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Manager, MCE Secretariat,
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Dear Mr Livingston,

The Australian Energy Regulator (AER) welcomes the opportunity to comment on the second Working Paper prepared by Allens Arthur Robinson for the Retail Policy Working Group (RPWG). The AER reiterates its support for the objectives and evaluation criteria against which regulatory options are to be assessed.

Distributor interface with customers

The framework and legal architecture proposed for distributor interface with customers is consistent with that proposed for retailer-customer interface in Working Paper 1, and with existing institutional and governance arrangements adopted by the Ministerial Council on Energy (MCE) in the development of the economic regulatory frameworks for gas and electricity distribution and transmission. The AER reiterates its support for this approach to the regulation of the distributor-customer relationship.

While recognising that the appropriate scope and level of protection to be provided in deemed distribution contracts with small customers has yet to be settled at a policy level, the AER wishes to highlight an issue arising from the Working Paper's discussion of distribution service standards.

The Working Paper proposes that minimum terms and conditions should provide that the distributor must comply with any relevant service standards or guaranteed service levels which apply in the jurisdiction where the contract arises.

The AER agrees that it is appropriate that specified service standards, and a commitment to compliance with those standards, be included in the minimum terms and conditions of a distributor's deemed contract with customers. This clarifies the distributor's responsibility to the customer in upholding these standards, and provides a basis for recourse for the customer where standards are not met.

That said, in referring to relevant service standards or guaranteed service levels *which apply in the jurisdiction where the contract arises*, some clarification is needed of the

implementation arrangements for customer service performance standards. The agreed allocation of National and State/Territory functions was settled by the Council of Australian Governments (COAG) in the Australian Energy Market Agreement (AEMA), which lists as a National Function:

2. Service performance incentive scheme – for network service performance standards (as set by the jurisdiction where elected), and customer service performance standards, linked to economic regulation.

The AEMA draws a distinction between *network* service performance standards (ie, standards of performance based on measures such as System Average Interruption Duration Index) and *customer* service performance standards, which pertain more specifically to the relationship, or interface, between a distributor and its customers, including matters such as:

- providing a connection service on an agreed date;
- notice of planned interruption to supply;
- telephone service for reporting service faults and difficulties;
- repair of faulty street lights;
- the distributor's punctuality in keeping appointments;
- disconnection and reconnection.

Whilst the unique characteristics of particular networks may require specially set *network* service performance standards, the more generic nature of customer service performance standards is amenable to regulation on a nationally consistent basis. The AER considers that there would be a number of benefits if the MCE, and going forward the AEMC, were to set customer service performance standards on a national basis, as contemplated in the AEMA arrangements. A nationally consistent approach to customer service performance standards would be consistent with the evaluative criteria adopted by Allens Arthur Robinson on behalf of the RPWG, which prioritise consistency across jurisdictions except where necessary to deal with specific network or market characteristics, transparency and simplicity of regulation, and minimisation of the burden and cost of regulation.

The AER would welcome the MCE including the development of national customer service performance standards in its 2007 work program, with a view to progressive implementation of nationally consistent standards as current distribution price and revenue determinations fall due for regulatory review under the new national framework.

Distributor interface with retailers

The AER recognises the importance of having in place a sound, balanced regulatory framework to support the interface between retailers and distributors so that consumers ultimately benefit. The framework should ideally provide:

- certainty to retailers and distributors as to the general division of obligations and the minimum level of service which can be expected. It is proposed under the framework that this would occur through the default terms which must be approved by the Regulator;

- flexibility to update default terms over time and to accommodate the negotiation of better terms or alternative terms, in a timely fashion, tailored to individual parties' needs.

Default requirements provide certainty to parties of a guaranteed service level they can expect to receive. The determination of balanced default requirements to operate between retailers and distributors is a critical issue which will impact on the degree of commercial negotiation sought for alternative or better terms. The framework proposed contemplates the setting of default Use of System (UoS) standards through approved default contractual provisions. However, the AER notes that in submissions to previous consultation papers, industry participants have commented that some obligations contained in UoS agreements may be better placed as rules requirements. Retailers and distributors with practical experience of dealing with UoS agreements will likely have a view on whether certainty of enforceability for them would be enhanced through rules based requirements as opposed to contractual obligations.

This submission focuses on the flexibility in the framework for variations and negotiation of UoS terms and conditions to occur if parties desired a change to the provision of a service to that under the default terms and conditions. The AER would encourage further consideration of whether the framework proposed will best facilitate commercial negotiation of UoS terms and conditions at an individual level, and whether the framework is sufficiently flexible to facilitate changes to default terms and conditions over time.

Commercial negotiation and arbitration of UoS terms and conditions

Terms and conditions found in UoS arrangements are likely to remain contentious since they deal with issues such as the allocation of financial liability, timeliness of meter reading, and connection and disconnection. The AER considers there are two reasons why including an arbitration mechanism where commercial negotiation of UoS terms and conditions fail is better than the current recommendation that the default UoS will apply:

- first, the availability of arbitration is more likely to facilitate commercial negotiation of UoS terms and conditions;
- second, allowing for arbitration of UoS terms and conditions is consistent with the access dispute framework in the exposure draft National Electricity Law and National Gas Law.

The AER understands that the commercial negotiation of UoS terms has not occurred much in practice to date. The AER notes in this respect that default terms and conditions provide for a status quo of uniform treatment. The availability of default terms and conditions, while necessary, may create a disincentive for parties to negotiate anything outside those boundaries. This disincentive will be enhanced in a framework, such as the one proposed, where parties can in effect refuse to negotiate and simply insist on the default terms and conditions. The ability to have a matter taken to arbitration may offset this disincentive. Provision for arbitration may be effective in facilitating negotiation where parties understand it is available, even if recourse is not had to it.

Retailers will ultimately choose whether to negotiate alternative terms and then whether to recourse arbitration if negotiation fails according to their own view of the costs involved and

of the potential benefits, including whether any of their competitors may gain some of the benefits. Recognising this choice, the AER considers that it is important that this possibility for parties to negotiate remain open, and that this would be best facilitated by allowing for an arbitration mechanism. In saying this, the AER recognises that departures from default arrangements may have cost implications for distributors with business models based around efficient cost delivery of default UoS terms. The AER notes that it would be appropriate to take those costs into account as part of the arbitration process.

The AER notes that provisions in the current exposure drafts of the National Gas Law and the National Electricity Law provide for an arbitration mechanism to deal with access disputes. The proposal in the framework to not allow for arbitration of proposed UoS terms and conditions is contrary to a general position that 'access disputes' should be subject to arbitration in these exposure drafts. It is difficult to reconcile why UoS terms, which involve non-price terms of access, should be outside of a general access dispute model covering terms of access.

Default UoS terms and conditions

The framework proposed will allow for consultation on default UoS terms and conditions at the time of a revenue / price determination. The distributor will be open to propose, and interested parties will be open to comment on, the form of default arrangements for approval. This consultation would have a different focus to the individual nature of a commercial negotiation between a retailer and a distributor for better or alternative terms of service. The AER would welcome further consideration of whether changes to default terms and conditions between revenue determinations may be justifiable. If such a capacity is deemed appropriate, the AER would welcome consideration of the appropriate framework by which changes could be made.

The AER notes that recently, the Victorian ESC has, in effect arbitrated a dispute over network credit support and required changes to distributors' default terms and conditions. This example highlights an instance where a regulator has responded to a developing issue as it arose. The AER can see benefits to allowance in the framework for the approval of variations to default arrangements outside of revenue cap/price determinations. In saying this, the AER understands that changes to default terms and conditions may impose costs. Under the framework proposed the regulator would necessarily have to consider, via consultation, the justification behind any proposal to change default UoS terms and conditions at a regulatory reset. Similarly, a change to the default UoS terms and conditions, outside of a regulatory reset, should be open to be justified and approved. Some form of materiality test may assist to ensure that there are potential benefits to such changes intra-period to outweigh any identified cost of change.

Credit support

The AER would like to see credit support moved from the table of terms and conditions for further consideration for inclusion into the list of explicitly recommended minimum UoS terms and conditions. Under the recommended modified linear approach, the retailer will pay the distributor for network charges but the retailer will be solely responsible for customer credit risk and collecting network and energy charges. The form and level of credit support to be provided by retailers to distributors is a contentious issue which impacts on distributor

and retailer's risks and underlying costs. In the paper it is considered that it would be appropriate for a default position to be prescribed in the model terms. The AER view is that some form of credit support should be a requirement in all UoS agreements (default or negotiated) to manage the exposure of the distributor.

Thank you for the opportunity to comment on the second Working Paper. We look forward to ongoing involvement in this consultation.

Yours sincerely

A handwritten signature in black ink, appearing to be 'S. Roberts', written in a cursive style.

Sebastian Roberts
General Manager
AER Markets Branch