



9 December 2011

By email: submissions@aemc.gov.au

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Commissioners,

Submission to AEMC

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Australian Energy Market Commission's (the **Commission**) Consultation Paper; *National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2011 (Consultation Paper)*.

Consumers and the state of the current regulatory framework

To contextualise our views on the rule changes proposed to the National Electricity and Gas Rules (the **Rules**) by the Australian Energy Regulator (the **AER**) and the Energy Users Rule Change Committee (the **EURCC**), we draw upon our experience as consumer representatives and the needs and interests of residential consumers.

Residential consumers have essentially quite basic needs when it comes to energy. They simply want to be able to flick a switch and turn their lights on (or, in other words, be able to use energy for domestic household purposes). Beyond that, their needs, for the most part, are not terribly complex. They want to be charged, and to pay, a fair and reasonable price for the energy they use. They want to be able to afford their energy bills, and for these bills to fit within their household budgets. Not unreasonably, they do not want to have to deal with unnecessary or unfair high prices, complex contract terms and conditions, complex tariffs and predatory or unfair behaviour. *However*, many residential consumers continue to face these issues in the current market. Through our legal and financial counselling services, we see the impact of this, represented through unaffordable pricing, payment difficulties, financial hardship, as well as marketing problems including difficulties in making effective choices. This consumer detriment is a clear indication of market failure.

These proposed rule changes provide a real opportunity for the Commission to affect consumer outcomes in the energy market, starting with fair electricity prices. The proposed rule changes ultimately relate to the price of energy, and therefore affects the needs and interests of residential consumers.

Specifically, we strongly support a process whereby the Rules undergo robust review, with the scrutiny necessary to enact a change that:

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- will ensure the businesses charges reflect actual and efficient costs;
- recognises the interests and needs of consumers within the market; and
- seeks to address the power imbalance consumers face with these monopoly businesses.

If businesses and policy makers continue to overlook the role, interests and needs of consumers in the market, consumers will continue to pay more than is necessary for their energy.

The way the Rules are drafted currently encourages distribution businesses to build more assets and to build upon their returns to shareholders. The Rules fail to require businesses to fully consider the impact of this on their key stakeholders—consumers. The Rules and their application by the AER are currently too weak to counter the power and superior information position of the distribution businesses. Changes to the Rules are therefore necessary to ensure that the AER is able to address each review with the appropriate power to ensure that these businesses are more accountable to their customers—by keeping price rises to the minimum necessary.

Prescription versus Discretion

One of the key debates in the Consultation Paper is the level of prescription versus discretion available to the AER in the Rules. This debate cannot be divorced from the overall regulatory process, which includes the ability of businesses to appeal AER decisions.

"[Barriers to fair network prices](#)", the recent report from Consumer Action and the Consumer Utilities Advocacy Centre details our attempts to intervene in the merits review process after the AER's final decision in Victoria.

We found that, despite what the NEL states about consumers being able to intervene in that process, it is impossible to do so. We encountered insurmountable barriers caused largely by the significant information imbalance and the costs risks to consumer organisations. Yet networks can essentially cherry pick, appealing the parts of a decision that suits them, with little to no risk to them.

Our report argues that the merits review process should be abolished and businesses should only be able to pursue judicial review of the AER's economic regulatory decision.

We are aware that the merits review system is to be reviewed by Standing Committee of Energy and Resources (**SCER**) in coming months. We think the outcome of this review is important to inform a position about whether the Rules should be more prescriptive or provide further discretion to the AER.

As we understand it, the more discretionary regime afforded to the ESC in the previous economic regulatory system resulted in significant reductions in the revenue claims of the distribution businesses and most importantly in costs and prices for consumers. Further, this level of discretion made the decision difficult to challenge in a merits review appeals process.

We are interested therefore in the totality of the debate and as there are clear no outcomes about review processes yet, we find it difficult to be conclusive on this issue, beyond stating that if there remains a merits review process then it is likely to be more appropriate that the AER is granted more discretion. However if the merits review process is to be abolished, we think a more prescriptive approach might be better. Generally speaking, it is harder for businesses to appeal a wide discretion under merits review.

Ultimately, the outcome the Commission needs to focus is one that discourages what is now a predictable step in the process, of distribution businesses appealing the AER's final decision. Instead, the Rules need to encourage more transparent engagement in the AER processes with more accountability of the businesses.

Expenditure framework

In relation to the capital expenditure and operational expenditure framework, the Rules currently give the AER limited ability to challenge the revenue proposals put forward by the distributors. As a result, the businesses can undertake to build their asset base and as long as the projects are run efficiently, they can pass the costs onto consumers.

As we found with our own work in the Victorian Energy Distribution Price Review process, we are concerned that inflated forecasts are forming the basis of much of the price rises we have seen—these are significantly higher than previous periods and higher than the AER's forecasts.

Under the current rules, the onus is on the AER to prove that the proposed forecasts do not reasonably reflect efficient costs. They must do this despite nearly all of the information being provided by the distribution businesses. Even where consumer groups raise doubts about forecasts, which is really all we can do with such limited information and resources, it has little impact due to the test the AER must apply.

The evidentiary burden should instead be placed on the businesses to prove that the proposed forecasts reasonably reflect prudent and efficient costs.

Incentives

We are deeply concerned by the current incentives provided by the Rules which mean that any expenditure by the businesses (which typically seems to occur towards the end of the regulated period) can be rolled into the asset base for the next regulatory period. This enables the businesses to profit from this expenditure, notwithstanding the expenditure might not have been efficient or necessary. We support changes to these arrangements that more fully ensure network expenditure is carried out when and where it is necessary rather than based on how businesses can further profit from it and support a rule change that achieves this outcome.

Cost of capital

The way the cost of capital is set is of significance to consumers due to the impact this has on prices.

Further, it is obvious to us that there is significant financial advantage for the businesses and their shareholders should the WACC be increased, at the expense of consumers.

Something so singularly supported by distribution businesses deserves much more scrutiny by policy makers so that the Rules do not allow businesses to achieve a return on capital that is far above other businesses.

Both the AER and the EURCC have proposed changes to the Rules to address this. We strongly support an approach that will most effectively reduce the potential for windfall gains to businesses. When determining the best outcome, it is essential that the Commission focuses on ensuring the level of WACC and the cost of capital is no more than necessary from a consumer perspective, so as to maintain fair and efficient prices.

The Regulatory Process

The efficiency of the regulatory process needs to address the inequity that currently exists for fair and balanced participation by consumers and consumer organisations. It also needs to recognise the limitations facing consumer representation in the process.

Consumer advocacy faces significant resource limitations. As a result, consumer advocates are typically required to have a broad, rather than specific, knowledge base to enable us to work and represent consumers across the entire spectrum of generation, distribution/transmission and retail markets. Under current funding models, this is unlikely to change. The limitations on resources in consumer advocacy are contrasted by the extent of expertise within each of the distribution businesses and the level of resources dedicated to the price determination process.

We note Rod Sims', Chairman of the Australian Competition and Consumer Commission, comments¹ in relation to consumer engagement in price review processes which recognised that there is "growing disillusionment about the ability of traditional regulatory approaches to lead to effective consumer engagement". On the basis of research conducted for the Independent Pricing and Regulatory Tribunal by Cambridge Economic Policy Associates, he highlighted two key means for improving consumer engagement, including:

- *"consumer engagement should begin before the regulated business makes its submission, not after as is usually the case; and*
- *responsibility for initiating this engagement rests both with the regulator and the business."*

We support these initiatives and urge for these to be included in the outcomes of these rule changes as a means to increase the level of consumer engagement in the process. Particularly, as additional to being resource constrained, consumer advocates and other stakeholders have only a short amount of time (as outlined in the regulatory framework) to participate in the review - a difficult task when facing such significant amounts of information from the businesses.

In addition, the information available is often such that it is opaque to everyone other than the distribution businesses. Both in its sheer quantity, but also as large amounts of it is marked as commercial in confidence and much important information blacked out when it is made public—which renders it essentially useless to external stakeholders—and precludes the necessary scrutiny to ensure a balanced process.

The Commission needs to consider the current process for the AER and recognise the constraints on consumer advocacy—with the goal of seeking an outcome that sufficiently addresses the AER needs, and which holds the businesses accountable. Consumer interests need to be adequately provided for and protected, within this process, regardless of the level of consumer participation.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia.

¹ Sims, Rod, Speech at PIAC's EWCAP conference, June 2011 access: <http://piac.asn.au/news/2011/06/iparts-rod-sims-speaks-ewcap-conference>

Since September 2009 we have also operated a new service, *MoneyHelp*, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians with changed financial circumstances due to job loss or reduction in working hours, or experiencing mortgage or rental stress as a result of the current economic climate.

Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Consumer Action has been actively involved in energy advocacy work in Victoria and nationally since the 1990s. Over this time we have provided key consumer input into important energy regulatory processes for consumers, including the current Victorian smart meter rollout and initiatives relating to improved energy price and product information disclosure following the deregulation of Victorian retail energy prices. Over the past two years in particular, we have been involved in the Victorian Electricity Distribution Price Review process, and also the recent appeal process by the Victorian businesses to the competition tribunal.

Through our work we have gained strong insight into the way consumers are experiencing the market.

Consumer Advocacy Panel grant recipient - disclaimer

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The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission.

Should you have any questions about this submission, please contact me on 03 9670 5088.

Yours sincerely
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