



AER STRATEGIC PRIORITIES AND WORK PROGRAM 2012-13



Australian Competition and Consumer Commission
23 Marcus Clarke Street, Canberra, Australian Capital Territory, 2601

© Commonwealth of Australia 2012

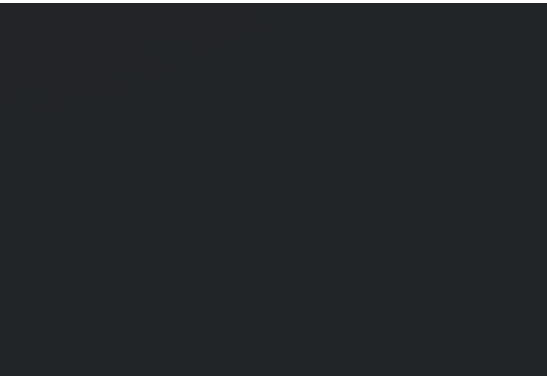
This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced without prior written permission from the Commonwealth available through the Australian Competition and Consumer Commission. Requests and inquiries concerning reproduction and rights should be addressed to the Director Publishing, Australian Competition and Consumer Commission, GPO Box 3131, Canberra ACT 2601 or by email to publishing.unit@accc.gov.au.

ISBN 978 1 921964 84 8
ACCC 07/12_45164_546

www.aer.gov.au

Cover and page 3 image: Wind Farm—Hydro Tasmania

Page 14 image: Gas processing plant—Origin Energy



CONTENTS

THE AER	2
OUR OBJECTIVES AND VALUES	2
STRATEGIC PRIORITIES FOR 2012-13	3
WORK PROGRAM FOR 2012-13	6



THE AER

The Australian Energy Regulator (AER) is the national energy market regulator and an independent statutory authority funded by the Commonwealth, with staff, resources and facilities provided through the Australian Competition and Consumer Commission (ACCC). This report sets out the AER's strategic priorities and expected work program for the period 1 July 2012 to 30 June 2013.

The AER operates under the *Competition and Consumer Act 2010* (Cwlth). Our functions are set out in national energy market legislation and rules, and mostly relate to electricity and gas markets in eastern and southern Australia.

These functions include:

- setting the prices charged for using energy networks (electricity poles and wires and gas pipelines) that transport energy to customers
- wide ranging responsibilities in retail energy markets in those jurisdictions adopting the National Energy Retail Law (Retail Law), including a price comparison website; enforcing compliance with the retail legislation; authorising retailers to sell energy; approving retailers' policies for dealing with customers in hardship; administering a national retailer of last resort scheme; and reporting on retailer performance and market activity
- monitoring wholesale electricity and gas markets to ensure suppliers comply with the legislation and rules, taking enforcement action where necessary
- publishing information on energy markets, including the annual *State of the energy market* report
- assisting the ACCC with energy-related issues arising under the *Competition and Consumer Act*, including enforcement, mergers and authorisations.

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 Retail Law aim to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of energy consumers with respect to price, quality, safety, reliability and security of supply.

The AER aims to give effect to these legislative objectives by pursuing the following goals:

- preventing monopoly pricing in the energy network sector
- providing protection for small retail customers in their electricity and gas supply arrangements, and encouraging small customers to engage in the retail market
- ensuring wholesale energy markets operate competitively and that participants comply with the market rules
- promoting vigorous and informed competition by analysing price and other market behaviour.

In undertaking our roles we aim for:

- transparency and co-operation through consultation and engagement with energy customers, businesses and other stakeholders
- the application of high quality expertise in our work
- 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 2012-13

The AER's strategic priorities identify areas of particular focus over the following twelve months. Our wider ongoing functions (outlined elsewhere in this report) will remain of critical importance and continue to account for a significant portion of our work program.

Our work program in 2012–13 will reflect three strategic priorities.

1. Promoting more effective network regulation

The AER sets the prices charged by over 30 Australian energy network businesses for using electricity poles and wires and gas pipelines to transport energy to customers. The energy legislation requires us to regulate the networks to promote investment and prices that meet the long term interests of consumers.

Substantial increases in network charges over the past three or four years led the AER in 2011 to propose changes in the national energy rules that determine how we set network prices. While recognising the fundamental drivers of higher network costs—new investment to meet demand growth, higher finance costs and the replacement of ageing assets—we consider some changes are needed to allow us to set prices that better reflect the objectives of the legislation. In particular, we consider the current rules are leading to consumers paying more than necessary for energy services. The Australian Energy Market Commission (AEMC) is considering our rule change proposals and expects to make a final decision in November 2012.

In addition to the rule change proposals, we will pursue other approaches to streamline and improve the quality of network regulation. In particular, we aim to:

- further refine benchmarking techniques and tools and their application in regulatory decisions. We will further develop key benchmarking indicators in consultation with industry, with a view to applying enhanced metrics in 2012–13 in regulatory reviews of the New South Wales and ACT electricity distribution networks.
- further refine information requirements on energy business, to improve the quality and consistency of data for regulatory reviews and annual performance reporting. The enhancements also aim to improve the robustness of regulatory decision making, and provide important data for developing and applying benchmarking techniques. While our work in this area to date has focused on electricity distribution, we aim to extend this approach in future to transmission businesses and the gas pipeline sector.
- refine elements of our approach to determining the weighted average cost of capital (WACC) for network businesses, in light of recent decisions by the Australian Competition Tribunal. We will undertake the refinements in consultation with stakeholders. The AER is also required to complete a major review of the WACC by May 2014; the review parameters are subject to a Rule change proposal. Under current provisions the review would likely commence in 2012–13.

- enhance our internal technical expertise—for example, in electrical and gas system engineering—to engage more directly and effectively with network businesses and other stakeholders. This would complement the internal expertise we have already developed in wholesale market monitoring, and supplement the technical expertise in network issues we currently draw on externally.
- participate in various workstreams on demand side response aimed at helping consumers make informed choices about their energy use and promoting efficient business responses. The workstreams include stage 3 of the AEMC demand side participation review (*Power of Choice*), scheduled for completion by September 2012; and the Australian Government’s energy efficiency opportunities program and Energy Savings Initiative’s peaking investigation. The AER will draw on this activity to enhance our knowledge of demand side response in undertaking regulatory functions. For example, we intend to strengthen the current incentive-based regulatory schemes on demand management to encourage greater business participation.

2. Fostering customer confidence and engagement through our new retail functions

The Retail Law will transfer a number of functions from state and territory agencies to the AER. The transition date will vary between jurisdictions, with the AER ready to assume its new responsibilities from 1 July 2012. The Retail Law will work hand in hand with the Australian Consumer Law to provide small energy customers with effective protections around their electricity and gas supply arrangements.

Our focus in 2012–13 will be to ensure small energy customers are adequately protected and encouraged to engage in the market. We will continue to engage with

customers to strengthen their understanding of the new regime and build confidence in the protection framework covering such matters as hardship, door to door selling and what to do if a retailer fails.

In particular we will:

- launch a new price comparator website (www.energymadeeasy.gov.au) in line with the commencement of the Retail Law to help customers compare energy offers generally available in their area. Over the following months we aim to raise customer awareness of how to use the website to choose a retailer and contract that best suits their needs.
- make continued enhancements to the new AER website (www.aer.gov.au), launched in May 2012, to maximise ease of use and consumer accessibility. The website will enable consumers to subscribe to regular AER announcements about decisions, media releases and other developments.
- target matters of interest to consumers in the AER newsletter, *AER Energy Update*, launched in 2012.
- publish educational materials, both online and in print, for consumer groups including financial counsellors and community legal centres. We will consult with consumer groups on strategies to target cultural and linguistically diverse audiences and develop materials in accessible formats such as audio, to ensure our consumer education initiatives reach a broad cross-section of the community.
- publish information for energy customers on what factors are driving retail energy price changes, including the impacts of networks charges, wholesale energy costs and carbon pricing.

More generally, we will continue to refine our online strategy to identify further opportunities to raise awareness and encourage consumers to access the information we provide. We also intend to research any barriers against our effective engagement with consumers.



3. Fostering competition in wholesale energy markets

In 2012–13 we will aim to promote competition in wholesale energy markets by:

- monitoring for the exercise of market power, and communicating with stakeholders and the ACCC on our findings
- providing expert assistance to the ACCC on energy-related matters; for example, in relation to mergers and the foreshadowed privatisation of generation assets in New South Wales.

We will also promote regulatory arrangements for energy networks that enhance competition in wholesale markets.

To pursue this priority in 2012–13, we will:

- review the service target performance incentive scheme for electricity transmission and make proposals to the AEMC's transmission frameworks review, aimed at minimising network congestion. Lowering congestion would enhance competition and promote more efficient dispatch of generation plant
- monitor the application of the regulatory investment test for transmission (RIT-T) to ensure businesses apply principles of competitive neutrality and assess capital proposals in a transparent manner.

WORK PROGRAM FOR 2012-13

The AER's work program reflects both our strategic priorities and wider ongoing functions in the energy sector.

1. Regulating energy networks

The AER sets the prices for using electricity networks in Queensland, New South Wales, Victoria, South Australia, Tasmania, and the ACT; and prices for gas pipelines in jurisdictions other than Western Australia and Tasmania. We typically review a network's prices once every five years.

In 2012–13 we are reviewing, or commencing reviews of the prices charged by 14 energy networks. The reviews cover electricity poles and wires and gas pipelines, and include long distance transmission networks and local area distribution networks. 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.

The regulatory process begins with a network owner submitting a price application for the AER to assess. We consult widely on each proposal, and may commission the work of specialist consultants in some areas.

1.1 ELECTRICITY NETWORKS

The AER regulates the five networks forming the transmission grid in the National Electricity Market (NEM), covering southern and eastern Australia, as well as two cross-border 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' revenue requirements from network services to cover its assessment of 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 is for the AER to operate incentive schemes for operating costs and service performance, to identify efficient levels over time. In future, the AER will increasingly rely on benchmarking to assess efficient costs.

In *electricity transmission*, the AER sets a ceiling on the revenues a network can earn during a regulatory control period (typically five years) and then translates these allowances into network prices. The process begins thirteen months before the end of the current regulatory control period, when a business must submit 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.

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, there is a preliminary stage in which we consult on our framework and approach. This begins 24 months prior to the end of the current regulatory period and takes about five months. The AER must publish a final decision on a proposal at least two months before the beginning of the next regulatory period.

Our strategic priorities include refinements to the regulatory approach, aimed at promoting more effective regulation to serve the long term needs of energy consumers (see priority 1).

WORK PROGRAM FOR 2012–13

Figure 1 sets out the regulatory timelines for AER determinations on the revenues or prices of electricity networks. The AER in 2012–13 will:

- complete a review of regulatory proposals for the South Australian electricity transmission network (ElectraNet) for the five year period from 1 July 2013; and the Murraylink interconnector between Victoria and South Australia for the 10 year period commencing 1 July 2013
- undertake preliminary work on a review of regulatory proposals for electricity distribution networks in New South Wales (AusGrid, Endeavour Energy and Essential Energy) and the ACT (ActewAGL), for the five year period from 1 July 2014. The AER is consulting publicly on its framework and approach to these reviews during 2012
- commence reviews of regulatory proposals for the Victorian transmission network (SP AusNet) for the five year period from 1 April 2014; and for the New South Wales and Tasmanian networks (TransGrid and Transend respectively) for the five year period from 1 July 2014.

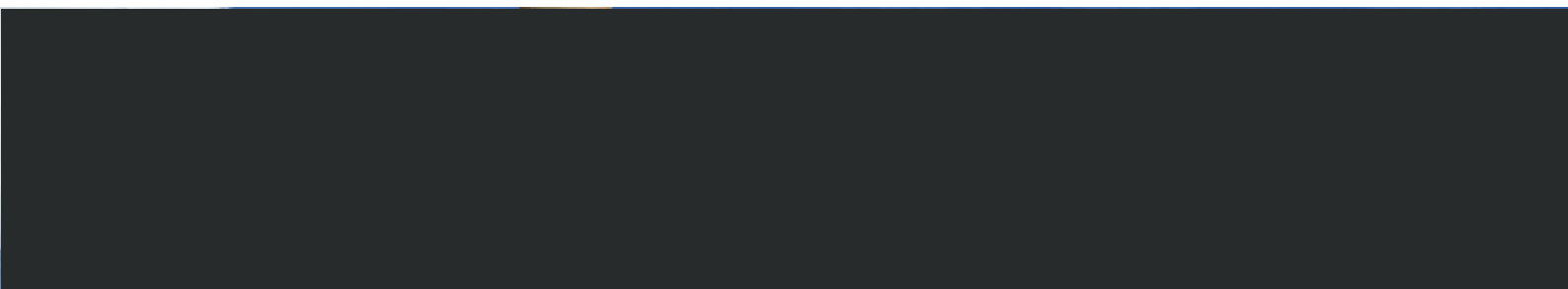
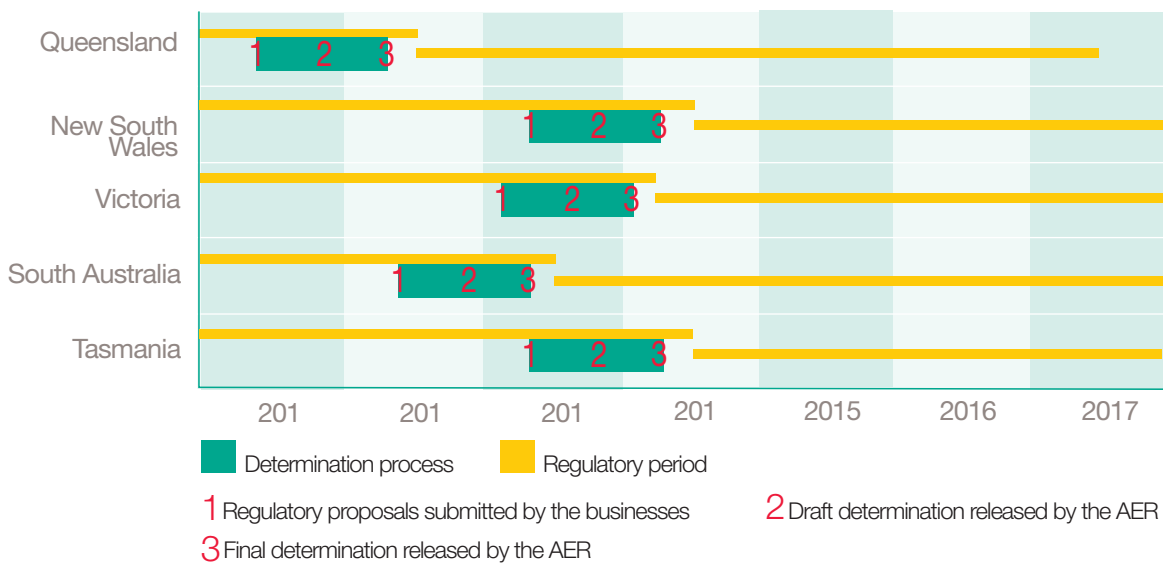
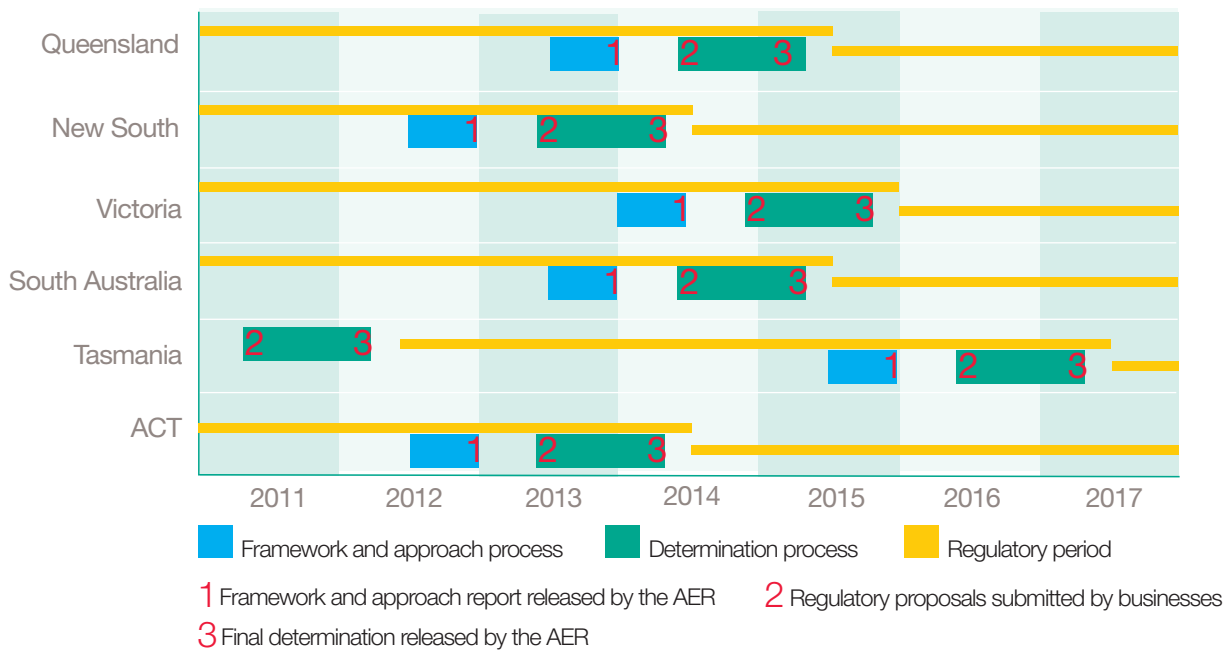


Figure 1 Timelines—AER determinations on regulatory proposals for electricity networks

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 Rules allow for income adjustments from incentive mechanisms to reward efficient operating practices.

WORK PROGRAM FOR 2012–13

Figure 2 sets out the regulatory timelines for AER determinations on access arrangement proposal for gas pipelines. The AER in 2012–13 will review access arrangements for:

- Victoria's transmission system (GasNet) and gas distribution networks (SP AusNet, MultiNet and Envestra) for the period 1 January 2013 to 31 December 2017
- the Roma to Brisbane Pipeline for the period 1 July 2012 to 30 June 2017.

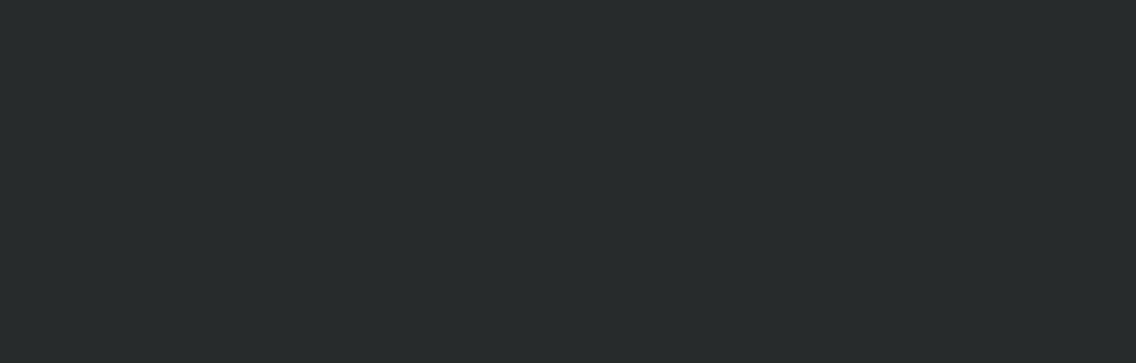
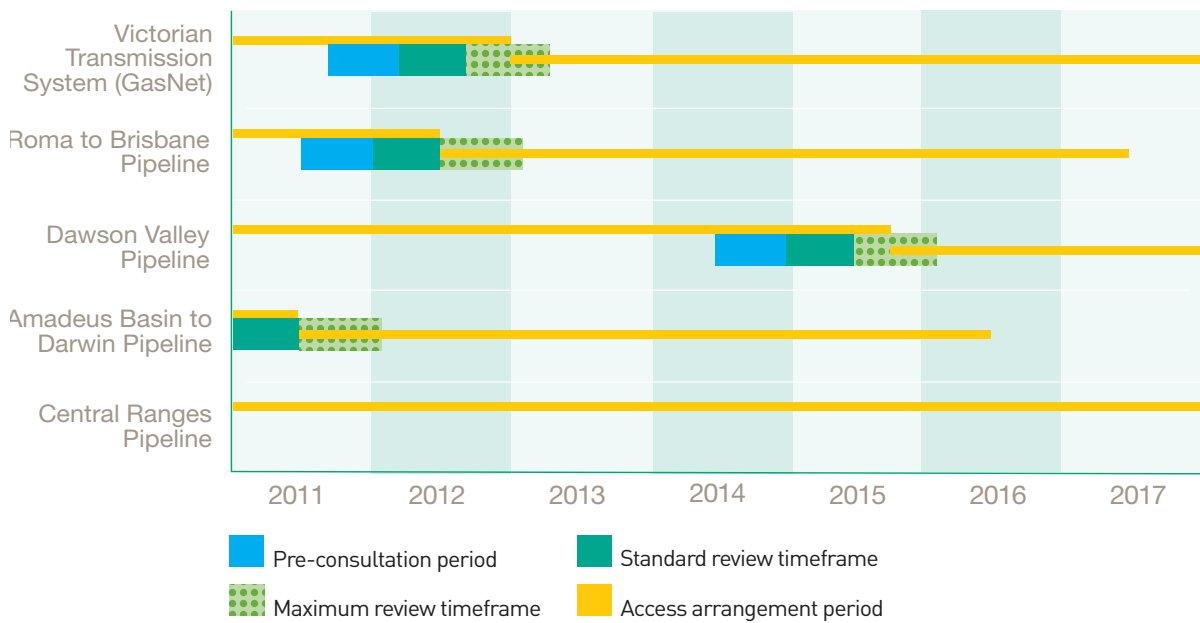
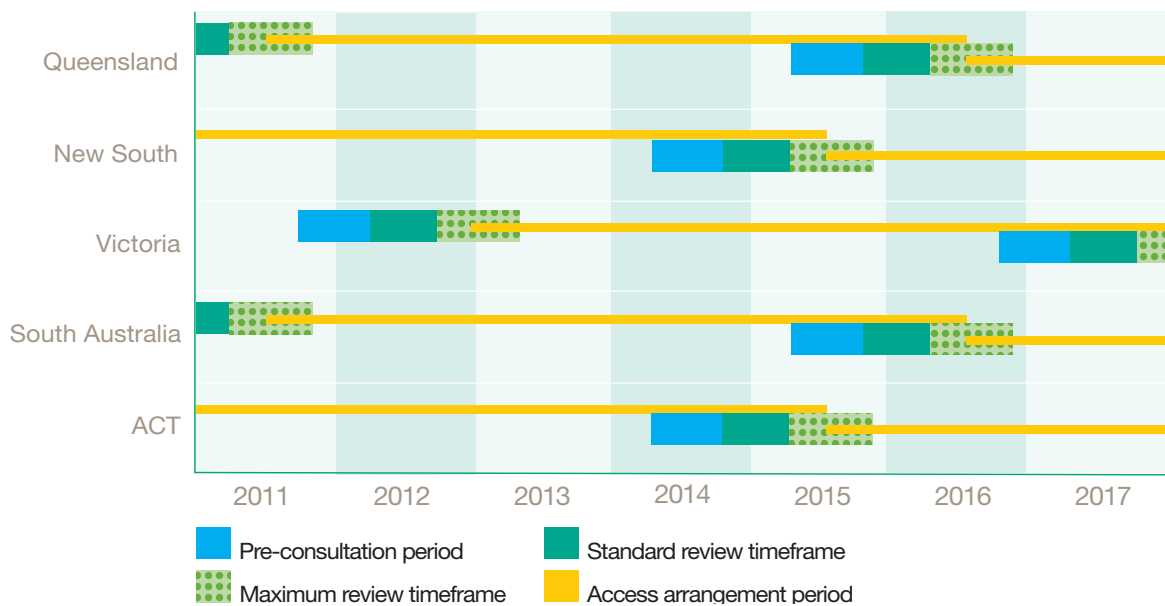


Figure 2 Timelines—AER determinations on access arrangement proposals for gas pipelines

Gas transmission



Gas distribution





1.3 MERITS REVIEW OF REGULATORY DECISIONS

The AER's decisions are subject to a limited merits review by the Australian Competition Tribunal. The AER must assist the Tribunal in undertaking its reviews.

In December 2011, the Standing Council on Energy and Resources (SCER) brought forward a legislated review of the merits review regime. The review is scheduled to be completed by 30 September 2012. The AER will participate in the review by making submissions and assisting the review panel as required.

1.4 OTHER REGULATORY WORK

In addition to revenue determinations, the AER undertakes other functions associated with economic regulation. We assess network proposals on prudent discount applications, cost pass-throughs, revenue re-openers and contingent projects; develop and apply service incentive regimes and ring fencing policies and other regulatory guidelines; assist in access and connection disputes; and undertake annual tariff reviews for distribution businesses. The AER monitors the compliance of network businesses with the energy legislation and rules, and reports on outcomes, including in our quarterly compliance reports.

The AER publishes and periodically updates guidelines on our approach to network regulation. In 2012–13 we will continue our consultative process on the development of ring fencing guidelines for electricity distribution businesses. Currently, there is a lack of consistency in ring fencing guidelines between the jurisdictions. The consultation process will guide the AER's evaluation of whether nationally consistent guidelines should be developed. We will also begin developing an investment test for electricity distribution (RIT-D), pending the AEMC finalising the relevant rules.

In addition to our work under the national energy legislation, the AER undertakes certain regulatory functions in electricity and gas distribution under state and territory legislation. These roles (for certain jurisdictions) include performance reporting; resolving customer disputes on network access; and regulating the capital contributions of customers connecting to distribution networks.

The AER is also responsible for determining revenues and charges 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. In addition, the AER administers a fire factor (f-factor) scheme imposed by the Victorian Government on the five Victorian electricity distributors. The scheme provides financial incentives and penalties to reduce the risk of fire starts and loss or damage caused by fire starts.



2. Regulating retail energy markets

The AER will be ready to assume new regulatory responsibilities in retail energy markets from 1 July 2012. The transition date will vary between participating jurisdictions—Queensland, New South Wales, Victoria, South Australia, Tasmania and the ACT.

Our new functions include:

- providing an energy price comparator website (www.energymadeeasy.gov.au) for small customers, from the commencement of the Retail Law
- enforcing compliance with the Retail Law and supporting Rules and Regulations
- authorising 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
- administering a retailer of last resort scheme, to protect customers and the market if a retail business fails
- reporting on retailer performance and market activity, including on energy affordability, disconnections and competition indicators.

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

Following the launch of *Energy Made Easy*, we will monitor retailers' compliance with their obligations to provide relevant information, consult with consumer groups on the website's effectiveness, and make progressive refinements to assist small customers. We will also make continued enhancements to the new AER website (www.aer.gov.au) launched in May 2012, to maximise ease of use and consumer accessibility.

The discussion of our strategic priorities outlines other aspects of our work program in the retail space during 2012–13.

3. 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 the markets, and where appropriate takes enforcement action for breaches.

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 2012–13 we will continue to publish weekly reports on:

- wholesale market activity in the NEM; including discussion of prices above \$250 per megawatt hour and prices below—\$100 per megawatt hour; we also publish more detailed analysis and reporting of prices above \$5000 per megawatt hour
- activity in the Victorian gas market and gas short term trading market (operating in Sydney, Brisbane and Adelaide). We also publish more detailed reports on significant price variations in the Victorian market and short term trading markets. We aim in 2012–13 to finalise a guideline 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 inefficient outcomes (such as market manipulation). The outcomes of this monitoring inform submissions and other contributions to work undertaken by the Standing Council on Energy and Resources, AEMC, and other bodies.

COMPLIANCE

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

- monitoring 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; in 2012-13 we will continue to audit the systems of pipeline operators to submit timely and accurate data
- audits of compliance programs for technical performance standards; the audits in 2012–13 will continue to focus on the compliance programs of generators and network businesses to meet these standards
- forums and other meetings with industry participants to discuss our approach to compliance
- publishing quarterly wholesale market compliance reports (an accessible summary of our compliance activities) and compliance bulletins (when additional guidance on the rules is warranted).

ENFORCEMENT

We will engage with stakeholders to continue 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 good compliance and strive for a proportionate response to breaches, taking account of the impact of the breach, its circumstances, and the participant's compliance programs and compliance culture. We will also continue our focus on specific projects aimed at reducing identified harm issues in the market.

4. Publications and communications

The AER publishes determinations, guidelines, bulletins and reports related to our work program. 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 launched a new website and newsletter in 2012 to enhance our communication with stakeholders.

All publications are available on our website (www.aer.gov.au).

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 industry. 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.

AER WEBSITE

The AER's new website (www.aer.gov.au), launched in May 2012, provides more accessible information, improved search functionality and a specific portal for energy customers. It also allows market participants and the wider community to access long-term statistics on energy market activity. A self-managed subscription service will enable targeted and effective communication with stakeholders.

AER ENERGY UPDATE—NEWSLETTER

The AER published its first newsletter, *AER Energy Update*, in May 2012 to enhance our communication with stakeholders. The newsletter will provide timely information to stakeholders as the need arises, and will have a strong focus on retail issues.

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, and focus 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 schemes.

During 2012–13, the AER will develop performance reports on all electricity transmission networks in the NEM. This reporting will be progressively extended to the electricity distribution sector during 2012–13.

We also expect to begin performance reporting on the retail energy sector from 2013.



AER head office contact details

STREET ADDRESS

Level 35
360 Elizabeth Street
Melbourne VIC 3000

POSTAL ADDRESS

GPO Box 520
Melbourne VIC 3001

PHONE AND FAX NUMBERS

Tel: (03) 9290 1444
Fax: (03) 9663 3699

EMAIL

AERInquiry@aer.gov.au

WEBSITE

www.aer.gov.au

www.aer.gov.au