

Submission to the: Ministerial Council on Energy Standing Committee of Officials

Re: Application of the Industry Levy to Fund the AER and AEMC

Response to Discussion Paper



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1. Introduction

This submission responds to the *Discussion Paper – Application of the Industry Levy to fund the AER and AEMC* (the Discussion Paper) circulated for comment by the Ministerial Council on Energy Standing Committee of Officials (MCE) on 12 March 2004.

This submission is from United Energy Distribution (Vic), Multinet Gas (Vic.) and Alinta Gas Networks (WA) ('the companies' hereafter). United Energy is an urban electricity distributor supplying some 600,00 customers in Melbourne's eastern suburbs. Multinet Gas is an urban distributor servicing some 626,000 gas connections in Melbourne's eastern suburbs and Alinta is a gas distributor which serves more than 440,000 gas customers in Western Australia.

The companies strongly endorse the move to a national regulatory approach as long as sufficient consultation is undertaken with the industry and the national approach is based on efficient and effective regulation.

The companies would like to comment on three aspects of the funding of the national regulator:

- the incentives on the regulator to be effective and efficient;
- the need to ensure that the movement to a national regulatory model sees an overall reduction in fees to support state regulators as states reduce or eliminate their regulatory responsibilities; and
- the need to distinguish between gas and electricity and their respective regulatory costs.

2. Distinguishing Between Gas and Electricity Assets

The Discussion Paper states that the objectives for the funding mechanism include economic efficiency, competitive neutrality, equity, transparency and incentives for the responsible behaviour by energy sector participants.

The companies believe that different costs exist between sectors subject to energy *market* regulation and energy *access* regulation. Electricity *market* regulation involves monitoring industry compliance with the market rules as set out in the National Electricity Code. There is no current equivalent in the national gas market. In addition, the costs of the Gas Code and the Electricity Code will be different given their different legislative backgrounds.

The companies consider that the issues arising from market and access regulation are different and this difference should influence any decision to recover the full costs of the regulator from industry participants.

3. The Right Incentive Structure for Regulators

The companies have significant reservations on the accountability of the Australian Energy Regulator (AER) and the Australian Energy Management Commission (AEMC) in

undertaking their tasks especially with current experience with industry funded regulators in Australia. Governments currently use licence fees and direct cost recovery to fund regulatory responsibilities at the state level.

Some funding arrangements may create perverse incentives. The Productivity Commission found that “the funding regulations in Western Australia might change the incentives facing the regulator”, and may “create incentives that run counter to agency efficiency and encourage undesirable practices”.¹ These concerns arise from the lack of accountability of the regulator to budgetary and parliamentary processes, brought about by the ability of the regulator to bill pipelines directly for costs incurred in the regulation of them.²

The companies consider that the model which provides the best incentive structure for a regulator is that from the Federal Energy Regulatory Commission (FERC) in the United States. This operates within an annual government appropriation, which is redeemed throughout the year through licences and fees for service.

The companies consider that this is a best regulatory model, as it requires the regulator to justify its budget within government under competition with other budget priorities and using consistent budgetary principles on which to allocate funds. This budget would then become the amount returned from an industry levy (and fees for services). Any additional expenditure would be the responsibility of the government to fund and would provide a further good governance model on the regulator.

For example, this good governance would include compliance with budgetary guidelines such as the *Commonwealth Cost Recovery Guidelines (the Guidelines)*. Basic principles outlined in the *Guidelines* require cost recovery frameworks to be cost effective, consistent with policy objectives and not to stifle competition and industry innovation.³ Importantly, the *Guidelines* recognise that not all activities of a regulatory agency are suitable for cost recovery, and that those that are funded in that way need to be cost effective, efficient, consistent with policy goals, and not impose costs on regulated businesses that are contrary to the goals of the regulation.⁴

It would appear that there are at least some intended activities of the AER and AEMC that would not satisfy these requirements, meaning that at least part of the AER and AEMC budgets must be derived from general taxation revenue. Examples of these activities include legal actions and Ministerial servicing.

Any decision to levy the energy distribution sector needs to come with a guarantee that all costs will be included in the allowable operating costs of businesses as incurred. These pass through costs should include both forecast expenditure as well as a capacity for early recovery of any unanticipated costs arising from regulatory activities. These measures would act as a form of discipline to ensure these costs are accountable to the market in a timely manner.

¹ Productivity Commission (December 2003). p. 363

² OffGAR determines its performance with reference to the costs incurred to assess and oversee the regulation of a “standard” \$500 million pipeline. OffGAR’s 2002/03 Annual Report estimates that it’s costs for assessing and overseeing a standard pipeline have increased from \$611 000 in 2001/02 to \$1.22m in 2002/03. OffGAR *Annual Report 2002/03*
<http://www.offgar.wa.gov.au/library/RegulatorReport2003.pdf>

³ Australian Government Department of Finance and Administration (2002) p 5

⁴ Australian Government Department of Finance and Administration (2002) pp. 15 and 20.

4. The need to Rationalise Regulatory Fees

Further, given the intention that the new arrangements streamline regulation and reduce the number of regulators operating in the market, it is appropriate to expect an industry levy to deliver a total reduction of regulatory costs currently incurred by market participants.

This requires that state governments should eliminate their industry levies as the national model develops. In this way consumer prices for energy should fall and the benefits of a national regulatory approach will be delivered to consumers.

Many industry participants currently pay jurisdictional license and regulatory charges that may span several years. Effective tax principles require that there should be no overlap in these arrangements between State and National regulators.

The companies recommend that the rationalisation of industry regulatory costs be accorded a high priority within the MCE process and that a post implementation review of the costs of regulation in Australia is undertaken when the national model is fully operable.