# 21 Governance

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| **Key points** |
| * Effective governance of the National Electricity Market (NEM) and its institutions is critical to meeting consumer interests. It affects network revenue and price determinations, network planning, the speed of reform and, accordingly, the ultimate cost to consumers. * Governments and stakeholders have expressed concerns about the governance of the Australian Energy Regulator (AER), including its accountability, capability, communication with stakeholders, independence from the Australian Competition and Consumer Commission (ACCC), and transparency. * Many of these perceptions are not backed by solid evidence and may reflect the usual tensions between an economic regulator and the parties it regulates. Others have more foundation, but can be remedied to ensure that the AER can assume the role of being the single national energy regulator. * While the AER is strongly independent from industry or government influence, perceptions of too close a link with the ACCC and a lack of transparency would be addressed by giving the AER more control over its budget and resources, and making it more accountable for how it manages those resources. * Concerns about resourcing and capability themselves will largely be addressed by additional funding announced by the Australian Government in late 2012. * An independent review of the AER should assist in addressing any remaining limitations in its operations, and would address any ill-founded perceptions about the organisation. * Establishing the AER as a separate agency from the ACCC is not justified at this stage. However, a follow‑up independent review of the AER should occur in 2018 to examine whether the recent reforms have had the desired impacts and, where they have not, consider other changes that might be beneficial, including the possibility of structural separation. * The Australian Energy Market Commission (AEMC), the Australian Energy Market Operator and the new proposed National Energy Consumer Advocacy Body should be independently reviewed by 2018. All NEM institutions should be reviewed, thereafter, every 10 years. * The participation of consumers in NEM policy, regulatory, Rule change and review processes is fragmented. Recent decisions by the Australian Government and the Standing Council on Energy and Resources (SCER) to create representative consumer bodies will address some of these deficiencies. However, on efficiency grounds, the proposed National Energy Consumer Advocacy Body should incorporate the overlapping functions of the Consumer Challenge Panel and the Consumer Advocacy Panel. * The National Electricity Law should be amended to require the AEMC to undertake an accelerated Rule change process where the Rule changes are requested by SCER and arise from recommendations, agreed to by SCER, of an appropriately undertaken independent review, including previous AEMC reviews. * SCER should reform its own processes and decision making so that critical NEM policy reviews, Rule changes and their implementation occur in a timely fashion. * SCER should convert the current AEMC’s review of reliability into an accelerated Rule change process to be completed by December 2013. SCER’s Rule change request should draw on the Productivity Commission’s recommendations. * A merits review body should not be co-located with the AEMC. |

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
* 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:

* the extent to which its prime charter is in the overall public interest
* to whom it is answerable, how it is funded, and its degree of independence
* how it is led, who selects and appoints its leaders and/or its board
* 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 plans, budgets and 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, external reviews and audit, and change.

In many respects, the central deficiency in the governance of the NEM is parochialism. Notwithstanding that the creation of the NEM was intended to create a *nationally* coherent energy market, state and territory governments have exercised control over critical areas important to the efficiency of the network. These areas have included: licensing arrangements; transmission planning; network reliability and safety; retail pricing and other features of the retail market; and in Queensland, New South Wales and Tasmania, ownership of the network businesses. At times, jurisdictional arrangements have not been in the interest of consumers, nor met other desirable principles of governance, such as transparency. This chapter does not address these governance issues directly, as the Commission has examined them separately in the preceding chapters. However, they are relevant to the future role of the Australian Energy Regulator (AER), as touched on below.

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

#### The governance of the Australian Energy Regulator and other institutions

The governance of the AER is an important issue. The Commission has made recommendations in this report that steer Australian regulatory arrangements away from the enduring parochialism discussed above. Such reform would substantially increase the regulatory responsibilities of the AER and change the way it deals with the businesses and consumers. However, several Australian governments and a variety of stakeholders in this inquiry have raised concerns about how the AER manages its current functions. This has implications for its capacity to perform in its new role, and may prejudice the willingness of the Standing Council on Energy and Resources (SCER) and the Council of Australian Governments (COAG) to move to a more national energy market in some key areas. Sections 21.1 and 21.2 explores these issues in depth. There are also grounds for periodic review of other bodies (section 21.3).

#### The role of the consumer

The goal of the NEM, expressed through the NEO is to promote efficient investment in, and efficient operation and use of, electricity services for the ‘long term interests of consumers’. However, it is widely recognised that existing arrangements do not involve sufficient engagement with consumers (section 21.4).

#### Maximising the value of policy review

As observed in chapter 1, policy review in electricity is a busy space. A key question is how to maximise the value of such reviews, without having to repeat the process through the existing arrangements managed by the Australian Energy Market Commission (AEMC) and SCER. While those arrangements have many benefits, they can slow reform and duplicate analysis. Section 21.5 considers how to better manage the review and Rule making processes.

A related matter — addressed in section 21.6 — relates to what governance arrangements might be most appropriate for any new merits review body.

## 21.1 Governance and performance 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 the then *Trade Practices Act 1974* (now the *Competition and Consumer Act 2010).* It is funded by the Australian Government, with staff, facilities and other resources supplied by the Australian Competition and Consumer Commission (ACCC). The AER has three ‘members’ — two state and territory members (including the chair) nominated by SCER and a Commonwealth nominated member who is required to be an ACCC commissioner. The AER has permanent staffing of around 130 people, though there are around 10 ACCC staff working on AER matters (table 21.1).[[1]](#footnote-1) Taking account of these, the AER accounts for nearly one-fifth of the total ACCC workforce (AER, pers. comm. 15 August 2012).

Table 21.1 Staff numbers in the Australian Energy Regulatora

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| Year | Number of staff |
| 2007‑08 | 83 |
| 2008‑09 | 111 |
| 2009‑10 | 112 |
| 2010‑11 | 110 |
| 2011‑12 | 129 |

**a** As at 30 June.

*Source*: AER (sub. DR 104).

The structure of the AER — including its links with the ACCC, SCER, and two external review bodies — is set out in figure 21.1.

Figure 21.1 Structure of the Australian Energy Regulator

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| Figure 21.1 Structure of the Australian Energy Regulator. This figure shows the organisational structure of the AER and its relationship with the ACCC. |

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

The AER’s electricity network-related functions 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 concept of a national regulator had its origin in the Parer Review Panel, which proposed a coherent electricity market overseen by a single regulator. It envisioned:

… a regulator … with strongly defined independence … and a national focus … established under a legislative approach agreed by all jurisdictions, accountable to these jurisdictions, with Commissioners appointed by the Ministerial Council on Energy and a charter that extends to the distribution and retail functions currently carried out by state and territory based regulators. (Parer et al. 2002, pp. 84‑6)

The Panel’s view was that ‘the most appropriate approach’ is for the national regulator to be ‘a separate energy sector-specific agency’ (Parer et al. 2002, pp. 13, 84, 86). However, as noted by the AER, the Panel considered that the location of the agency was less important than other aspects of its governance, indicating that its location was a matter for COAG (AER, sub. DR92, p. 23; Parer et al. 2002, p. 86).

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). The final model for the regulator also varied in other respects from the Parer Review Panel’s proposal. Most notably, it had a narrower remit than intended and weaker accountability to the MCE.

Nevertheless, 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.

### Areas of concern

Seven years on, participants in this inquiry and other commentators have raised concerns — some inter-linked — about the governance, performance and capabilities of the AER. In assessing these concerns, the Commission has drawn on several core principles, which it considers to apply to ‘good governance’ broadly defined (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 efficiently 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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It is relatively easy to establish such principles, but harder to identify whether they are being effectively met. The Commission has assessed the AER’s performance using several approaches. First, where possible, the Commission has used objective information in areas of contention, such as on staff turnover, budget reporting practices, and the degree to which governance structures match best practice. Second, it has used evidence on the perceptions of various stakeholders. Third, the Commission has had to make judgments in several areas — most particularly in relation to the desirable level of resourcing of the AER — a matter that has been recently addressed (see below).

#### Broad perceptions of the agency

Submissions to this and the Senate Select Committee on Electricity Prices, supplemented by the Commission’s confidential consultations with all key stakeholders, provided mixed views about the performance of the national regulator (box 21.2). A similarly diverse picture emerged from stakeholder surveys commissioned by the AER (figure 21.2).

In particular, the AER’s 2011 stakeholder survey found positive views in some critical areas. For example, 70 per cent rated the independence of the agency as good or excellent. Moreover, 73 per cent indicated that the AER was fulfilling its statutory role in protecting the long-term interests of Australian consumers with regard to the price, quality and reliability of energy services (Buchan 2011, p. 9). As this is the objective of the National Electricity Law, it is a key measure of its performance. Around the same share of respondents considered that the agency provided the right ‘volume and sufficiency’ of information.

Nevertheless, any agency can improve its performance. The (independent) Limited Merits Review Panel recently opined:

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)

The AER’s 2011 stakeholder survey identified several apparent weaknesses, suggesting where efforts for improvement may be best directed. The share of respondents rating an attribute of the AER as good or excellent was only:

* 53 per cent for the AER’s communication responsiveness[[2]](#footnote-2)
* 43 per cent for the AER’s output quality, 44 per cent for the agency’s analytical and intellectual capacity and 40 per cent for technical competence
* 43 per cent for leadership
* 36 per cent for the AER’s industry understanding.

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| Box 21.2 Mixed views on the capabilities of the AER |
| Some were positive. For example:  … Overall, I think our experience of working with the AER is generally a positive one. We feel that we have ability to engage with them quite easily. [The AER] has its own customer consultative group, of which we’re a member. They engage in numerous forums and opportunities for input during price examination processes. (Consumer Action Law Centre, trans., p. 87‑9)  … there are very good people there who have been hamstrung to a considerable extent by the rules. (Garnaut cited in SSCEP 2012, p. 76)  [We have found] … AER staff to be highly capable and professional … there just are not enough of them and that they do not have enough power. (Total Environment Centre cited in SSCEP 2012, p. 76)  However, others perceived problems:  The Businesses would welcome improvements to the AER’s approach to communicate and engage constructively with industry, as this will assist AER staff in gaining a more thorough understanding of the electricity industry, how it operates and key factors influencing critical network investment decisions, and allow improved understanding of the specific characteristics of individual DNSPs and their respective customer groups. (CitiPower et al., sub. DR90, p. 15)  … they need a greater level of resourcing of people who understand the business operations. … there’s a limited extent to which you can use consultants to assist. … regulation has got too adversarial in Australia and … more understanding of the businesses’ needs from both sides … would be better than the processes we have at the moment, where there’s too much emphasis on the legal side … they need more strength of resourcing, independence, including engineering capability. (SP AusNet, trans., p. 37)  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. (Grid Australia 2012b, p. 39)  [There is an] ongoing reported concern by ENA [Energy Networks Australia] members about a relative lack of stability and continuity within AER review teams even within the duration of a single review period of 12–24 months. Perhaps as a consequence of this, members have reported that relatively junior staff typically play a significant role in the initial stages of the AER’s determination process, at times effectively ‘pre-setting’ some aspect of the AER’s approach, and closing off alternative or more negotiated regulatory approaches. The AER does not appear to have an obvious central ‘cadre’ of specialists with detailed commercial industry background such as occurs in broadly equivalent regulatory bodies such as Ofgem in the UK. (ENA, sub. 40, p. 2)  In the Commission’s confidential meetings, some participants said that the AER’s determination process was ‘combative and adversarial’, and lacking in consultation, with frequent ‘surprises’ arising from determinations. Some claimed that the consultation process between United Kingdom distributors and Ofgem was better, as it involved significant ongoing contact. |
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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 | **Reputation**  Respondents who rated aspects of the AER’s reputation as ‘well’ or ‘very well’ |
| **Consultation**  Respondents’ views on whether the AER’s processes provide adequate opportunities for consultation with stakeholders | **Communication**  Respondents who rated aspects of the AER’s communication processes and materials as ‘good’ or ‘excellent’ |

**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 Energy Customers Framework (retail law); and electricity and gas network regulation. The number of respondents in 2011 was 112 and in 2008 was 114.

*Data source*: Buchan (2011).

Of course, it is difficult to be certain what constitutes a good or bad outcome from any information based on the perceptions of stakeholders, some of whom must be aggrieved because decisions did not go their way or that have a ‘vested’ interest (Major Energy Users (MEU), sub. DR66, p. 9). The Commission is aware that other regulators also conduct stakeholder surveys. As the AER noted, as these develop, comparisons between the various surveys would be a useful benchmarking tool for the AER (sub. DR92, p. 20).

While such cross-regulator comparisons would be useful, so too would analysis of trend data for any individual regulator. For instance, 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 (figure 21.2).

On face value, these trends in the survey results are disturbing. However, some stakeholders considered that such survey evidence was of doubtful usefulness.

* Some argued that survey respondents would over-represent regulated businesses, which might have an axe to grind (Consumer Action Law Centre (CALC), sub. DR79, p. 6). However, while the survey did cover many stakeholders in the energy sector — including generation, gas and electricity distribution, and retailing — it was more diverse than this. Consumer groups, governments, regulators, ombudsman offices and ministers’ offices accounted for around one third of the total of 112 respondents in the 2011 survey.
* Others noted that the survey was based on perceptions. This is correct, but inevitably, much of the information about the performance of a regulator must be based on the perceptions of various stakeholders. The AER observed that they were a snapshot of perceptions, and did not constitute a report card on the performance of the AER. In contrast, it indicated that the report of the Senate Select Committee on Electricity Prices gave a more balanced view on the performance of the AER, and that ‘witnesses provided evidence that the AER has highly capable and professional staff’ (sub. DR92, p. 20). However, the actual evidence presented to the Senate Select Committee related to the perceptions of just three participants, of which two indicated that the internal staff were of high quality. On face value, the AER’s survey should have more weight — given that it was conducted with confidentiality and with a sample size nearly 40 times greater than the number of Senate Select Committee witnesses cited by the AER. To some degree, the AER must have taken its survey results seriously as a measure of its own performance because it sought to make improvements based on them (sub. DR92, p. 19 and trans., p. 115ff).
* The context of the survey meant that it was likely to elicit negative comments. The AER indicated that the 2008 survey took place during a honeymoon period, while the 2011 survey was undertaken when the AER had completed distribution revenue resets and had assumed some responsibility for retail regulation (sub. DR92, p. 19).[[3]](#footnote-3) Moreover, as pointed out by the AER, the merits review processes of the time were inherently adversarial, which could be expected to carry over to the qualitative impressions of the AER by the businesses concerned. Finally, as several participants commented, negative views about an agency’s effectiveness can readily reflect constraints on the organisation, such as inadequate resourcing or a flawed regulatory environment (MEU, sub. DR66, p. 9; Total Environment Centre (TEC), sub. DR50, p. 7).

The last point seems particularly pertinent, and suggests care in interpreting the trend results in too negative a light. Nevertheless, the Commission considers that, at the time it was undertaken, the AER’s 2011 stakeholder survey did identify several genuine concerns.

#### Resourcing and capacity

It is important that the AER has adequate resources and capacity (including appropriate in-house specialist expertise) to undertake its functions efficiently and effectively, including to apply rigorous analysis to its revenue and price determinations for network businesses.

As noted above, the Commission envisages a much broader role for the AER. Recent Rule changes also require the AER to develop guidelines in certain areas, and to produce annual benchmarking reports, presenting further challenges for the agency (AEMC 2012r). These add to the resourcing pressures stemming from a new set of network revenue determinations and the movement of retail regulation to the AER. While the evidence is incomplete, at least prima facie, it appears to the Commission that the AER may not have had sufficient funding in the past. There is an even more compelling case that the AER’s existing resourcing and capacity would undermine its capacity to fulfil its future expanded role. The Senate Select Committee on Electricity Prices reached a similar conclusion (SSCEP 2012, p. 77).

Many stakeholders also identified resourcing problems in the AER both prior and after the Commission’s draft report (box 21.3). Most supported a draft Commission recommendation about the need for adequate resourcing of the regulator.

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| Box 21.3 Views on the resourcing of the Australian Energy Regulator |
| [The 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. (Energy Users Association of Australia, sub. 24, p. 10)  … It is clear the AER does not have sufficient resources or powers to effectively play its full role in the NEM. The focus of the discussion should therefore be not on institutional reform, but on the needs of the AER as a regulatory body. These needs are likely to become greater given the range of proposals for reform in the NEM. For example, the [Productivity] Commission suggests that the AER maintain in-house expertise for the technical analysis required to undertake sophisticated benchmarking of network businesses, but the AER’s capacity to do this at present is very limited. Likewise, initiating a public tender process for infrastructure projects would require more resources for the AER, but the costs would be more than offset by savings in the form of less infrastructure spending. (Total Environment Centre, sub. DR50, p. 7)  We agree that more resourcing for the AER would be a good thing … (CALC, sub. DR79, p. 6)  Enhanced resources is a pragmatic solution. (Alinta Energy, sub. DR81, p. 5)  … We have said consistently that the AER would always welcome additional resources, as would any investigative agency … additional resourcing is an important factor. (AER, trans., p. 130)  The [Senate Select Committee on Electricity Prices] shares the concerns raised about the adequacy of the AER’s resourcing. The AER’s resourcing — as it relates to the regulator’s ability to effectively perform its role — should be the subject of ongoing consideration. The committee is also conscious that it, and others, have recommended expanded or additional powers for the regulator and therefore recommends that the AER should be allocated greater funding, expertise and accountability, particularly in light of any additional responsibilities it is given. (SSCEP 2012, p. 77). |
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In December 2012, the Australian Government announced that it would allocate an additional $23 million over four years to the AER’s budget (Gillard 2012; table 21.2). This represents around a 20 per cent increase in funding above existing levels. However, over the subsequent three years, its funding is to decline in both nominal and real terms, which may affect its ability to plan for the long term. The adequacy of the AER’s funding should be tested as part of the review proposed by the Commission (see below).

Table 21.2 Funding available for the Australian Energy Regulatora

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| --- | --- |
| Year | Funding |
|  | $’000 |
| 2013‑14 | 32 321 |
| 2014‑15 | 30 492 |
| 2015‑16 | 30 361 |

**a** Funding received by the ACCC for the AER is net of efficiency dividends and adjusted for parameter movements. Data include the further funding for the AER that was announced at December’s COAG meeting.

*Source*: AER (sub. DR104).

There is equally a need to ensure adequate internal expertise and an appropriate mix of skills (Energy Supply Association of Australia, trans., pp. 176‑7; Grid Australia 2012b, p. 39) — an area also highlighted by the survey results above. The AER indicated that it had responded to these concerns, saying that it had:

… taken on board comments received in the 2011 survey, drawn on its experience and implemented a number of significant changes. It has acted on concerns about in-house technical expertise and employed more in-house technical experts. It has also put significant effort into improving engagement with network businesses. These efforts are bearing fruit with better engagement between the AER and network businesses. (sub. DR92, p. 19)

In responding to queries by the Commission, the AER (sub. DR92 and sub. DR104) also argued that some impressions about its staffing and expertise were not well founded.

* Staff have been recruited from other energy regulators (both state utility regulators and international energy regulators, such as Ofgem, consulting firms and the energy sector.
* The AER has staff exchange arrangements with other relevant agencies, such as the Australian Energy Market Operator (AEMO) and Ofgem.
* The AER is also involved in a range of international energy fora. The AER attends the World Forum on Energy Regulation and participates in the working groups under this forum. The AER hosts the website for the Energy Intermarket Surveillance Group and participates in all the Group’s meetings.
* The AER disputed the claim that it faced ‘internal competition’ for high quality staff from other parts of the ACCC and experienced rapid staff turnover (a claim made by Energy Networks Australia (ENA), sub. 40, p. 2). The AER said that it is:

… seen as an attractive area to work, with internal and externally advertised vacancies attracting strong and competitive fields. While there is some movement from the AER into other areas of the ACCC, this turn-over is at a low level. (sub. DR92, p. 20)

Data provided by the AER to the Commission confirm that it has low labour turnover rates (table 21.3).

The Commission finds it difficult to reach any clear conclusion on the issue of staff capabilities in the AER. The AER has some good mechanisms in place to secure expertise, and its labour turnover rates suggest an organisation that is attractive to its employees. During the course of this inquiry, the Commission itself has routinely engaged with AER staff, and has learnt from their lengthy experience in the industry. However, since many industry parties (and others) have raised the issue of the adequacy of expertise in the AER, it would be useful if the proposed review (discussed below) examined this issue more closely.

Table 21.3 Labour turnover in the Australian Energy Regulator

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| Year | Staff separations | Staff turnover |
|  | Number | % |
| 2007‑08 | 12 | 14.5 |
| 2008‑09 | 9 | 8.1 |
| 2009‑10 | 8 | 7.1 |
| 2010‑11 | 10 | 9.1 |
| 2011‑12 | 12 | 9.3 |

*Source*: AER (sub. DR104).

#### Errors

Participants, most notably ENA (sub. 40, p. 3), raised concerns about errors in the AER’s decisions identified by the Australian Competition Tribunal (‘the Tribunal’) in its limited merits reviews.[[4]](#footnote-4) AER decisions reviewable by the Tribunal include:

* revenue and price determinations for transmission and distribution in electricity (including the application of regulatory tests)
* decisions not to exempt entities from ring fencing guidelines or to impose additional ring fencing requirements in electricity.[[5]](#footnote-5)

Most disputes have related to the weighted average cost of capital (WACC), and these have had the largest impact on revenue determinations (AER, sub. DR92, p. 21). There is little doubt that errors have been made. For example, in a case involving the *Application by EnergyAustralia and Others [2009] ACompT 8*, the Tribunal found that ‘the AER exercised its discretion incorrectly, or its decision in this respect was unreasonable …’ (p. 32). However, the Tribunal has also found in favour of the AER in a range of other matters.

Errors are inescapable. The question is whether there are too many of them. ENA drew attention to the high count of errors in the case of the WACC. However, as the AER noted, some counts of errors relating to the WACC cover the same matter, leading to an upwardly biased measure of errors (sub. DR92, p. 21).

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 (Yarrow et. al. 2012b, annex 1). Applications to the Tribunal since 2008 appealed some 50 elements of decisions not involving WACC parameters. The AER conceded errors in five elements. The Tribunal found in favour of the AER in around 21 matters, with the remaining 25 elements varied by the Tribunal or remitted to the AER. On the face of it, outside the contested WACC issues, the AER and the businesses have rough parity in error making in matters brought to the Tribunal. It is hard, therefore, to assign lack of rigour to one party without doing so for the other.

In any case, some caution is needed in drawing strong conclusions about the degree to which raw counts of errors reveal much about the capabilities of the AER.

* 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 higher likelihood that the AER made an error, 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, the AER’s aggregate estimate may have been judged, at times, to be reasonable (which may be a better measure of error).
* Appeals concerning the WACC are likely to have arisen because of novel circumstances — first, the volatile credit market movements during the global financial crisis and, second, the first round of determinations by the AER under the new Rules.

A related issue is the degree to which the AER had sufficiently defended its position in appeal cases. There were two strands of concern in this area.

* The first was whether the AER had taken an overly narrow view of its status as a model litigant in defending its determinations before the Tribunal — a matter flagged by the Limited Merits Review Panel (Yarrow et. al. 2012b, p. 59, AER 2012l, pp. 7, 8). A requirement to be a model litigant does not appear to rule out the proper defence of a position (Lee 2006, p. 10).
* The second was the apparently paradoxical failure by the AER to use a provision in the National Electricity Law (s. 71O (1)) that would have allowed it to broaden the scope of an appeal, such that some appeal outcomes would have more favoured consumers.

However, on the former matter, the final report by the Limited Merits Review Panel did not make any clear finding — indicating that ‘there was, to say the least, some confusion on these matters’ (Yarrow et. al. 2012c, p. 47). On the latter, the answer is more definitive. On investigating the matter, the Acting Solicitor General agreed with the AER that it did not have such a power (ASG 2012). To the extent there is a fault in this area, it lies with the National Electricity Law and Regulations, and not with the AER.

#### The issue of ‘independence’

In addition to the above (contested) concerns about how the ACCC has affected the AER’s resourcing and capacity, some parties expressed concern about the independence of the AER. The word ‘independence’ means different things to different people, and is worth clarifying. The context in which most parties have used it in this inquiry is the independence of the AER from the ACCC, and not between the AER and government and business. For example, the Limited Merits Review Panel heard views that:

… the AER Chair and members are constrained in their ability to independently direct the development and utilisation of the organisational expertise and capabilities that are required for the effective performance of its role. The relevant points ranged from practical, administrative points such as limitations on the ability to direct organisational strategy and performance and to recruit and retain suitably qualified staff, to more fundamental issues such as the difficulties of reconciling a culture of ‘continuous engagement’ with stakeholders of the kind associated with contemporary utility regulation with the necessarily more arm’s length culture that is appropriate to an enforcement agency such as the ACCC. (Yarrow et al. 2012c, p. 61)

While actually repudiating any substantive issue, the inaugural chair of the AER, Edwell, also framed independence in terms of the relationship between the AER and the ACCC. He observed 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. (2005, p. 5)

Whatever the *actual* circumstance, the fact that the two bodies are co‑located, share staff, and have no separate annual report and budgets might reduce stakeholders’ confidence that the de jure provision for independence was in fact being fully realised. In that vein, the AER’s contention that the Commission’s ‘discussion of the AER’s independence overlooks the fundamental point that the AER is established as an independent regulatory authority’ (sub. DR92, p. 22) misses this important distinction. The distinction is not lost on state and territory governments, some of whom have publicly called for structural separation (Department of Primary Industries (Vic), sub. DR94, pp. 13ff). A recent SCER report to COAG noted:

… Some Ministers expressed concern that the existing structure of the AER within the Australian Competition and Consumer Commission … could limit the regulator’s ability to effectively perform its operations and considered that structural separation could be considered by the Council of Australian Governments … . (SCER 2012b, p. 1)

As noted above, the creation of an entirely separate entity is consistent with the findings of the Parer Review Panel (and the MCE proposed industry funding of such a regulator in 2003). The Limited Merits Review Panel recently recommended that the ‘issue of the AER’s independence from the ACCC be revisited’ (Yarrow et al. 2012c, p. 61). On the other hand, some other participants have questioned whether the issue is relevant (TEC, sub. DR50, p. 7).[[6]](#footnote-6)

The Commission assesses the desirability of re‑structuring the AER later in this chapter.

## 21.2 Reform of Australian Energy Regulator governance

### The immediate way forward

The AER is aware of some of the areas of concern about resourcing, capacity and consultation — and appears to be taking measures to address them (SSCEP 2012, p. 77; AER, sub. DR92, p. 19). As noted above, the Australian Government has provided additional funding, while COAG (2012, pp. 1‑2) has also recognised some of the concerns about governance identified above. COAG announced a reform package, which included:

* budget transparency for the AER, including the allocation of program funds over the previous financial year, and information on projected AER funding and staffing (separately from that of the ACCC) over the forward estimates period
* the conversion to full-time status of the currently part‑time state‑nominated AER board member (with the chairman and the other board member already being full time)
* a regular public report by the AER on its activities, including its budget and business plan, its performance against key performance indicators, and its views on emerging regulatory issues
* an independent review by the Australian Government of the AER and its operational requirements initiated in July 2014 to ensure that its resourcing is adequate and its operational arrangements are effective.

The Commission recommended many of these reforms in its draft report, such as greater transparency and a focused review,[[7]](#footnote-7) and so does not reiterate the desirability of these broad reforms. Nevertheless, several observations can be made about some of the details of such reforms not touched upon by COAG. In relation to reforms of its governance, the AER should:

* submit a separate annual report from that of the ACCC, and not just separate reporting in a joint ACCC/AER annual report
* have 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 will likely require negotiating separate service level agreements with the ACCC for corporate services and other ‘overheads’, with the specification of charges, levels of service and expected performance. Given the greater need for benchmarking (and the associated reporting of these results), it will be important that the AER establishes and retains the necessary specialist expertise to competently carry out its role, in accordance with recommendation 8.6
* publicly reveal its strategies for improving its performance, including how it intends to address concerns from stakeholders that become apparent from various stakeholder surveys. This includes providing milestones against which to assess whether the strategy is working. Given comments from various parties, a critical element of this will be regular ongoing communication and interaction with network businesses, their customers and other relevant stakeholders
* be able (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 AEMO and the AEMC, as well as state and territory utility regulators such as the New South Wales Independent Pricing and Regulatory Tribunal (IPART) and the Victorian Essential Services Commission (ESC)
* 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.

Recommendation 21.1

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

* submit a separate annual report of its performance
* have administrative control over its own budget, which would need to be adequate for it to manage its functions efficiently and effectively, including acquiring, developing and retaining the necessary specialist expertise
* publicly reveal its strategies for addressing current stakeholder concerns and those raised in future stakeholder surveys
* 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 strengthens and retains the necessary specialist expertise to competently carry out its role, in accordance with 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.

In relation to the 2014 review of the AER announced by SCER, in the Commission’s view, it:

* 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 would be important. The panel reviewing the limited merits review regime exemplifies this model
* should include consideration of the remuneration conditions offered by the AER (particularly, compared with the AEMC) to attract and retain the specialist expertise necessary to perform its role
* could involve the commissioning of an independent stakeholder survey (as a substitute for the ones previously commissioned by the AER)
* should include consideration of funding options for the agency.

Recommendation 21.2

The 2014 independent review of the resourcing and capacity of the Australian Energy Regulator (AER) should be undertaken by a small group of senior and experienced persons.

* These persons should be external to the Australian Competition and Consumer Commission and the AER, have an appropriate understanding of the competencies required to undertake utility regulation, and include some contemporary international experience from counterpart regulators.

The review should, among its other tasks:

* specifically address any difficulties the AER has in attracting and retaining specialist staff
* consider the commissioning of an independent stakeholder survey covering the relevant review issues
* consider funding options for the AER.

### Longer‑run governance issues

#### Structural change?

There are many possible structural configurations of the AER. In the Commission’s discussions, three broad options for change emerged, which involved:

* integrating the AER completely within the ACCC and abandoning a separate specialist energy regulator
* combining the AER and the AEMC
* separating the AER from the ACCC.

However, the first option would hardly address the concerns about adequate independence of the AER from the ACCC and, accordingly, could frustrate a shift to a more NEM‑wide regulatory model.

In principle, the second option 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 2011b, p. 5). However, this option also raises potential conflicts of interest for the rule makers in the merged agency. For instance, they may be influenced to make rules that ease the task of the regulators in the agency, rather than being beneficial for the wider community. Concerns about coordination and overlap in the activities of the AEMC and the AER might be better addressed under the 2009 Memorandum of Understanding between the ACCC, the AEMC and the AER.

Several stakeholders have raised the third option. While the COAG implementation plan for energy reform does not include any proposal for separation of the AER from the ACCC, it suggests that the issue of the structure of the AER remains open (COAG 2012, p. 2).

Were separation to occur, the AER would be reconstituted as an independent and separate national regulator with appropriate governance arrangements (that met the principles in box 21.1) and a budget that allowed it adequate scope to have access to satisfactory levels of internal and external specialist expertise. Implementation could occur by:

* enacting new South Australian legislation akin to the *Australian Energy Market Commission Establishment Act 2004*, or
* amending the *Competition and Consumer Act 2010*, which currently establishes the AER.

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

This option would involve carefully weighing a range of tradeoffs.

##### The advantages of retaining the AER within the ACCC

On the one hand, the current arrangement of retaining the AER within the ACCC has the following advantages.

* Their proximity and sharing of some resources may encourage a more 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 (AER, sub. DR92, p. 23).[[8]](#footnote-8) 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 IPART and the ESC) 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. The Commission understands that if the regulator had to handle these tasks on a stand‑alone basis, the AER might need more staff with lower average utilisation. Although there are clear benefits from resource sharing, 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.
* There would appear to be real synergies between the two organisations, a point emphasised by the CALC (sub. DR79, p. 6). 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 WACC and benchmarking technical matters from a special ACCC‑wide analytical branch.

However, were the AER to be separated from the ACCC, some of the current synergies with the ACCC could be retained. For example, the AER could still 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 risk that an industry‑specific regulator may identify too closely with the interests of the industry (‘regulatory capture’) — an observation also made by CALC (sub. DR79, p. 7). The Limited Merits Review Panel extended this to political capture as follows:

… what may be the strongest argument for the ACCC connection [is] namely the protection of regulatory decision making processes from pressures to be inappropriately swayed by the agendas of influential parties, including by what may be the fluctuating priorities of the government of the day. (Yarrow et al. 2012c, p. 61)

However, the Limited Merits Review Panel noted that the ‘current ACCC connection does not appear to have prevented the AER, in the recent period, from making statements about electricity prices that are quite political in nature’ (Yarrow et al. 2012c, p. 62).

Even as a stand‑alone entity, risks of capture 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 energy retailing (through the adoption of the National Energy Customer Framework).

* Further mechanisms to reduce the risks of capture include:
* the creation of a consumer body, which would be expected to be active in the AER’s regulatory processes (see below)
* an AER with appropriate governance, such as an appropriately constituted board
* secondments and exchanges of AER senior managers with counterpart international regulators
* transparent reporting and periodic review of the AER
* a ‘fully investigative review process’ as proposed by the Limited Merits Review Panel (Yarrow et al. 2012c, p. 62).
* 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 enacting or amending legislation, developing a new organisational structure, making staff appointments, and establishing payroll and information technology systems. Any structural separation would risk disrupting complex regulatory determinations already in play. Also, the Australian Government is concerned about the proliferation of small agencies, and has previously taken measures to reduce their number.

##### The advantages of separation

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 enduring natural monopoly status of electricity networks, than some other forms of infrastructure, such as telecommunications. Thus, 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)

Biggar (2011b) 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 … 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. ( 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 deceptive 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. The Limited Merits Review Panel similarly observed recently:

… A significant part of the incentive effects of regulation derive from the existence of an ongoing relationship between the regulator and the NSPs [network service providers]. For example, the longer-term relationship should, if it functions correctly, serve to discourage opportunism on both sides, and, since a vulnerability to opportunism is one of the weaknesses identified by the Panel in relation to the operation of the existing LMR [limited merits review] regime, this may be an important consideration when thinking about issues of institutional design. (Yarrow et al. 2012c, p. 61)

As noted earlier, participants have already expressed concerns about the allegedly combative approach of the AER and the lack of consultation.

* Separation would resolve any perceptions (well‑founded or not) that there were conflicts of interests between the AER and the ACCC.

##### The Commission’s view

There are clearly arguments for and against creating an energy regulator entirely separated from the ACCC. On balance, the Commission’s judgment is that the status quo should be maintained. The decisive factor is that the change would be costly and disruptive, and would underplay the capacity of less ambitious reforms to improve the AER’s governance. In particular, more resourcing, and improved transparency and accountability should shore up trust in the agency, without the significant transactions costs of full structural separation. However, a follow-up independent review in 2018 should examine whether the measures outlined in recommendation 21.1 have achieved their goals, and if not, re‑consider the structural issues.

Recommendation 21.3

The Australian Energy Regulator (AER) should remain located within the Australian Competition and Consumer Commission (ACCC). However, a follow‑up independent review should be carried out in 2018 to examine if the reforms to the AER’s resourcing and transparency (recommendation 21.1) have had the desired impacts. If not, the issue of the AER’s structural separation from the ACCC should be examined together with other possible changes to improve its performance.

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

Currently, the Australian Government takes entire responsibility for funding the AER. Some saw another source of income as potentially useful:

PIAC [The Public Interest Advocacy Centre] accepts that an industry levy may need to form part of the AER’s funding base, particularly if a review of resourcing identifies the need for a dramatic increase in AER resources. However, … it would be important that the AER’s source of income not compromise its independence. (sub. DR65, p. 26)

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.

While alternative funding models would become immediately relevant were the AER to be entirely separated from the ACCC, the potential for an industry or some other kind of shared funding arrangement might still be applicable even were the AER to remain within the ACCC.

Several Australian utility regulators — such as the ESC, IPART, 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’[[9]](#footnote-9) 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 sector, there are 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). The National Offshore Petroleum Safety and Environmental Management Authority is fully funded from the 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 might allow the regulator to have a remuneration policy that is more consistent with the needs of being able to attract and retain the necessary specialist expertise required to fulfil the AER’s role (to the extent that this is a well-founded issue).
* 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 the regulation of national energy markets.
* The regulator would be better able to plan for an adequate and efficient level of resources, rather than being subject to global efficiency dividends or other short‑term Australian Government budget stringencies.

However, there are potential concerns about an industry levy, such as impressions of industry capture, the legislative challenges of giving it effect, and the considerable complexities in gathering funding from the multiple jurisdictions in the NEM.

Given that the Australian Government has announced significant new funding, the Commission does not see grounds at this stage for a change in the funding model. As discussed earlier, funding options should be considered as part of the 2014 review.

## 21.3 What about AEMO, the AEMC and other NEM bodies?

Few parties have suggested that the governance arrangements for AEMO and the AEMC should be altered radically. However, the MEU and Visy argued that there were benefits from reviewing all aspects of the institutional arrangements.

In addition, the MEU considers that the performance of the key NEM institutions, including importantly the AEMC, require independent review to ensure proper resourcing and quality performance. This will follow the recent review of the limited merits review regime and the AER … (MEU, sub. DR66, p. 6)

… There must be a review of the AEMC, the institution responsible (more than any other NEM institution) in compromising Australia’s hitherto strategic competitive advantage in electricity pricing since 2007. … The AEMC must be made to be more accountable for its actions and be more cognisant of consumer interests and issues. Its performance to date has been found wanting. (Visy, sub. DR98, p. 2)

The fundamental point made by the MEU is sound and is consistent with the view articulated by the Australian Government in its 2012 Energy White Paper (DRET 2012b, p. 171). The key (non‑political actors in the NEM) are the merits appeal body, the AER, the AEMC and AEMO. The first (the Australian Competition Tribunal) has recently been reviewed, and the second will be shortly. There are grounds for independent reviews of the other two agencies to identify any potential for improvement.

Such reviews do not need to occur immediately, but should be undertaken within the next five years. Moreover, the National Energy Consumer Advocacy Body proposed by SCER should be subject to review after some years of operation. Reviews should occur for all institutions in the NEM (including the AER), preferably, at 10 year intervals after 2018.

Along with identifying potential for improvement, the reviews should consider resourcing and capacity issues.

Recommendation 21.4

The operation and performance of the Australian Energy Market Commission, the Australian Energy Market Operator and the proposed new National Energy Consumer Advocacy Body should be independently reviewed by 2018 to identify opportunities for improvements. All these institutions and the Australian Energy Regulator should be reviewed at least at 10 year intervals after that time.

## 21.4 Consumer engagement and representation

The NEO refers expressly to the ‘long term interests of consumers’, and yet until recent reforms (listed below), the role of consumers in regulatory outcomes had been weak.

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’ covers 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.[[10]](#footnote-10)

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 nine 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 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 provides grants[[11]](#footnote-11) for consumer advocacy and research for the benefits of consumers of electricity or natural gas (AEMC 2011j, k). The 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 2011‑12, the Consumer Advocacy Panel allocated funding for grants totalling around $2.5 million, which included around $1.6 million for electricity advocacy and $29 000 for panel‑initiated electricity research (AEMC 2011j, pp. 98‑9).[[12]](#footnote-12) Most groups received relatively small grants — often for narrowly‑defined projects.

Despite these mechanisms, there is widespread dissatisfaction with consumer engagement in electricity network regulation (box 21.4), and a view that, regulators in other countries engage with consumers or consumer representatives more than the AER (AEMC 2012r, p. 100).

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| Box 21.4 Consumers have a weak voice in electricity network regulation |
| Mountain (who often represents the Energy Users Association of Australia) noted the disempowerment of users in regulatory reviews:  … 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. (2012b, p. 23)  The Limited Merits Review Panel said that consumers were seen as ‘inconvenient guests’ in the merits review process (Yarrow et al. 2012b, p. 44). The Panel also noted that network service providers themselves recognised weaknesses in their relationships with consumers and major energy users (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]. Whilst 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. (Yarrow et al. 2012b, p. 67)  In a report for ENA, Fels (2012, p. 80) observed that funding through the Consumer Advocacy Panel was ‘derisory’, the benefits of funding were too dispersed among groups to make a difference, the focus of consumer groups was too narrow, and an attention to state‑based matters undermined a NEM‑wide perspective.  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 or subjects; insufficient resources and funding; insufficient skills or access to the right technical expertise; failure by decision makers to consult adequately; and a lack of attention given to the overall regulatory framework (pp. 46‑7).  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 under‑developed. 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) |
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### New policies for consumer engagement

In late 2012, Australian governments announced several measures to encourage greater consumer engagement including the following.

* The creation by the Australian Government of a Consumer Challenge Panel comprising industry experts and located in the AER, with its goal to represent consumers’ interests in regulatory determinations (Gillard 2012 and COAG 2012). The AER has announced it will establish the Panel by 1 July 2013 (AER 2013b).
* By the end of 2013, SCER will create a National Energy Consumer Advocacy Body to contribute to energy policy development, Rule change processes, and network determinations (including appropriate appeals processes). SCER will develop the funding, form and scope of the new body in consultation with consumer groups. The new body will be ‘equipped to engage in regulatory processes, support targeted research and advocacy initiatives, and lead on national advocacy issues’ (COAG 2012, p. 6; SCER 2013a).
* In January 2013, SCER announced a review of the objectives of the new body, its governance funding models and relationships with other advocacy arrangements (Tamblyn and Ryan 2013, pp. 3, 5) to be completed by 30 April 2013 (SCER 2013a). The Productivity Commission supports the scope and process of this review. As outlined below, it has examined some of the key issues, which hopefully will contribute to the review’s findings.[[13]](#footnote-13)
* As the establishment of the new body is likely to require legislative change, and so could not be implemented immediately, SCER has indicated that some immediate steps will be taken to improve consumer representation in the energy market (though these were not specified).
* By June 2013, SCER will develop improved criteria for grants made by the Consumer Advocacy Panel, so that the grants have a greater focus on addressing priority needs of average energy consumers, ‘including in AEMC processes’ (COAG 2012, p. 6). SCER will consider the appropriate mechanism and location of the function for the allocation of consumer grants, given the creation of the other two institutions above.
* The AEMC (2012r, p. 7, pp. 35ff, and pp. 148, 180) has made Rule changes that mandate certain types of consumer engagement. The AER is required to provide an issues paper accessible to consumers about a network business’s proposal and to hold a public forum. Network service providers are also required to provide a plain language overview that explains how it has engaged with consumers and that outlines its revenue proposal. The AER has the power to require re‑submission of the paper if it were not adequate. When determining the capital expenditure and operating expenditure allowances of a business, the AER is also required to take into account the extent to which the network service provider had engaged with consumers in preparing its forecasts.

The proposals are generally consistent with the views of many parties (including the Commission in its draft report) that a more coherent model for consumer engagement in energy policy and regulation, including a national representative body, was required.[[14]](#footnote-14)

Detailed models have been proposed by some parties, including participants in the Commission’s inquiry. For example, CALC (sub. DR79), the TEC (sub. DR50) and the Public Interest Advocacy Centre (PIAC, sub. DR 65) proposed a new national advocacy body called Energy Consumers Australia. However, their proposed body would not be broadly representative of all energy consumers. It would focus on residential consumers and small business consumers, particularly those who are vulnerable. Further, it appears that the proposed body would not exclusively focus its attention on the achievement of the NEO. Instead, it would appear, from its stated objectives, that there is a risk it might give undue weight to additional goals such as social and environmental objectives that could give rise to conflicts with the NEO.

#### The role of the Consumer Advocacy Panel and research grants

It is legitimate to provide grants for some research and associated advocacy, recognising that coordinated action by the large number of households and small businesses to engage in research or advocacy on consumer issues is not likely to occur. In any case, such activities are most valuable when consumers have an effective conduit to affect regulatory processes and policy, which is also clearly lacking. To that extent, there is a strong rationale for the role performed by the existing Consumer Advocacy Panel.

However, there is little rationale for the existence of the Panel as a separate entity. There are likely to be economies of scope and scale in incorporating the grant function into the National Energy Consumer Advocacy Body. (This would also recognise the increasing antipathy by governments to the proliferation of many small agencies.) The latter would have the expertise to determine the research and associated advocacy projects most likely to further the interests of consumers, and to have the knowledge to make merit‑based choices among competing grant applications. There are also grounds for the new body to directly commission research relevant to its objectives, but with a quota on the share of funds that it can use this way. The implication is that the existing Consumer Advocacy Panel should be wound up when the National Energy Consumer Advocacy Body is created. While there was some support for the removal of the Consumer Advocacy Panel, such as by the NSW Distribution Network Service Providers (sub. DR85, attachment A, p. 8), others were concerned that its removal might threaten funding of existing advocacy groups (for example, CALC, sub. DR79, p. 2). The Commission considers that the appropriate budget for funding of advocacy and research external to the National Energy Consumer Advocacy Body is a separate issue. There is already some process for determining the budget of the Consumer Advocacy Panel and a similar (if not more rigorous) process could be used to determine the *external* grant budget of the National Energy Consumer Advocacy Body.

There is also little rationale for providing grants to groups that would be likely to undertake research and advocacy in the absence of subsidies. It is notable that the two peak bodies representing major users (the Energy Users Association of Australia and MEU) received around 18 per cent of the Consumer Advocacy Panel funding for 2011‑12.[[15]](#footnote-15) Unlike the bulk of other consumer groups receiving funding from the Consumer Advocacy Panel, these bodies represent relatively few electricity customers, which also command large resources. It seems likely that without eligibility for grants, these groups would continue to exist and to champion the interests of their constituents. While there should be no blanket ban on grants to any given group, the grant panel of the National Energy Consumer Advocacy Body should only provide grants where it is reasonably satisfied that the grants fund activities that are important and would not otherwise occur. These activities cover research and the associated capacity to make informed submissions to reviews, appeals and determinations so that individual groups can represent their constituencies. Funding should be provided on a contestable basis.

#### The National Energy Consumer Advocacy Body

##### Functions and governance

SCER’s proposed objectives and activities for the National Energy Consumer Advocacy Body (SCER 2013c, p. 2) would address the main deficiencies in the current arrangements, though these functions should be expanded to include the provision of grants and a capacity for reaching negotiated settlements with the network businesses (chapter 8).

However, as currently specified there appears to be a major overlap between the Australian Government‑funded Consumer Challenge Panel and the National Energy Consumer Advocacy Body. Both are to be involved in network determinations. It is hard to see how the two bodies would interact in undertaking their roles without wasteful duplication, especially since it is not clear that they would, or should, have significantly different constituencies. An alternative would be for the Consumer Challenge Panel to be part of the National Energy Consumer Advocacy Body. It would be a secondary issue whether the Australian Government were to fund this part of the body. However, the National Energy Consumer Advocacy Body should be independent from the regulator. This reflects the desirability that the AER be seen as a neutral player. It would also recognise that the National Energy Consumer Advocacy Body would be acting in its own right at merits reviews, in any negotiated settlements, in Rule change requests, and submissions to AEMC reviews, and might sometimes want to adopt positions contrary to that of the AER. The independence of the National Energy Consumer Advocacy Body would not preclude it from having ongoing communication about technical and procedural issues with the AER (and indeed with the AEMC and AEMO).

Nevertheless, it will be some time before the National Energy Consumer Advocacy Body is created. An advantage of the Consumer Challenge Panel is that it is planned to be operational by mid-2013 and thus has the potential to make an immediate impact in the regulatory process. Accordingly, there are grounds for a separate Consumer Challenge Panel in the shorter run.

The implication of the above is that ultimately there should be a single national consumer body with a focus (initially at least) on energy policy and regulation, rather than three overlapping national bodies.

To act effectively, the role and associated skill set of the National Energy Consumer Advocacy Body would have to go beyond the current focus of many consumer groups on affordability issues (though these remain important). Thus, the body should have strong expertise in economic regulation in energy markets and competence in the relevant engineering areas.

The governance arrangements of the body should reflect its broad role and the necessity for the body to genuinely represent consumers as a whole, and not particular constituencies (such as vulnerable consumers alone). This can be achieved through the appointment of an expertise‑based board, 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 National Energy Consumer Advocacy Body should be financed through a small ongoing levy on market participants (effectively amounting to a consumer levy). This would provide greater certainty, and independence, of funding than annual government budget appropriations. However, were the body to be funded by government, there should be commitment to a long‑term (such as a rolling five year) budget.

##### Who should the National Energy Consumer Advocacy Body represent?

The Commission considers that the key function of such a body would be to represent the interests of *all* energy consumers (for example, households, businesses and major industry users) during policy, regulatory, rule‑making and limited merits review processes (such as an AER regulatory determination process).

The fact that large energy users have ‘deep pockets’ (TEC, sub. DR50, p. 3) is relevant to their eligibility for grants, but not for their representation in the National Energy Consumer Advocacy Body. In fact, bringing them to the table carries with it the benefits of highly sophisticated and demanding customers, adding to the negotiating grunt and authority of the body. Once there are carve outs of particular groups, there is a risk that the remaining body would become a creature of sectional interests, which would not assist its credibility or effectiveness.

Moreover, on many issues, consumers have common concerns — they would like high quality services at sustainably efficient prices. It is notable that the MEU and the Energy Users Association of Australia have championed changes to the Rules that would produce benefits for all consumers. There is no reason why some issues important to some consumers — such as hardship policies — should be neglected in this model. The inclusion of an advisory group in the governance structure would ensure that all consumer voices were heard. The National Energy Consumer Advocacy Body could develop competencies in disparate areas — such as smart meters, critical peak pricing, reliability and policies for vulnerable consumers.

Nevertheless, the Commission agrees that there will be tensions between the interests and enthusiasms of disparate consumer groups on some matters. While these may lead to robust but healthy debates within the National Energy Consumer Advocacy Body, they could, if not managed carefully, undermine the effectiveness of the body. For example, the MEU said:

Certainly, consumer advocates with an environmental bias have quite clearly enunciated differing views to large and small businesses in a number of key aspects, although they have common views in other areas. (sub. DR66, p. 11)

However, there are two rejoinders to these concerns.

* The National Energy Consumer Advocacy Body should not be the only outlet for consumer advocacy. It should not preclude the involvement of other consumer groups in regulatory and policy processes — such as in merits 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.[[16]](#footnote-16) That, if achieved, should increase the options for participation by many consumer groups. (As noted above, some of these could access the grants provided by the body.)
* It is not clear that any such ‘national’ body could function well if it did not compromise. For example, households are not homogenous. People with air conditioners might well prefer to prevent critical peak pricing, while others would rather stop cross‑subsidising them. An important aspect of an effective National Energy Consumer Advocacy Body will be that it concentrates on the NEO as its underpinning principle, and not the interests of particular consumer groups that are contrary to the long‑term interests of most consumers. As noted by GDF Suez Energy Australia (sub. DR68, p. 4), a focus on the long term is important to avoid the ‘temptation for customer groups and political interests to focus on short‑term gains’. Notably, among all customer groups, industrial customers with long‑lived energy‑intensive assets must recognise that there is a tradeoff between low prices now and reliable long‑run electricity supply. This provides another benefit of the involvement of large users in the national body.

A national consumer body is an experiment. It appears to have functioned well enough in other countries, but the outcomes will depend crucially on its governance, and the design of the regulatory arrangements that give it a capacity for influence. As in any other major institutions, its effectiveness should be evaluated after a suitable period (recommendation 21.4).

*The initial focus on energy might extend to water*

The initial energy policy and regulation focus of the national consumer advocacy body could also be extended to water. 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’.

#### The obligations to engage

As described earlier, the AEMC has introduced Rule changes that mandate certain engagement arrangements. Some, such as the obligation for the AER to produce an issues paper and for networks to provide an overview of their proposals, do not appear costly and may assist consumers to some extent. However, some other aspects of the Rule changes *may* have unintended consequences.

* A requirement for businesses to detail their engagement with consumers in their overview document might risk a ‘compliance’ mentality. It is hard to differentiate engagement in good faith from engagement due to a statutory requirement — thus, undermining the goal of the Rule change.
* Hinging any amount of the revenue determination on the AER’s judgment about the seriousness of a network business’s engagement with consumers on forecasts would involve many subjective judgments and might risk arbitrary decisions.

The AEMC has only recently determined these Rules, so their actual effects are as yet unknown. They may actually prove useful, or at worst innocuous. However, given the risks of unintended consequences, the AEMC and the AER should monitor their usefulness during the current determination processes.

However, an unresolved question is whether these kinds of Rules should have been made in the first place. It might have been better to have assessed whether encouragement by the AER for network businesses to voluntarily engage more with consumers would produce positive outcomes, without the need for what some might see as a rather heavy‑handed statutory requirement. Indeed, the industry collectively could have produced its own voluntary code in this area. After all, it has already acknowledged a need to improve its engagement with consumers. In regulation more generally, there is an increasing awareness by governments that regulations also impose costs and should not be made lightly. There are grounds for SCER, the AEMC and the AER to consider whether there are alternatives to these kinds of regulations. At the very least, the AER should provide advice as to how it intends to interpret and apply these Rules.

Recommendation 21.5

The new National Energy Consumer Advocacy Body proposed by the Standing Council on Energy and Resources should:

* have expertise in economic regulation and relevant knowledge and understanding of energy markets
* represent the interests of all consumers during energy market policy formation, regulatory and rule‑making processes, merits reviews, and negotiations with providers of electricity networks and gas pipelines
* subsume the role of the existing Consumer Advocacy Panel into its broader functions, but only provide grants to consumer bodies where the research proposal is judged to have merit and unlikely to proceed without some government funding
* ultimately subsume the role of the Consumer Challenge Panel
* receive adequate ongoing funding through a levy on market participants, drawing on the approach used to currently fund the Consumer Advocacy Panel
* have a governance structure that involves an expertise‑based board of members appointed on merit, and an advisory panel to give the board advice on the needs of the mix of customers concerned
* be independent from the Australian Energy Regulator.

The recently commissioned independent review into the best design of the National Energy Consumer Advocacy Body should take these recommendations into account.

## 21.5 Processes for amending electricity network regulation

This section examines the processes for policy change in the NEM since these 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. SCER is responsible for developing energy policy and for changes to the National Electricity Law. However, it does not have power of its own to change the National Electricity Rules,[[17]](#footnote-17) which are the principal source of regulation of the NEM. Instead, the AEMC has responsibility for developing and amending the Rules to achieve the NEO. It initiates changes to the Rules that are minor or prescribed in the Regulations or, on more important matters, responds to requests, including from SCER, to consider and then decide upon changes to the Rules (figure 21.3). An additional critical role of the AEMC is to undertake reviews of its own accord, or as directed by SCER — such as its reviews of transmission frameworks (AEMC 2012j) and demand management (AEMC 2012u). The AEMC provides reports of these reviews to SCER, which can then request Rule changes. Although SCER can set the timetables of reviews in its directions to the AEMC, it is not able to do so in respect of Rule changes.

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). In practice, however, this can take one year to complete
* a fast‑track process where: there has been adequate first round public consultation by an ‘electricity market regulatory body’ (such as the AER or AEMO); or the Rule request is based on an AEMC‑initiated review or a SCER‑directed review and there was adequate consultation during the review. (Other reviews are not covered by this provision.) This process can take 21 weeks from initiating the process, but is rarely used (AEMC, pers. comm., 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 21.3 Pathways to changing the National Electricity Rules

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| Figure 21.3 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.

Figure 21.4 The standard Rule making process and timelinea

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| Figure 21.4 The 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 August 2012 and 5 October 2012); AEMC (2012s).

The Rule change processes administered by the AEMC have several desirable features in that they:

* enable NEM participants and others in the community to actively participate in initiating Rule changes
* involve genuine consultation on any Rule change proposals
* are compatible with COAG’s regulatory impact analysis framework (PC 2012d, figure 1.3, p. 39) and, in particular, with elements of a Regulation Impact Statement (Department of Finance 2008). 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)
* enable technical changes to be implemented expeditiously.

However, notwithstanding these features, the roles and processes for decision‑making in the NEM are, to some extent, poorly defined, slow and cumbersome and, in other ways, counter‑intuitively, rapid. They differ markedly from the usual policymaking processes in Australia.

* 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 SCER, parliament or government. Arguably, providing the AEMC with a Rule making power may be an appropriate response to the inertia that is sometimes associated with the difficulties of getting ministerial agreement in COAG bodies. (The struggle to achieve a National Energy Customer Framework exemplifies this concern.) Given the historically parochial nature of energy policy in Australia and the requirement for reasonable nimbleness in making policy changes, this structure was desirable at the commencement of the NEM, but it cannot be said to be conventional or necessarily desirable over the long run.
* While the respective functions of SCER and the AEMC are ostensibly clear, in practice the roles are blurred.
* In many respects, the AEMC is a policymaker. For example, by any standards, the outcomes of the Rule change involving the economic regulation of network service providers (AEMC 2012r) represents a major policy change. Certainly, outside the NEM, a parliamentary Act making similarly sweeping changes in the regulatory environment would be regarded as a fundamental piece of legislation and policy reform. The ‘separation of roles’ between SCER and the AEMC claimed by several network businesses is rather indistinct.[[18]](#footnote-18)
* The corollary of the above is that the distinction between the AEMC’s processes in undertaking major framework reviews and Rule making is more semantic than real. Both involve intensive consultation and the consideration of broad policy issues.

Consequently, consideration of the current arrangements should not start with the premise that they are structurally sound. There are grounds for adaptation of the arrangements that move them — even if incrementally — towards conventional policymaking.

### Rule change processes need reforming

The Commission has not investigated in any detail the full extent of any desirable adaptations, but was struck during this inquiry by an anomaly in policymaking in the NEM compared with other economic sectors. The Commission has undertaken an extensive public inquiry into many aspects of network regulation and made many highly specific recommendations that could be given effect in Rule changes. Other reviews concerning electricity network regulation — for example, the independent panel carrying out the limited merits review commissioned by SCER, the inquiry by the Senate Select Committee on Electricity Prices and, indeed, many of the AEMC’s own reviews — may well be in the same boat. Yet, even if SCER considered that any such recommendations should be implemented through the Rules, this could not happen with any speed, if at all. (In contrast, a change to the National Electricity Law could be made quickly, despite the fact that the National Electricity Law and the National Electricity Rules are both statutory instruments giving effect to policy.)

The adverse consequences of this are that the usual sovereign powers of parliaments are weakened, the benefits from reforms are delayed, there is an added consultation burden on stakeholders, and there is duplication in the resourcing of reviews.

For example, were the standard process for Rule changes to be applied to give effect to the Commission’s proposal to reform transmission and distribution reliability by December 2013 (recommendation 21.8), it would need to start before July 2013 (figure 21.5). Delaying this process means that there is a risk that the reforms would not have any beneficial impact on forthcoming regulatory determinations for the most costly part of the system (distribution) commencing in July 2015 (figure 21.5). (The impact of additional processes to those of the Rule change processes in further delaying such reforms are considered later.)

Figure 21.5 The standard Rule change process within the context of forthcoming regulatory resetsa

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| Figure 21.5 The standard Rule change process within the context of forthcoming regulatory resets. This figure shows a timeline for regulatory resets should the PC’s recommendation 21.8 be adopted. |

**a** The standard Rule change process is assumed to take around 26 weeks.

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

#### Improving Rule change processes would reduce inefficiency and accelerate reform

One way in which improvement could be achieved would be for the AEMC, in particular circumstances, to take on a role more akin to a parliamentary drafter, simply translating relevant recommendations from its own and other reviews into Rule changes, together with expediting commentary on these changes.

However, the Commission recognises that any such arrangement would need strong disciplines.

* Rule changes would need the assent of SCER, consistent with the conventional political processes of accountability in a democracy. SCER should decide which recommendations would go through this process.
* Any non‑AEMC review would have to meet strict criteria (see below). (The presumption is that previous AEMC reviews would automatically meet these criteria.)
* The draft Rule changes would still be subject to scrutiny and consultation, but *without the policy reasons underlying the Rule change being re‑opened.*
* The Rule change process would have a tight timetable and be completed within six months. This tight timetable could be achieved through legislative amendments in the National Electricity Law to existing fast‑track and expedited processes, or through the introduction of a new accelerated process.

The Commission’s draft recommendation for improving the Rule making process took a rather more expansive form than the above. The Commission recommended that the National Electricity Law be amended to expedite the making of Rules arising from recommendations by non‑AEMC reviews by giving both the AEMC the power to expedite Rule change requests and the South Australian Minister a broader power to make Rules with the agreement of SCER (the latter by‑passing the AEMC altogether).

The Commission’s draft recommendation, particularly the increased role of the South Australian Minister, was met with considerable disquiet by industry participants. On further reflection, the Commission does not consider that such a ministerial prerogative would be necessary as a solution to the particular problem identified above. (However, over the longer term, there may well be benefits in revisiting the overall decision‑making processes in the NEM, reflecting the broader issues raised above — but that is neither a matter for this inquiry nor an urgent imperative.)

More broadly, participants were also troubled that acting on non‑AEMC reviews could risk losing the checks and balances of existing Rule change processes, such as:

* an inability for stakeholders to have a sufficient say about matters directly affecting them (Alinta Energy, sub. DR81, p. 5; Ergon Energy, sub. DR63, p. 9; GDF Suez Energy Australia, sub. DR68, p. 4)
* a failure to test policy against the NEO — an obligation of existing Rule change processes (Origin Energy, sub. DR64, p. 2)
* the capacity for Rule changes stemming from reviews conducted by ‘any number of organisations’ (Origin Energy, sub. DR64, p. 7)
* incoherent changes to the Rules as no one organisation would be responsible (ENA, sub. DR71, attachment A, p. 20)
* greater regulatory uncertainty (GDF Suez Energy Australia, sub. DR68, p. 4).

The Commission agrees that any alternative arrangement for achieving Rule changes would need to address these risks. However, having tough disciplines on any eligible review is intended to solve just these kinds of problems.[[19]](#footnote-19) Accordingly, any non‑AEMC review used as the basis for accelerated Rule changes would need to comply with the following key criteria.

* The reviewing institution is independent and has the necessary expertise.
* The review is consistent with COAG’s regulatory impact analysis framework —for example, the review involves public consultation, considers all the elements of a COAG Regulation Impact Statement, and makes the outcomes of the review public (preferably with a draft report as part of the process).
* The review is sufficiently recent that stakeholder consultations would be against the background of the contemporary regulatory environment (Jemena, sub. DR77, p. 11). This would also recognise that too dated a review would neglect the views of any new stakeholders. (The Commission recognises that its draft report view that a review might be as old as two or three years would not be appropriate.)
* The review contains sufficiently suitable and detailed analysis to support a Rule change proposal.[[20]](#footnote-20)
* The review assesses the proposals against the NEO.
* The review is cognisant of the overall regulatory environment.

Additionally, SCER would need to support the relevant recommendations from such reviews for them to enter the Rule change process. These are tough requirements and would be rarely met. Any such process would ensure adequate consultation and avoid the haphazard introduction of Rule changes.

Recommendation 21.6

The National Electricity Law should be amended to require the Australian Energy Market Commission (AEMC) to accelerate the process for making Rule changes within six months where they:

* are requested by the Standing Council on Energy and Resources, and
* arise from the recommendations of an appropriately conducted independent review, including previous AEMC reviews, relevant to the National Electricity Market.

### There is a broader need to reform SCER’s processes

Some of the more critical reforms in the NEM — for example, those relating to transmission and distribution reliability, transmission planning, smart meters and time‑based pricing — have already taken far too long. While the Rule change process described above creates one friction for timely and efficient policy change, it is not the main source of slow reform in electricity network regulation. Reform appears to have been frustrated by complex processes, constant and overlapping reviews, and a lack of agreement by relevant governments about either the reforms themselves or the need for more timely progress to a genuinely NEM‑wide approach to energy regulation.

This is exemplified by the processes for reforming transmission planning and reliability. Reviews in this area have been ongoing since 2002, increasing in frequency to the extent that several now overlap. These include:

* *Towards a Truly National and Efficient Energy Market* by Warwick Parer (chair) (March 2002 to December 2002)
* *Energy Reform: The way forward for Australia* by the Energy Reform Implementation Group (February 2006 to January 2007)
* *Towards a Nationally Consistent Framework for Transmission Reliability Standards* by the AEMC (December 2007 to August 2008)
* *Reliability Standard and Reliability Settings Review* by the AEMC (March 2009 to April 2010)
* *Transmission Frameworks Review* by the AEMC (April 2010 to March 2013)
* *Electricity Network Regulatory Frameworks* by the Productivity Commission (January 2012 to April 2013)
* *National Electricity Network Reliability Framework and Methodology* by the AEMC (February 2013 to November 2013).

The significant and avoidable costs imposed on consumers by the current institutional arrangements would suggest that (as just one example) the implementation of the Productivity Commission’s model for transmission reliability planning should take place as soon as practicable. While some work needed to implement the reforms can begin immediately, such as the collection of estimates of the value of customer reliability and the development of national probabilistic modelling by AEMO, it now appears that the actual operation of the new approach will be delayed because of the newly announced AEMC review into national electricity network reliability framework and methodology (SCER 2013b). This review will also examine options for national models for transmission reliability planning and will not be completed until November 2013. Following this review, further steps will still be required before reform can be implemented in forthcoming regulatory determinations, including:

* the need for SCER to agree on an implementation plan, which would provide detail on required Rule and legislative changes. The implementation plan would not be considered until June 2014 under the current timetable if the recommendations of the review are agreed in November 2013
* the need for SCER to request a Rule change. The time taken to make such a request could readily take months, unless the matter was treated urgently
* the time taken to complete a standard Rule change process in practice would take at least one year
* a sufficient period of time for transmission businesses to develop their regulatory proposals based on reasonable certainty about the reliability and planning regime (that is, after the Rule change) — around three to six months prior to the submission to the AER
* the timing of forthcoming regulatory determinations (figure 21.5 and table 2.5 in chapter 2) and length of the determination process (between 11 and 15 months).

The upshot of these constraints is that SCER could commit to the Commission’s framework in late 2014, but that its actual application in a regulatory determination would not begin until 2017 for Powerlink, and over the following five years for the remaining transmission businesses.[[21]](#footnote-21) In fact, delays in any of the above steps mean that the process might not even be complete in time for Powerlink’s regulatory period beginning July 2017 (but for which regulatory proposals are due by 31 January 2016).

This is despite the fact that reform of this area is one of the most critical components to enable achievement of the NEO. Delay will cost consumers hundreds of millions of dollars of avoidable costs to their electricity bills. It appears that consumer interests have been subordinate to process. Yet, paradoxically, all governments, transmission businesses, AEMO, and the AEMC have agreed to many elements of the reforms suggested by the Commission (or close alternatives to these).

It is therefore an imperative that SCER reforms its processes and expedites its decision making so that critical NEM policy reviews, Rule changes and their implementation occur in a timely fashion. In the case of transmission (and distribution) planning reforms, the Commission’s inquiry, along with recently (or soon to be) completed AEMC reviews, directly overlap with the terms of reference for the AEMC’s new review into network reliability (SCER 2013b). In the Commission’s view, the recent reviews, which have involved wide consultation with stakeholders, along with several relevant earlier reviews, provide the necessary evidence to support reform recommendations in this area. Moreover, ample evidence exists that the cost to consumers of further delays to reform is large.

Accordingly, the Commission believes that the latest AEMC review into network reliability should be converted into an accelerated Rule change process, consistent with recommendation 21.6, to be completed by December 2013. Even an accelerated Rule change process will provide adequate opportunity for further stakeholder input through the AEMC’s consultation processes without the need to revisit the case and nature of reforms — aspects that have already been the subject of a number of previous reviews. Following the Commission’s approach would allow reforms to transmission reliability planning to begin to take effect in the next round of regulatory determinations, starting in July 2015, with reforms becoming operational across the NEM by 2018 (figure 21.6). The Commission conservatively estimates that the benefits from bringing forward transmission reliability reforms alone would be in the order of $500 million (in present value terms over 30 years), but could be as high as $800 million (appendix F). The significant delays that would be caused by proceeding with the current review would therefore be very costly for Australian consumers.

Figure 21.6 Timelines for implementing reliability reforms

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| Figure 21.6 Timelines for implementing reliability reforms. This figure shows the current SCER timeline for implementing reliability reforms compared with the timeline proposed by the Productivity Commission. |

**a** Assumes the accelerated Rule change process reflects the Commission’s recommendation 21.6.

*Data sources:* AER (2013c); chapter 2, table 2.5.

Recommendation 21.7

The Standing Council on Energy and Resources should reform its processes and decision making so that critical policy reviews of the National Electricity Market, the corresponding changes to the National Electricity Rules, and their implementation occur in a timely fashion.

Recommendation 21.8

The Standing Council on Energy and Resources (SCER) should convert the current Australian Energy Market Commission’s (AEMC’s) review of distribution and transmission reliability into an accelerated Rule change process (as set out in recommendation 21.6) to be completed by December 2013. SCER should request the AEMC to draw on the Productivity Commission’s recommendations 15.1, and 16.1 to 16.7, as well as the quantitative assessment of the benefits of the recommended reforms, in formulating the proposed Rule changes.

## 21.6 Merits review processes

COAG and SCER have established a plan for implementing reform of the limited merits review regime (COAG 2012, pp. 3‑4), following the findings and recommendations of the Limited Merits Review Panel (Yarrow et al. 2012c). SCER has commenced a regulatory impact assessment process.

Many of the Panel’s observations are consistent with the tenor of this inquiry report, though the Commission has not examined the issue of whether a new merits review body is warranted.

Were governments to create such a new body, an important issue is how it would fit within the existing institutional arrangements of the NEM. Having looked closely at these arrangements, the Commission questions the overall benefits of the Panel’s recommendation that the body should be attached to the AEMC (Yarrow et al. 2012c, pp. 52ff). The Panel’s proposal is that, while the review body would operate as an independent body, the AEMC would provide administrative support and expert resources. The Panel proposed that there be regular, periodic meetings between AEMC commissioners and the review body’s members to discuss regulatory supervision.

The Panel recommended this arrangement for several reasons.

First, there would be administrative resource savings from co‑location within an existing body. On the other hand, the Panel observed that other agencies could also serve this role, and so this is not a decisive factor.

Second, the AEMC has strong expertise in energy matters. This is true. However, its expertise is greater in legal and economic matters than in engineering, which various parties have nominated as critical, including the Limited Merits Review Panel (Turvey 2000b; Yarrow et al. 2012c, p. 24). While the existing Tribunal has the advantage of having experience in many other technical infrastructure matters, such as in telecommunications and other essential facilities of national significance, it too lacks engineering expertise. However, other parties could provide expertise, such as through secondments to the merits review body or simply as expert witnesses.

Finally, the Panel considered that both the AEMC and the merits review body shared a common function, serving as constraints on the conduct of the regulator — the former through the Rules and the latter through the ex post assessment of any regulator’s decisions disputed by relevant parties:

We have noted that rule changes currently under consideration by the AEMC tend to have the effect of affording the AER greater discretion in its decision making. Again, in a well functioning regime, it might be expected that any reduction in supervision *ex ante* (i.e. via rules) might well be accompanied by adjustments to supervisory arrangements that operate on an *ex post* basis, as appeals/review processes do. At a minimum, if the primary regulator is given more discretion, it might be expected that there would be some simultaneous consideration of whether, on standard checks and balances arguments, the extra power/discretion granted merited some counter-balancing adjustment in supervisory arrangements. The panel therefore sees merit in having these two aspects of supervision — via rules and via the oversight of standards of (primary decision making) performance — which need to be coordinated in some way or other, under the same organisational roof. (Yarrow et al. 2012c, pp. 52‑3)

Nevertheless, this argument has some flaws. In particular, the discretion that the AER possesses under the new arrangements are a *consequence* of decisions by the AEMC, and not a policy accident that requires extra supervision by the AEMC. Were the AEMC suspicious of discretion, it should not have made the Rule change, or it should have introduced safeguards against its abuse within the Rules. For sure, if it all ends in tears, the AEMC can make further amendments to the Rules, but it does not need the review body as a bedfellow to do this.

As discussed earlier, the AEMC sometimes serves as a de facto policymaker, and in that context, it is highly questionable that it should have any closer relationship with the merits review body than any other stakeholder. Review bodies are best the cold and distant relatives to policymakers.

1. The AER advised that other ACCC staff — such as legal, corporate and IT staff — spend some time working on AER matters. [↑](#footnote-ref-1)
2. Similar views about a lack of constructive engagement between the regulator and network service providers were expressed to the Limited Merits Review Panel (Yarrow et al. 2012c, p. 61). [↑](#footnote-ref-2)
3. However, ENA (sub. 40, p. 4) suggested that the expected trend would be the other way, given that when the first survey was undertaken the AER was a relatively new agency, and likely to face teething problems. The survey consultants themselves were also more positive about the value of the comparisons between the 2008 and 2011 outcomes, and made no qualifications about their interpretation (Buchan 2011, p. 22). [↑](#footnote-ref-3)
4. 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-4)
5. 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-5)
6. Opposition was mainly from parties that represent consumer interests (for example, CALC, sub. DR79, p. 6; MEU, sub. DR66, pp. 9‑10; and PIAC, sub. DR65, pp. 25‑6.) [↑](#footnote-ref-6)
7. Many participants in this inquiry supported such a review. For example, the Department of Primary Industries (Vic) (trans., p. 277); ENA (sub. DR71, attachment A, p. 19); MEU (trans., p. 182); National Seniors (sub. DR62, p. 17); the NSW Distribution Network Service Providers (sub. DR85, p. 4); PIAC (sub. DR65, p. 26). CALC (sub. DR79, p. 7) considered that any such review should be scheduled at a later date as part of a general review of the effectiveness of reforms. [↑](#footnote-ref-7)
8. The AER (sub. DR92, p. 22) also noted the conclusion of the Hilmer Review that ‘there are sufficient common features between access issues in the key network industries to administer them through a common body.’ The AER did not go so far as to say that the AER and the ACCC should be merged, but saw the existing model as a satisfactory hybrid between the Parer and Hilmer models. [↑](#footnote-ref-8)
9. The ‘national regulatory cost’ relates to the ACT Government’s obligations under the Australian Energy Market Agreement to contribute to funding the AEMC and SCER. [↑](#footnote-ref-9)
10. However, consumer groups had told the Limited Merits Review Panel of their ‘attempts’ to get their ‘voices heard’ at Tribunal hearings (Yarrow et al. 2012b, p. 43), suggesting that their participation in Tribunal hearings has not been effective. [↑](#footnote-ref-10)
11. The Consumer Advocacy Panel can award grants for specific projects as well as ‘global advocacy funding grants’ — where one grant supports a range of nominated priority projects nominated by the recipient — and ‘capacity-building grants’ — which are used for advocacy and to build capacity in a recipient to facilitate its advocacy activities. [↑](#footnote-ref-11)
12. The total funding also includes grants for gas advocacy and research, as well as for joint electricity and gas advocacy and research. [↑](#footnote-ref-12)
13. The Commission has not considered more ambitious consumer representation models — such as a national body representing consumers across multiple utility and other sectors. This is the approach taken in some other countries, such as Consumer Focus in the United Kingdom. In California there is 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 *all*utilities, and not just those in the energy sector (Mountain 2012b, p. 28). The Commission (PC 2008) recommended the creation of a representative national peak body for all relevant consumer issues in its inquiry into consumer policy (which the Australian Government did not adopt). While there are some advantages to a more holistic approach to consumer representation, it is highly unlikely that this would gain traction in Australia, given governments have already committed to certain policy measures and that radical re-configuration of these would not be practical over the shorter run. [↑](#footnote-ref-13)
14. While there were differences in views about the design and scope of any bodies, there was support for a national advocacy body from Fels (2012, p. 81); CHOICE and ACOSS (as cited in SSCEP 2012, pp. 134‑5); and the Senate Select Committee on Electricity Prices (SSCEP 2012, p. 135). A diverse group of participants in this inquiry also supported some kind of formal representation (including the AEMC, sub. DR89; the AER, sub. DR92; AGL, sub. DR86; CALC, sub. DR79; EnergyAustralia, sub. DR82; the NSW Distribution Network Service Providers, sub. DR85; TEC, sub. DR50). [↑](#footnote-ref-14)
15. Funding was provided through a global advocacy funding grant for 2011-12. [↑](#footnote-ref-15)
16. The Limited Merits Review Panel expressed some concern about representation of one consumer agent in the merits review process (Yarrow et. al 2012c, p. 60), arguing for the benefits of a variety of consumer perspectives. This is consistent with the Commission’s proposed arrangement since the national advisory body would not have exclusive access to the merits review process, and other groups would continue to be funded. [↑](#footnote-ref-16)
17. Historically, with the approval of the other energy ministers, the South Australian Minister has had, and exercised, powers to make initial Rules on certain matters. However, the advice given to the Commission suggests that this capacity for making new Rules is now exhausted, so that any further power for SCER to make Rule changes through this route would require amendment of the National Electricity Law. [↑](#footnote-ref-17)
18. ENA (sub. DR71, attachment A, p. 20) and Ergon Energy (sub. DR63, p. 9). [↑](#footnote-ref-18)
19. Some considered that, subject to such disciplines, a fast-track arrangement would be appropriate (Energy Retailers Association, sub. DR76, p. 10). [↑](#footnote-ref-19)
20. The Commission has recently considered the relevance of previous reviews in regulation making in its benchmarking report on regulatory impact analysis (PC 2012d, pp. 135ff). [↑](#footnote-ref-20)
21. If all deadlines under SCER’s timeframe are met, a Rule change to implement the new transmission planning and reliability framework would not be completed until mid-2015. This would be too late for TransGrid and Transend to include into their revenue proposals, which are due on 31 May 2014. Similarly, for Victoria, where regulatory proposals are due by 31 October 2015, there will not be sufficient time for SP AusNet to implement the new regime in its proposal. In particular, it would require additional time to implement the reforms compared with other transmission businesses as it would now have to undertake augmentation planning activities which were previously conducted by AEMO. [↑](#footnote-ref-21)