

Expert Review Panel
Secretariat Review of Governance Arrangements for Australian Energy
Markets
Energy Division
Department of Industry and Science
GPO Box 9839
Canberra ACT 2601

Submitted via email energygovrev@industry.gov.au

5 May 2015

Dear Dr Vertigan, Professor Yarrow and Mr Morton,

Re Review of Governance Arrangements for Australian Energy Markets

Thank you for the opportunity to comment on the Review of Governance Arrangements for Australian Energy Markets. As the peak body for the community services sector in South Australia, SACOSS has a long-standing interest in the delivery of essential services. Our research shows that the cost of basic necessities like electricity and gas impacts greatly and disproportionately on vulnerable and disadvantaged people. Our advocacy is informed by our members; organisations and individuals who witness these impacts in our community.

We thank the Panel for an extension of time for our submission. However, due to the limited timeframe for consultation, SACOSS only has capacity to provide brief comments on aspects of the Review's Issues. SACOSS anticipates it will attend the Melbourne Consumer Roundtable where we will be available to elaborate on comments made in this submission.

AEMC and AER Relationship

SACOSS appreciates the interrelationship between these two institutions and the fact that in many other jurisdictions, the functions of regulatory design and implementation are housed in the one institution. SACOSS notes that there is some discussion as to whether the two institutions should be merged.

On the side of maintaining two separate institutions, SACOSS notes the extensive collaboration which it has observed between the AEMC and AER. For example, the treatment of metering during the network regulatory resets is one case where policy development about the competitive metering environment was occurring at the same time as regulatory decision making processes were impacting the future face of the metering environment. SACOSS was able to observe extensive collaboration between AEMC and AER, which enabled the two institutions to successfully negotiate the policy and regulatory implications of a market based rollout of advanced metering infrastructure.

Also in support of the idea of maintaining separate institutions, the NSW distribution determination appears to be a case in point where the political independence of the regulatory institution is critical. SACOSS has observed that the AEMC are more closely linked to the state and territory political processes than the AER and believes that the NSW distribution determination is a case in point where the AEMC's links would have been detrimental to the long term interest of consumers if it were acting as regulator. The independence that the AER has in being more removed from political processes does appear to operate in the consumer interest in this case. SACOSS notes that the NSW

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distribution determination is cited as the example in this case due to the state ownership of the distribution businesses.

SACOSS has a perception that the AEMC is more closely linked to political processes due to our experience interacting with the AEMC. For example, SACOSS has had extensive interaction with the AEMC about concessions reform but believes that a barrier to progress the issue is the AEMC's formal links to the political process. SACOSS was part of a coalition of organisations which wrote to the AEMC calling on the AEMC to undertake a National Concession Review in September 2014 (see Attachment A). The verbal response received from the AEMC in February 2015 was that the AEMC was unable to proceed with this Review due to state and territory government expectations about concessions reform being a state and territory jurisdiction. SACOSS notes that AEMC representatives had previously indicated that they were favourably disposed to the idea of the AEMC undertaking a National Concessions Review but then indicated the AEMC was unable to proceed with the Review without endorsement from the Energy Ministers.

Functions of COAG Energy Council, AEMC and AER – rate of return

The approach taken to determining the rate of return now includes a regulatory device inserted in the Rules (at 6.5.2(c) & (h) and elsewhere) by the rule change mentioned earlier: the benchmark efficient entity (BEE). The role of the BEE is described in the AEMC's Final Determination on the rule change (emphasis added)¹:

“The common framework to be implemented requires the regulator to make an estimate of the rate of return that is consistent with an overall objective. The objective is focused on the rate of return required by a benchmark efficient service provider, with similar risk characteristics as the service provider subject to the decision. Under this approach the regulator has the flexibility to adopt the approach it considers appropriate to estimate the rate of return, provided it considers relevant estimation methods, financial models, market data and other information. This is so that the best estimate of the rate of return can be obtained that reflects efficient financing costs of the service provider at the time of the regulatory determination.”²

The AEMC's Draft Determination also stated that:

“A key feature of the new framework is that the allowed rate of return is effectively determined on a "determination by determination basis". This will ensure that the regulator can better respond to changing financial market conditions, particularly where volatile market conditions impact on a NSP's ability to attract sufficient capital to finance its expenditure requirements.”³

The AER's Rate of Return Guideline (and explanatory material)⁴ goes on to define the benchmark efficient entity, conceptually, as *'a pure play, regulated energy network business operating within Australia'*. This is reiterated in the Preliminary determination.

The regulatory framework, in effect, determines the rate of return required for the BEE rather than the actual NSPs. As a result, the businesses themselves can make higher profits by being more efficient than the BEE and, conversely, lower profits if they are less efficient than the BEE.

¹ AEMC (2012) available from: www.aemc.gov.au/Rule-Changes/Economic-Regulation-of-Network-Service-Providers

² AEMC (2012) p.iii

³ AEMC (2012) p.23

⁴ AER (2013) <http://www.aer.gov.au/node/18859> p.7

This pivotal role for the BEE in the framework and the sensitivity of total revenue to the rate of return on a (growing) Regulatory Asset Base (RAB) makes the definition and interpretation of the BEE a critical determinant of the prices paid by consumers and the profits of NSPs.

As to whether it should be a policy or regulatory decision, the BEE has been conceived by the AEMC and defined by the AER but it is, arguably, unclear whether the BEE is more an instrument of policy (Energy Council), market development (AEMC) or regulation (AER). It does not sit comfortably in the governance arrangements and, arguably, is worthy of much greater attention by the Governance Review:

- Clearly, the application of the BEE has policy implications since it relates to one of the energy market reform agenda's prime motivators; attracting investment - and political touch-points; electricity prices;
- It defines the 'efficient frontier' of the market so the 'continuous improvement' of the BEE's efficiency has a market development role in the pursuit of the NEO;
- Its application is as a regulatory device but that doesn't imply it is exclusively a regulatory instrument.

As consumers, we are interested in a steadily more efficient over-time BEE and for NSPs to meet their service targets (while continuing to be more efficient than the BEE).

Scope of policy, market development and regulation

There is increasing divergence in the national energy market: consumer protections, access to smart meters, penetration of cost reflective tariffs, retail price deregulation all differ from jurisdiction to jurisdiction. SACOSS believes that a pertinent scope issue for the Panel is whether there should be an increased focus on jurisdiction by jurisdiction policy and market development.

For example, in its consideration of the Potential Generator Market Power Rule Change Proposal by the Major Energy Users "The [AEMC] however accepts, informed in particular by its analysis of outcomes in South Australia, that there are some circumstances in which substantial market power could exist and be exercised."⁵ However, the AEMC found that "A rule as proposed by the MEU, or similar, which seeks to limit occasional price spikes by capping generator dispatch offers, is difficult to reconcile with the fundamental features of the NEM."⁶ On one analysis, South Australian consumers were disadvantaged by being treated as part of the NEM – because a South Australian specific phenomenon could not be addressed by a NEM wide rule.

Other examples to consider are the network regulatory reset outcomes. It is noteworthy that outcomes from state based regulators are considerably more beneficial to consumers compared with those awarded by the AER. It may be the case that state based regulators are more aware of state specific differences within the networks, which makes them more able to translate regional differences in to the final determinations.

AEMO Membership structure

SACOSS strongly believes that the current 60:40 membership split in the AEMO corporate structure is in the long term interest of consumers and would strongly oppose a split which gave industry more members proportional to government. SACOSS believes that in general, government is more accountable to consumer interests than industry.

SACOSS also believes that consumer focussed representation should be provided for on the board of AEMO.

⁵ AEMC (2013) <http://www.aemc.gov.au/getattachment/b0fec33-0630-45e8-9bfc-54dfa262acd0/Final-Determination.aspx> p.i

⁶ AEMC (2013) p.v

We thank you in advance for your consideration of our comments. If you have any questions relating to the above, please contact SACOSS Senior Policy Officer, Jo De Silva on 8305 4211 or via jo@sacoss.org.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ross Womersley', with a large, sweeping flourish at the end.

Ross Womersley
Executive Director

ATTACHMENT A

Jo De Silva
Convenor
National Consumer Roundtable on Energy
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1 September 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pierce,

Re: Review of State and Territory Energy Concessions

We are writing to request that the Australian Energy Market Commission undertake a Review of State and Territory Energy Concessions.

Energy concessions are an important tool used by governments to improve access to domestic energy for people living on low incomes or experiencing temporary financial difficulty. For these households, government intervention is essential if the energy market is to enable them to meet their basic needs: lighting, hot water, food preparation, washing and cleaning, communications, heating and cooling. Meeting these needs is necessary not only for basic health and physical welfare, but also to ensure people can maintain social connections and fully participate in society.

In April 2013 the Australian Council of Social Service, in conjunction with the Energy Retailers Association of Australia and the Australian Energy Ombudsmen, held a National Energy Affordability (NEA) Roundtable at NSW Parliament House.

One of the key issues identified at the NEA Roundtable was the lack of national consistency in the provision of energy concessions. The NEA Roundtable report recommended that SCER:

...initiate a national review of energy concessions with a view to recommending a design for a nationally consistent framework and identifying an appropriate level of concessions.

The National Consumer Roundtable on Energy echoes this recommendation.

The NEA Roundtable recommendation was informed by a series of industry and community sector reports – including the AEMC's own *Power of Choice Report* – which have highlighted the flaws in existing concessions frameworks, including inconsistencies and inequities in the targeting of assistance.

These flaws create horizontal and vertical inequities both within and between jurisdictions. For example, some concessions and payments are made available to holders of Commonwealth Pension Concession Cards (PCC) but not to Commonwealth Health Care

Card (HCC) holders, despite the fact that the majority of HCC holders have significantly less income than PCC holders. Further, by failing to provide additional assistance to households with larger energy requirements or higher per-unit energy costs, fixed-amount 'flat' concessions are inadequately targeted to need. Households affected by this include large households and households in regional areas who typically face higher dollar-per-kWh costs.

Recent research has documented the inconsistency of concessions across jurisdictions¹. By comparing the contribution of concessions to the actual cost of energy for a range of household types, significant jurisdictional inequities are evident and must be seen as a priority for energy market reform. Given the particular impact of energy prices on low-income households, targeted assistance on top of general market reforms remains central to ensuring access to energy.

In the National Energy Customer Framework (NECF) (constituting the consumer protection framework of the National Energy Market (NEM)), targeted assistance is predominantly delivered through Community Service Obligations (CSOs). CSO regulations remain the responsibility of State and Territory jurisdictions.

Energy concessions make up a significant part of the CSO schemes.

The three main types of concessions are:

- a. An amount paid through the energy bill to reduce the cost of consumption for low-income households.
- b. An amount paid to customers with specified medical equipment to assist in the added cost of operating such equipment.
- c. An amount paid to customers with thermo-regulatory illness to assist in heating and cooling costs.

As you know, under the framing of the Australian constitution energy is a residual power of State Governments. However, through a series of micro-economic reforms starting in the 1980s the States, Territories and the Commonwealth have progressively negotiated a national framework, resulting in the NEM across the eastern jurisdictions. This has included most consumer protections and has largely been delivered through the Council of Australian Governments (COAG).

As a result of national harmonisation, consumer protections for residential customers are located in the National Energy Customer Framework, comprising the National Energy Retail Law, the National Energy Retail Rules and the National Energy Retail Regulations. Under the NECF, CSOs – which include energy concessions – remain the responsibility of the State and Territory jurisdictions.

While targeted reforms to energy concessions could be achieved on a state-by-state basis, any move towards national harmonisation would need broader consensus amongst COAG Energy Council members.

With the above considerations in mind, we propose that the Terms of Reference for this Review include consideration of best practice or potential improvements in:

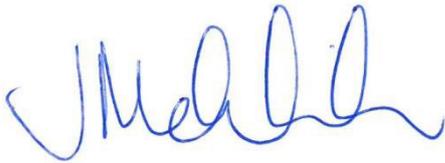
- The adequacy of concessions, in terms of:
 - the amounts available for various concessions, and how and whether they are keeping pace with rising prices;
 - the eligibility criteria for various concessions;

¹ St Vincent de Paul (2014) The Relative Value of Energy Concessions 2009-12 at http://www.vinnies.org.au/page/Our_Impact/Incomes_Support_Cost_of_Living/Concessions/

- the list of things for which concessions are available;
- The accessibility of concessions;
- The adaptability of concessions, in terms of the processes and structures needed to ensure concessions can respond to changing market structures and economic and social practices and needs;
- Cross-border issues including:
 - the consistency of concessions levels between different jurisdictions and ensuring that all systems provide a basic minimum of support for vulnerable and disadvantaged people;
 - the different eligibility criteria in different jurisdictions;
- The appropriate jurisdiction for different types of concessions (for example, whether in a national energy market it would be appropriate for responsibilities for energy concessions to be with the Federal Government – and what revenue implications and trade-offs this may entail);
- Identification of National Concessions Principles, including specification of purpose, outcomes and features;
- The potential role for special tariffs such as social or hardship tariffs.

If you would like to clarify any aspect of this letter, please contact Jo De Silva, SACOSS Senior Policy Officer on 08 8305 4211 or jo@sacoss.org.au

Yours sincerely,



Jo De Silva

On behalf of the:
National Consumer Roundtable on Energy

South Australian Council of Social Service
 St Vincent de Paul Society Victoria
 Alternative Technology Association
 Consumer Action Law Centre
 Consumer Utilities Advocacy Centre
 Kildonan UnitingCare
 Victorian Council of Social Service
 ACT Council of Social Service
 Queensland Council of Social Service
 Uniting Communities
 Tasmanian Council of Social Service
 Total Environment Centre
 Council of Social Service of New South Wales
 Ethnic Communities' Council of NSW
 Council on the Ageing Queensland
 Public Interest Advocacy Centre
 Brotherhood of St Laurence
 Anglicare Tasmania
 Australian Council of Social Service
 Western Australia Council of Social Service