6 March 2009

Regulatory Burdens Review
Productivity Commission
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Energy Industry Response to the Productivity Commission's Annual Review of Regulatory Burdens on Business: Social and Economic Infrastructure Services Issues Paper

The Energy Supply Association of Australia, Energy Networks Association, Energy Retailers Association of Australia, National Generators Forum and the Australian Pipeline Industry Association appreciate the opportunity to provide collaborative comment and feedback to the Productivity Commission on its Annual Review of Regulatory Burdens on Business: Social and Economic Infrastructure Services Issues Paper.

Australia's energy supply industry comprises over $120 billion in assets, employs 49,000 people and contributes $14.5 billion directly to the nation's Gross Domestic Product. The energy supply industry strongly supports the principle of reviewing regulatory obligations over time and addressing the issue of regulatory burdens as they arise.

The energy sector has been an active participant in an ongoing energy reform process led by the Ministerial Council on Energy (MCE) designed to enhance the national character of energy market governance and streamline and lower the cost and complexity of regulation facing investors.[1] Progress has been made by the leadership of the MCE over an ambitious set of national regulatory reforms, however, the timeliness of delivering the reform program remains of concern. A series of initiatives have been completed under these reforms but a range of initiatives are still being considered and developed to reduce the costs of regulation and improve its quality.

Due to the breadth of the Commission's review and the range of regulatory burdens that exist in the energy sector, the industry has chosen to focus on five areas of regulatory burden, overlap and duplication where it considers further practical progress needs to be

[1] *Australian Energy Market Agreement*, Clause 2.1 <http://www.ret.gov.au/Documents/mce/default.html>

made, or where emerging issues have not been adequately addressed to date. These areas are:

- duplication between energy-specific and general legal obligations;
- the implementation and expansion of energy information-gathering powers;
- a trend of increasing complexity and cost of price and revenue reviews affecting both monopoly infrastructure and contestable market sectors;
- a growth in duplicative energy efficiency and greenhouse measures at all levels of government; and
- ongoing costs and inefficiencies created by 'split level' regulation of energy matters.

While many existing review and reform processes touch on aspects of these matters, the energy sector is concerned about a lack of tangible outcomes to date in addressing these burdens.

This paper makes a series of recommendations for the Commission to consider as part of its review. The key areas of regulatory burden discussed in this submission represent only a small proportion of areas of actual and potential concern for the energy industry. Appendix A provides a brief listing of a range of associated additional areas of regulatory burden which are of significant current concern to the sector.

Approach

The energy supply chain is subject to a wide and growing range of market, access and consumer focused regulation.

To assist the Productivity Commission in its Review of Regulatory Burdens industry has deliberately sought to focus this submission on key areas of regulation that represent ongoing or emerging areas of concern, rather than exhaustively listing all the areas of concern. In taking this approach, the energy sector is conscious of the breadth of matters potentially within scope of the Commission's review across sectors engaged in the delivery of social and economic infrastructure services.

Following the renewal of significant energy market reform initiatives over the past eight years, there are a range of complex reform initiatives, reviews and refinements of energy sector regulatory obligations being undertaken cooperatively at a national level, and by individual States and Territories. In addition, the Australian Energy Market Commission is tasked with a series of ongoing reviews of energy regulatory matters, and has a responsibility to consider proposed changes to statutory rules which set out many detailed aspects of the operation of national energy regulation.

Due to this, the energy sector has sought to specifically focus comments in this submission on key emerging areas of regulatory burdens. The approach taken has been to provide an outline of those areas with the highest potential net commercial or societal cost where either no process exists to examine these burdens, or where there is industry concern around the adequacy and expected outcomes of any existing regulatory reform processes. The energy sector also proposes to offer further detailed information on the issues outlined following the Commission's Draft Report.

Yours sincerely

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Key issues in regulatory burdens in energy sector

To better understand ways in which regulatory burden can be addressed in the energy sector, it is important to consider the root causes of the imposition of regulations which are burdensome, duplicative or unjustified in cost and benefit terms.

Causes of regulatory burdens in energy

The split responsibility between the States and Territories and the Commonwealth in respect of energy is one important driver of regulatory burden. Where regulatory matters are determined on a jurisdictional basis, but applied to energy businesses operating in a number of States and Territories, the potential for regulatory inconsistency and burden is high. However, it is important to note that a potential *positive* benefit of this approach is that it allows for competitive innovation in regulatory regimes and approaches, which can in some cases outweigh the obvious, measurable and direct benefits of a 'standardised framework'. This makes it crucial that reforms simply targeted at the goal of national consistency or uniformity in approach are examined closely, and the costs and benefits of the approaches they adopt as weighed just as rigorously as proposals with other objectives.

More broadly, the split responsibilities for various critical aspects of the delivery of energy services between Commonwealth, State and Territory governments fosters a diffusion of responsibility and a lack of coordination among government authorities. With split responsibilities, the overall burden imposed by different authorities each seeking to ensure their concerns are met is likely to be higher than if a single level or point of responsibility is established.

Another factor promoting regulatory, rather than market-based, responses is that both electricity and gas are typically seen as essential services, introducing major political and institutional risks for any government or agency which is seen to fail to ensure reliable access to energy supply. Historically, this risk was managed by government ownership or vertical integration of energy supply firms. This industry structure has unwound over the past two decades and produced material economic benefits to the Australian community. Through this period there has been a process of incremental experimentation over the appropriate 'reach' and intensity of regulation. As an example, retail energy pricing has only moved gradually towards market-based pricing in the last decade, despite the emergence of robust competition which on many measures is stronger than many comparable service markets. In many cases, the optimum balance of regulatory oversight has not yet been reached.

One of the reasons for this is that the costs of regulation are typically passed through to a diffuse base of consumers, with low individual incentives to act to ensure the minimisation of regulatory imposts. Some entities operating in highly competitive markets may find it problematic to pass on to final consumers the proportion of high regulatory and institutional costs that overregulation can impose. At a societal level, however, the financial burden of regulation is spread widely, meaning less attention is paid to the absolute level of imposts. This phenomenon is also evident in the proliferation of State and Territory

charges or cross-subsidies delivered by means of final energy bills. These include the recovery of ambulance levies, costs associated with energy efficiency or rebate programs, and inter-customer transfers created by various State and Territory solar energy feed-in tariff schemes.[2]

Duplication between energy-specific and general legal obligations

One of the most significant drivers of regulatory burden and duplication in the energy sector is the overlap between many industry-specific regulatory obligations and obligations already imposed by generic legislation and statutory rules.

For the reasons discussed above, energy is often seen as a 'special case' requiring detailed regulatory oversight, even where this oversight duplicates broader obligations imposed by laws governing:

- corporations;
- anti-competitive conduct or access to monopoly infrastructure;
- consumer protection; and
- occupation health and safety matters.

In some cases, this overlap is exacerbated by inconsistencies between State and Territory laws, so that an energy business may be subject to energy-specific obligations, and a number of inconsistent jurisdictional regimes (as can occur in relation to consumer protection). [3]

Even where this does not occur, the cost, complexity and uncertainties created by operation of general Commonwealth laws and energy-specific regimes can be significant. One example which remains unresolved is the potential for dual coverage of the national access regime under Part IIIA of the *Trade Practices Act*, and the electricity access regime set out in the *National Electricity Law* and associated statutory rules.[4] Until this issue is resolved, owners of nationally significant energy assets are required to contemplate the application of two existing access regimes applying to a single set of assets. Another example is that the gas pipeline sector consider that industry-specific regulation is unnecessary, and that the generic national access regime is sufficient to provide a framework for nationally significant gas transmission infrastructure.

In future energy policy-making there needs to be a closer regard to the actual need for energy-specific regulatory responses to issues that arise and are dealt with by generic legislative regimes. In particular, a clearer linkage is needed between any special features of the energy supply chain and the need for energy-specific regulatory approaches.

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[2] See for example Section 34F *Energy and Utilities Administration Act 1987* (NSW)
[3] See for example Productivity Commission *Review of Australia's National Consumer Policy Framework – Inquiry Report*, Vol.2, p.X, 30 April 2008
[4] A commitment to engage in a process of certification of the revised electricity and gas access regimes is contained in *Australian Energy Market Agreement*, Clause 13.3, but has not yet been carried out.

A stronger focus on the extent to which costs and benefits of proposed energy sector regulatory proposals are affected by existing generic obligations would also assist. While the energy sector supports the leadership of the Ministerial Council on Energy in driving a series of complex and challenging energy reforms, the Office of Best Practice Regulation has published evidence that indicates that some of these reform proposals have not been subject to a consistent level of cost and benefit assessment required by the Commonwealth government. The preparation of Regulatory Impact Statements (RISs) is designed to address many of the issues identified above. In energy, however, this has not worked as well as it could, with a lower rate of compliance with key RIS requirements experienced over 2006-07 than in a range of other active reform areas.[5]

Recommendations

Strengthen regulatory impact assessment arrangements to set a 'higher bar' for measures with the potential to duplicate in form existing generic regulatory or legal obligations. This should promote the outcome that energy-only policy proposals should only be adopted where generic obligations or powers are not consistent with desired energy policy outcomes.

Separate Productivity Commission inquiry into the degree of overlap between existing general legal obligations and energy-sector obligations with an assessment of the costs and benefits of specific energy-sector obligations.

Implementation and expansion of energy information-gathering powers

An emerging area of regulatory burden with the potential to impose high costs on the energy sector is the use and expansion of energy-specific information collection powers.

New national electricity and gas legislation introduced over 2007-08 established significantly enhanced information-gathering powers for the Australian Energy Regulator (AER). These powers were assigned for the carrying out of its important economic regulation and rule enforcement functions under the legislation. The operation of these powers, however, has been far more intrusive and problematic than anticipated by stakeholders at the time of their design and implementation. The major powers granted are the capacity to issue Regulatory Information Notices (RINs) and Regulatory Information Orders (RIOs). These empower the AER to specify the manner and form in which regulated energy businesses collect and maintain information.

These information instruments were intended to assist the AER in the conduct of its core economic regulatory functions. It is uncontroversial that economic regulatory bodies charged with regulating the prices, terms and conditions of infrastructure monopolies require the capacity to obtain information to assist in regulatory decision-making. In this context, the energy sector accepted proposals to strengthen and standardise requirements in the national economic regulatory regime. Since their implementation,

[5] Office of Best Practice Regulation *Best practice Regulation Report 2006-07*, 21 December 2007, p.76

however, a number of developments have occurred which mean these instruments have the potential to impose a significant regulatory burden on industry.

The first development has been their practical implementation and use by the AER. Energy distribution businesses have been served with notices that are up to 30-40 pages long, requiring in many cases the provision of information which the regulated business does not collect for its normal commercial operations, and the categorisation of existing information in a manner not consistent with current business systems. Through regulatory pricing reviews to date, there is evidence that these new regulatory information instruments have not fostered movement to a standard industry-wide information base upon which decision making could occur, an objective identified by the AER in pushing for increased powers. Rather, the instruments have themselves created additional regulatory burden and uncertainty by virtue of complex requirements upon the business and the regulator to transform and reconcile information between existing robust business systems and new inconsistent categories of information required by the business.

A further adverse development has been an increasing conflation in the intended roles of Regulatory Information Notices (designed as a specific one-off information request) and Regulatory Information Orders (designed as document eventually able to be applied generically across multiple businesses). Practice to date indicates that RIOs have primarily been used as the basis of ongoing performance reporting, contrary to the explicit intention of the relevant provision, and that information notices are being issued without sufficient guidance as to the how the information collected will be used, or any assurance that further inconsistent information requirements will not be imposed in the lead up to future regulatory pricing reviews.[6]

As an example of the simple direct costs of these increasing obligations, in 2007 gas transmission operator GasNet sought specific allowance of around $90 000 per annum for additional regulatory compliance staffing and auditing resources to deal just with increased workload associated with the new information reporting requirements under the new *National Gas Law*.[7] While the AER approved in-principle the need for such additional resources, delays in the entry into force of the Law meant that such costs were deferred in that specific case. With the new Laws now in place, however, it can be expected that similar increased reporting costs are now being encountered by electricity and gas transmission and distribution businesses operating under the new national framework. These costs will ultimately in turn affect the profitability and competitiveness of private sector energy producers and consumers.

The second negative trend in relation to information-gathering relates to the tendency of wide information powers granted for one purpose to expand into other areas where more targeted approaches are sufficient. Since the introduction of RIOs and RINs, in response to the particularly intense information needs of monopoly pricing regulation, there have been a range of policy initiatives and proposals seeking to have similar instruments

[6] An example of this has been moves to collect accounting based 'book value' information in circumstances in which the economic regulatory regime does not utilise such values.
[7] ACCC Draft Decision *Revised Access Arrangement by GasNet Australia Pty Ltd for Principal Transmission System*, 14 November 2007, p.107

imposed on a wide range of market participants, such as energy retail and generation businesses operating in contestable market segments. These information powers are claimed to be necessary to support functions as diverse as:

- longer-term energy supply forecasting undertaken by the new Australian Energy Market Operator (AEMO);

- detailed forecasting and planning work of the newly approved body National Transmission Planner, operating as part of AEMO; and

- the operation of the Short-term Trading Market and Bulletin Board for gas.

Given emerging concerns over their use in the narrow application which the information powers were originally designed for, this suggests a wide range of energy sector participants may soon face an increasingly intrusive and unnecessarily burdensome information collection regime for no demonstrated beneficial purpose.

Recommendations

Review of the costs and benefits of energy-specific information gathering powers within 5 years of their implementation.

Moratorium on the introduction of any new energy-specific information gathering powers until first reviews of costs and benefits have been completed.

Mandatory reporting by the AER of the internal costs of the exercise of expanded information collection powers to inform a future cost-benefit analysis.

Complexity and cost of regulatory pricing reviews

An ongoing area of regulatory burden across the energy sector is the increasing complexity and cost associated with regulatory pricing and revenue reviews.

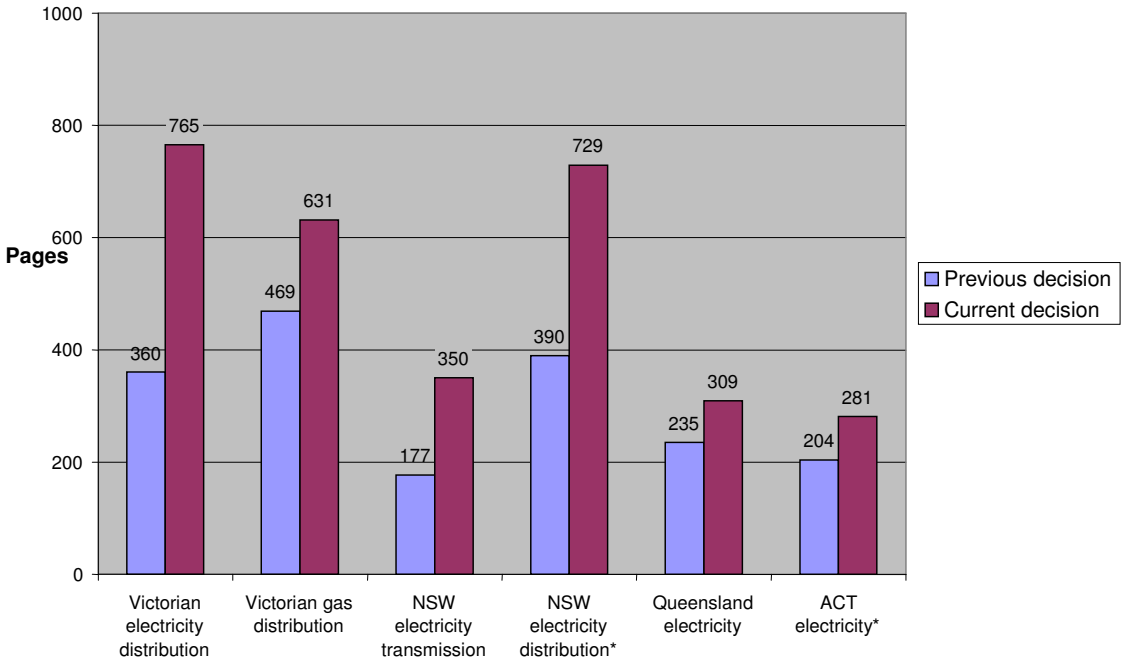
These reviews typically determine maximum prices or revenues recoverable by regulated electricity and gas infrastructure owners. Most commonly, the regulatory reviews occur each five years. Regulatory reviews of this type involve significant commercial and public interest considerations, and as a deliberate measure there is designed to be a high degree of transparency around the process, factual basis and reasons for the decisions made. A striking trend, however, has been the growing length and complexity of the regulatory review process over time.

The increasing complexity and cost of such reviews can in part be attributed to a process of refinement of the operation of regulation, and is a reflection of the growing body of expertise and practice in energy regulation. It also arises, however, from an increasing tendency for regulatory pricing decision processes to evolve from high-level reviews of the reasonableness of proposed access terms or prices, into a detailed review of all aspects of the commercial operations of regulated infrastructure. As an economic regulator's

expertise in this field is limited, these reviews are increasingly characterised by opposing expert views provided on detailed operational aspects of planned network investments, efficiency assumptions, and expected labour costs. Complexity of regulatory decisions is also driven by the increasing complexity of regulatory pricing arrangements adopted aimed at mimicking competitive processes.

One simple measure of the increasing complexity of regulatory price reviews over time is the tendency for regulatory pricing decisions to grow in absolute length. Examining a cross sample of energy regulatory decisions applying to electricity and gas infrastructure, it is clear that over the past decade, the size and complexity of the decisions has substantially increased. Figure 1 provides the raw total page length of the some recent regulatory pricing decisions, and compares it to the previous final regulatory final decision applying to the same infrastructure.

Figure 1 – Page length of selected past and current energy infrastructure decisions



Source: Victorian Essential Services Commission, QCA, IPART and Australian Energy Regulator websites.

Note: * denotes decisions which have been transitioned to the AER.

On current trends, the next round of regulatory decisions could reasonably be expected to produce regulatory decisions of over 1,000 pages in length. Underpinning these regulatory decisions can be up to a dozen or more expert reports, detailed annexes and other material supporting the primary decision.

The trend stands in stark contrast to the stated objective of the Ministerial Council on Energy reform program of streamlining regulation. It is also noteworthy that the trend

towards increasingly complex and lengthy decisions does not seem to have been affected by the movement of responsibility of some economic regulation from State and Territory energy regulatory bodies to a single national body – the Australian Energy Regulator. This suggests this is a systemic, rather than transitional issue, which needs to be addressed.

One key driver of the increasing complexity and cost of regulatory reviews is to be found in a specific design feature of current merits-based reviews for major energy determinations. Merits-based review is a positive feature of energy access regimes, and should be retained and strengthened. The concept of 'review on the papers' (which generally restricts the review body from considering new evidence not tendered in the review process) does, however, create some perverse consequences. For potential administrative review proceedings this feature incentivises the comprehensive lodgement and detailed consideration of extensive expert reports on *all* matters that could potentially fall under dispute in a final review determination. As a review feature, such an approach does positively address the potential for a party to seek to 'withhold' key information for strategic use in any administrative review stage. It is unclear, however, whether this potential efficiency benefit in relation to future administrative reviews actually outweighs the costly impact of the design on every individual price review undertaken.

One possible direction for reforming the increasing cost and complexity of price reviews is to recognise that the form and operation of incentive-based regulation applied to many monopoly infrastructure networks is likely to mean current costs are based on efficient industry practice. This opens an opportunity to consider simplified or 'fast-track' pricing or revenue review processes in circumstances, for example, where future access charges fall within historical trends, or are based on asset investment programs that have been independently assessed as prudent. There is a range of potential models for evolving regulatory processes away from their current cumbersome, lengthy and costly form. Further examination of these models is warranted.

The issues of growing cost and complexity in reviews is not limited to pricing assessments for monopoly infrastructure. Increasing complexity and cost is also evident even where regulatory reviews are focused on contestable or competitive market sectors. All jurisdictions in Australia, except Victoria, continue to regulate retail prices – some at levels below cost. A study undertaken for esaa by CRA International into the effect of retail price regulation found that price regulation in contestable retail energy markets is likely to confer little or no public benefit but impose considerable direct and indirect costs, thus reducing overall welfare[8].

Recommendations

Consideration of adoption of fixed cost ceilings for the expenditure of the AER on individual pricing reviews and reconsideration of the current limitation of merits

[8] esaa (January 2007) The effects of retail price regulation in Australian energy markets, CRA International. Available from http://www.esaa.com.au/reports__studies.html

based review occurring only on information submitted through the regulatory process.

Productivity Commission inquiry into alternative lighter handed regulatory models to apply to existing regulated monopoly infrastructure, to provide scope for access charges which do not depart from established trends to be subject to less costly and intrusive review processes.

Removal of retail price regulation in contestable energy markets.

Duplicative energy efficiency and greenhouse schemes

Energy efficiency and greenhouse emission reduction schemes are an important area of emerging regulatory burden for energy sector participants.

An increasing number of overlapping energy efficiency and greenhouse focused regulatory and market-based schemes are being developed and implemented at Commonwealth, State and Territory, and local government levels. Initially, the energy sector understood these schemes were largely adopted with the objective of fostering momentum towards a national suite of emissions reduction and energy efficiency programs. Examples of such programs in operation or in their implementation phases include:

- Victorian Renewable Energy Target;
- Victorian Energy Efficiency Target;
- New South Wales Greenhouse Gas Abatement Scheme;
- New South Wales Energy Savings Scheme[9];
- South Australian Residential Energy Efficiency Scheme;
- Expanded Federal Renewable Energy Target;
- Queensland Gas Electricity Scheme;
- Queensland 10% Renewable and Low Emissions Target;
- Solar feed-in tariff schemes (multiple jurisdictions); and
- Commonwealth Greenhouse Friendly product and service labelling program.

Each of these programs and schemes has closely aligned objectives of promoting emissions reductions directly, or emissions reduction technologies.

[9] Formerly the Energy Efficiency Target Scheme

Following the policy decision to implement the Federal Government's Carbon Pollution Reduction Scheme (CPRS) there exists the opportunity to rationalise and simplify a range of greenhouse-related programs, focusing on the CPRS as a primary instrument of incentivising emissions reduction. In February 2008, the Commonwealth announced a strategic review of climate change policies aimed at establishing which existing measures were effective complements to the CPRS. The review also formed part of a Council of Australian Governments (COAG) commitment for all Australian governments to develop coherent and streamlined climate change measures across jurisdictions to support the efficient operation of an emissions trading regime.[10] To date, the report and outcomes of the strategic review, headed by Mr Roger Wilkins and based in the Department of Finance and Deregulation, have not been released.

COAG's consideration of the regulatory duplication and inconsistencies inherent in the diverse range of jurisdictional initiatives listed above has been incremental to date. At its November 2008 meeting, COAG established principles which effectively permitted the continued proliferation of State-based feed-in tariff schemes with no clear timetable for their removal or transition into a consistent measure. Movement to a more consistent national approach on energy efficiency measures and schemes was deferred until later this year.[11]

Recommendation

Release of Commonwealth strategic review of climate change measures and establishment of defined government commitments to phase out inconsistent State and Territory based climate change measures.

Costs and inefficiencies created by 'split level' regulation of energy matters

A further area of regulatory duplication and burden relates to the remaining dual layer of regulation to which many businesses in the energy sector remain subject.

A series of ongoing energy market reforms have been pursued with the objective of enhancing the national character of energy market regulation, reflected in the creation of national energy institutions - the Australian Energy Regulator and Australian Energy Market Commission - and reforms to nationally applicable energy laws and rules. Most recently, the 2006 *Australian Energy Market Agreement* sought to define the scope of a further set of national reforms centring on a national framework for distribution and retailing regulation. Annexure 2 of this Agreement defined a range of energy regulatory functions to remain state and territory responsibilities, and identified those to be transitioned to a national framework.

While the 'split' of functions and responsibilities that emerged by agreement between Commonwealth, State and Territory governments focused on promoting an efficient national energy market, inevitably the divisions of responsibilities has left areas of

[10] Joint Media Release, Minister for Finance and Deregulation and Minister for Climate Change and Water '*Strategic review of climate change policies*', 27 February 2008
[11] Council of Australian Governments, Meeting Communiqué, 29 November 2008

duplication and inefficiency. An example of this is in the key area of management of the reliability of electricity transmission and distribution systems. Under the *Australian Energy Market Agreement* primary responsibility on service reliability standards remain with State and Territory governments, while service performance incentive schemes and regulatory revenue setting are administered by the national AER. This can lead to the emergence of a critical disconnect between evolving service performance standards set at a jurisdictional level, and the adequate planning and funding of delivering these performance outcomes which is critically linked to decisions made in the AER revenue setting process.

A further example is in the area of technical licensing or business authorisations. This area is one of ongoing State and Territory responsibility, and licenses to operate electricity and gas infrastructure are typically granted either by State or Territory regulatory bodies, or in some cases directly by relevant Ministers on the advice of energy departments. Separately the Australian Energy Regulator has been given the role of monitoring, compliance and enforcement of national energy rules. In specific areas, these roles can intersect with compliance and monitoring responsibilities to create duplicative reporting and compliance arrangements. Examples of this include business performance reporting and quality of service and reliability reporting.

A final point is ensuring that the planned movement to national arrangements does not itself result in a net increase in regulatory burdens. Where transition to national regulation occurs it is important that associated reforms embody best practice regulatory approaches. Reforms which adopt a 'lowest common denominator' approach of adopting the regulatory system which imposes the highest potential cost on industry participants should be avoided. Often, lowest common denominator approaches (which can include those imposing the *highest* level of obligation) are developed in response to the particular historical and commercial circumstances of the original jurisdiction, and do not reflect an appropriate 'least cost' regulatory approach that is suitable for national adoption.

There is some evidence that in development of the national energy distribution and retailing framework this risk is emerging. There is also evidence of the risk in development of national network connection and capital contribution arrangements, where an increased role for the AER compared to current arrangements in some jurisdictions is being proposed. Under current proposals, the AER would be given the task of 'pre-approving' standard electricity distribution connection agreements. There are also emerging indications that in a positive area of identified national regulatory reform – the harmonisation of energy supply industry technical and safety regulation – there are risks of a 'second best' approach of prescriptive input-based regulation being adopted out of an overriding desire for a single approach.

Recommendation

COAG to review the split of responsibility for energy regulation established in Annexure 2 of the Australian Energy Market Agreement.

Appendix A – Additional issues

Issue	Type of regulatory burden
National Energy Customer Framework	Potential for regulatory burden to arise during transition to regime, and from residual areas of consumer protection framework which remain at the State and Territory level
Energy transmission planning and permitting	Inconsistent State and Territory approaches, and complex processes in some jurisdictions have the potential to hamper the timely provision of new or upgraded transmission services
Inconsistent trade training arrangements	This imposes direct and opportunity costs of retraining personnel, and can serve as a critical barrier to effective deployment of energy tradespersons in emergency or disaster recovery operations.
Inconsistent connection application processes.	Electricity generators can face differing processes and timelines between jurisdictions when seeking to connect to transmission and distribution systems, differences which are often underpinned and perpetuated by inconsistent regulatory instruments in each State and Territory.