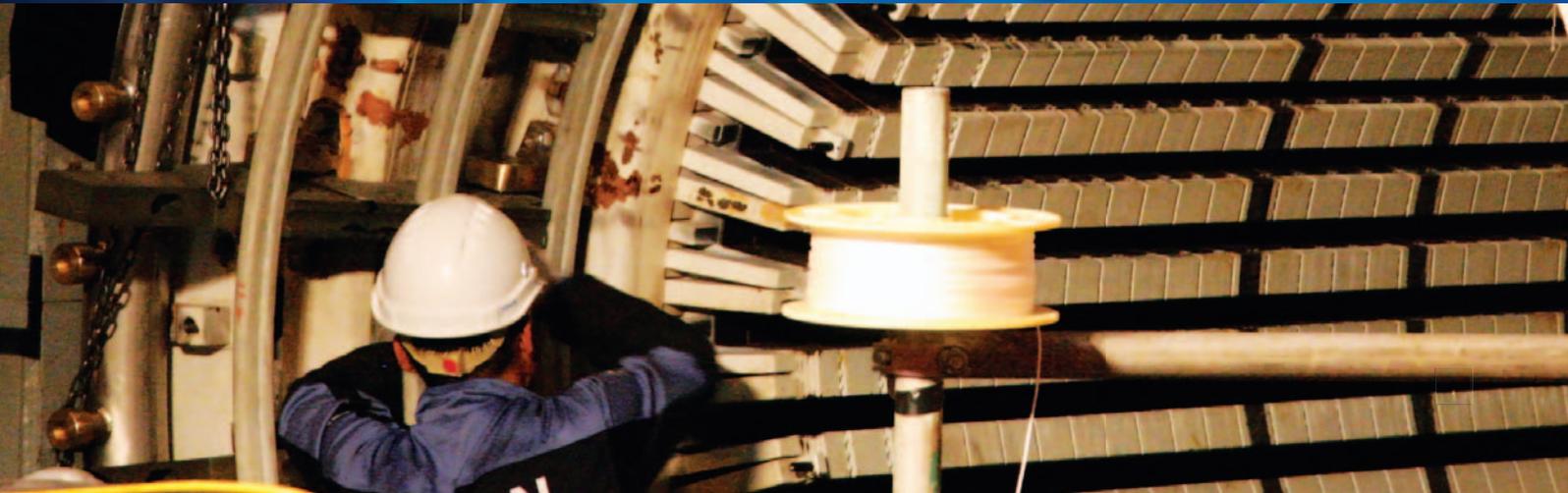




# AER STRATEGIC PRIORITIES AND WORK PROGRAM 2011-12





# **AER STRATEGIC PRIORITIES AND WORK PROGRAM 2011-12**

Australian Competition and Consumer Commission  
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# THE AER

The Australian Energy Regulator (AER) is Australia's independent national energy market regulator. Its independent Board is made up of three members who are statutory appointees. The AER is part of the Australian Competition and Consumer Commission (ACCC). This report sets out the AER's corporate priorities and expected work program for the period 1 July 2011 to 30 June 2012.

The AER operates under the *Competition and Consumer Act 2010* (Cwlth). Our functions are set out in national energy market legislation and rules. These functions include:

- setting the prices charged for energy networks (electricity poles and wires and gas pipelines) to transport energy to customers
- monitoring wholesale electricity and gas markets to ensure suppliers comply with the legislation and rules, and taking enforcement action where necessary
- publishing information on energy markets to assist participants and the wider community
- assisting the ACCC with energy-related issues arising under the Competition and Consumer Act, including enforcement, mergers and authorisations.

The AER will assume new responsibilities in 2012 for the regulation of retail energy markets. These responsibilities are wide ranging and will include monitoring and enforcing compliance with the National Energy Retail Law; authorising retailers to sell energy; approving retailers' policies for dealing with customers facing hardship; reporting on retailer performance and market activity; and administering a national retailer of last resort scheme in the event a retail business fails. While the AER will not regulate retail energy prices, we will provide an online price comparison service to help consumers select a suitable energy supply contract.



# OUR OBJECTIVES AND VALUES

The objectives of the national energy legislation guide the AER's strategic priorities and work program. The National Electricity Law, the National Gas Law and the National Energy Retail Law 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 AER aims to give effect to these legislative objectives by pursuing the following corporate goals:

- controlling monopoly power in the energy network sector by setting network prices that are efficient
- ensuring wholesale energy markets operate competitively and that participants comply with market rules
- promoting vigorous and informed competition by publishing data and analysis of prices and other market behaviour
- encouraging consumers to engage in the market by publishing clear and accessible information on retail prices and informing consumers of their rights in relation to such matters as hardship, door to door selling and what to do if their retailer fails.

In undertaking our roles we aim for:

- transparency and co-operation through consultation and engagement with energy customers, businesses and other stakeholders
- clarity, timeliness and consistency of regulatory approach
- vigilance in our market monitoring, compliance and enforcement roles
- innovation to improve process and outcomes over time
- effective communication through high quality information.



# STRATEGIC PRIORITIES FOR 2011–12

To achieve our corporate goals in 2011–12 our work program reflects five strategic priorities

## 1 Ensuring network regulation arrangements meet the long term needs of energy consumers

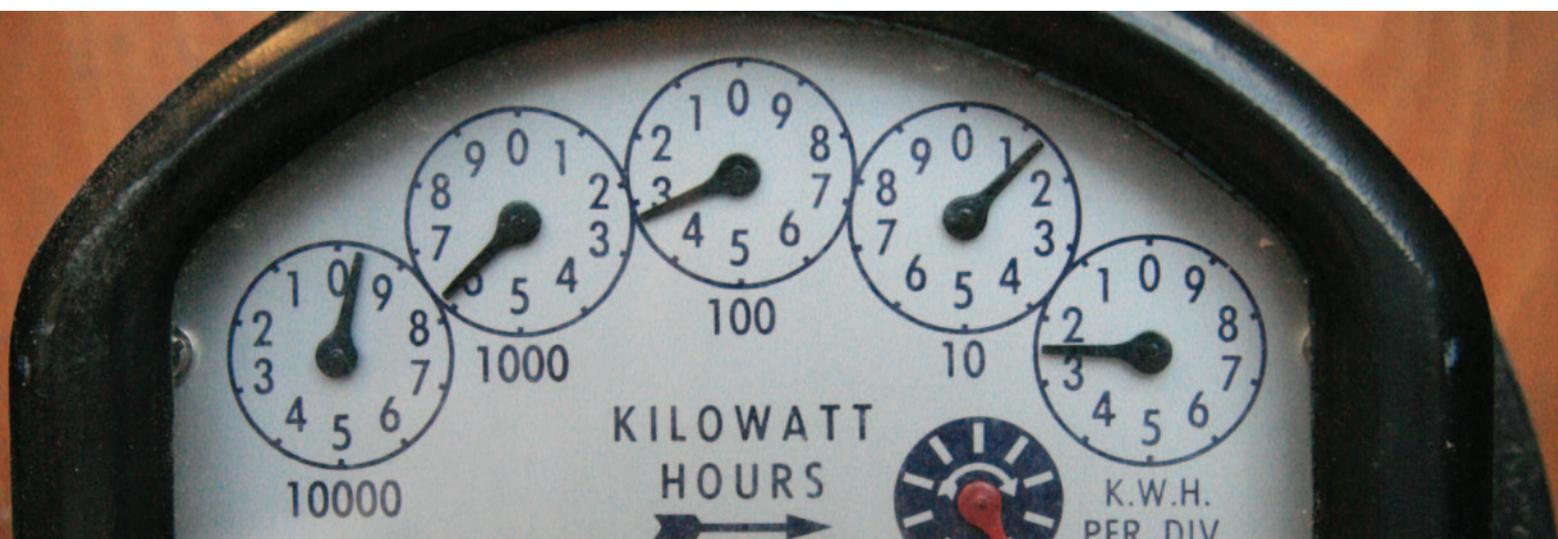
The central focus of our regulatory work is to set the prices charged by over 30 Australian electricity and gas network businesses. These businesses own and operate the electricity poles and wires and gas pipelines that transport energy to consumers. While the high cost of investing in energy networks can make it efficient to have a single supplier, this can also lead to monopoly power in the industry. One of the AER's roles is to regulate the networks to ensure their supply charges are no more than customers need to pay for the safe and reliable supply of energy.

The AER has almost concluded its first cycle of revenue or price determinations for electricity distribution networks under the National Electricity Rules. The cycle will be completed with the Tasmanian business, Aurora Energy (which submitted its proposal in May 2011). The AER has also completed its first cycle of determinations for transmission networks (apart from the Murraylink and Directlink interconnectors) under the current rules.

The AER is using this opportunity to take stock of its experiences with the regulatory regime and review whether any changes would better meet the regime's underlying objective—to promote efficient investment in and use of electricity services for the long term interests of energy consumers.

The review commenced in early 2011 and focuses on the regulatory framework set out in chapters 6 and 6A of the National Electricity Rules. The AER is also considering ways to enhance efficiency incentives for network businesses and improve the administrative efficiency of the regulatory decision making process.

From this review, the AER has identified changes to the rules that we consider would better protect consumers from paying more than they should for the safe and reliable supply of electricity. We will be proposing rule changes to the Australian Energy Market Commission (AEMC) in the third quarter of 2011. This timing is to ensure that any amendments to the framework are in place for the next round of revenue or price determinations (starting with the New South Wales and ACT networks).



The rule change proposal will focus on how the regulator can ensure that the allowances for the businesses are no more than necessary, reflecting an unbiased estimate of efficient costs. Further, the AER is examining ways to ensure that businesses are not rewarded for unnecessary and excessive overspends.

It is also necessary to reform the process for deciding the businesses' allowable returns. The AER is proposing to replace the various processes currently used across electricity and gas transmission and distribution networks with a single consistent framework. Changes are needed to ensure that returns are consistent with current commercial practices and financing costs.

Complimenting its review of the regulatory framework, the AER is undertaking a review of its information collection, analysis and reporting processes that inform revenue and price determinations. Considering these processes together will ensure that the type and quality of information collected reflects the AER's choice of analytical tools and allows for effective assessment of business performance.

The AER is aiming to implement its amended processes to allow for the collection of robust and consistent data across the businesses it regulates by June 2013.

In light of the AEMC's current review of electricity transmission frameworks, we will also review specific regulatory arrangements for transmission services, including the service target performance incentive scheme; and arrangements for connecting to the transmission network.

## 2 Preparing for national retail regulation

The AER will continue preparing for national regulation of retail energy markets, which in 2012 will see the AER take on significant new regulatory roles. Our focus in this area is to ensure energy consumers are adequately protected and encouraged to engage in the market. For example, we will ensure consumers can access information on retail prices and their rights and options in relation to such matters as retailer switching, hardship issues, door to door selling and what to do if their retailer fails.

The AER aims to establish its reputation as the incoming regulator and build on productive and cooperative relationships with regulated businesses, customer groups, energy ombudsman schemes, industry associations and other stakeholders. In 2011–12 we will finalise guidelines and procedures explaining our approach to retail regulation, including in areas such as customer hardship policy approval, compliance monitoring, performance reporting and retailer of last resort arrangements.

We will also aim to:

- ensure continuity and minimise disruption in the transition from jurisdictional regulatory arrangements
- assist all parties to be ready by the transition date of 1 July 2012 and finalise key AER guidelines and instruments well in advance to ensure this can occur
- help manage consumer uncertainty about the transition, and educate and inform energy customers to be active participants in the market.

### 3 Promoting compliance, supported by transparent, fair and effective enforcement

We will continue to engage with stakeholders to promote a culture of compliance with energy laws, rules and other obligations; and report on areas of concern. We will use tailored mechanisms to ensure a high level of compliance and strive for a proportionate response. We will investigate breaches and potential breaches and, where necessary, take rigorous enforcement action in a fair and effective manner.

In 2011–12 we will continue with our established monitoring, compliance and enforcement programs, as outlined in the quarterly reports published on the AER website. We will also widen our compliance focus to consider selected instances of behaviour that causes market harm and develop metrics against which to measure outcomes.

Two areas of focus in 2011–12 will include:

- developing a compliance monitoring and enforcement regime on the application by electricity network businesses of the regulatory investment test for transmission (RIT-T)
- auditing the systems used by pipeline operators in the gas short term trading market to submit timely and accurate data; and developing guidelines on what constitutes a significant price variation in that market.

### 4 Enhancing customer understanding of energy prices

Upward pressure on retail energy prices is causing considerable concern among energy customers. While the AER has (and will have) no regulatory control of wholesale or retail energy prices, we are looking at ways of making energy price information more transparent and comparable to help customers make informed choices when choosing an energy supplier. In 2011–12 the AER will:

- develop a retail price comparator website (to be launched in July 2012) to assist consumers
- launch an AER newsletter that will cover energy market issues including retail price movements
- finalise a guideline on how energy retailers must present their prices in a retail offer
- develop indicators of energy affordability that will form a basis for future performance reporting arrangements
- continue to publish clear, accessible and relevant information on energy market activity and outcomes.

### 5 Promoting competitive wholesale energy markets

To achieve the objectives of the energy market legislation, we aim to ensure wholesale energy markets operate competitively, and that electricity generators and gas producers do not use market power to drive prices above competitive levels. In 2011–12 the AER is participating in consultation by the AEMC on a rule change proposal in relation to the potential exercise of market power by generators in the National Electricity Market (NEM).

More generally we will continue to monitor wholesale energy markets to detect possible instances of the exercise of market power; and publish data and analysis of wholesale prices and other market behaviour that may be indicative of issues in the market. This is consistent with our monitoring of the market for detection of possible breaches of market rules. We will also continue working with the ACCC on energy-related issues under the Competition and Consumer Act, including enforcement, merger and authorisation matters.



# WORK PROGRAM FOR 2011–12

## 1 Regulating energy networks

The AER sets the prices charged by the following energy network businesses:

- electricity transmission and distribution services in the NEM jurisdictions of Queensland, New South Wales, the ACT, Victoria, South Australia and Tasmania
- gas transmission and distribution services in jurisdictions other than Western Australia.

There are differences between the regulatory approach in electricity and gas, and between transmission and distribution. The AER publishes guidelines on its approach in each area.

### 1.1 Electricity networks

The AER regulates the five networks that form the NEM transmission grid, as well as two cross-border transmission interconnectors. It also regulates the NEM's 13 major distribution networks.

The regulatory approach is set out in the National Electricity Law and Rules and requires a network business to submit a proposal to the AER for approval. The proposal forecasts a business's revenue requirements from network services to cover its efficient costs including a commercial return. A challenge for the regulator assessing a proposal is having access to sufficient business specific information to determine the efficient level of costs for that network. One way to mitigate this issue has been for the AER to provide financial incentives for service providers, including through the development of incentives schemes relating to operating costs and service performance, to attain and disclose efficient levels of costs and service performance over time. The AER will, in the future, place increasing reliance on benchmarking as a complementary tool to assess efficient costs.

### *Electricity transmission*

The AER sets a ceiling on the revenues a transmission network can earn during a regulatory control period (typically five years) and then translates these revenue allowances into network prices. The regulatory process begins 13 months before the end of the current regulatory control period, when a network business must submit to the AER a revenue proposal (with proposals on a negotiation framework and pricing methods for prescribed transmission services). The AER must publish a draft decision within six months of receiving a revenue proposal and issue a final decision at least two months before the beginning of the next regulatory period.

### *Electricity distribution*

The range of regulatory approaches is wider in electricity distribution than transmission, but generally requires the AER to set a ceiling on the revenues or prices a network can earn or charge during a regulatory period. Given the AER's wider discretion over certain parameters, the regulatory process includes a preliminary stage in which it develops and publishes a framework and approach to each determination. This process begins 24 months prior to the end of the current regulatory period and takes about five months. The AER must publish a final decision at least two months before the beginning of the next regulatory period.

### Work program for 2011–12

Figure 1 sets out the regulatory timelines for AER determinations on the revenues or prices of electricity networks in the NEM. The AER in 2011–12 will:

- review regulatory proposals for Queensland’s electricity transmission network (Powerlink) for the period 1 July 2012 to 30 June 2016 and release a final determination in April 2012
- review regulatory proposals for Tasmania’s electricity distribution network (Aurora Energy) for the period 1 July 2012 to 30 June 2016 and release a final determination in April 2012
- commence reviews of regulatory proposals for South Australia’s electricity transmission network (ElectraNet) for the period 1 July 2013 to 30 June 2017 and the Murraylink interconnector between Victoria and South Australia for the period commencing 1 July 2013.

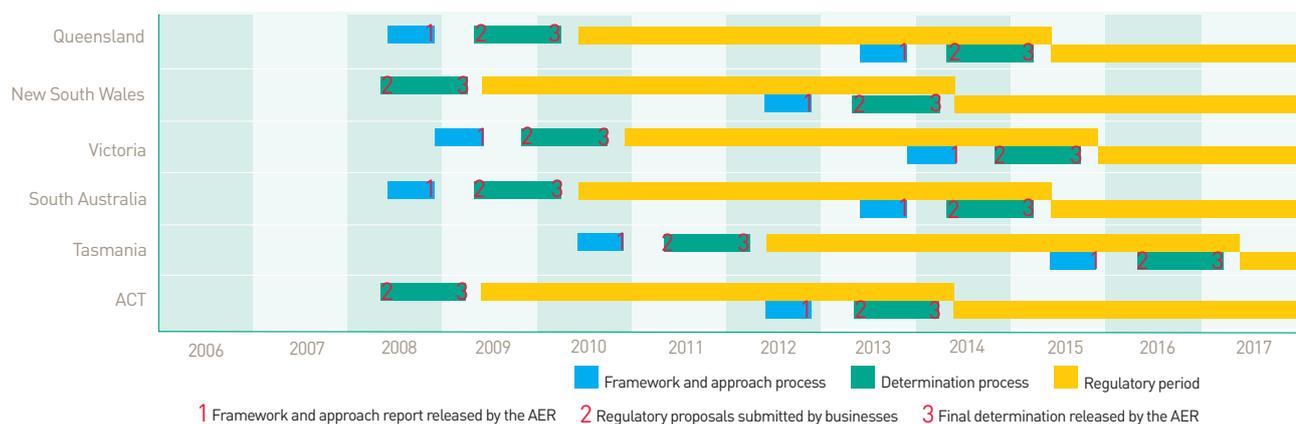
Figure 1

### Timelines—AER determinations on regulatory proposals for electricity networks

#### Electricity transmission



#### Electricity distribution



## 1.2 Gas pipelines and networks

There are various tiers of regulation for gas pipelines. For pipelines subject to *full regulation*, the AER periodically reviews access arrangements submitted under the National Gas Law and Rules by pipeline service providers. An access arrangement establishes reference tariffs (prices) and other terms and conditions under which a third party can use a gas pipeline. These tariffs must reflect the efficient costs of providing the relevant service. Several Australian pipelines are subject to *light regulation*, which involves no upfront price regulation.

The AER currently regulates five transmission pipelines (including the Victorian transmission system) and 10 distribution networks that are subject to full regulation. The AER has six months (plus stop-the-clock time at certain stages of the process) to make a decision to approve or not approve an access arrangement proposal. This can be extended a further two months, with a maximum of 13 months to make a decision.

The regulatory approach involves assessing the pipeline revenues necessary to cover efficient costs plus a benchmark

return on capital; and then deriving reference tariffs for the pipeline. The National Gas Rules allow for income adjustments from incentive mechanisms to reward efficient operating practices.

### Work program for 2011–12

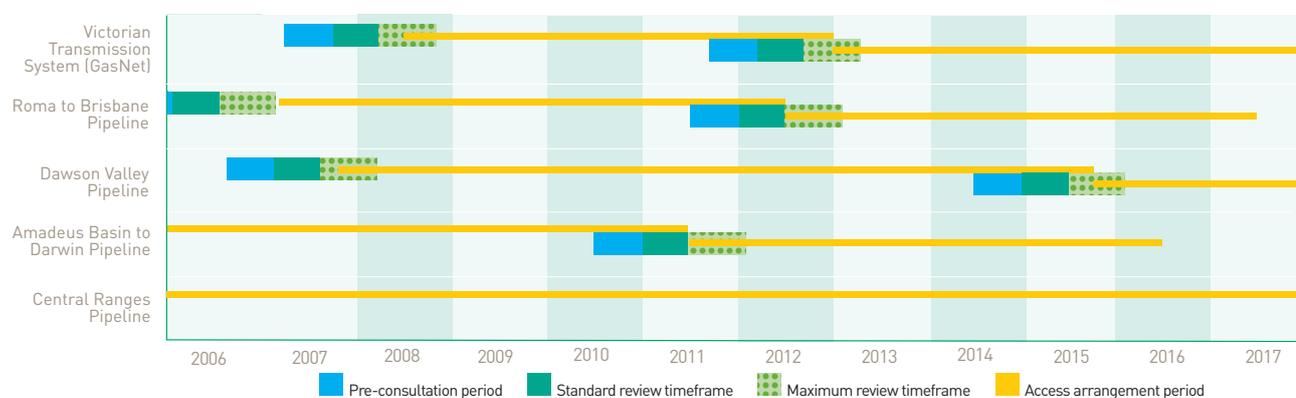
Figure 2 sets out the regulatory timelines for AER determinations on access arrangement proposal for Australian gas pipelines. The AER in 2011–12 will:

- finalise its review of the access arrangement for the Amadeus Gas Pipeline for the period 1 July 2011 to 30 June 2016
- review the access arrangement for the Roma to Brisbane Pipeline for the period 1 July 2012 to 30 June 2017 and release a final decision in June 2012.
- commence reviews into access arrangements for the Victorian transmission system (GasNet) and Victoria's gas distribution networks (owned by SP AusNet, MultiNet and Envestra) for the period 1 January 2013 to 31 December 2017.

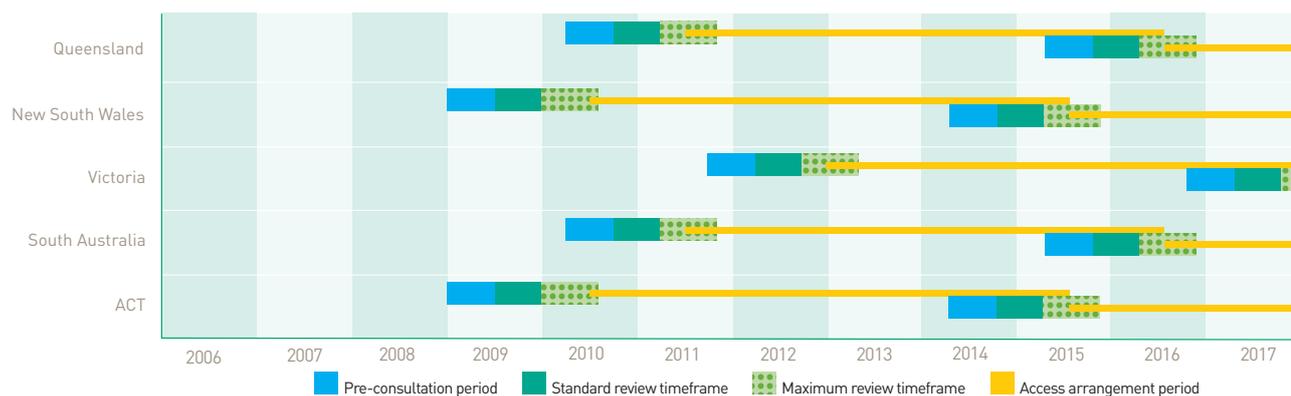
Figure 2

### Timelines—AER determinations on access arrangement proposals for gas pipelines

#### Gas transmission



#### Gas distribution



### 1.3 Merits review of regulatory decisions

The AER's decisions are subject to a merits review by the Australian Competition Tribunal. Between September 2008 and May 2011 network businesses sought reviews of the determinations on three electricity transmission networks, 11 electricity distribution networks and two gas distribution networks. Five reviews were continuing in May 2011. The AER must assist the Tribunal in undertaking these reviews.

### 1.4 Review of regulatory arrangements

One of the AER's priorities in 2011–12 is to complete a review of the approach to economic regulation under chapters 6 and 6A of the National Electricity Rules, to define improvements which can be made. We are proposing changes in market rules which we believe would better promote efficient investment in and use of electricity services for the long term interests of energy consumers. The review commenced in early 2011. We intend to make a submission to the AEMC on this matter.

We will continue to develop and refine our methods of regulation, particularly through improving the quality and relevance of data provided to us by regulated firms.

### 1.5 Other regulatory work

In addition to revenue determinations, the AER undertakes other functions associated with economic regulation. It assesses network proposals on prudent discount applications, cost pass-throughs, revenue re-openers and contingent projects; develops and applies service incentive regimes and ring-fencing policies and other regulatory guidelines; assists in access and connection disputes; and undertakes annual tariff reviews for distribution businesses.

The AER monitors the compliance of network businesses with the underpinning laws and rules and reports on these in our quarterly compliance reports and other reports. For example, providers of gas transmission and distribution pipeline services must report by 31 October each year on their compliance with certain provisions and rules under the National Gas Law. We publish an overview report each year outlining outcomes.

The AER publishes and periodically updates guidelines on its approach to network regulation. In 2011–12 we will develop guidelines on:

- how an electricity distribution business may charge customers for network connection services under the new chapter 5A of the National Electricity Rules; and
- how customers may seek the AER's assistance to resolve a connection dispute with their network provider

- the conditions for exempting a network from the operation of certain provisions of the National Electricity Rules: exemptions may be available in some circumstances to parties such as retirement villages, shopping centres and office blocks.

The AER will also review the operation of the service target performance incentive scheme for electricity transmission businesses, which has operated in some form since 2003 and was last amended in 2008. As the scheme has now applied to all electricity transmission networks for two regulatory periods, it is timely to conduct a review prior to the next round of determinations. The AER expects to complete the review by 2012.

The AER will begin work on developing a national demand management scheme to eventually replace the range of schemes that currently apply. The schemes provide incentives for electricity distribution networks to adopt non-network approaches to manage demand growth. The AEMC has indicated the national scheme should be expanded to cover innovations in connecting generators to distribution networks. The AER's work in this area is pending outcomes from the AEMC's stage 3 review of demand side participation in the NEM.

### 1.6 Regulatory roles under state and territory frameworks

Under Victorian legislation, the AER undertakes certain regulatory functions of Victoria's Essential Services Commission in electricity and gas distribution. These roles include:

- publishing performance reports
- approving electricity distributors' applications for exclusions from the Victorian Guaranteed Service Level payment scheme
- resolving customer disputes on network access
- enforcing breaches of licence conditions, including connection charge disputes, and the Victorian Electricity Distribution Code.

The AER is also responsible for determining revenues and charges for 2012–15 associated with the rollout of advanced metering infrastructure in Victoria. This rollout is mandated by the Victorian Government and is being undertaken by the distribution businesses.

The AER has also acquired a role in regulating the capital contributions of customers connecting to distribution networks in Queensland, New South Wales, the ACT and South Australia.

## 2 Market monitoring, compliance and enforcement

One of the AER's roles is to ensure compliance with the legislation and rules for wholesale energy markets. To fulfil this role the AER monitors wholesale electricity and natural gas markets, and where appropriate takes enforcement action for breaches.

### 2.1 Market monitoring

Market monitoring allows us to inform participants and the community about wholesale market activity, assess levels of compliance and identify breaches of rules and laws. During 2011–12 we will continue to publish weekly reports on:

- wholesale market activity in the NEM, with more detailed analysis and reporting of extreme prices (above \$5000 per megawatt hour).
- activity in the Victorian gas market and the new short term trading market (currently operating in Adelaide and Sydney, and expected to commence in Brisbane in 2011). In 2011–12 we aim to develop guidelines on what constitutes a significant price variation in the short term trading market as a basis for future reporting on extreme price events.

We also monitor the markets to detect compliance issues and inefficient market outcomes (such as the manipulation of the markets by energy producers). The outcomes of this monitoring inform submissions and other contributions to work undertaken by the Standing Council on Energy and Resources (formerly the Ministerial Council on Energy), AEMC, and other bodies.

### 2.2 Compliance

The AER's *Compliance and Enforcement—Statement of Approach* (available on the AER website) sets out our compliance and enforcement strategy in wholesale energy markets. Our activities within this strategy include:

- monitoring of wholesale markets to identify compliance issues
- targeted compliance reviews of a range of provisions each quarter by writing to selected participants (adopting a differing spread of participants each quarter) to identify how they comply with their obligations
- general audits of compliance with certain provisions, both randomly and in response to market events or inquiries that raise compliance concerns
- audits of compliance programs for technical performance standards; in 2011–12, the audits will focus on the compliance programs used by generators and network businesses to meet these standards
- forums and other meetings with industry participants to discuss our approach to compliance; in 2011–12 we will focus on meeting with gas industry participants
- publishing quarterly wholesale market compliance reports (an accessible summary of our compliance activities) and compliance bulletins (when additional guidance on the rules is warranted).

We are enhancing our compliance activity in 2011–2012 by introducing a new stream of projects which focus on specific issues in wholesale energy markets. The projects will focus on an identified market 'harm' and will use specific tools for specific harms over a defined period. We will develop metrics against which to measure effectiveness.



In gas, an area of focus will be the new short term trading market. A new market with new rules requires careful scrutiny to ensure all participants comply with their obligations. In 2011–12 the AER will audit the systems used by pipeline operators in the market to submit timely and accurate data. We will also continue to monitor the compliance of market participants with the rules underpinning the National Gas Market Bulletin Board.

### 2.3 Investigations and enforcement action

The purpose of our compliance monitoring regime is to identify any incidents of non-compliance with energy market laws and rules. In some cases, a more thorough investigation may be needed to determine the existence, nature and extent of a breach.

In 2011–12 we will continue to undertake specific investigations as required. We will generally report on outcomes, subject to confidentiality constraints.

The AER considers a number of factors when deciding whether to take enforcement action and which action to adopt. We aim for a proportionate enforcement response taking into account the impact of the breach, its circumstances, and the participant's compliance programs and compliance culture.

## 3 Retail energy markets

The AER is expected to take on significant regulatory roles in energy retail and distribution on 1 July 2012 under the National Energy Retail Law. These roles, which will transfer from state and territory agencies, include:

- monitoring compliance and enforcing breaches of the National Energy Retail Law
- approving the authorisation of retailers to sell energy; and granting exemptions from the authorisation requirements (for example, to nursing homes and caravan parks that onsell energy)
- approving retailers' policies for dealing with customers facing hardship
- reporting on performance matters such as customer service, rates of disconnection and hardship programs, and reporting on energy affordability and retail market activity
- administering a national retailer of last resort scheme in the event a retail business fails
- providing an online price comparison service for small customers.

The states and territories will remain responsible for regulating retail prices.

In 2011–12 we will further consult with customer groups, retailers, state and territory agencies, small customer dispute resolution schemes / ombudsmen and other stakeholders to finalise guidelines and procedures for retail performance reporting; retail pricing information; retailer of last resort arrangements; customer hardship policies; compliance and enforcement; authorisations and exemptions; and connection charging arrangements. Information on the current stage of work in each area is available on the AER website. We will also progress the development of a retail price comparator website in 2011–12 to assist energy customers in making informed choices when choosing a retailer.

## 4 Publications and communications

As noted, the AER publishes various determinations, guidelines, bulletins and reports related to our energy market activity. We also publish an annual *State of the energy market* report and have a widening role in performance reporting on the energy sector.

The AER plans to launch a new website and newsletter in 2011 to enhance our communication with stakeholders.

All publications are available on our website ([www.aer.gov.au](http://www.aer.gov.au)).

### 4.1 State of the energy market

We will continue to publish the annual *State of the energy market* report, which is designed as a user-friendly overview of the sector. Each edition consists of a market overview, supported by more detailed analysis of activity and performance in electricity and gas. The report draws on information available through our regulatory and monitoring work and other public information.

### 4.2 Performance reporting

Performance reporting on energy businesses enhances transparency and accountability and provides incentives for businesses to improve performance over time. Our reporting on the performance of regulated business is part of the regulatory cycle and is an input into the regulatory determination process. The reports are prepared from information provided by network businesses, focusing on financial and operational performance. They present information on network profitability and investment outcomes, comparing actual data with forecasts in

regulatory decisions. The reports also cover performance in relation to incentives, such as the service target performance scheme, efficiency benefit sharing scheme and demand management incentive scheme.

In 2011–12 the AER will publish performance reports on:

- electricity transmission networks in the NEM (for 2009–10)
- Victorian gas and electricity distribution networks (for 2009 and 2010 respectively)
- New South Wales and ACT electricity distribution networks (for 2009–10).

In the future we will publish performance reports for other energy distribution networks and the retail energy sector.

### 4.3 Newsletter

The AER expects to launch a newsletter in 2011–12 to enhance our communication with stakeholders. We expect the newsletter to become an increasingly important means of updating stakeholders during the transition to national regulation of retail energy markets.

### 4.4 Website

In 2011–12 we intend to complete a website redesign to make it more user friendly. The new website will have particular regard to our interface with energy customers.

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