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Competition Policy Review — Jemena response to Final Report

We welcome the opportunity to respond to the Final Report published by the Review Panel as part of the review of Australia's Competition Policy.

As a participant in the energy transmission and distribution industries, Jemena has a strong interest in the review, particularly relating to the recommendations on competition and regulatory institutions governing our energy market (the governance framework).

Jemena is an $8.5 billion company that owns and manages some of Australia's most significant gas and electricity assets. These include the:

- Jemena gas distribution network servicing 1.3 million customers around NSW
- Eastern Gas Pipeline which delivers gas from Victoria's Gippsland basin to the ACT, Sydney and regional NSW
- Queensland Gas Pipeline which supplies Gladstone and Rockhampton
- Jemena electricity network which delivers power to over 320,000 homes and businesses in north-west Melbourne
- part ownership of the ActewAGL electricity and gas distribution networks in the ACT as well as United Energy, which supplies electricity to over 600,000 customers across south-eastern Melbourne and the Mornington Peninsula.

Our energy markets are changing

The Final Report acknowledges that change is a constant presence in our economy, and that it brings opportunities as well as challenges. Nowhere is this more evident than in Australia's energy markets which are undergoing significant change with major implications for energy industry participants and our customers.

As competitive forces continue to play a growing role in determining services and prices in traditionally monopolistic energy network markets, decisions relating to 'what should be regulated and how' will become increasingly important.

The governance framework—including the institutions, their roles and the 'tools' available to them to perform those roles—are critical in supporting these changes in a way that promotes our customers' long-term interests.

Given the size of the energy sector and its importance to dependent markets, we also recognise the importance of the governance framework in promoting efficient energy markets to enhance productivity and growth in the broader Australian economy.

The governance framework remains well placed to manage the changes occurring in our energy markets and require refinements only

In our view, the governance framework has positively affected the choices and prices paid by customers for energy services. This framework provides clear, separate and accountable decision-making responsibilities—including relating to policy, coverage, the 'rules of the game' and economic regulation—and an overarching focus on customers' long-term interests. For this reason the current governance framework remains well placed to manage the changes occurring in energy markets, and we would caution against wholesale change.

In our view, refinements to the governance arrangements will need to occur and we support the Final Report's focus on:

1. revitalising a robust competition policy agenda and ensuring that competition drives the outcomes that customers value and that innovation occurs to provide energy services in an efficient, responsive and customer-focused way
2. testing the efficiency and effectiveness of the framework to ensure they are capable of adapting to these changing circumstances.

Consumer and investor confidence is vital for well-functioning energy markets, and we believe there are opportunities to refine the governance framework in a way that promotes customers' long-term interests and enhances productivity and growth in the broader Australian economy.

These refinements to the governance framework involve

1. **Introducing a 'pro-competition' focus in the governance arrangements through the creation of a new body to:**
    - determine 'what should be regulated and how' ('coverage' decision making at an asset, service or company level)
    - provide targeted and coordinated policy advice to COAG or jurisdictional governments, including scoping, procuring and integrating advices from other energy institutions to ensure a 'pro-competition' focus is embedded in the institutions governing Australia's energy (and other) markets.
2. **Refining the roles and responsibilities of the existing institutional structure to make better use of their areas of expertise and drive timely energy reform:**
    - the Australian Energy Market Commission (AEMC) could also provide targeted and coordinated policy advice to COAG or jurisdictional

governments, including scoping, procuring and integrating advices from other energy institutions

- the Australian Energy Regulator (AER) to solely focus on and be accountable for the implementation or administration of economic regulation (rather than what should be regulated and how)
- the Australian Energy Market Operator (AEMO) to focus on and be accountable for the efficient operation of the national market (rather than broader advice around policy and market reform)

3. **Considering more effective use of low cost 'error correction' steps within decision-making processes of the AER, AEMC and ACCP** to improve procedural accountability and transparency at minimal cost (i.e. avoid merits review or further Rule change reviews).[1]

Attachment A provides a summary of key recommended refinements to the governance framework that we consider will promote our customers' long-term interests and enhance productivity and growth in the broader Australian economy.

A new economic regulator with a mandate that overrides the 'separation of powers' principle is unlikely to encourage efficient investment in our energy market

Significant changes, if not considered in an evidenced-based and consultative way—consistent with best practice regulation principles—have the potential to increase the risk faced by investors, which can dampen incentives for innovation and investment in typically long-lived infrastructure assets or new innovative energy service markets. This is not in the long-term interests of customers.

The Final Report's recommendations to establish a new economic regulator—the Access and Pricing Regulator, and transfer access regulation functions previously with the National Competition Council to the Access and Pricing Regulator—would allow the regulator to effectively control the scope of its own authority which can preclude new business models (including network business models) from driving innovation in newly contestable markets[2] and dilute regulatory accountability.[3]

For these reasons we do not support these recommendations.

We are concerned that the Final Report does not clearly articulate why the current governance framework, including the existing institutions and their roles, is not best placed to manage the changes in the energy market, nor does it provide any evidence-base of the benefits and risks in alternative arrangements.

Attachment B outlines why we consider that Final Report's recommendation to establish a new economic regulator is not likely to be in the long-term interests of our customers or drive productivity and growth in the broader Australian economy.

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[1] For example, the AER currently has a range of low cost 'error correction' tools it can use (for example, National Gas Rules, Clause 68); however there is significant opportunity for better use of these measures to avoid more costly interventions.

[2] Given that the separation of powers is an important principle in the energy market, and one from which our private investors derive much confidence.

[3] Given the regulator's performance would need to be evaluated not on the basis of the quality of its access and pricing decisions, but also where it chose to apply its regulatory 'powers'.

We welcome an ongoing dialogue

The COAG Energy Council's review of the energy market's governance arrangements represents an important step in this process and we have been participating in this review.[4] We encourage further consideration of how to integrate these important reviews.

We have contributed to the Energy Network Association's submission and support its detailed comments on the performance of the current governance framework and the opportunities to refine these arrangements in a way that promotes customers' long-term interests and drives productivity and growth in the broader Australian economy.

We welcome the Final Report's contribution to this complex issue. However we note that encouraging a well-functioning energy market also requires addressing a range of other reform barriers beyond the governance framework. For example, jurisdictional constraints on pricing and metering, the removal of government ownership in the NEM and the deregulation of retail gas and electricity prices across all jurisdictions, and a co-ordinated national approach to funding and delivering targeted assistance to customers in hardship, are all essential to supporting the refinements to our governance arrangements. We welcome the Final Report's advice on many of these issues.

If you wish to discuss the submission please contact Alexus van der Weyden, Manager Regulatory Economics and Policy on (02) 9867 7326 or at alexus.vanderweyden@jemena.com.au.

Yours sincerely

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[4] https://scer.govspace.gov.au/files/2015/05/19-Jemena-non-conf.pdf

ATTACHMENT A: Summary of key recommended refinements to the governance framework

Institutional function	Institution	Objective	Refinements required
Policy setting	COAG Energy Council	Leading a transparent, consultative, timely and coordinated policy agenda	• Publishing transparent and coordinated energy reform road-map, with periodic progress reports • Greater consultation with key stakeholders on roadmap and implementation (including ahead of COAG Energy Council meetings) • Greater coordination of institutional reviews to avoid overlapping or duplication (e.g. avoid current situation where both AER and COAG are considering current and future exempt selling regimes) • More delegation of targeted policy reviews – to either the COAG Energy Market Reform Working Group, ACCP or AEMC (see below)
Rule making	AEMC	Continuing to provide a transparent, predictable, evidenced-based and consultative decision-making related to National Electricity Rules, National Gas Rules, Energy Retail Rules	• Greater clarity on priorities for progressing relevant Rule changes • Introduction of low cost 'error correction' steps
Coverage decision-making (access regulation)	ACCP	Independent and consultative decision-making related to what assets and services should be regulated and how	• Creation of the ACCP to ensure a 'pro-competition' focus continues to be embedded in the institutions and regulations governing our energy market • ACCP to absorb: – current NCC functions relating to what gas assets should be regulated (access regulation) – current AER functions relating to what gas and electricity services should be regulated and how (see below)

Institutional function	Institution	Objective	Refinements required
Economic regulation of energy infrastructure	AER	Focusing on transparent, predictable, evidenced-based and consultative decision-making relating to economic regulation of non-contestable elements of the energy market	• AER to focus on and be accountable for the implementation or administration of economic regulation of non-contestable elements of energy market. Performance could be improved through: – greater number of Board members – more meaningful and innovative engagement with customers – introduction of low cost 'error correction' steps • ACCP to take-over current AER functions relating to how services should be regulated ('form of regulation') including decision making relating to: – classification of network services[5] between direct control, negotiated services and unregulated services – ring fencing of non-contestable assets/services
Market analysis and targeted policy advice	ACCP or AEMC	Leveraging ACCP or AEMC's independence, economic expertise and consultative processes to drive policy, market and regulatory design	• ACCP or AEMC could provide targeted and coordinated advice - including scoping, procuring and integrating advices from other energy institutions - to COAG or jurisdictional governments on: – changes to industry specific policy, Rules, market design or regulations that may promote the long-term interests of customers – performance of markets, such as AEMC retail market reviews, current East Coast wholesale gas market and pipeline frameworks review and electricity (and potentially also gas) retail price trend reports

5 The Jemena Electricity Network provides a range of services to the community. Some of these services—such as our core distribution network services—are provided solely by us. However, other services are provided in more competitive markets, meaning we compete alongside other businesses to provide these services to our customers, such that direct regulatory oversight by the AER is not required. The National Electricity Rules require us to indicate how our services should be regulated (through the classification of distribution services), including which services require direct regulatory control by the AER of the prices we charge or revenues we recover from our customers, indirect regulatory control with the AER approving a negotiating framework or being involved in any arbitration, and which services are best left unregulated with outcomes determined in the competitive market. The AER then makes a determination on the classification of services for the regulatory period.

Institutional function	Institution	Objective	Refinements required
Market operation	AEMO	Effective, efficient and transparent market operation	• Refining scope to avoid advocating or initiating policy or market reform (i.e. focus on market operation and avoid duplicating work undertaken by other institutions) • Greater transparency about any policy advice provided to COAG or Governments (such as review of national minimum specification of meters)

Attachment B: Final Report recommendations relating to the creation of a new economic regulator—the Access and Pricing Regulator—are not in the long-term interest of customers

The importance of the separation of powers

We agree that a well-resourced and focused economic regulator operating within a framework of clear, separate and accountable decision-making responsibilities is crucial for a well-functioning energy market. It provides confidence to policy makers, customers and investors.

However we question whether the introduction of a new economic regulator—the Access and Pricing Regulator—that covers a wide and disparate portfolio of infrastructure decision-making will necessarily improve the focus, accountability, and expertise in making decisions that promote the long-term interests of energy customers.

An economic regulator with a wide portfolio may have the tendency to adopt a 'one size fits all' approach to regulation, particularly if the regulator is not well resourced or experienced in navigating the inevitable (and in some cases, significant) sectoral differences in between infrastructure markets.

For these reasons we do not support the Draft Report's recommendations to introduce the Access and Pricing Regulator.

Additionally, a single body making both access and pricing decisions effectively means that it can control the scope of its own authority. This is undesirable given that separation of powers is an important principle in the energy market, and one from which private investors derive much confidence. Such a body may also have diluted accountability given its performance would need to be evaluated not on the basis of the quality of its access and pricing decisions, but also where it chose to apply its regulatory 'powers'.

In our view, the Harper Review's noting of the telecommunications access regime—where the ACCC performs both declaration and arbitration functions—does not reflect a model that is best placed to manage the changes occurring in the energy market.

Bigger may not be better

Well-functioning and innovative energy markets also require policy and regulatory settings that are transparent and predictable, such that customers, stakeholders and policy-makers can have confidence that change to the framework occurs in a consultative and evidence-based way.

Consistent with the principles of best practice regulation[6] this obliges a clear articulation of the 'problem', the range of feasible options or 'solutions' and the

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6 COAG, Best practice regulation: Guide for Ministerial Councils and National Standard Setting Bodies, 2007.

identification of the option which best promotes the long-term interests of customers, using a clear evidence-based approach and following extensive consultation with stakeholders.

The Draft Report notes that in the AEMC's view, some of the key factors driving the success of energy market reforms to date were that:

- material problems were defined and clear reform objectives were set
- strong and appropriate support structures were established with key stakeholder participation, and the pace of the reform allowed for effective consultation across all stakeholders. [7]

In this context, we are concerned by a number of the Final Report's broad assertions that appear to be neither evidence-based nor made following consultation with a range of stakeholders, particularly the assertions about:

- regulatory 'capture' and a resulting inflexibility in regulatory approaches[8]
- investment decisions being distorted as a result of inconsistency in regulatory approaches.[9]

In our view, there is little evidence to support these concerns, particularly in the energy market.

Rather, the Final Report's assertion that industry specific regulators may lose the necessary independence from the regulated industry seems to be reliant on the views of a small number of stakeholders.[10] However, from this flows the recommendation that a single access and pricing regulator would reduce the risk of capture. We are not aware of any credible observer positing that the AER has been subject to capture by regulated network businesses, and we note that in developing and consulting on its Better Regulation reforms, the AER examined the operation and success of a range of 'regulatory tools' in place in the energy sector and other sectors both in Australia and overseas.

The Final Report's assertion that regulatory precedent plays a diminished role in decision making by industry specific regulators, and that efficient investment decisions will occur when there is "national uniformity to industry regulation"[11] also seem to be misplaced, particularly in the energy market.

Given the size of the energy sector and its importance to dependent markets, we recognise the importance of promoting efficient investment to enhance productivity and growth in the Australian economy. Efficient investment is most likely to occur where regulators follow processes and make decisions that are consistent with best practice regulatory principles. One of the key principles is "to take into account relevant industry circumstances and changes in those circumstances over time…to reflect

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https://www.dpmc.gov.au/deregulation/obpr/proposal/coag_requirements/docs/COAG_best_practice_guide_2007.pdf#page=6

7 Draft Report, p.121.

8 Final Report, p.471.

9 Final Report, p.472.

10 Monash Business Policy Forum, Submission to Competition Policy Review - Issues Paper.

11 Ibid p.140.

developments in best practice regulation and in relevant economic and finance theories."[12] That is, efficient investment decisions are more likely to occur when regulatory decisions are not only transparent and predictable, but also responsive to market conditions.

The Final Report's does not acknowledge the risks associated with a single access and pricing regulator applying national uniformity to industry regulation. For example, the changes occurring in the energy market heighten the risks associated with a 'one size fits all' approach to economic regulation that may occur in a multi-industry regulator covering a wide and disparate portfolio. This is most likely to occur when the regulator is not well resourced or experienced in navigating the inevitable sectoral differences between infrastructure markets. Standardised treatment of regulated industries could in fact distort investment, rather than promote efficient investment.

In our view, the periodic development of, and ongoing consultation around guidelines, including the AER's Better Regulation guidelines, enhance efficient investment decisions by promoting transparent and predictable regulatory settings that are responsive to market conditions.

[12] ACCC in Productivity Commission, National Access Regime, Inquiry Report, October 2013, p.142.