energy networks association

REVIEW OF COMPETITION POLICY

Response to Issues Paper

10 June 2014

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OVERVIEW

The Energy Networks Association (ENA) welcomes the Competition Policy Review *Issues Paper* released in April 2014.

ENA strongly supports the goal of revitalizing a strong competition policy agenda which takes account of the significant progress made to date, encourages and incentivises the timely completion of existing competition reform commitments, and extends the reform agenda to relevant new areas.

In energy, significant incomplete areas for competition reform include:

a) the dismantling of retail energy price regulation, which does not benefit consumers and has the potential to distort efficient investment in the energy supply chain; and

b) achievement of more flexible energy pricing that better delivers efficient investment and consumption signals, aiding dynamic and allocative efficiency objectives. This is a a goal that requires active monitoring and a coordinated sequence of individual actions by Australian governments, networks, energy rule making bodies and regulatory bodies.

A key challenge looking forward is to ensure that elements of a new national competition reform agenda take into account the competition issues that are emerging from current market, technology and competitive trends impacting on the energy networks sector (and other utility sectors). As an example, changing technology costs, and changing digital technologies are bringing about significant changes in the nature of services available in a range of sectors traditionally associated with regulated monopoly services. These are diverse and range from such developments as the ability for electricity consumers to be 'prosumers' (both consumers and producers of energy), to emerging competition by applications such as Uber for segments of the traditional taxi market.

These issues mean it will be important that infrastructure access regimes have robust capacities not just in executing traditional natural monopoly regulation, but recognizing and flexibly and efficiently regulating only true 'bottleneck' infrastructure services. Access regimes, including the 'model' national access regime, should evolve to ensure they recognize emerging effective competition, countervailing market power, as well as emerging areas of efficient integration and bundling of infrastructure and other services.

The network sector strongly supports the maintenance of an effective 'model' national access regime under Part IIIA of the *Competition and Consumer Act* (the Act), which is transparently linked through formal certification processes to the energy access regimes contained in the National Electricity and Gas Law and Rules. ENA does not support, however, the proposal from the Productivity Commission's recent *Review of the National Access Regime* to remove from State and Territory governments a previously agreed obligation to seek certification of the energy access regimes under Part IIIA. This risks undermining the fundamental purpose of the national access regime in providing guidance to industry-specific access regimes as set out in Section 44AA (b) of the Act.

This CoAG commitment being left incomplete means regulated energy infrastructure owners are left exposed to the potential risk of 'dual regulation' and significant disruptive regulatory uncertainty were an application for declaration of any existing energy infrastructure to be contemplated or made under Part IIIA. This exposure has significant potential adverse consequences for consumers, through the unnecessary creation of regulatory risk.

Finally, ENA supports moves to achieve the completion of previous steps by the then Ministerial Council on Energy towards a single independent specialist energy regulator, including the transfer of economic regulatory functions in energy in Western Australia and the Northern Territory to the AER, and the clear separation of the Australian Energy Regulator from the general competition agency functions of the ACCC.

BACKGROUND

The Energy Networks Association is the national industry association representing the businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia. ENA members own assets valued at over $100 billion in energy network infrastructure.

PERSPECTIVES ON COMPETITION POLICY FORWARD AGENDA

ENA is supportive of a revitalization of competition policy reforms to enhance productivity and enhance living standards for the Australian community.

Energy competition policy reforms have historically been identified by a series of review bodies with oversight of competition and policy reform process as examples of a well-advanced, but yet to be completed, reform agenda.

This reflects substantial cooperative Federal and State achievements in promoting vertical disaggregation in the sector to enhance competition, the progressive introduction of retail competition for major users and households, the establishment of industry-specific third party access regimes in gas and electricity, and the introduction of a set of national institutions and bodies oversighting market development and rule making (AEMC), rule enforcement and independent economic regulation (AER) and market operation (AEMO). These apply a set of national laws and rules which apply across most (but not all) Australian jurisdictions.

These represent substantive national achievements of continuing value to the Australian community. Into the future, however, the outstanding issues in the energy sector are how:

- INCOMPLETE ELEMENTS OF THE EXISTING REFORM AGENDA IN ENERGY CAN BE ASSISTED IN BEING BROUGHT TO COMPLETION BY A REVITALISED COMPETITION REFORM AGENDA;

  For example, extending consistent national energy regulatory frameworks and institutions to WA and NT, achieving full retail contestability and price deregulation across all States and Territories, and development of effective market-based demand side participation mechanisms; and

- TO ENSURE THAT ELEMENTS OF A NEW NATIONAL COMPETITION REFORM AGENDA REFLECT THE COMPETITION ISSUES THAT ARE EMERGING FROM CURRENT MARKET, TECHNOLOGY AND COMPETITIVE TRENDS IN THE ENERGY SECTOR

  For example, increasing contestability of some previous monopoly services, metering arrangements, the importance of cost-reflective pricing for efficient market operation. Other issues include ensuring ring-fencing guidelines frameworks are fit for purpose and do not preclude monopoly network providers providing seamless customer energy solutions and ensuring infrastructure pricing regimes are responsive to consumers willingness to pay and preferences.

COMPETITION POLICY AND COMPETITIVE NEUTRALITY

The principle of competitive neutrality is generally well-reflected in components of the energy regulatory framework impacting on networks. As an example, competitive neutrality principles underpin a single consistent third party access framework applying to both publicly and privately owned network service providers.

There remain substantial outstanding elements of energy market reform relating to competitive neutrality that are yet to be fully implemented. These include full retail price deregulation in electricity and gas.

Industry-specific competition review arrangements involving regular competition reviews and non-binding recommendations to State and Territory governments has meant significant lags in the removal of unnecessary price controls. The current mechanism for the removal of price controls is effectively reliant on sequential jurisdiction-specific market assessments undertaken by the Australian Energy Market Commission, with non-binding recommendations made to the relevant State and Territory governments. This has led to a slow and piecemeal assessment process, with significant gaps between AEMC recommendations and any final actions by jurisdictional governments. These process delays were comprehensively discussed and identified in the recent Productivity Commission *Review of Electricity Network Regulation*.

These price controls negatively impact on the interests of consumers, distorting investment patterns in electricity and gas supply chains, limiting innovation in energy market product and services and imposing material risks on networks which may not be adequately compensated through the regulatory regime (for example, increasing networks exposure to retailer default risk through constraining retailers capacity to price to recover wholesale costs).

There are also a set of further competition-related reforms more relevant to current technology, market and competitive developments in the energy market that should form part of a reactivated competition policy reform agenda, such as:

a) Implementing enhanced intergovernmental agreements and monitoring/assessment processes on cost reflective energy pricing, including a systematic review and removal of barriers to more cost reflective pricing represented by jurisdictional pricing obligations

Information Box 1 – Competition policy and energy pricing issues

Jurisdictional instruments in South Australia and Victoria impose a range of constraints on distribution network tariffs , including in some cases a cap on fixed charges, statewide (postage stamp) pricing which prevents locational pricing, common distribution network tariff structures for time of use charges and uniform retail tariffs which restrict the pass-through of the relevant network tariff.

Further pricing distortions arise from the interaction of past policy interventions to offer substantial feed-in tariffs to encourage the uptake of roof-top solar to residential energy consumers. The interaction of these policies and existing pricing structures introduces an inefficient cross-subsidy at variance with competition policy objectives and past infrastructure pricing reforms. This arises because customers with solar PV are able to reduce their energy consumption and at the same time reduce the contribution they make to the network cost to serve, which is largely fixed. The network costs that are under-recovered from customers with solar PV then have to be paid for in the higher electricity bills of all other customers.

ENA has estimated that an average customer without solar PV could pay a subsidy of $60 per year to support the under-recovery of network costs for an average customer with solar PV. For large customers, the subsidy could be up to $180 annually. This dynamic is consistent across jurisdictions. For instance, it has been estimated that the high penetration of solar PV in Queensland has added $100 million to the electricity bills of households without solar PV. Under a tariff that better reflects the networks actual cost to serve a customer, such as a capacity tariff, solar PV customers would pay their fair share of the network costs.[1]

b) Ensuring industry-specific regulatory regimes in electricity do not **foreclose** on any participants (including networks, provided regulatory arrangements are sufficient to address any concerns around 'leveraging' of remaining monopoly power) competing in emerging contestable energy services, distributed generation and metering markets.

Information Box 2 – Ensuring regulation recognises emerging competition

There is a need to ensure policy decisions and rule-making do not present unwarranted barriers to networks participation in providing enhanced integrated service offerings to customers. Networks should be in a position to offer their customers efficient and innovative network solutions, be it through deployment of smart metering technologies, and partnering with and participating in efficient distributed generation projects. Similarly, as competition and contestability emerge in new services, there is need for an orderly, independent process to ensure the consumer benefits of competition are recognised, and intrusive pricing regulation is withdrawn.

c) Development of a system for assessing the continuing need for bespoke jurisdictional or energy industry specific arrangements (such as marketing codes, reliability frameworks, minimum functional specifications for smart meters, National Energy Consumer Framework regulations and *National Energy Retail Law*), with a clear policy preference for greater reliance where possible on general nationally harmonized arrangements, and competition provisions of the *Competition and Consumer Act* and associated Australian Consumer Law.

d) Review any opportunities for achieving greater transparency in the upstream gas sector, to promote confidence in wholesale market arrangements and developments. This could include for example a national stocktake of joint marketing authorisations and lease retention arrangements

Finally, the COAG Energy Council is currently undertaking a number of reforms designed to enhance electricity industry efficiency more broadly. These include, for example, strengthening market access for alternative ways to meeting end user needs rather than constructing additional network capacity and ensuring that there are appropriate commercial incentives on network owners to plan and operate their networks in the interests of end users.

[1] ENA *The Road to Fairer Prices*, April 2014, See Figure 5.

ROLE AND OPERATION OF NATIONAL ACCESS REGIME

Value of the national access regime

The national access regime is designed to serve both as a 'model' access regime encompassing elements of current best practice and to provide a 'residual' access regime for access to infrastructure services which are not otherwise covered by State, Territory or industry-specific regimes.

In ENA's view it discharges the first objective effectively, while a small number of cases with highly individual characteristics has raised questions over its flexibility and adaptability for the latter, its role as a 'residual' regime. Both objectives, however, should be considered together in any proposed amendments to the national regime (as, for example, recently put forward by the Productivity Commission in it 2013 *Review of the National Access Regime*, see below).

In particular, proposals to make amendments to address issues encountered in the application of Part IIIA in its residual capacity (for example, the recently protracted Pilbara rail and port access cases) should take consideration of whether those amendments are appropriate for a model national regime which indirectly shapes other access regimes, or whether issues encountered should be addressed by alternative actions.

Key features of the national infrastructure access regime which in the view of energy networks enable efficient new and ongoing investment to support the delivery of safe and reliable services at least economic cost include:

a) An economic efficiency-focused objective, providing a clear and certain basis for consideration of substantive interventions affecting the property rights and commercial interests of private infrastructure owners;

b) Competition, market power-based and public interest thresholds needing to be satisfied prior to the imposition of regulated access terms and conditions, with a presumption that commercial agreements should be the primary basis for access terms and conditions;

c) Legislated revenue and pricing principles, setting out a transparent and certain basis for access pricing decisions with significant commercial impacts on proposed and existing long-lived infrastructure;

d) Mechanisms to allow both owners of new infrastructure facilities, or existing facilities, to achieve upfront certainty around potential mandatory terms and conditions of access; and

e) Access to merits-based review on decisions which have the effect of requiring an infrastructure owner to provide third party access to the infrastructure.

Findings of the Review of the National Access Regime

ENA generally supports the findings and recommendations of the 2013 *Review of the National Access Regime* around proposed improvements to the regime, the continuing need for and importance of the regime, and the benefits of periodic review of the regime.

An exception to this support is the Productivity Commission's recommendation to remove from State and Territory governments an agreed obligation to seek certification of the national electricity and gas access regimes.

The Productivity Commission has proposed sound amendments to the declaration process under Part IIIA which would provide for a streamlined conclusion that an application for declaration of an infrastructure facility cannot succeed where a certified regime is in place. It justifies this on the basis of providing upfront clarity to access seekers and infrastructure facility owners around the capacity of these assets to be declared under Part IIIA.

The very same considerations apply to monopoly energy infrastructure. Network assets valued at over $100 billion are currently regulated under the energy access regimes (*National Electricity Law* and Rules, *National Gas* Law and Rules and WA *Electricity Networks Access Code*).

Australian governments committed under the 2006 *Australian Energy Market Agreement* to seek without delay the certification of the national energy access regimes. This remains an outstanding policy commitment, which has never been withdrawn, amended or qualified by any CoAG decision.

Over $40 billion of electricity and gas network investment has occurred since 2006. Networks, and their debt and equity capital providers have undertaken those investments on the basis that the resulting infrastructure facilities are

intended as a matter of policy to be solely subject to the applicable national energy access regimes, and that Australian governments were committed to seeking certification of these regimes to ensure this position. ENA understands that on the basis of the clear CoAG policy commitment to certification, most if not all, investors in network infrastructure currently assume that that the national access regime has no residual capacity to determine terms and conditions of access. This position remains uncertain, however, in the absence of the commitment to certification being carried out.

The principal objections to certification of energy access regimes cited in the Productivity Commission report center on the small likelihood of an application for declaration to energy infrastructure services meeting all the other criteria for declaration (given the existence of a detailed and complete industry-specific access regime), and potential difficulties in ensuring that the changing body (for example, through minor changes the *National Electricity Rules*) of the energy access regime remains certified.

The first objection should be accorded little weight, as the Productivity Commission has itself recommended that in all non-energy access regime cases (in which the chances of declaration would be similarly low) even this small degree of uncertainty should be extinguished with a streamlined procedure whereby access cannot be declared to services covered by certified regimes.

This objection also ignores the administrative disruption and regulatory uncertainty created by the potential for 'dual regulation' to be created by a declaration application. While potentially a 'low probability' event, an application for declaration would raise issues of a single set of infrastructure services being regulated by two inconsistent regimes, and raise substantial issues of investment and regulatory uncertainty and conflict of laws. These uncertainties have the potential to unnecessarily increase financing costs or distort investment incentives, to the detriment of energy consumers.

Several options for dealing satisfactorily with the second objection have already been raised in an expert review of energy certification arrangements undertaken some time ago for the Ministerial Council on Energy (for example, considering key elements of the regime, or time limiting the period of certification).

A longer term risk of the course proposed by the Commission is the risk of substantial and unchecked divergence of the energy-specific access regime from the sound principles embodied in the Commonwealth's 'model' national access regime.

This would lead to the potential for investment distortions to be created across infrastructure sectors, without any countervailing benefits. It would also frustrate the objectives of both Part IIIA (set out in Section 44AA (b) of the *Competition and Consumer Act 2010*) and a range of co-operative Federal agreements such as the *Competition and Infrastructure Reform Agreement* and the *Competition Principles Agreement*.

ADMINISTRATION OF COMPETITION POLICY

Promoting an active reform agenda

The key need is for a self-sustaining process of further competition policy reforms to be initiated and supported by independent organisations able to monitor, challenge and make recommendations regarding outstanding barriers or policy steps.

The competition reform payment process did provide a significant financial incentive for States and Territories to implement reform until the payments expired in 2006. ENA would support a further similar set of incentives being developed in a cooperative fashion, but recognises that these are matters for decision by governments that face a wider range of considerations and potential fiscal constraints.

It should be noted, however, that further competition policy reforms should bring about medium-term fiscal benefits to Federal, State and Territory governments through promoting increased economic activity in related markets, and enhancing community living standards over the medium term. The magnitude of these future benefits can be reasonably estimated and such analysis should take into account realized benefits from similar reform processes already completed. This provides some basis for establishment of a future 'incentive payments' arrangement to be explored.

Institutional structure for competition policy

The broad institutional structure for competition law and policy is generally operating effectively, but there are significant improvements that can be made by clearly more separating economic regulatory functions relating to energy infrastructure from the ACCC and completing intended

reforms to enhance the national basis of energy infrastructure regulation.

Australian Competition and Consumer Commission and Australian Energy Regulator

Currently the AER operates as a constituent part of the ACCC, with, for example, all AER staff formally employees of the ACCC, co-location of offices and shared services. This effectively means that in some respects the AER forms one element of a broader agency with a diverse set of consumer protection and competition law enforcement goals.

This 'nesting' of the AER, which regulates infrastructure assets valued at over $100 billion, under the ACCC is incompatible with the critical importance of its decision-making functions, independent of competition issues, to the long-term interests of the Australian community.

While some elements of the ACCC do carry out infrastructure access pricing functions (in water, airports, telecommunications), these are typically of bespoke regimes with key differences to the detailed regulatory rules that apply in energy. This means that in practice, economies of scope which originally were argued by the ACCC to justify the ACCC carrying out a wide range of utility regulatory functions have not arisen in practice. Even were these synergies found to exist, they imply that a cross industry economic regulator would be the preferred solution, not the existing combination of utility regulation and competition functions.

The ENA considers that the separation of the AER into a stand-alone independent industry-specific regulatory body would assist it in having the flexibility to further develop its specialist expertise in the energy sector, provide greater autonomy and give better scope for development of an organization culture focused on providing appropriate, predictable and credible long-term signals for efficient investment, rather than a consumer protection and enforcement culture which quite appropriately informs the approaches and actions of the ACCC.

For these reasons, ENA has supported the separation of AER and ACCC. This is a move which has also been consistently supported by a range of State and Territory governments for similar reasons. The CoAG Energy Council has also signaled its intention to examine the issue of the independence of the AER in an institutional review scheduled to commence through 2014.[2]

National Competition Council – the ongoing need for a competition assessment agency

The NCC plays a significant role under both the national and the gas access regimes in making recommendations on the appropriate scope of third party access regulation.

This role of assessing whether and what form of third party access regulation is required and in the public interest should be exercised independently of the regulatory body that will eventually be tasked with applying such regulation. This is because there are poor incentives created by regulatory bodies effectively controlling the scope of their own authority, and the potential for third party access regulation to be applied where it is not required, or for more intrusive forms of regulation to persist where workable competition is emerging.

The institutional regime of the NCC assessing declaration (and under gas, coverage determinations) and making recommendations to a Ministerial decision-maker was an appropriate recognition of the principle of separating the decision 'whether and what to regulate' from the day to day application of economic regulation to monopoly services.

Developments in both gas and electricity markets (such as the potential for significant wholesale gas price rises, and emerging competitive pressures around traditional monopoly electricity network services) makes this role of assessing the need for existing intrusive pricing and access frameworks more important than at any time over the past decade. It is recommended that Australian governments should either retain an independent functioning NCC or by ensuring alternative independent agencies (such as the AEMC) are resourced and tasked by regulatory frameworks to carry out this critical function.

Australian Competition Tribunal

ENA strongly supports the role of the Australian Competition Tribunal in hearing limited merits review matters relating to key regulatory determinations made by the AER, WA Economic Regulation Authority (in the case of gas of in Western Australia), and the NCC.

Merits review remains a fundamental part of ensuring accountable, high-quality regulatory determinations, and promoting the required investor confidence for major long-lived network infrastructure investments required to be made on an ongoing basis.

Recently a round of reforms to the scope of the limited merits reviews have occurred under both the national access regime and the energy access regimes. These have focused on ensuring amended decisions fully and explicitly

[2] CoAG Energy Council Meeting Communique, 1 May 2014, p.3

consider the long-term interests of consumers. These revised arrangements have yet to be applied in practice.

State and Territory Regulators

The ENA is not well-placed to make significant comment on the performance of State and Territory regulators with respect to their wider competition functions beyond the energy sector.

As noted previously, however, a critical outstanding element of previous national energy reforms is achieving the consistent application of a single set of energy access rules across Australia.

While this has been completed across the interconnected Eastern Australian States and Territories, significant exceptions are Western Australian and the Northern Territory. ENA understand the Northern Territory may be seeking over the medium term to effect a possible transference of these functions to the AER, and that the current WA Electricity Market Review will also consider this issue.

ENA strongly supports the transfer of economic regulatory functions under the *National Electricity Law* and *National Gas Law* and Rules from the WA Economic Regulation Authority and NT Utilities Commission to the Australian Energy Regulator, and the consistent application of the third party access pricing rules (in particular, Chapters 6 and 6A of the *National Electricity Rules*, and the *National Gas Rules*) to energy networks in WA and NT.

This goal is consistent with the key objectives of the *Australian Energy Market Agreement* to enhance the national consistency and character of economic regulation and promote investor certainty. It is a reform that was completed across Eastern Australian States and Territories from 2005.