The Commission has been told by various participants that the:
* AER determination process is ‘combative and adversarial’, and lacking in consultation, with frequent ‘surprises’ arising from determinations
* consultation process between UK distributors and Ofgem involves significant ongoing contact between the regulator and firms, whereas consultation between the AER and the network businesses occurs mainly between a network’s initial proposal and the draft determination, with very little interaction outside this period
* AER is the ‘poor cousin of the ACCC’, in contrast to generally favourable comments about the AEMC.

Figure 21.2 Australian Energy Regulator Stakeholder Survey responsesa

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| **Performance**  Respondents who rated the AER as ‘good’ or ‘excellent’ on specific performance indicators Australian Energy Regulator Stakeholder Survey responses. This figure compares responses related to performance from surveys conducted in 2008 and 2011. | **Reputation**  Respondents who rated aspects of the AER’s reputation as ‘well’ or ‘very well’ This figure compares responses related to reputation from surveys conducted in 2008 and 2011. |
| **Consultation**  Respondents’ views on whether the AER’s processes provide adequate opportunities for consultation with stakeholders This figure compares responses related to consultation from surveys conducted in 2008 and 2011. | **Communication**  Respondents who rated aspects of the AER’s communication processes and materials as ‘good’ or ‘excellent’ This figure compares responses related to communication from surveys conducted in 2008 and 2011. |

a The Australian Energy Regulator Stakeholder Survey, undertaken in 2008 and 2011, assesses stakeholder views about the AER in relation to four areas: performance, reputation, consultation, communication. The most recent survey allowed stakeholders to give feedback on these areas in relation to how the AER carried out the following three roles: monitoring, compliance and enforcement under national electricity and gas laws; preparing for responsibilities under the National Electricity Customers Framework (retail law); and electricity and gas network regulation. b The number of respondents in 2011 was 112 and in 2008 was 114.

*Data source*: Buchan (2011).

#### Resourcing and capacity

The AER needs adequate resources and capacity (including appropriate in-house specialist expertise) to undertake its functions effectively, including to apply rigorous analysis to its revenue and price determinations for network businesses. Should the Commission’s recommendations be accepted, the AER will require additional resources to be effective.

Participants have expressed concerns that the current resourcing and capacity of the AER does not adequately support its current functions, let alone any expansion of these. For example, the Energy Users Association of Australia noted that network service providers:

... have been calling for more resources for the regulator in the context of the current debate about economic regulation of energy networks. This can be seen, for example, in their submissions to the AEMC on the AER’s rule change proposals. (sub. 24, p. 10)

Some have claimed that the ACCC has an adverse influence on this capacity. The Energy Networks Association (sub. 40, pp. 1–2) also considered the following:

* The AER faces ‘internal competition’ for high quality staff from other ‘high profile’ parts of the ACCC. The consequences of this include ‘rapid’ staff turnover, the loss of specialist in-house expertise in the AER, a relative lack of stability and continuity within AER review teams, and relatively junior staff typically playing a significant role in the initial stages of AER determination processes.
* The lack of equivalent resources within the AER ‘drives’ a significant reliance on externally sourced specialist expertise, which does not add to the ongoing knowledge capital of the AER. This may be an unintended consequence of the AER being bound to employ staff on the same terms and conditions as ACCC staff and being subject to the same human resourcing challenges facing the Australian Public Service as a whole.
* Other energy regulatory bodies and institutions have been able to develop or have an in-house capacity of specialist expertise — for example, the UK Office of Gas and Electricity Markets (Ofgem) and the AEMC.

Grid Australia agreed that the AER should be strengthened and have more skills:

... What we are concerned about is a regulator that does not have the skills or capability and just gets it wrong. ... the industry expects [the regulator] to have the knowledge of the industry, not only the economic and legal, but also the engineering competence, and the ability to engage with businesses in a deep and constructive way to truly understand the businesses’ needs and business cases. (2012b, p. 39)

Unfortunately, transparent information about the resourcing and capacity of the AER is not separately available to help assess these concerns. Information about the AER’s budget, the AER’s in-house expertise, staff allocation across areas of the AER’s work, and staff movement between the AER and ACCC is not on the public record.

Nonetheless, at least prima facie, it appears to the Commission that the resourcing and capacity of the AER to undertake its functions is currently inadequate. The lack of transparent information itself raises further concerns about the accountability and independence of the AER.

#### Errors

Participants raised concerns about errors in the AER’s decisions identified by the Australian Competition Tribunal (‘the Tribunal’) in its limited merits reviews.[[2]](#footnote-2)

AER decisions reviewable by the Tribunal include:

* revenue and price determinations for transmission and distribution in electricity (including application of regulatory test)
* decisions not to exempt entities from ring fencing guidelines or to impose additional ring fencing requirements in electricity.[[3]](#footnote-3)

Based on its analysis of the applications by network businesses to the Tribunal since 2008 (when limited merits review commenced[[4]](#footnote-4)), the Energy Networks Association (ENA 2012; sub. 40, p. 3) observed that the:

* Tribunal found material errors in many AER network revenue and price determinations, including ‘recurring fundamental errors’
* material errors found by the Tribunal related to ‘fundamental issues’ such as the use of relevant evidence, the interpretation and application of accepted statistical techniques, and the application of logically consistent principles to derive conclusions from empirical evidence
* AER itself conceded errors on its part in more than one-third of over 60 specific matters raised in the appeals to the Tribunal.

Information provided by the Australian Government Solicitor to the limited merits review panel also shows the extent of errors found by the Tribunal in AER (electricity and gas) decisions not involving weighted average cost of capital (WACC) parameters (table 21.1). Applications to the Tribunal since 2008 appealed some 50 elements of those decisions. The AER conceded errors in five elements. Around 21 elements appealed were affirmed by the Tribunal, with the remaining 25 elements varied by the Tribunal or remitted to the AER.

Table 21.1 Tribunal cases involving non-WACC parameters in AER electricity and gas decisions, January 2008 to February 2012

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| --- | --- | --- | --- | --- | --- |
| Application to the Tribunal by: | Date of Tribunal judgment | No. of elements appealed | No. of elements remitted  or varied | No. of elements affirmed | No. of elements conceded by AER |
| United Energy Distribution | 6 Jan 2012 | 14a | 7 | 6 | 2 |
| Envestra Ltd | 11 Jan 2012 | 2 | 1 | 1 | 0 |
| Jemena Gas Networks (NSW) | 25 Feb 2011 | 5 | 2 | 3 | 0 |
| Ergon Energy Corporation Ltd (Service Target Performance Incentive Scheme) (No. 5) | 24 Dec. 2010 | 1 | 0 | 1 | 0 |
| Ergon Energy Corporation Ltd (Non-system Property Capital Expenditure) (No. 4) | 24 Dec 2010 | 1 | 1 | 0 | 0 |
| Ergon Energy Corporation Ltd (Labour Cost Escalators) (No. 3 and No. 9) | 24 Dec 2010 10 Feb 2011 | 3 | 2 | 1 | 0 |
| Ergon Energy Corporation Ltd (Customer Service Costs) (No. 2) | 24 Dec 2010 | 1 | 0 | 1 | 0 |
| Ergon Energy Corporation Ltd | 13 Oct 2010 | 1 | 1 | 0 | 0 |
| ETSA Utilities | 13 Oct 2010 | 1 | 1 | 0 | 0 |
| United Energy Distribution | 23 Dec 2009 | 1 | 1 | 0 | 0 |
| Energy Australia and Others (No.1 and No.2) | 12 Nov 2009 25 Nov 2009 | 4 | 3 | 1 | 1 |
| Energy Australia | 16 Oct 2009 | 11 | 5b | 6 | 2 |
| ElectraNet Pty Ltd (No. 3) | 30 Sept 2008 | 2 | 1 | 1 | 0 |

a The finding of the Tribunal in relation to one element is unknown for confidential reasons. b Although the Tribunal affirmed the AER’s decision in 4 elements, it suggested the AER may reconsider the issue on remittal.

*Source:* Yarrow et. al. (2012b, annex 1).

Examples of the elements varied or remitted, included errors by the AER in its:

* methodology for indexing the regulatory asset base for inflation (United Energy Distribution, 6 January 2012)
* rejection of the applicant’s claim for an addition to be made to its regulatory asset base in respect of easements extant as at 1 July 1999 (ETSA Utilities, 13 October 2010)
* calculation of ‘other’ operating expenditure in relation to public lighting (Energy Australia, 16 October 2009).

However, some caution is needed in drawing strong conclusions about the degree to which this reflects a lack of rigor (as some claim).

* There is a selection bias associated with appeals cases. Because of the costs involved, applicants are unlikely to appeal any case that does not have a good prospect of success. Hence, any cases that are appealed are likely to represent a high likelihood that an AER error was made, rather than the reverse.
* Appeals cases typically represent a tip of the iceberg of all AER decisions (that are potentially subject to review by the Tribunal).
* The Tribunal can look at particular components of an AER decision without considering other related components. Had the Tribunal taken a more holistic approach, sometimes the AER’s aggregate estimate may have been seen to have been reasonable (which may be a better measure of error).

#### A model litigant?

Another area of concern, flagged by the limited merits review panel, is the degree to which the AER has used its powers under the National Electricity Law, in relation to reviews of its decisions by the Tribunal, to raise:

(a) a matter not raised by the applicant or an intervener that relates to a ground for review, or a matter raised in support of a ground for review, raised by the applicant or an intervener;

(b) a possible outcome or effect on the reviewable regulatory decision being reviewed that the AER considers may occur as a consequence of the Tribunal making a determination setting aside or varying the reviewable regulatory decision. (s. 71O (1))

The limited merits review panel described the ‘puzzle’ of why the AER abstains from exercising its powers as follows:

A major question that has arisen in the context of evaluating the operation of the [limited merits review] to date is: *why has the AER systematically declined to use its s. 71O (1) powers in electricity (s. 258 (1) powers in gas), even in circumstances where it was manifestly the case that (a) the matters being appealed were economically related to other aspects of the AER’s determinations which were not being appealed, and (b) decisions on the contested matters could be expected to have very significant implications for the long term interests of consumers.* (Yarrow et. al. 2012b, p. 59)

In its submission to the limited merits review panel, the AER stated that its role in reviews is to ‘actively and objectively’ assist the Tribunal.

In doing so, the AER does not act as a protagonist. Instead, it acts to ensure that all relevant issues are canvassed before and understood by the Tribunal. (2012b, p. 9)

The AER’s usual practice is to make submissions to the Tribunal that:

* explain the Tribunal’s functions and powers and the relevant procedures and processes
* adduce evidence and present its view where it does not agree there is an error
* promptly concede where it agrees there is an error, to minimise the time and expense incurred before the Tribunal
* raise issues of public interest with the Tribunal.

The AER considers this role as ‘appropriate’ given the National Electricity Law and the National Gas Law, and the obligation on it to act as a ‘model litigant’ (2012b, p. 9). However, while the above role is consistent with the notion of a model litigant (box 21.2), a requirement to be a model litigant does not appear to rule out the proper defence of a position (Lee 2006, p. 10). The question then is whether the AER has the ability to use its prerogative under s. 71O (1) of the National Electricity Law (and its equivalent provision in the National Gas Law).

The limited merits review panel sought ‘authoritative legal advice’ from the Australian Government Solicitor as to why s. 71O (1) of the National Electricity Law and the equivalent section in the National Gas Law have not been used ‘more actively’ by the AER (Yarrow et. al. 2012b, p. 65). The Australian Government Solicitor was of the opinion that the sections do not enable the scope of a review before the Tribunal to be broadened by the AER or the Tribunal itself to encompass additional grounds of review.

Paragraph (a) permits the original decision maker to raise a ‘matter’ not otherwise raised. However, the matter must ‘relate[ ] to’ a ground for review ‘raised by’ the applicant or intervener. Paragraph (b) permits the original decision maker to raise ‘a possible outcome or effect’ of the Tribunal setting aside or varying the original decision, but similarly does not broaden the basis (that is, the grounds) on which the Tribunal might set aside or vary the decision or decisions under review. (AGS 2012, p. 6)

The limited merits review panel will be considering the issue further in its final report to SCER (Yarrow et. al. 2012a, 2012b).

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| Box 21.2 The Australian Government’s model litigant provisions |
| **The obligation**  1 Consistently with the Attorney-General’s responsibility for the maintenance of proper standards in litigation, the Commonwealth and its agencies are to behave as model litigants in the conduct of litigation.  **Nature of the obligation**  2 The obligation to act as a model litigant requires that the Commonwealth and its agencies act honestly and fairly in handling claims and litigation brought by or against the Commonwealth or an agency by:   1. dealing with claims promptly and not causing unnecessary delay in the handling of claims and litigation   (aa) making an early assessment of:  (i) the Commonwealth’s prospects of success in legal proceedings that may be brought against the Commonwealth; and  (ii) the Commonwealth’s potential liability in claims against the Commonwealth   1. paying legitimate claims without litigation, including making partial settlements of claims or interim payments, where it is clear that liability is at least as much as the amount to be paid   (c) acting consistently in the handling of claims and litigation  (d) endeavouring to avoid, prevent and limit the scope of legal proceedings wherever possible, including by giving consideration in all cases to alternative dispute resolution before initiating legal proceedings and by participating in alternative dispute resolution processes where appropriate  (e) where it is not possible to avoid litigation, keeping the costs of litigation to a minimum, including by:  (i) not requiring the other party to prove a matter which the Commonwealth or the agency knows to be true  (ii) not contesting liability if the Commonwealth or the agency knows that the dispute is really about quantum  (iii) monitoring the progress of the litigation and using methods that it considers appropriate to resolve the litigation, including settlement offers, payments into court or alternative dispute resolution, and  (iv) ensuring that arrangements are made so that a person participating in any settlement negotiations on behalf of the Commonwealth or an agency can enter into a settlement of the claim or legal proceedings in the course of the negotiations  (f) not taking advantage of a claimant who lacks the resources to litigate a legitimate claim  (g) not relying on technical defences unless the Commonwealth’s or the agency’s interests would be prejudiced by the failure to comply with a particular requirement  (h) not undertaking and pursuing appeals unless the Commonwealth or the agency believes that it has reasonable prospects for success or the appeal is otherwise justified in the public interest, and  (i) apologising where the Commonwealth or the agency is aware that it or its lawyers have acted wrongfully or improperly. |
| *Source:* AGS (2005). |

### The way forward

The Commission understands that the ACCC/AER is aware of many of the above areas of concern — particularly in relation to its resourcing and capacity — and appears to be taking measures to address them.

At its October meeting, the SCER (2012) has commenced a discussion on options relating to ‘institutional governance and funding’. All ministers agreed that the AER, however structured, should have sufficient capacity to manage the enhanced role envisaged through the current reform processes. There was ‘strong support’ from a number of ministers for structural separation of the AER from the ACCC.

The Commission notes that, as some of the areas of concern about the AER’s governance are inter-linked, an option intended to address one area of concern may also address another. For example, improving the resourcing and capacity of the AER may not only enable it to be more effective in undertaking its functions, it can lift stakeholders’ confidence and trust in the regulator.

The remainder of this section considers two broad options in relation to the AER’s governance:

* options for improving the resourcing, independence and accountability of the AER while retaining it within the ACCC
* options involving the separation of the AER from the ACCC.

#### Options for improvement while retaining the Australian Energy Regulator within the Australian Competition and Consumer Commission

One option is to integrate the AER completely within the ACCC and to abandon having an independent specialist energy regulator. However, the Commission considers that this option, although possible, is not likely to lead to significantly improved outcomes in terms of addressing the areas of concern discussed earlier.

The Commission considers there are two other credible options for improving the governance of the AER, while retaining it within the ACCC, which should occur immediately.

##### An independent review of the resourcing and capacity of the Australian Energy Regulator

As an important step, the Commission considers that there should be an independent small-scale and quick review of the resourcing and capacity of the AER to undertake all its functions, including with respect to the gas market.

The review should, among other things, examine:

* resourcing of the AER from the ACCC — its budget, staffing, and other resources
* staffing matters such as the AER’s capacity to recruit appropriate specialist expertise, work allocation, staff competencies in relation to the performance of the AER’s role, staff turnover within the AER, and staff movement between the AER and ACCC
* remuneration conditions offered by the AER (particularly, compared with the AEMC) to attract and retain the specialist expertise necessary to perform its role
* the extent of cost savings and other benefits from the AER being located within the ACCC
* whether current approaches to resourcing impede the AER’s effectiveness
* options for improvement.

The review should involve consultation with AER board members and staff, ACCC commissioners and staff, and external stakeholders.

The review panel should consist of a small group of senior and experienced persons drawn from outside of the ACCC/AER with an appropriate understanding of the competencies required to undertake utility regulation and, particularly, electricity network regulation. Including in the panel persons with international experience of similar regulators could be helpful.

draft Recommendation 21.1

There should be an independent review of the resourcing and capacity of the Australian Energy Regulator to undertake all its functions, including whether there are impediments to its performance and options for improvement.

##### Measures to improve the Australian Energy Regulator’s independence and accountability

Since a review of the AER’s resourcing and capacity is likely to take time, the Commission believes that some immediate ‘no regrets’ measures should be taken. While retaining the AER within the ACCC, these measures would give the regulator greater independence and, at the same time, make it to more accountable for how it manages its resources.

* Giving the AER administrative control over its own budget, which would need to be adequate for it to manage its functions effectively, including acquiring developing and retaining the necessary specialist expertise. This might require negotiating with the ACCC to pay for corporate services and other ‘overheads’.
* Requiring the AER to submit a separate annual report from that of the ACCC.
* Ensuring that the AER publicly reveals its strategy for improving its performance, including how it intends to address concerns from stakeholders that become apparent from the Australian Energy Regulator Stakeholder Survey. This includes providing milestones against which to assess whether the strategy was working.
* Enabling the AER (where it sees merit in this approach) to independently negotiate resource sharing arrangements with other relevant agencies, not just the ACCC. Other agencies could include NEM institutions such as the AEMO and AEMC, as well as state and territory utility regulators such as the New South Wales Independent Pricing and Regulatory Tribunal and the Victorian Essential Services Commission.
* Ensuring that the AER has the resources and capacity to establish and retain specialist expertise to carry expanded functions recommended by the Commission in relation to benchmarking (draft recommendation 8.6).
* Ensuring that the AER has regular ongoing communication and interaction with network businesses, their customers and other relevant stakeholders.

draft Recommendation 21.2

The Australian Energy Regulator should have greater control over, and accountability for, the resourcing and management of its functions. It should:

* have its own separate budget sufficient to meets its role
* submit a separate annual report of its performance
* publicly reveal its strategy for improving its performance
* have an independent capacity to negotiate resource sharing arrangements with a range of agencies, not just the Australian Competition and Consumer Commission
* ensure that it establishes and retains the necessary specialist expertise to competently carry out its role, in accordance with draft recommendation 8.6
* develop a program for regular ongoing communication and interaction with network businesses, their customers and other relevant stakeholders, with those interactions not just confined to periods of regulatory determinations.

#### Options involving the separation of the Australian Energy Regulator from the Australian Competition and Consumer Commission

The options above, although seen as essential and capable of being implemented immediately, would not redress the impression amongst some stakeholders that the AER is ‘Commonwealth-centric’, and likely to be resource constrained due to ongoing budgetary pressures, as the AER would still be funded by the Australian Government. Nor would the options address all concerns about the influence of the ACCC on the AER, including on its culture and attitudes.

An option that would involve more substantial changes to the governance of the AER would be to separate it from the ACCC and merge it with the AEMC to create a single agency responsible for rule making, market development, and regulatory monitoring for compliance and enforcement (similar to the UK Ofgem).

Such a merger could promote closer interaction, communication and coordination between the ‘regulators’ and the ‘rule makers’, which could lead to better quality rules and decisions being made. Currently, lack of coordination and overlap of AEMC and AER activities has been seen as problematic (for example, Grid Australia 2012c, p. 5).

However, this option raises conflicts of interest for the rule makers in the merged agency — for example, 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. Indeed, the Commission believes that the clear separation of roles — with the SCER being responsible for policy, the AEMC being responsible for rule making and the AER being the regulator — is good practice and should not be compromised.

Accordingly, the Commission does not propose the option of a merger between the AER and AEMC. Indeed, concerns about coordination and overlap in the activities of the AEMC and the AER might be better addressed under the current Memorandum of Understanding between the ACCC, AEMC and AER (2009).

However, in relation to the current inquiry, the Commission seeks participants’ input on the separation of the AER from the ACCC and establishing it as a new separate entity funded by an industry (NEM) levy. An independent and separate national regulator was envisaged by the Parer Review Panel in 2002, with ‘industry funding’ proposed later by the MCE in 2003. The following discusses this option in two parts.

*Establishing the Australian Energy Regulator as an independent separate entity*

This option would remove the AER from the ACCC and reconstitute it as an independent and separate national regulator with appropriate governance arrangements (that meet the principles in box 21.1) and a budget that allowed it greater scope to have access to internal and external specialist expertise.

Implementation could occur by way of:

* enacting new South Australian legislation akin to the *Australian Energy Market Commission Establishment Act 2005*, or
* amending the Competition and Consumer Act, which currently establishes the AER.

The AER could, where appropriate, negotiate arrangements with the ACCC, AEMC, AEMO and other relevant organisations, to share resources such as: offices, payroll services, and information and communications technology services; and professional staff.

This option would involve a range of tradeoffs that need to be carefully weighed. On the one hand, the current arrangement of retaining the AER within the ACCC has the following advantages.

* It enables a consistent and co-ordinated multi-sectoral approach to the economic regulation of infrastructure — not just to electricity networks, but also to gas, water, postal services, rail services and telecommunications. As Dassler et. al noted:

In contrast [to Ofgem and other sector-specific regulators], if, for example, the Australian model of relying on a quasi-independent regulatory authority to act as regulator for a variety of regulated entities had been adopted in the UK, a common set of resources and benchmarking expertise could have evolved for application across a number of regulated industries. Such a concentration of expertise might have had the advantage of allowing lessons learned in one industry to be better applied in other industries than is the case at present. (2006, p. 172)

Indeed, many other state and territory regulators (such as the New South Wales Independent Pricing and Regulatory Tribunal and the Victorian Essential Services Commission) are responsible for a range of infrastructure industries.

Having said that, there may also be value in having competing approaches in methods of analysis — this could lead to innovation and improvements.

* There are resource sharing benefits for the AER in that the ACCC can quickly provide staff to the AER when demands upon the regulator become ‘peaky’. This is likely to occur during revenue and price determinations. Although there are clear benefits, it might contribute to the perception of some stakeholders about staff working in the AER on determinations with little or no background in the electricity sector. The Commission understands that the AER might need more staff with lower average utilisation if the regulator had to handle these tasks on a stand-alone basis.

Arguably, however, peak demands could be addressed by way of resource sharing arrangements with relevant agencies having the necessary expertise, not just with the ACCC, or by changing the scheduling of revenue and price determinations.

* There would appear to be real synergies between the two organisations. The ACCC should be able to benefit from the AER’s advice and input on energy sector competition and consumer protection matters. The AER, in turn, should be able to gain from intellectual inputs on the weighted average cost of capital and benchmarking technical matters from a special ACCC-wide analytical branch.

However, were the AER to be separated from the ACCC, it could be argued that some current synergies with the ACCC could still be retained. For example, the AER, could still continue to interact with the ACCC (as well as other relevant regulators) in coordinating regulatory groups — such as the Infrastructure Consultative Committee and the Utility Regulators Forum — as well as in arrangements to share professional staff.

* Retaining the AER within the ACCC addresses the risks of ‘regulatory capture’ of industry regulators. Regulatory capture is where the regulator identifies with the interests of the industry.

However, even as a stand-alone entity, these risks could be mitigated to the extent that, in addition to its network regulation functions, the AER also has regulatory functions in gas (sometimes a substitute to electricity), generation (where there are concerns about connection with transmission networks) and retail (through the adoption of the National Electricity Customer Framework). Further mechanisms to reduce the risks of capture include: the creation of a consumer body (draft recommendation 21.3), which would be expected to be active in the AER’s regulatory processes; an AER with appropriate governance arrangements such as an appropriately constituted board; and secondments and exchanges of AER senior managers with counterpart international regulators.

* There are pragmatic concerns about separating the AER from the ACCC. There would be establishment costs associated with separating the AER and the ACCC such as relating to enacting or amending legislation, developing a new organisation structure, making staff appointments, and establishing payroll and information technology systems. Also, the Australian Government, concerned about the proliferation of small agencies, has previously taken measures to reduce their number.

On the other hand, there are potential advantages in removing the AER from the ACCC.

* Although the AER and the ACCC have commonalities, electricity (and gas) network regulation involves unique and complex conceptual challenges. Arguably, it requires more prescriptive detailed regulation (befitting the natural monopoly status of networks), than some other forms of infrastructure. It could be said that the most important links for the AER are not to the ACCC, but to the AEMC, AEMO and the various other electricity and gas regulators around Australian and globally.
* The ACCC faces a difficult balancing act in its role as an economic regulator and as a competition watchdog and a consumer protection regulator. A senior ACCC executive acknowledged that, along with the benefits of a ‘multi-sectoral body’, there are ‘significant challenges’ including that:

Governance and decision making needs to be provided in a framework that manages the various risks inherent in a multi-sectoral body such as the ACCC (Pearson 2011, p. 9)

A senior advisor to the ACCC considered there was a confusion of roles in utility regulators, such as the ACCC and AER:

At present there is some confusion whether a utility regulator in Australia should act on behalf of customers, soliciting and promoting their views, or whether it should objectively weigh and assess the claims of both parties — playing the role of an independent arbitrator. This is particularly an issue for the Australian Competition and Consumer Commission (‘ACCC’) which plays a consumer protection role in other sectors. The combination of increasing political pressure on utility prices, combined with weak and ineffective representation from consumer groups, is leading to increased pressure on regulators such as the ACCC and the Australian Energy Regulator (AER) to exercise a customer protection role. … customer advocacy and independent arbitration are two distinct roles which should be performed by two different entities. Public utility regulators in Australia should play the role of the arbitrator, not the consumer advocate. (Biggar 2011b, p. 7)

A particular risk is that the ACCC’s roles as competition watchdog and consumer protection regulator can spill over and affect its approach to its role, and that of the AER, as an economic regulator of infrastructure. In the former roles, the ACCC prosecutes civil or criminal offences, such as those associated with deception or anticompetitive conduct, and is inevitably (and appropriately) adversarial. In contrast, the role of an economic regulator of networks is quite technical in nature, with a requirement for extensive ongoing consultation and communication with the businesses it regulates and other stakeholders, rather than being adversarial. As noted earlier, participants have already expressed concerns about the combative approach of the AER and the lack of consultation.

##### Funding the new entity through an industry (or National Electricity Market) levy

An alternative to full Australian Government and/or state and territory government funding of an independent AER is to enable the regulator to recover its costs in part or full from an industry (or NEM) levy. (Such a levy might also be considered as a source of funding for the AER were it to remain within the ACCC.)

The option of full funding of the AER (and the AEMC) through ‘appropriate industry levies’ was recommended by the MCE in 2003. Although a consultation paper was subsequently released (MCE Standing Committee of Officials 2004b), this option did not eventuate, although the reasons for this are not apparent.

Several Australian utility regulators — such as the Victorian Essential Services Commission, the New South Wales Independent Pricing and Regulatory Tribunal, and the ACT Independent Competition and Regulatory Commission — currently recover some of their costs of providing regulatory services through mechanisms such as levies (licence fees, and charges) on regulated businesses. For example, the ACT Independent Competition and Regulatory Commission imposes an ‘energy industry levy’ to recover the amount of its ‘national and local regulatory costs’[[5]](#footnote-5) in relation to energy industry sectors as well as a licence fee on ‘prescribed energy utilities’ not covered by the levy (ICRC 2012). AEMO is currently fully funded from energy market participants.

Beyond the utility — and energy — sector, there are many other Australian examples of industry funding of national regulators. The Civil Aviation Safety Authority is fully funded from the aviation industry through fees for over 260 regulatory services, including licences and ratings, examinations, medicals and aircraft registration (CASA 2012). And the National Offshore Petroleum Safety and Environmental Management Authority is fully funded from offshore petroleum industry through a range of levies and fees including ‘safety case’ levies, well levies and an environmental plan levy (NOPSEMA 2012).

There are several potential advantages in shifting the full funding of the AER from the Australian Government’s budget to full or partial funding from an industry levy.

* Even if the initial costs were borne by NEM participants, the ultimate incidence of a levy would fall on end users of energy — a reasonable outcome for an economic regulator. The cost per customer would be very small.
* A levy coupled with the removal of the AER from the Australian Government might allow the regulator to have a remuneration policy that is more flexible than that of the Australian Public Service, and more consistent with the needs of being able to attract and retain the necessary specialist expertise required to fulfil the AER’s role.
* Partial funding through an industry levy, supplemented with some Commonwealth funding, would still enable the Australian Government to demonstrate its financial commitment, and to have a stake in regard to the regulation of national energy markets.

However, there are potential concerns about an industry levy.

* The Commission understands there might be constitutional legal issues relating to an industry levy. It might be seen as discriminatory — between those jurisdictions within the NEM and those that are not (that is, Western Australian and the Northern Territory).
* There might also be perceptions that the independence of the AER would be impaired if it were industry-funded, even though the levy could be imposed as part of the NEM settlements process administered by AEMO (rather than directly on businesses themselves).

The Commission seeks participants’ views on the costs and benefits of the following measures concerning the location and funding of the Australian Energy Regulator compared with the arrangements proposed in draft recommendation 21.2:

* removing the Australian Energy Regulator from the Australian Competition and Consumer Commission and creating a fully independent agency
* funding the Australian Energy Regulator through an industry (or National Electricity Market) levy.

## 21.2 Consumer engagement and representation

The NEO refers expressly to the ‘long term interests of consumers’.

Consumer groups collectively represent a diverse array of interests — including large industrial users, household consumers, and low income and vulnerable consumers. (Indeed, the term ‘consumer’ is hereafter used to cover all these groups of electricity customers.) Many of the consumer groups are small with most funded from a mix of public and private sources. While the larger industrial customer groups are focused on energy policy, the groups representing households have a broader interest in consumer policy and generally represent low income and vulnerable consumers.

Consumer groups have traditionally been involved at various stages of electricity network regulation — primarily, in attempting to decrease network prices or to develop better arrangements for disadvantaged consumers. They have proposed changes to the National Electricity Rules, submitted to AER network determinations, and participated in Tribunal reviews.

Each of the NEM institutions has some mechanism in place for consulting with consumers (and other stakeholders). For example, the AER has a Customer Consultative Group (consisting of 10 consumer advocacy groups) to provide it with advice on issues affecting energy consumers that fall within the scope of the AER’s functions under the National Energy Retail Law and National Energy Retail Rules. Its consultation with consumers on transmission and distribution pricing issues, however, occurs through individual determination processes, except where there are issues of ‘national significance’ (AER 2012m).

While not a consultative or advocacy body in its own right, the industry-funded Consumer Advocacy Panel (box 21.3) provides grants for consumer advocacy and research for the benefits of consumers of electricity or natural gas. This Panel was established under the *Australian Energy Market Commission Establishment Act* to promote the interests of all energy consumers, particularly small to medium consumers. The Panel’s electricity-related functions are funded by a fee levied by AEMO on NEM participants. In 2010-11, the Consumer Advocacy Panel allocated grants of around $450 000 for electricity advocacy, around $225 000 for electricity research, and over $1.4 million for joint electricity and gas advocacy/research and capacity building (table 21.2).

|  |
| --- |
| Box 21.3 The Consumer Advocacy Panel |
| The Consumer Advocacy Panel is an independent body established under the Australian Energy Market Commission Establishment Act.  The Panel’s functions include:   * identifying areas of research that would be of benefit to consumers of electricity or natural gas (or both) * developing, and submitting for the approval of the SCER, guidelines for the allocation of grants for consumer advocacy projects and research projects for the benefit of consumers of electricity or natural gas (or both) * preparing, and submitting for the approval of the SCER, annual budgets for the allocation of grants for consumer advocacy projects and research projects for the benefit of consumers of electricity or natural gas (or both) * determining (subject to the approved guidelines and the approved budget) how grants for consumer advocacy projects and research projects for the benefit of consumers of electricity or natural gas (or both) are to be allocated * preparing, and submitting for the approval of the SCER, guidelines for the assistance of applicants for grants for consumer advocacy projects and research projects for the benefit of consumers of electricity or natural gas (or both) * publishing on the Panel's website and in other appropriate ways the results of research supported by a grant and other research of interest to consumers of electricity or natural gas (or both).   The Panel may, in performing its functions with respect to the allocation of grants — initiate its own research projects to be funded through the provision of grants; invite or accept applications for grants from other persons or bodies.  The objectives of the Panel in performing its functions are to —   * have regard to any relevant objectives set out in a National Energy Law, and * promote the interests of all consumers of electricity or natural gas while paying particular regard to benefiting small to medium consumers of electricity or natural gas.   The Panel consists of a chair and four other members appointed by the Minister on the recommendation of the SCER.  The Panel must submit an annual report to the AEMC, which is published as part of the AEMC’s annual report.  The AEMC and AEMO are responsible for funding the advocacy and research grants and administrative costs of the Panel. The AEMC is responsible for those functions of the Panel related to consumers of natural gas. The AEMO is responsible for functions relevant to consumers of electricity. |
| *Sources*: AEMC (2011j, k). |
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Table 21.2 Consumer Advocacy Panel grants, electricity-related, 2010–11

| Applicant | | Approved project | | $ grant |
| --- | --- | --- | --- | --- |
| **Electricity advocacy** | |  | |  |
| Australian Council of Social Service (ACOSS) | | Revised grant to support travel costs for consumer representatives on the National Smart Meter Working Groups | | 3 390 |
| Queensland Council of Social Service (QCOSS) | | Submission to Queensland Competition Authority Benchmark Retail Cost Index draft decision | | 10 000 |
| Ethnic Communities Council of NSW | | NEM Advocacy 2010-11 | | 22 000 |
| Alternative Technology Advocacy | | Consumer representation on the National Smart Metering Program National Stakeholder Steering Committee | | 23 315 |
| St Vincent de Paul Society NSW and Vic | | NSW tariff-tracking tool | | 38 587 |
| ClimateWorks Australia | | Cogeneration portfolio project: designing solutions to unblock barriers | | 40 000 |
| Manningham City Council (representing the Street Lighting Group) | | Appeal against the AER decision on the Victorian electricity distribution determination 2011-2015 | | 48 864 |
| Meta Economics Consulting Group | | Agricultural electricity consumer issues in the NEM | | 53 800 |
| Alternative Technology Association | | NEM Advocacy 2010-11 | | 103 338 |
| Consumer Action Law Centre and Consumer Utilities Advocacy Centre | | Support for intervention in Tribunal proceedings on AER Victorian distribution price determination | | 103 800 |
| Total | |  | | 447 094 |
| **Electricity research** | |  | |  |
| Etrog Consulting | | Electricity supply disconnection on change of small business tenancy | | 6 500 |
| Etrog Consulting | | Electricity and gas customer transfer issues for small business customers | | 7 800 |
| MS Australia – Tas | | Keeping Tasmania Cool Campaign | | 19 560 |
| City of Victor Harbour | | Demand side participation in the Feurleu region | | 20 000 |
| QCOSS | | Electricity supply disconnection on change of residential tenancy | | 20 800 |
| Engineroom Infrastructure Consulting | | Scoping study into electricity service quality | | 21 000 |
| Total Environment Centre | | Consumer reactions to increased cost of electricity | | 28 000 |
| QCOSS | Electricity and gas customer transfer issues | | 31 200 | |
| Engineroom infrastructure | Mapping retail electricity standing offer prices Australia-wide | | 31 500 | |
| Moreland Energy Foundation | Residential energy information portal evaluation project | | 38 300 | |
| Total |  | | 224 660 | |

(Continued next page)

Table 21.2 (continued)

| Applicant | | Approved project | $ grant |
| --- | --- | --- | --- |
| **Joint electricity and gas advocacy, research and/or capacity building** | | | |
| Centre for Energy and Environmental Markets University of NSW | Energy efficiency information disclosure policies for residential and commercial leased properties. | | 31 500 |
| Ethnic Communities Council of NSW | Ethno-specific small business and culturally and linguistically diverse (CALD) residential energy consumer consultation report | | 32 600 |
| ACOSS | National consumer roundtable on energy meeting 2010-11 | | 37 461 |
| Tasmanian Council of Social Service | Energy research and advocacy 2010-11 | | 39 340 |
| Consumer Utilities Advocacy Centre | Overcoming the information asymmetry: approaches to improving customer participation in the energy retail market | | 44 700 |
| 100% Renewable Community Campaign | Regional and rural Australian Energy White Paper project | | 62 000 |
| Qld University of Technology Credit and Consumer Law Program | NEM advocacy 2010-11 | | 70 390 |
| Uniting Care Australia | Informing Uniting Care Energy Advocacy 2010-11 | | 100 000 |
| Kildonan UnitingCare | Indigenous community energy education and advocacy | | 102 102 |
| South Australian Council of Social Service | NEM reform advocacy capacity building project – SA – 2010-11 | | 109 080 |
| Total Environment Centre | NEM advocacy 2010-11 | | 127 000 |
| ACOSS | NEM advocacy 2010-11 | | 143 000 |
| Major Energy Users | Global funding 2010-11 | | 206 000 |
| Energy Users Association of Australia | Priority projects for 2010-11 | | 206 000 |
| Consumer Action Law Centre | NEM Network Coordinator and Consumer Advocate 2010-11 | | 217 226 |
| Total |  | | 1 432 369 |

*Source*: AEMC (2011j, pp. 101–7).

Despite these mechanisms, there is widespread dissatisfaction with consumer engagement in electricity network regulation.[[6]](#footnote-6)

* Mountain (2012b), in his submission to the Senate Select Committee on Electricity Prices, observed ‘consumer disempowerment’ during regulatory processes:

Users are entitled to participate in consultations during regulatory reviews, and to make submissions on proposals and draft decisions. But in practice, participation in these processes seems to have been ineffective in delivering outcomes that serve the long term interest of consumers. The regulator and the industry it regulates seems to have become focused on each other, rather than the needs of users. (p. 20)

* The limited merits review panel noted that consumers were seen as ‘inconvenient guests’ in the merit review process (Yarrow et al. 2012b, p. 44). However, it also observed more deep-seated problems:

The bigger problem is, to put matters simply, the inadequate attention given to the long term interests of consumers, first by the NSPs [network service providers] then by the AER, and then by the ACT [Australian Competition Tribunal]. While the Panel can make recommendations to address the third leg of this chain of neglect, more effective improvements in performance are likely to come from change that starts at the beginning of the chain, with NSPs. (p. 67)

* The limited merits review panel further noted that network service providers themselves recognised weaknesses in their relationships with consumers and major energy users (Yarrow et al. 2012b, p. 45).
* In a report for the Electricity Networks Association submitted to the limited merits review panel, Fels (2012) considered the inadequacies of existing arrangements for consumer advocacy in regulatory processes in the energy sector:

1. The levels of funding available through the Consumer Advocacy Panel is derisory especially when compared to the resources that are required to fund participation in a complex regulatory framework;
2. It seems counterproductive to split limited resources across a large number of separate [consumer advocacy] organisations. …
3. The focus of existing organisations on certain consumer issues (ie vulnerable end users) while clearly desirable, does not necessarily mean they are well placed to participate in economic regulation;
4. While there is a role for state-based advocacy, there is no apparent basis for allowing this to distract attention from developing a national capacity in the context of a national regime administered by a national regulator. (p. 80)

* A report funded by the Consumer Advocacy Panel (Renouf and Porteous 2011) identified several weakness with current consumer advocacy in energy markets, including: a lack of a national voice; insufficient coordination; insufficient research and data (such as the lack of a national research base on energy consumer issues and inadequate access to relevant data); a too narrow focus on particular consumer groups; insufficient resources and funding; insufficient skills or access to the right technical expertise; failure by decisions makers to consult adequately; and a lack of attention given to the overall regulatory framework (pp. 46–7).
* In its recent draft Rule determination on economic regulation of network service providers, the AEMC referred to a report by Brattle on regulatory approaches in other countries and said that:

… there does not appear to be a common approach to consumer engagement, but it would appear that other regulators engage with consumers or consumer representatives more than the AER does, both on a formal and informal basis. (2012r, p. 100)

In its recent draft Rule determination on the economic regulation of network service providers, the AEMC proposed changes with respect to the regulatory determination process, which, among other things, are intended to improve consumer engagement (2012r, pp. 152ff). These changes include requiring the:

* network service provider to indicate in its proposal the extent to which it has engaged with consumer representatives and to provide an overview paper for consumers
* AER to publish an issues paper after receiving the regulatory proposal. The purpose is to assist consumer representatives to focus on the key preliminary issues on which they should engage and comment
* AER to publish a benchmarking report that informs consumers on the relative efficiencies of network service providers
* AER, when setting capital expenditure and operating expenditure allowances, to take into account the extent to which a network service provider has engaged with consumers in preparing its forecasts.

The Commission agrees with the AEMC’s proposed changes, and sets out similar recommendations in chapter 8.

In addition, the Commission considers there are strong grounds for strengthening consumer engagement in electricity network regulation by introducing arrangements to eventually enable negotiated settlements between consumers and network services providers (described in chapter 8). Such arrangements — proposed by Littlechild (for example, 2011c) — involve consumers and appointed consumer representatives taking an active role in negotiating price and quality issues with providers, with the AER then approving (or otherwise) the settlements.

#### More effective consumer representation

The Commission also sees a need for the creation of a publicly-funded consumer body to more effectively represent the interests of consumers in NEM policy, regulatory, rule-making and merits review processes, including in negotiations with network businesses.

The case for adequate public funding of a consumer body in relation to electricity network regulation rests on the following arguments.

* It is unlikely that there would be sufficient market-based funding of a consumer body. The nature of consumer advocacy is akin to a public service or good where it is not possible to isolate the benefits to, or appropriate the costs for providing it from, individual consumers. There is therefore the potential for free-rider problems.[[7]](#footnote-7)
* Electricity network services are provided by comparatively few businesses, whereas there are a significant number of individual consumers with diffuse interests. A consumer body would provide countervailing strength to that of businesses, particularly during negotiations with those businesses and during policy, regulatory, rule-making and merits review processes.
* Electricity network service regulation is complex and the NEM itself has complex arrangements. This complexity makes it unlikely that individual consumers would have the interest, expertise and resources to participate in relevant processes, including in negotiations with network businesses. [[8]](#footnote-8)

An initial question is whether a publicly-funded consumer body should address electricity — or energy — issues alone.

Given there are economies of scope in considering competition policy matters across many sectors (gas, water, telecommunications, rail and energy, among others), there may be grounds for a single body with expertise encompassing economic regulation generally (and indeed, the even wider issues encompassed by consumer policy). This is the approach taken in some other countries:

* The United Kingdom had a major publicly-funded consumer group that performed this role — the National Consumer Council, which acted on behalf of consumers in many areas. That body has now been replaced with *Consumer Focus*, which merged the Welsh, Scottish and National Consumer Councils with *Postwatch* and *energywatch*. Accordingly, in the United Kingdom, there has been a shift towards even greater centralisation of advocacy and expertise.
* California has an independent consumer advocate within the California Public Utilities Commission (the Division of Ratepayer Advocates) that advocates solely on behalf of investor owned utility ratepayers in negotiated settlements with utilities. It employs around 140 staff and has an annual budget of under $US30 million and reports to the California legislature (Mountain 2012b, p. 24). The approach is described in further detail in chapter 8.

The Commission’s inquiry into consumer policy (PC 2008) addressed some of these issues. It explored the advantages and disadvantages of several models of consumer representation:

* a publicly-funded single body representing consumers across many areas of the economy (not just energy)
* more diversified support to the existing array of consumer groups.

The Commission recommended a hybrid arrangement, which was not implemented by the Australian Government:

Within the broader consumer policy implementation framework agreed to by the CoAG, the Australian Government, in consultation with [the Ministerial Council on Consumer Affairs], should take the lead role in developing arrangements to provide additional public funding to:

* help support the basic operating costs of a representative national peak consumer body;
* assist the networking and policy functions of general consumer advocacy groups; and
* enable and expansion in policy-related consumer research.

Part of the latter funding component should be used to establish and support the operation of a dedicated National Consumer Policy Research Centre (NCPRC), with the remainder provided as contestable grants for research on specified consumer policy issues. An independent review of the effectiveness of the NCPRC in delivering beneficial research outcomes should be conducted after 5 years. The new funding arrangements should be subject to appropriate guidelines and governance requirements to help ensure that taxpayer support contributes to high quality advocacy and policy research in priority areas, and that the national interest is appropriately represented. (PC 2008, recommendation 11.3)

It seems unlikely that a single consumer policy research agency will gain traction, let alone one with a wider role as an active agent in the regulatory process.

However, there are clear grounds for creating a body with a narrower focus on *energy* policy and regulation alone. Such a body could develop the appropriate economic expertise required for it to be effective. This recognises that the existing consumer groups must generally operate across a vast array of consumer policy matters. There are potentially significant economies of scale in a single body focusing on energy issues. Moreover, to the extent that a body is actively involved in negotiations, it must reasonably represent energy consumers as a whole. There is no obvious existing group that fulfils that role.

The Commission notes that there is existing support for a consumer body focused on energy policy. Having identified a range of deficiencies with current consumer advocacy in the energy sector, Fels (supported by a number of network service providers) considered that it ‘would seem likely’ that the only option[[9]](#footnote-9) with ‘any credible prospect of success’ was a ‘large peak national body’, which could be formed at the expense of existing institutions (while preserving the Consumer Advocacy Panel’s functions), and which would have substantial internal expertise and the ability to secure external assistance where necessary (2012, p. 81):

The essential problem is one of scale and resourcing. … That is not to say there is not merit in the engagement of consumer groups in their local communities, or that diverse interests cannot be represented. It merely points out that, in the limited field of economic regulation, these considerations may be trumped by the benefits of scale and centralised expertise. (2012, p. 81)

The Total Environment Centre recently noted in its submission to the Senate Select Committee on Electricity Prices that there is currently a formal process, involving the Consumer Advocacy Panel and the SCER, to create a national peak body (tentatively called Energy Consumers Australia) for consumer advocacy on energy issues (TEC 2012, p 11). The Centre noted that the funding of the new body is expected to come from existing sources, which would affect the advocacy done by existing consumer groups.

The Commission is attracted to the notion of a consumer body with adequate funding and centralised expertise in economic regulation in energy markets. This goes beyond the current focus of many consumer groups on affordability issues.[[10]](#footnote-10)

The key function of such a body would be to represent the interests of all energy consumers (households, businesses and major industry users) during policy, regulatory, rule-making and limited merits review processes (such as an AER regulatory determination process). The body could also act on behalf of all consumers during negotiated settlements with network businesses.

The body would require an appropriate governance structure, which would involve a board of members appointed on the basis of merit, and an advisory panel to give the board advice on the needs of the mix of consumers concerned. As for some other institutions in the NEM, the body would be financed through a small ongoing levy on market participants (effectively amounting to a consumer levy).

Its creation would not preclude the involvement of other consumer groups in regulatory and policy processes — such as in merit reviews, policies for disadvantaged consumers, and retail reform. Indeed, throughout this inquiry, the Commission has been mindful of the need for regulatory processes to be friendly rather than hostile to consumer participation. That, if achieved, should increase the options for participation by many consumer groups.

To avoid the proliferation of new institutions, the Consumer Advocacy Panel should be wound up. Accordingly, in addition to its major role as an informed and capable body with economic expertise, the new body would take over the grant-giving functions currently performed by the Panel.

draft Recommendation 21.3

There should be adequate ongoing funding of a single but broadly representative consumer body with expertise in economic regulation and relevant knowledge and understanding of energy markets. This body would:

* represent the interests of all consumers during energy market policy formation, regulatory and rule-making processes, merit reviews, and negotiations with providers of electricity networks and gas pipelines
* subsume the role of the existing Consumer Advocacy Panel into its broader functions
* be funded through a levy on market participants, drawing on the approach used to currently fund the Consumer Advocacy Panel
* have a governance structure that involved a board of members appointed on merit, and an advisory panel to give the board advice on the needs of the mix of customers concerned.

The Commission notes that the limited merits review panel has reported on the role of consumers and their representatives in relevant decision making processes, including review processes, and will be considering the issue further in its final report to SCER (Yarrow et. al. 2012a, 2012b).

## 21.3 Processes for amending electricity network regulation

The NEM overarching policy and legal framework contains processes that enable changes to the National Electricity Law, Regulations and Rules.

The National Electricity Rules, in particular, contain much national electricity regulation. As such, its processes for change are directly relevant to the implementation of many of the Commission’s recommendations in this inquiry. These processes can affect not only the quality of the changes, but the timeliness and cost of implementing them.

The SCER is responsible for developing NEM policy and does not have power of its own to change the National Electricity Rules. However, with the approval of the other energy ministers, the South Australian Minister has had, and exercised, powers to make initial Rules on certain matters (figure 21.3). Aside from the power to make the initial National Electricity Rules, it appears the Minister has exercised these powers four times. The latest use was in July 2012 in respect of the National Energy Retail Law and Regulations. However, the advice given to the Commission suggests that the capacity for making new Rules is now exhausted, so that the National Electricity Law would need to be amended to give the Minister a further capacity to act. There are precedents for this in narrow areas of policy concern, but there is no precedent or existing statutory basis for the Minister to wield broad powers.

The AEMC, as the rule maker, has responsibility for developing and amending the National Electricity Rules to achieve the NEO. It either initiates changes to the Rules that are minor, or immaterial, or prescribed in the Regulations, or it responds to requests, including from the SCER, to consider and then decide upon changes to the Rules (figure 21.3).

Figure 21.3 Pathways to changing the National Electricity Rules

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| --- |
| Pathways to changing the National Electricity Rules. This figure shows the processes undertaken by AEMC, SCER and the SA Minister to effect changes to national electricity rules |

*Data source*: National Electricity Law.

The AEMC administers three different rule making processes under the National Electricity Law:

* A standard process (figure 21.4) —involving two rounds of public consultation and a draft determination, which can be completed within 26 weeks of initiating the process (AEMC, pers. comm, 30 August 2012).
* A fast-track process for rules where: there has been adequate first round public consultation by an ‘electricity market regulatory body’ (such as the AER or AEMO); or the request is based on an AEMC Rule review or a SCER-directed review (National Electricity Law, s. 96A). This process can take 21 weeks from initiating the process, but is rarely used (AEMC, pers. com, 30 August 2012 and 5 October 2012).
* An expedited process for ‘non-controversial’ or ‘urgent’ rules, involving one round of public consultation, which can be completed within six weeks of initiating the process (AEMC, pers. comm, 30 August 2012).

Figure 21.4 AEMC’s standard rule making process and timelinea

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| AEMC’s standard rule making process and timeline. This figure shows the time taken between a request to change a rule and the final rule and determination. |

a This process is followed by the AEMC under the National Electricity Law, the National Gas Law and the National Energy Retail Law. In limited circumstances there may be provision for additional steps in the process — for example, the National Electricity Law provides for a public hearing before or after the draft Rule and determination.

*Data sources*: AEMC, pers. comm., 30 Aug 2012 and 5 Oct 2012; AEMC (2012s).

The AEMC’s rule making powers are unusual in that, unlike other national regulatory bodies such as the Food Standards Australia and New Zealand and the National Transport Commission, the AEMC is not required to have its Rules endorsed by the SCER, parliament or government.

The Rule change processes administered by the AEMC have several desirable features.

* They ensure that ministers in the SCER are focused on high-level policy in relation to the NEM, rather than on technical and detailed regulatory minutiae.
* They may avoid the inertia sometimes associated with the imperative to get ministerial agreement in COAG bodies (although the processes of the AEMC, in their own right, involve delays, sometimes of one or more years, with the exception noted below).
* They are compatible with COAG’s regulation impact analysis framework (PC 2012, figure 1.3, p. 39) and, in particular, with elements of a regulatory impact statement (box 21.4). For example, in considering a rule change request the AEMC: abides by the NEO; considers the benefits and costs of the proposed Rule change; considers whether there is a ‘more preferable’ Rule; consults with stakeholders; and issues a draft determination (AEMC 2012s).
* They allow the AEMC to fast-track or expedite the Rule change process in certain circumstances.
* They enable NEM participants, as well as the SCER and others in the community, to actively participate in initiating Rule changes.

However, it is not clear whether Rule changes proposed from reviews not already specified in the National Electricity Law can currently be fast-tracked (or expedited) by the AEMC. The Commission notes that, along with its own inquiry, there are other reviews concerning electricity network regulation — for example, the independent panel carrying out the limited merits review commissioned by the SCER. The recommendations from these reviews may require examination by the AEMC under its standard Rule change process.

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| Box 21.4 COAG regulation impact statements |
| A regulation impact statement is required for agreements or decisions of the Council of Australian Governments (COAG), Commonwealth-State Ministerial Councils and national standard setting bodies which, when implemented, would encourage or force businesses or individuals to pursue their interests in ways they would not otherwise have done.  The primary role of the regulation impact statement is to improve government decision-making processes by ensuring that all relevant information is presented to the decision makers when a decision is being made or agreement is otherwise being sought.  A regulation impact statement has seven elements, setting out:   * the problem or issues which give rise to the need for action * the desired objective(s) * the options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objective(s) * an assessment of the impact (costs, benefits and, where relevant, levels of risk) on consumers, business, government and the community of each option * a consultation statement * a recommended option * a strategy to implement and review the preferred option.   Although a COAG regulation impact statement is required in relation to changes to the National Electricity Law and Regulations, it is not explicitly required in relation to changes to the National Electricity Rules. |
| *Source:* Department of Finance (2008). |
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Two adverse consequences of this are that the benefits from reforms are delayed and there is an added consultation burden on stakeholders. For example, were the AEMC’s standard process for Rule changes to be applied to any of the recommendations from this inquiry, that process would need to commence well before September 2013 in order to have any possible effects on transmission and distribution regulatory determinations before they are next reset from 1 July 2013 (figure 21.5). The possible delays apparent in following this path have motivated the Commission to consider other approaches.

Figure 21.5 Timing is everythinga

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| Timing is everything. This figure shows the timing of the implementation of the recommendations of the PC within the context of the current AEMC standard Rule change process and network determination resets. |

a Assumes the standard Rule change process takes around 26 weeks.

*Data sources*: Dates for start of revenue resets of distribution and transmission – chapter 2, table 2.5.

As an alternative, the Commission considers that the existing National Electricity Law should be amended by giving the:

* AEMC the power to fast-track Rule change requests from the SCER where they stem from recommendations from an appropriately undertaken review and where the SCER agrees the recommendations could be suitably fast-tracked
* South Australian Minister a broader power to make Rules with the agreement of the SCER.

An appropriately undertaken review would comply with the following key features:

* The reviewing institution is independent and has the necessary expertise.
* The review is consistent with COAG’s regulatory impact analysis requirements — for example, the review involves public consultation, considers all the elements of a COAG regulatory impact statement (box 21.4), and makes the outcomes of the review public (preferably with a draft report as part of the process).
* The review is recent, say within the last two to three years.
* The review contains sufficiently suitable and detailed analysis to support a Rule change proposal.[[11]](#footnote-11)

This option would reduce: the burden on stakeholders from engaging in further unnecessary consultations; any undue delays in making Rules that have already been identified as worthwhile; and the costs of implementation. Although this option bypasses the checks and balances inherent as part of the current AEMC Rule change process, the Commission believes that the pre-conditions outlined provide an adequate alternative.

draft Recommendation 21.4

The National Electricity Law should be amended to expedite the making of Rules arising from any appropriately conducted independent review relevant to the National Electricity Market and that are agreed by the Standing Council on Energy and Resources. This should be achieved by giving the:

* Australian Energy Market Commission the power to expedite Rule requests and
* South Australian Minister a broader power to make Rules.

1. AER, pers. comm. 11 August 2012. These are staff directly engaged in AER work. Around another 10 ACCC staff work indirectly on AER matters. [↑](#footnote-ref-1)
2. Applicants seeking a limited merits review of an AER decision must establish grounds of review based on regulatory errors of fact or discretion and demonstrate there is a serious issue to be heard. [↑](#footnote-ref-2)
3. Other AER decisions subject to limited merits review are decisions to draft and approve (or revise) gas access arrangements and ring fencing decisions in gas. [↑](#footnote-ref-3)
4. Previously, decisions by the Tribunal involved a complete rehearing or reconsideration of the matter considered by the designated Minister or arbitration by the ACCC (COAG Reform Council 2011, p. 259). [↑](#footnote-ref-4)
5. The ‘national regulatory cost’ relates to the ACT’s obligations under the Australian Energy Market Agreement to contribute to funding the AEMC and the SCER. [↑](#footnote-ref-5)
6. Dissatisfaction about consumer involvement extends to public utility regulation generally. For example, in an ACCC/AER working paper, Biggar said:

   The involvement of customers in most regulatory processes in Australia is relatively weak and undeveloped. Customers do not take direct responsibility for regulatory outcomes. Customers are not directly involved in approving investments or investment-tariff trade-offs, or trade-offs between tariffs and service quality. Customers are not directly involved in the design of incentives, risk-sharing arrangements, or in the design of the regulatory framework itself. There is relatively little scope for customers to enter into new, innovative or out-of-the-ordinary arrangements with regulated firms — such as special arrangements for the approval of investment, information provision arrangements, complaint-handling procedures, longer-term price paths, and so on. (2011b, p. 42) [↑](#footnote-ref-6)
7. This is where a person does not pay for consumer advocacy because others will benefit without being require to pay for it. [↑](#footnote-ref-7)
8. Many of these points are extensions of the general arguments for the public funding of ‘general consumer advocacy’ set out in the Commission’s 2008 report on consumer policy framework (PC 2008, p. 59). [↑](#footnote-ref-8)
9. Fels also considered two other options — a stronger national secretariat or council to coordinate the activities of the existing consumer institutions, all of which would continue to be funded by grants from the Consumer Advocacy Panel; and a small new national body, separately funded from bodies receiving grants through the Consumer Advocacy Panel. [↑](#footnote-ref-9)
10. Indeed, the Commission supported a similar body in its report on the Australia’s urban water sector (PC 2011c, p. 238) where it recommended that ‘there might be a formal role for a consumer representative body in supply augmentation, pricing and setting service standards’. [↑](#footnote-ref-10)
11. The Commission has recently considered the relevance of previous reviews in regulation making in its draft benchmarking report on regulatory impact analysis (PC 2012d, p. 140). [↑](#footnote-ref-11)