Australian Energy Market Commission

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Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

By email: **www.competitionpolicyreview.gov.au**

Dear Professor Harper,

Competition Policy Review Draft Report

The Australian Energy Market Commission (Commission) welcomes the opportunity to provide further input into the Competition Policy Review Panel's Draft Report.

As you are aware, the AEMC is the rule maker and developer for Australian energy markets. This includes making rules in relation to the competitive sectors of the National electricity market (NEM); regulation of transmission and distribution networks; wholesale gas markets and natural gas pipelines. From 2012, our rule making expanded to include the retail sale of energy to consumers.

A unique and powerful characteristic of the energy market arrangements that facilitates market development and dynamic efficiency is that anybody, except the Commission itself can, and does, submit rule change proposals. Irrespective of the source of the rule change proposal the Commission is obliged to assess it in the same transparent way, against the same objective function.

This provides a continuously available forum and process for all stakeholders; Governments, individual consumers and members of the public, their representative organisations, industry participants and regulatory institutions to contribute to market development and respond to changing circumstances. It also builds robustness into the institutional arrangements which guards against any real or perceived risk of "capture" by a stakeholder group without having to monopolise market development and regulatory frameworks in the hands of either Government or its regulatory institutions.

The clarity of the legislated electricity, gas and retail objectives, the availability of judicial review, the transparency of the rule change process, the inability of the Commission to

initiate a rule change itself[1], the appointment processes for Commissioners and staff, and the reporting arrangements to the COAG Energy Council (the Council) establishes clear lines of accountability for the Commission with respect to both rule change decisions and, resource management and organisational leadership.

The Commission's other important role, which complements the first, is to provide Ministers responsible for the energy portfolio with strategic market development advice. This is usually though not exclusively provided to the Council via public market reviews on request by the Council and result in either policy and/or rule change recommendations. Recent examples include retail competition reviews, identification of the drivers of expected price changes, removing barriers to demand side participation, market and regulatory mechanisms to co-ordinate transmission and generation investment, establishing an economic framework for determining network reliability standards and recommendations to deal with systemic and financial contagion risks within the energy market.

As we noted in our submission to the Issues Paper, energy markets in the Eastern States are generally characterised by competitive wholesale and retail markets. This is due in large part to a history of successful structural and institutional reform that created the framework for competition to develop. The governance arrangements, implemented in 2004, have created an effective and transparent framework for ongoing reform to energy markets. The 'rules of the game' are amended through an open and transparent consultation process and supported by in-depth reviews of specific issues on behalf of the Council. Rule change requests and review recommendations are assessed against a clearly defined set of objectives, being the National Electricity Objective, the National Gas Objective and the National Energy Retail Objective which can be summarised as the long term interests of consumers.

In this context, we consider the energy specific arrangements are broadly working effectively in tandem with the broader competition laws to deliver competitive and appropriately regulated energy markets in the long term interests of consumers.[2] As recognised in the draft report, the AEMC is an example of a national, independent organisation operating in an area of state government responsibility. Our submission to the draft report seeks to provide further insight into the AEMC's experience of operating within this governance framework. It is hoped that this experience will highlight the alignment required across various aspects of a governance framework for the successful implementation of a national institution. Potential governance issues for the new institutions being recommended in the draft report are considered.

We would be happy to discuss any element of this submission with your further. Please do not hesitate to contact me directly on (02) 8296-7819.

Yours sincerely

John Pierce
Chairman

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1 Except for minor or non-material changes to the Rules such as correction of typographical errors.

2 The AEMC does not have a formal role in any aspect of administering the Competition and Consumer Act 2010.

AEMC governance arrangements

The draft report outlines that *"The AEMC is an example of an independent, national organisation, operating in an area of state government responsibility that has a governance structure supported by both the Commonwealth and the States and Territories."*[3]

Given this, it may be useful to outline the general principles or elements of institutional design that give the Commission the characteristics referred to above. The effectiveness of the AEMC's governance arrangements is derived from there being a clear "line of sight" and consistency between the following key elements:

1. The level of government with legislative responsibility for the stationary energy sector;[4]
2. The scope and clarity of the functions the organisation is given responsibility for;
3. The appointment process for Commissioners[5] and that the Chief Executive is appointed by, reports and is accountable to, the Commission;
4. The reporting and accountability mechanisms to the COAG Energy Council for how the organisation is managed as well as how it performs its functions; and
5. The source of funding.[6]

It is the consistency of each of these elements with one another that leads to the Commission being "owned" by all governments and "invested" in how it performs. It also gives it its *national*, as distinct from Commonwealth, status. An organisation where both the States and Commonwealth are involved in one element, say the appointment process, but funding is from the Commonwealth, is in effect and will behave like a Commonwealth agency. Fundamentally, accountability flows from legislative responsibility and funding.

As the Panel recognises, the AEMC is accountable to both State and Commonwealth governments as a national body. The legislative and funding arrangements form the foundation for this shared accountability. This reinforces the integrity, transparency and impartiality with which the Commission performs its role.

Accountability is strengthened through the Commission's strong internal governance framework with regular reporting to the Council on the work program and budget. This reporting includes the allocation of resources to various projects, the size of the project in terms of cost allocation and how overall costs are tracking against budget. The Commission provides updates on the work program, budget and strategic financial issues affecting the AEMC at the Council meetings. The detail provided in the budgeting provides an opportunity for the Council and its senior officials to review whether resources are being allocated in a manner consistent with the Council's evolving policy priorities.

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4 Under the Australian Energy Market Agreement, the Commonwealth and all States and Territories have agreed on the legislative and regulatory framework for Australia's energy markets. The agreement provides for national legislation for electricity, gas and retail energy markets that is implemented in each participating jurisdiction. South Australia is the lead legislator and other jurisdictions introduce application legislation to give effect to the South Australian legislation. The Commonwealth application Act applies the National Energy Laws in offshore areas.

5 The legislation establishing the *Australian Energy Market Establishment Act 2004 (SA)* provides for the composition of the Commission. It provides for a 3 person Commission with the Chairperson and one other member to be nominated by the States and Territories through the COAG Energy Council and one member to be nominated by the Commonwealth Minister on the Energy Council. The Australian Energy Market Agreement (section 7) sets out further details of how Commissioners will be appointed.

6 As agreed in the Australian Energy Market Agreement, the States and Territories fully fund the AEMC on the basis of a cost sharing agreement agreed to and reflected in a funding agreement between those jurisdictions.

Proposed institutional changes

There may be useful insights from the AEMC's governance framework that could assist the Panel as it builds its recommendations around the proposed institutional changes.

While the Competition Policy Review Draft Report seeks to ground competition policy itself in a set of principles, the draft recommendations with respect to institutional structures do not appear to be derived from any particular framework, criteria or set of principles. There is clearly an opportunity for the Panel to lay out such a framework, which would include recognition that institutions need to operate "...in the context of Australia's federal structure".[7]

In the event that the Panel's recommendations move to implementation, establishing the principles that underpin them becomes an essential tool for guiding the detail of such issues as the scope of the proposed advocacy and market studies functions of the Australian Council for Competition Policy or the boundaries between what access or pricing regulation is undertaken by national, Commonwealth or State level institutions. For instance what are the criteria which lead the Panel to observe that it is appropriate for public transport fares to be regulated by a State institution and urban water by a national one?

Where, in recognition of the way functions are allocated or have evolved within Australia's federal structure of government, the Review has recommended the establishment of national institutions, careful principles-based consideration will have to be given to the design of an effective sustainable governance structure.

The draft recommendations appear to be based around grouping common skill sets and economic frameworks within each institution. There is an attempt at giving the institutions a "national" flavour through the appointments process. Reflecting on the AEMC's experience key aspects of an effective governance framework such as alignment of the elements referred to above would appear to require further thought and development. Skill sets and common economic frameworks are themselves unlikely to be a sufficient basis for establishing effective national institutions.

A fundamental question posed by the draft recommendations is how an effective governance structure is put in place for an institution where some functions fall within the Commonwealths' areas of legislative responsibility while other functions fall within the States' or some combination of the two. For example the proposed Access and Pricing regulator would deal with telecommunications, an area of Commonwealth responsibility, and electricity networks which falls within the States' responsibility. If the institution is effectively a Commonwealth agency because of the way it is funded and its reporting arrangements, the result is a Commonwealth agency administering State laws and regulations. This raises the question as to how the States hold the Commonwealth to account for the institution's performance. Given the near impossibility of such a mechanism existing, the result becomes yet more mixed and confused, as distinct from shared, responsibilities within the federation.

In the circumstance where the outcomes of the electricity network regulatory process are seen to be inappropriate and in need of adjustment, where should this adjustment occur? When in the community's mind something is wrong and needs to be fixed is it the regulatory framework or the regulator? The Commonwealth or the States? Most discussions in other areas of service deliver such as human services where responsibility between the Commonwealth and States is mixed have come to lament the tendency towards "blame shifting" between jurisdictions as a constraint on improved performance. While the view may

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be taken that some element of this is unavoidable, an institutional design that facilitates and encourages this tendency is unlikely to be effective or endure.

If on the other hand the Access and Pricing regulator is established as a fully national institution, the Commonwealth may quite reasonably ask why the States need to share in responsibility for regulating the telecommunications sector when it falls unambiguously within the Commonwealth's jurisdiction.

If the marriage of effective institutional design and responsibilities under Australia's federal structure appears fraught, then particularly for access and pricing regulation a cleaner fit may involve access and pricing regulation in areas of Commonwealth responsibility by a Commonwealth agency (separate to the ACCC or not) and by a national agency for those sectors that operate across State borders but fall within the legislative responsibility of the States.

A narrowing of the scope of a regulator may be seen as raising the risk of "regulatory capture" by stakeholders.[8] However there is also scope for the Panel to evaluate the real nature of this risk, the circumstances under which it materialises and the contribution that governance, accountability and reporting arrangements can make to mitigating it. It can be noted that Australia's financial sector regulators are sector specific.

Energy access regimes being exposed to declaration

In the AEMC's submission to the Panel's issues paper, we raised a concern related to certification. COAG members agreed to certify their energy access regimes and remain certified under the AEMA. Northern Territory and Western Australia have had their electricity network access regimes certified: NT[9] on 21 March 2002 and WA[10] on 17 July 2006, both for 15 years. The Productivity Commission has since considered the costs of certification and subsequently recommended that COAG release the states and territories from requirements to certify their energy access regimes. We note however, that this still leaves open the risk that third parties may seek declaration of the energy access regime in certain circumstances. Consequently, we do not consider the recommendations go far enough in this respect.

The Commission remains of the view that a better option is for a change to Commonwealth legislation (such as an amendment to the CCA) that deems the national energy access regimes to be effective access regimes and therefore certified access regimes for a time period and/or subject to certain conditions being satisfied. To address concerns about material deviation between the energy access regimes and the National Access Regime over time (where the deviation represents a deviation from good regulatory practice) an exemption could involve a periodic review mechanism. For example, such a trigger could involve review of the exemption if the clause 6 principles of the Competition Principles Agreement or the objects clause of Part IIIA of the CCA significantly diverge from the objectives of the National Electricity Law or National Gas Law.

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9 The NT Regime comprises the *Electricity Reform Act*, the *Utilities Commission Act* and the *Electricity Networks (Third Party Access) Act 2000* (which includes terms and conditions of access). This certification is in relation to services provided by electricity network facilities operated by the Power and Water Authority (PAWA) in the Northern Territory, as nominated under the *Northern Territory Electricity Networks (Third Party Access) Act 2000* at December 2001. These network facilities include distribution and 132kV lines, transformer capacity and distribution substations.

10 The Western Australian regime is established under the Part 8 of the *Electricity Industry Act 2004 (WA)*, which received Royal Assent on 23 April 2004. The *Electricity Networks Access Code 2004 ('the Western Australian Electricity Network Access Code')* was gazetted on 30 November 2004. This legal framework sets out the rights and obligations of parties involved in the Western Australian regime.