



**Speech by Steve Edwell, inaugural Chair,
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to Energy Supply Association of Australia (ESAA)

‘Energy Business Lunch’

Thursday 14 July 2005-07-14

Palladium at Crown, Southbank, Melbourne

Introduction

- Thanks for the invite.
- Brad Page got in early. So early in fact I suspect he actually asked all the possible candidates for the Chair's appointment, including me as the "compromise candidate or the bolter" as the media has described it.
- Having shares in a couple of race horses who generally run at somewhat attractive odds, I have some considerably affinity with roughies or bolters; so I understand Brad's logic in having a bit each way. Bolters not infrequently get up; although holding the form is a constant challenge.
- I'm also not sure, however, that the element of surprise fits well with a sector that is looking for more regulatory certainty. So let's hope that that is the end of the AER surprises.

1. **Role of the AER**

- New regulatory framework is a major initiative and in the history of the industry will certainly be a major milestone.
- The rationale and benefits of AER's establishment are well known within the sector (consistency and greater regulatory certainty , cost reduction, a national approach for a national market, etc).
- In response to this, the AER will be a one stop shop national regulator assuming this role on a staged basis over the next 2 years.
- The timelines for transition of regulatory functions to the AER is established in the Energy Market Agreement between the Commonwealth and State and Territory Governments.
- At inception (as of today) the AER has responsibility for –
 - Economic regulation for electricity transmission in NEM jurisdictions

- Monitoring of the NEM wholesale electricity market
 - Enforcing the NEL, Regulations and Rules.
- I note that the AER has no responsibilities as of today for gas. Rather, gas transmission for all jurisdictions except WA will pass from the ACCC to the AER in 2006, following passage of necessary legislation in the various States and Territories.
 - The MCE has agreed to pass energy (gas and electricity) distribution and non-price retail regulation to the AER by end 2006. The transition of these functions to the AER will capture many of the benefits in the establishment of the new body. Up until then, however, we are an additional regulator rather than a replacement for the 12 or so State/Territory regulators. So the sooner we can move to the national framework the sooner the will benefits from this new model result.
 - Individual jurisdictions may choose to confer retail pricing functions on the AER by agreement with the Commonwealth.
 - So even leaving aside the retail area, the AER will have a comprehensive and challenging work agenda. There are nine gas distribution businesses and thirteen electricity distribution businesses regulated by the jurisdictions. Additionally, there are six electricity transmission businesses and four covered gas transmission pipelines. In all over thirty regulated entities.
 - A key focus of Members will be ensuring the organisation is be ready and equipped to assume this intensive role.

2. MCE Agenda and Commonwealth Taskforce

- There is still a labyrinth of energy policy matters for resolution; and the comprehensive ongoing work agenda of the MCE does bring some uncertainty regarding the timing of handover of certain of these functions to the AER and the final look of the regulatory landscape.
- The MCE has yet to develop its response to the PC review of the Gas Access Regime and other gas policy matters and is considering a harmonisation of gas and electricity regulation across jurisdictions. Exposure draft legislation is proposed for February 2006.
- A national framework for retail regulation is also proposed to be implemented before the AER assumes responsibility for non price retail regulation.
- Importantly, there is also the review of Chapter 6 of the EM Rules to be conducted by the AEMC by mid 2006 which will have a direct bearing on the regulatory framework for electricity transmission and ultimately distribution.
- Other key policy matters such as transmission planning; financial transmission rights and regional boundaries for the NEM are also yet to be resolved although these matters are less relevant to the AER.
- In addition, there is the response to the Prime Minister's Taskforce Report on Export Infrastructure earmarked for COAG consideration in 2006, which will presumably touch on the energy sector.
- The message here is that the comprehensive ongoing policy work will present some challenges to both the AER and industry in getting on with the job notwithstanding a still evolving regulatory framework.

3. Legislation

- The AER is established under Australian Government legislation but derives powers and functions from the NEL.
- Importantly, regarding electricity the AER, in fulfilling its role, needs to be consistent with the object of the market which is to achieve the efficient investment in and use of electricity assets in the long term interest of consumers. A similar object is likely to be reflected in the Gas Code.
- This object will necessarily govern the AER's administration of revenue determinations for Network Service Providers and covered pipelines and its undertaking of the market monitoring and enforcement role.
- This object was only recently included in the legislation and requires that the AER promote efficient investment occurring when its needed but still seek a reasonable balance between consumer benefits and industry returns.

4. Relationships with the AEMC and the ACCC

- It will be very important that there be effective working relationships between the AER, the AEMC and the ACCC.
- I think there is a very clear distinction between the roles of the individual bodies: the AER as energy regulator, the AEMC as the rule maker and provider of policy advice to the MCE and the ACCC as competition regulator. This clear demarcation of role (particularly between policy and regulation) was a major aim of the new governance framework; so each body needs to be conscious of this and perform their functions with total independence.
- However, good outcomes are best served with an effective and co-operative relationship between the organisations. I think there is zero tolerance for anything less than this.

- The AEMC and the AER have already commenced discussions about relationship processes. The MCE Agreement provides for an MOU to be agreed between the parties and this is in train, but good day to day working relationships between the bodies is the key to effective engagement. Regarding the AER and the ACCC, the legal construct of the AER as a constituent part of the Commission will not impact on its independence regarding regulatory decisions. The AER's establishment legislation is unequivocal on its independent decision making powers. The legal construct of the AER will deliver the dedicated and specialist focus on energy regulation sought by stakeholders without a duplication of resources and blurring of accountabilities of the AER and ACCC that would have occurred under another model.

5. AER's Priorities

- I see three priorities for the AER in the immediate months ahead. Firstly, there is the need to ensure we have a plan for implementing the transition of functions from State regulators to the AER. This needs to happen in a co-ordinated fashion and in a way that minimises regulatory uncertainty. (And we have established a branch within the organisation dedicated to this role.)
- As I said before, this process will be best served by establishment of a clear handover timeline, so that industry knows who they should be talking to and so the AER can effectively operationalise the handover process well in advance of statutory timelines for regulatory resets.
- Secondly, we need to develop internal arrangements and processes for market monitoring. This is a role previously held by NECA on which I will comment shortly.
- Thirdly, there is the ongoing work we have assumed from the ACCC such as Directlink's conversion application and the upcoming revenue reset for Powerlink in early 2006.
- We are in the process of addressing these matters.

6. Infrastructure Debate

- I have watched with keen interest the media debate on infrastructure and regulation. There is clearly no energy infrastructure crisis; certainly one caused by regulators. Independent reports and the evidence demonstrate this. So that's not the question. We need to move on from this debate.
- Rather, the question should be: are there deficiencies in the regulatory arrangements and practices in the sector and is the regulatory framework conducive to timely investment going forward? That is the relevant question.

- My response to that question is there are indeed some aspects of regulation we need to review to improve the existing framework.
- The Prime Minister's Infrastructure Taskforce has expressed concerns about the regulation framework with regard to its structure and administration; albeit more in the context of the export sector than energy. The Taskforce described regulation as "adversarial, cumbersome, time consuming, inefficient and subject to gaming by participants."
- The regulatory process should facilitate the operation of the market. It shouldn't be seen as a dampener to efficient investment occurring.
- In fact I don't see that there is a tension between an objective of encouraging investment and looking after consumers. In practice I see the two objectives are quite consistent. By promoting efficient investment in electricity services we are protecting the long term interests of consumers of electricity with respect to quality, reliability and security of supply. Having reliable and secure electricity delivered at a reasonable price is clearly a better outcome for consumers in the long run than short term price reductions which damage investment outcomes.
- So the AER's priorities will be to promote investment and the long term interests of users. Of course there is still a question of balancing the interests of service providers and consumers. We want to provide an environment that supports efficient investment, but this doesn't mean going soft on the industry. We need to ensure that consumer share in efficiency gains achieved by the industry.

- The NEM and gas sector have achieved major gains over the past decade. However, the industry has reached a new stage in its life cycle. The competitive reforms have released some significant gains in prices, productivity and service levels by better utilisation of existing assets. But we now need significant infrastructure investment across the sector and the regulatory framework needs to recognise this. So some change in regulatory approach and perhaps style is necessary.
- The establishment of the AER as a specialist energy regulator presents an opportunity for this change to happen.

7. What improvements can we make to the regulatory process?

- My observation is that action has or needs to occur at three levels. The first level relates to regulatory governance, including reducing the number of regulators. This has largely been addressed through the MCE's establishment of the AER and AEMC and the governance arrangements for their operation. Benefits however will only emanate from the timely hand over of responsibilities. I have already commented on this matter.
- The second level, is what I call the regulation framework as embodied in the various rules and codes. These instruments will directly influence the AER in undertaking its role. And under the new model it is the responsibility of the AEMC and the respective Governments to review these instruments.
- The response to the PC recommendations on changes to the Gas Code and the AEMC review of Ch 6 of the NEM Rules will be especially important processes. Three key questions will be:
 - How far should we move from the existing revenue and price setting arrangements in the Rules and the Gas Code.

- Should there be an introduction of an option for light handed regulation. If so, how is this to be defined (ie price monitoring) and who triggers the option.
- Thirdly, what level of prescription should be embedded in these Instruments to dictate the regulatory process?
- Industry and other stakeholders need to take these reviews seriously and be prepared to engage in the consultative process.
- The bottom line is that whatever comes out of this process will bind the AER in terms of its process and application.
- The third level is more in the AER's control. Within the construct that is eventually given to us, the AER is interested in how we can streamline regulation; make it more efficient. We haven't developed definitive views yet but we certainly see this as a priority.
- In terms of revenue regulation the up front rules should be clear to the industry. In other words, the way the regulator is to conduct his process should be very apparent well in advance; not to be changed half way through.
- I think the Statement of Regulatory principles released by the ACCC late last year represents a very positive step in improving regulatory certainty; in particular the decision not to revalue assets and the move from ex post to an ex ante review of capital expenditure. We need to build on these initiatives going forward.
- We need to look at ways that regulation can be less intrusive. This does not mean we compromise robust analysis. Rather, it's about getting the right pitch below which costs and delays in analysis outweigh the benefits. This is a challenge because of the old information asymmetry problem; but we need to look at initiatives like: streamlining information requirements; and simplifying process.

- We need serious attempts to shorten the time it takes for decisions.
- Also, Regulators can't replicate the most optimally efficient outcomes. We need to be conscious of this.
- I note however, that sectors of industry itself are guilty of a myopic approach to regulation. Some players are really comfortable in trying to win points on great detail. So perhaps we all need to take a step back.
- My personal view is that consumers need to be engaged more in the regulatory process. The challenge is how this can be achieved efficiently.
- I note that what we're not talking about is an approach that will be necessarily skewed to higher returns to infrastructure owners because, the AER still has to achieve balance in terms of ensuring consumers share in efficiency gains. So industry shouldn't read this as the AER going soft on the industry. I'm talking about regulation quality rather than engineering specific outcomes.

8. Market Monitoring and Enforcement

- A robust surveillance, monitoring and enforcement mechanism is recognised as necessary for a well-functioning wholesale market for electricity, so this will be a significant focus for the AER. Achieving compliance is in the interests of industry as well as consumers. Management is in the process of establishing a branch within the AER to focus on this area.
- To date NECA has operated a light-handed regime that emphasises voluntary Rule compliance. This is probably an appropriate approach and to date we seem to have a fairly good track record on compliance within the sector. The outcome I would like to see is a culture of corporate compliance. This is far preferable to an adversarial approach and the costs and disruption that go with it. However, for this regime to work effectively, it needs to be complemented by detailed monitoring of participant conduct and effective enforcement.
- Hopefully, we can achieve a culture of compliance with the Rules within the NEM. If market participants are operating within the rules, they have nothing to worry about from any enforcement regime.

9. Conclusion

- In conclusion I emphasise that the AER will be striving to be a best practice regulator. To my mind that encompasses:
 - Truly independent decision making;
 - Efficient and predictable process;
 - An internal skills base of the highest order, in particular analytical competency;
 - Being accessible to and having effective relationships with industry and other stakeholders, including a helpful and open door approach;
 - Recognising that regulation is an art; not a science;
 - Having its feet on the ground and being pragmatic where called for.
- The bottom line is the regulation is a difficult job. The stakes are high for all stakeholders, so it would be naïve to expect tensions will not arise. However, adversary lends little and, indeed, detracts from the process. To the extent we all have a job to do, I would hope we can all work in a non adversarial way and I and the other Members look forward to engaging with all sectors of the industry in this context.
