

Our Ref: 54408  
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1 August 2014

Professor Ian Harper  
Chair of the Review Panel  
Competition Policy Review

Dear Professor Harper

**AER submission to Competition Policy Review**

The Australian Energy Regulator (AER) welcomes the opportunity to provide this submission to the Competition Policy Review.

Some submissions to the Review have raised the AER's institutional arrangements as an issue. We understand that the matter has also been raised with the Panel through meetings.

The AER considers the current institutional arrangements enable the organisation to fulfil its functions and responsibilities to promote the objectives of the energy market legislation.

This submission addresses the issue of the AER's institutional arrangements and independence, and outlines the distinct roles of the AER and Australian Competition and Consumer Commission (ACCC). Further, the submission highlights recent reforms that improve the resourcing, transparency and accountability of the AER and, separately, reforms that address community concerns about high energy prices.

## **Independence of the AER**

The AER is an independent decision-making body whose functions and powers are set out in the national energy legislation and rules. The independence of the AER's activities is underpinned by:

- clearly defined roles and functions
- a well-established governance and reporting framework
- the application of a rigorous process of timely, considered, evidence-based and transparent decision making.

The AER operates under the *Competition and Consumer Act 2010* and is responsible for:

- economic regulation of electricity and gas transmission and distribution service providers in south east Australia and gas pipelines in the Northern Territory
- monitoring compliance with the National Electricity Law (Electricity Law), National Gas Law (Gas Law) and National Energy Retail Law (Retail Law) and associated regulations and rules (together referred to as the national energy legislation)
- investigating breaches or possible breaches of national energy legislation and instituting and conducting enforcement proceedings.

The COAG Energy Council in March 2014 outlined its expectations of the AER under new accountability and performance frameworks. The statement sets out the Council's expectations about the AER's roles and responsibilities, our relationship with government, and issues of transparency and accountability. In response, the AER released a Statement of Intent that sets out how it will meet the Council's expectations, including through its strategic priorities and wider ongoing work program. The statement also sets out deliverables and performance indicators to measure the AER's progress in meeting these expectations.

The AER has an independent Board comprised of two State members and a Commonwealth member. The Australian Energy Market Agreement, entered into between the States and the Commonwealth, outlines the process for Board appointments. The two State members are recommended for appointment by agreement of at least five States and Territories. The Commonwealth member is recommended for appointment by the Chair of the ACCC. Appointments to the AER Board are made by the Governor-General-in-Council. The AER Board therefore operates within a national but jurisdiction-sensitive framework.

The Board is assisted in discharging its responsibilities and in the management of the AER by a CEO, who is accountable to the Board, and a dedicated body of staff. AER staff are accountable to the AER CEO.

The staff and facilities of the AER are funded through the ACCC's agency appropriation. AER Board members are also members of the ACCC/AER Corporate Governance Board, which oversees the agency's corporate and financial performance and considers agency-wide operational issues (such as risk management).

Responsibility for the management of the AER's financial budget and other resources lies with the AER CEO and Board. Transparency and accountability has been improved through:

- budget transparency, through a separate program for the AER over the forward estimates period
- accountability, through 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.

The AER Board, in consultation with the CEO and senior staff, sets the strategic priorities of the AER and the strategic direction for the work of the AER staff. The AER Board approves the internal budget allocation according to its strategic priorities, anticipated work program and workforce requirements.

The detailed management of the workforce plan is the responsibility of the AER CEO. At present, the AER has around 130 staff who are engaged exclusively on energy matters. The AER also has access to specialist legal and economic staff, which it shares with the ACCC. The sharing arrangement reflect economies of service provision, and the specialist nature of the knowledge and skills involved in the application of regulatory economic and legal frameworks. When the shared legal and economic staff are engaged on AER matters, they work within the AER framework to the Board.

The AER Board is required to make a wide range of statutory decisions (such as revenue, 'price cap' and access arrangement approvals), and decisions on compliance and enforcement matters. The Board also approves major policy submissions and provides direction and guidance to staff on these matters.

The AER's decision making is directed by the national energy objectives, that is, to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to:

- price, quality, safety, reliability and security of supply of energy
- the reliability, safety and security of the national energy systems.

These decisions are made by the AER Board supported by the CEO and senior staff. This process is informed through detailed analysis of information, and constructive engagement and consultation with a range of stakeholders—including the regulated businesses, consumer groups, other energy market bodies, state governments and jurisdictional regulators, and the investment community. Decisions are made on their merits, transparently reported and are made in accordance with the regulatory framework. Decisions of the AER are subject to judicial (including procedural fairness) and limited merits review.

### **AER and ACCC responsibilities**

Economic regulation of energy networks is a core responsibility of the AER. Network regulation is also a key ACCC role, with regulatory responsibility in communications, rail, ports, water and postal services. The AER also has enforcement, consumer protection and

education responsibilities under energy legislation that have similarities to the responsibilities of the ACCC under the Australian Consumer Law.

These functions are undertaken pursuant to different legislative frameworks and are undertaken separately by the AER and ACCC as distinct, independent entities. The extent to which the AER's practices, procedures or policies are similar to those of the ACCC is a reflection of commonly practiced good principles of government administration and public policy. Examples include similar approaches to internal budgeting and risk management frameworks, general approaches to regulatory pricing considerations, and general principles applying to enforcement policies.

The Productivity Commission (PC) considered energy sector institutional arrangements in its 2013 inquiry. The PC explored possible structural configurations of the AER, and weighed the advantages of both retaining the AER within the ACCC and of separation.

On balance, the PC concluded that the current ACCC/AER institutional arrangements should be retained. As stated by the PC:

... 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. (p. 784)

The institutional arrangements that exist between the AER and the ACCC have assisted both organisations in taking a coordinated approach to issues of common interest under the Competition and Consumer Act and national energy legislation. The issue of door knocking by energy company marketers is an example where responsibilities of the AER and ACCC potentially overlapped, and where the AER was able to assist the ACCC.

### **AER resourcing and performance**

The challenges of the current operating environment, and the AER's expanding role in retail markets, place an emphasis on our resourcing and capacity to undertake our regulatory functions. Recent initiatives include enhancing the AER's technical capacity and information systems, and making our operations more transparent by publishing a separate annual report.

Recent energy sector reviews have considered the AER's technical capability to undertake its functions efficiently and effectively, especially in network regulation.<sup>1</sup>

To address concerns about resourcing and technical capability, from 2013-14, the Australian Government provided additional funding to the AER of \$23.1 million over four years. This has allowed the AER to improve our in-house technical capability, and our information and analytical tools, such as our economic benchmarking capability. We have appointed four engineering technical advisors to provide us with greater industry expertise—particularly in

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<sup>1</sup> See Productivity Commission's inquiry into Electricity Network Regulatory Frameworks (April 2013), Senate Select Committee on Electricity Prices: Reducing energy bills and improving efficiency (November 2012); and Yarrow et al. advising on Review of the limited merits review regime (September 2012).

electricity networks. This adds to the extensive energy and regulatory expertise and experience of the AER Board and staff.

The AER publishes a separate annual report containing detailed information of its activities, financial results, and performance against key indicators. The first of these, for the 2012-13 year, provided greater transparency around the AER's resourcing, staffing capabilities and work program, and reported against key performance indicators and deliverables. The 2013-14 AER annual report will be released in September 2014.

The AER recently completed its 2014 stakeholder survey. The results and commentary overall tell a positive story about the AER's performance—indicating stakeholders have confidence in the AER and our ability to make good decisions, within the boundaries of the regulatory regime. The AER received strong positive feedback about our recent initiatives to improve the way we engage with stakeholders, and communicate our processes and decisions.

### **Community concerns about high energy prices**

A separate issue to the AER's institutional arrangements is community concerns about high energy prices, especially in recent years. The biggest cause has been the increasing costs of using electricity and gas networks, which make-up roughly 45 per cent of retail energy bills.

Governments, policy makers and regulators have progressed important reforms so that future network price determinations ensure customers pay no more than necessary for an efficient and reliable energy supply.

First, reforms to the National Electricity Rules provide for a more balanced assessment of the need to allow for ongoing efficient investment to ensure a reliable energy supply, with the need to minimise costs to consumers. In 2011, the AER submitted a rule change proposal to the AEMC to address weaknesses in the regulatory framework. Following detailed public consultation, the AEMC announced in November 2012 significant reforms that address the areas of concern identified by the AER.

The AER is well positioned to make network determinations that are in the long term interests of consumers. We finalised our Better Regulation guidelines in late 2013, which develop our regulatory approach and processes under the new rules. The next 'round' of network pricing determinations started in 2014.

Second, reforms to the limited merits review regime have recently been implemented, following the appointment of an expert panel to review the arrangements. Now, the Tribunal must assess not only whether a ground of review has been made, but whether addressing that ground of review, having regard to any interlinked matters would deliver a regulatory determination that results in a materially preferable outcome in the long term interests of consumers. In short, the hurdle for seeking review is higher.

Third, some states are revising network reliability standards. The setting of lower standards can have a significant impact on the level of network investment that is required.

### **AER view on current institutional arrangements**

The current institutional arrangements do not impede the AER's ability to make decisions that are in the long term interests of consumers. Further, recent reforms address the concerns expressed by some stakeholders about the resourcing, transparency and accountability of the AER.

The AER welcomes the opportunity to participate in the Harper Review process. If you would like to discuss any aspect of this submission, please contact either myself or Anthony Bell, Director, Regulatory Strategy and Coordination, on (03) 9290 6914.

Yours sincerely

A handwritten signature in black ink, appearing to read 'A. Reeves', with a stylized flourish extending to the right.

Andrew Reeves  
Acting Chair  
Australian Energy Regulator