

RECOMMENDATION REPORT - REVIEW OF GAS TRADING AND DISTRIBUTION LICENCES

October 2006

Economic Regulation Authority



WESTERN AUSTRALIA

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1 Executive Summary

The Economic Regulation Authority (**Authority**) is undertaking a review of gas trading and gas distribution licences, granted pursuant to the *Energy Coordination Act 1994 (Act)*. The review is being undertaken consistent with best practice design for regulation.

With the establishment of the electricity licence regime in January 2005 and the progressive grant of electricity licences from June 2005 onwards, there currently exist material differences between the terms and conditions of gas and electricity licences.

Consequently, the Authority proposes to modernise gas trading and distribution licences by making licence terms and conditions consistent, to the extent practical, with those for electricity as well as recognising energy licensing developments occurring at a national level.

As part of its review of gas trading and gas distribution licences, the Authority has proposed 85 recommendations to improve their efficiency and effectiveness. These recommendations are discussed in detail in Parts 4-7 and 9-11. In general, recommendations propose that gas trading and distribution licence terms and conditions are amended to reflect equivalent electricity licence terms and conditions. The proposed new gas licence templates are attached to this report.

The Authority has discussed the recommendations put forward in this report with members of a Gas Industry Reference Group (Reference Group) which included representatives of existing gas licensees, the Office of Energy, *EnergySafety* and the Western Australian Council of Social Services (WACOSS). The Reference Group has generally supported the recommendations.

Consistent with the Authority's Public Consultation Guidelines for Electricity, Gas and Water Licences, the public is provided with 20 business days to comment and unless otherwise requested in the public submissions received, all public submissions will be posted on the Authority's website at <http://www.era.wa.gov.au>.

Once the closing date for public comment has elapsed (16 November 2006), the Authority will consider the comments and prepare and publish the final licence templates. Depending on the outcome of the public consultation process, the Reference Group may be reconvened to consider issues raised and the Authority's proposed response.

2 Review Scope, Objectives & Process

2.1 Scope

The scope of the gas licence review is to examine:

- terms and conditions contained within a gas trading licence (Part 5);
- terms and conditions contained within a gas distribution licence (Part 6);
- mandatory licence conditions contained within the Act (Part 7);
- the applicability of constituted Supply Areas (Part 8);
- the need for licence exemptions (Part 9);
- applicable licence fees (Part 10); and
- key differences between gas and electricity licensing (legislative) frameworks (Part 11).

The review does not involve consideration of:

- *Energy Coordination (Gas Tariffs) Regulations 2000*; and
- Western Australian Gas Retail Market Rules,

as these matters operate outside of the gas licence framework.

2.2 Objectives

Since the first gas trading and distribution licences were issued in 2000 at the time the Government-owned Gas Corporation was privatised, there has been no comprehensive review of the terms and conditions contained within gas trading and distribution licences nor the licensing framework.

The Authority's review objectives are to:

- reflect the current regulatory environment and promote consistent licence regulation across the energy sector;
- enhance consumer protection, including providing scope for improved compliance;
- reduce the regulatory burden on business, particularly by removing spent, redundant or inappropriate licence provisions and thereby reducing compliance costs; and
- utilise best practice principles of utility licensing.

2.2.1 Reflecting current regulatory environment and promoting consistent licence regulation across the energy sector

In July 2003, the Government commenced a comprehensive reform of the State's electricity market, including establishing a regulatory framework applicable to the supply of electricity.

A new electricity licence regime was established, under the *Electricity Industry Act 2004 (EIA 2004)*, in January 2005 with the first licence issued in June 2005. As at 1 July 2006, 39 electricity licences have been granted providing for the generation, transmission, distribution and retail of electricity.

Presently, all existing gas licensees, their parent companies or associated subsidiaries, hold electricity licences. However, there exist material differences in the form, content and structure of energy licences.

The electricity licence framework was and is being developed by the Authority involving extensive public consultation. Effectively, this framework consists of:

- application guidelines;
- template electricity generation, transmission, distribution, generation and integrated regional licences;
- public consultation guidelines;
- customer service charter guidelines;
- licence compliance reporting guidelines;
- compliance reporting manuals;
- asset management guidelines (electricity, gas and water licences); and
- guidelines for conducting operational audits and asset management system reviews (electricity, gas and water licences).

Electricity licences, relative to gas, are minimal and far less prescriptive. In contrast to gas, the electricity model is characterised by the use of extrinsic industry codes which are imposed by Government as licence conditions.

Once imposed, the Authority monitors and enforces code compliance through the licence framework. Electricity industry codes relevant to the licence framework established to date are:

- *Code of Conduct for the Supply of Electricity to Small Use Customers 2004*;
- *Electricity Industry Customer Transfer Code 2004*;
- *Electricity Industry Metering Code 2005*; and
- *Electricity Industry (Network Quality and Reliability of Supply Code) 2005*.

As a result of codification, the electricity licences typically deal with procedural or compliance matters such as transfer, cancellation and amendment of licence, asset management, performance audits and individual performance standards.

In contrast, current gas licences deal with a number of day to day operational matters in a prescriptive manner such as obligations to offer to supply, maintain supply, connect supply etc.

It is a key objective of the gas licence review to modernise the gas licences consistent with Western Australian electricity licences in order to reflect current regulatory practice.

2.2.2 Enhancing consumer protection, including providing scope for improved compliance

The Authority proposes to enhance consumer protection, including improving compliance through consistency of gas and electricity regulatory practice. The Authority proposes to achieve this by establishing consistent:

- energy licence application guidelines;
- public consultation processes;
- performance audit and asset management guidelines;
- arrangements relating to standard form contracts; and
- standardising terms and conditions applicable to both gas and electricity licences on such matters as performance and financial reporting.

Standardisation of licensing arrangements:

- promotes confidence in the regulatory regime by providing for consistency of application within the energy sector;
- minimises regulatory costs by avoiding duplication of compliance activities where possible;
- enables regulatory capability to be developed within industry and the Authority, which is transferable between the gas and electricity sectors; and
- provides for consistency of supply arrangements and standards applicable to energy customers such that one type of customer does not have lesser rights than the other.

A good example as to how standardisation across utilities can work in practice is the Western Australian Energy Ombudsman scheme. A Gas Industry Ombudsman scheme was created in 2004 and extended to include electricity in 2005 thereby creating an Energy Ombudsman scheme which:

- satisfies the individual statutory requirements of the Act and Energy Industry Act 2004;
- enables capital and operating costs to be spread over both sectors;

- enables the Authority to streamline the regulation of the energy sector through the administration and enforcement of a single Ombudsman scheme; and
- benefits consumers by providing for a one-stop-shop approach to resolving energy disputes.

2.2.3 Reducing the regulatory burden on business, particularly by removing spent, redundant or inappropriate licence provisions and reducing compliance costs

The initial gas trading and distribution licences were granted in 2000 in a climate of privatisation and a progressively liberalised gas retail market. In the period 2003-04, the Act was amended and various pieces of subsidiary legislation enacted to protect customers and facilitate the introduction of full retail contestability, which occurred on 31 May 2004.

With the passage of time and the reform of the gas and electricity markets, the current gas licences contain a number of provisions which the Authority considers are either spent, redundant or inappropriate. Examples include:

- a distribution licence containing third party access provisions (clause 9) notwithstanding the enactment of the *Gas Pipelines Access (Western Australia) Act 1998*;
- a distribution licence containing provisions (clauses 17, 18, Schedules 4, 5 and 6) which are redundant following the enactment of the *Gas Standards (Gas Supply and System Safety) Regulations 2000*;
- a trading licence containing provisions (clause 7) relating to the marketing of gas notwithstanding the enactment of the *Code of Conduct for Marketing of Gas to Small Use Customers*; and
- provisions requiring the Authority and a licensee to meet to review a gas trading and distribution licence within prescribed time periods (clause 6) notwithstanding that the parties can do this at any point in time.

These matters are discussed further in Parts 5 and 6.

2.2.4 Utilise best practice principles of utility licensing

The Authority utilises best practice principles of utility licensing which are based on the Authority's experience and the views of others, such as the Organisation of Economic Cooperation and Development, Australian Competition and Consumer Commission and Taskforce on Reducing Regulatory Burdens on Business¹. The Authority has prepared a draft paper on best practice utility licensing² and subsequently is encouraging interested parties to make submissions to the Authority on the proposed characteristics of effective licensing as described in this paper. It is considered, for example, that best practice licensing principles include:

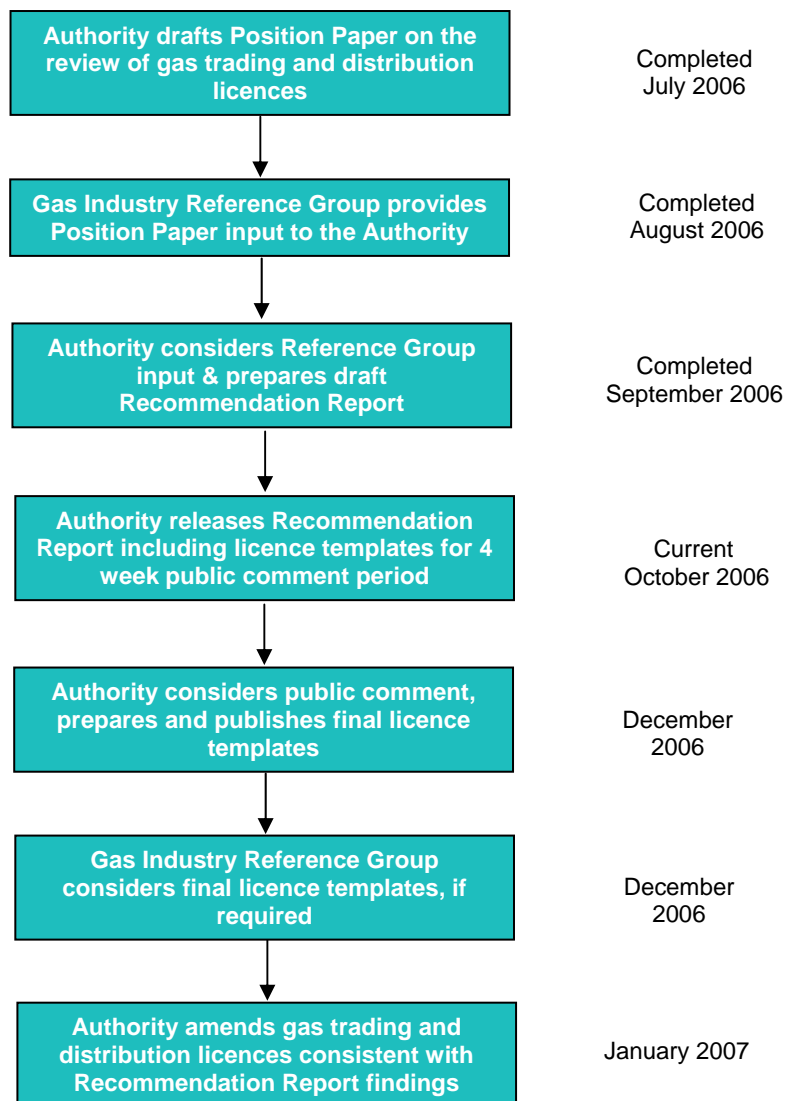
¹ Regulation Taskforce 2006, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January.

² Economic Regulation Authority, *Best practice licensing*, Economic Regulation Authority, October 2006.

- Maintaining service standards. A licensing regime should include processes that maintain the licensee's focus on service standards to customers. To maintain service standards, the Authority ensures its processes are consumer focussed, consistent across industries and based on consultation with consumer representatives. In this review, it is recommended to make gas licence service standards consistent, where possible, with electricity licence service standards.
- Minimising regulatory risks. To minimise regulatory risk, the Authority ensures its decisions are predictable, consistent, timely, transparent and based on effective consultation. In this review, it is recommended to minimise regulatory risks through standardisation of licensing provisions. The Authority is also seeking public comments on these recommendations.
- Minimising compliance costs. A licensing regime should aim to achieve its policy objectives at least cost to the licensee. To minimise compliance costs, the Authority ensures its processes incorporate simple and targeted language, are consistent with other laws and integrated across jurisdictions, are flexible and are formulated with input from interested parties. Further, licensing requirements should be proportionate to the problems that exist, not unduly prescriptive and the minimum necessary to achieve the objective. In this review, it is recommended to reduce compliance costs by deleting and or amending unnecessary licence provisions. As above, the Authority seeks input from interested parties as to the reasonableness of these recommendations.

2.3 Gas Licence Review Process

Figure 1: Process for reviewing and amending gas trading and distribution licences



The gas licence review began with the drafting of a Position Paper in July 2006. The Authority discussed the proposed recommendations put forward in the Position Paper with the Gas Industry Reference Group (**Reference Group**) in August 2006.

The Reference Group was chaired by the Secretariat of the Authority and its membership consisted of:

- existing licensees (AlintaGas, Wesfarmers Kleenheat Gas and BRW Power Generation (Esperance) Pty Ltd);
- Office of Energy;
- Western Australian Council of Social Services; and
- Energy Safety.

The Reference Group's role and function was to provide input from:

- existing and prospective gas licensees;
- Government policy makers;
- consumer representatives; and
- gas safety and technical regulators.

The Reference Group generally accepted the proposed recommendations with a few minor alterations to recommendations 22, 23, 25, 26 and 38. The Authority has subsequently revised the recommendations and produced this Recommendation Report for wider public consultation.

For the purposes of accountability and transparency, the discussion section preceding each revised recommendation includes relevant comments from the Reference Group to explain any revisions made.

In addition, the proposed gas trading and distribution licence templates following the recommendations are provided in appendices 5 and 6, respectively.

3 National Gas Licence Developments

As part of the review of gas trading and distribution licences, the Authority also met with the following regulatory bodies, in July 2006, in their respective States:

- Australian Energy Regulator (AER);
- Essential Services Commission South Australia (ESCOSA);
- Essential Services Commission Victoria (ESC);
- Queensland Government, Department of Energy; and
- Independent Pricing and Regulatory Tribunal (IPART) New South Wales.

Key outcomes of those discussions are set out below.

3.1 Why the need for gas licences

- The essential nature of a gas service, once connected, and the potential impact upon consumers in the event of market failure, requires an effective regulatory regime that is flexible and dynamic to respond to changing market circumstances.
- Licensing is seen as an efficient and minimally necessary way to monitor and enforce gas service standards and promote compliance.
- Licensing is perceived to be more responsive to changes in market circumstances relative to Acts of Parliament or regulations.

3.2 How can gas retail and distribution licence frameworks be improved?

By far the most consistent response from Eastern State regulators is the need for consistency between gas and electricity frameworks (terms and conditions, industry codes of practices, licence guidelines etc) *within* each State as well consistency *between* the States.

Regulators considered the key issues affecting their licence frameworks are:

- Regulatory duplication.
- Large amount of regulatory instruments and the need to combine/consolidate mechanisms on such matters as energy reporting manuals, industry codes of practice etc.
- Timeframes and processes to make changes to licensing frameworks, especially with respect to legislation.

Other matters raised are:

- Better definition of “entry test” (i.e. who should be licensed and who should not).

- Information reporting requirements contained within a licence being clarified and justified.
- The ability to recognise good compliance (i.e. the extent to which a licensee was required to comply with entry level licence obligations (financial and technical) over the life of the licence).
- Greater clarity of information gathering and licence revocation powers.

3.3 What aspects of licensing frameworks are operating effectively?

- Consistency of gas and electricity licence conditions.
- Guaranteed gas distribution service standards.
- “Light handedness” of licence terms and conditions combined with the use of codes of practice developed in collaboration with industry and other key stakeholders.
- Effective dispute resolution characterised by the use of Energy Ombudsman schemes.
- Streamlined reporting requirements.
- Use of regulatory forums to ensure open communication and dialogue between regulators on a regular basis.

3.4 What are the key licensing issues under consideration and what are the emergent trends?

Issues currently being addressed by Eastern State licence regulators include:

- Gas full retail competition.
- Privatisation of State owned assets.
- Transfer of regulatory functions to the AER.
- Licensing of reticulated LPG systems.
- Marketing practices of new retail market entrants.
- Third-party sub-contracting, such as on-selling, to potentially avoid licence obligations.
- Disconnection provisions and hardship arrangements as potential barriers to entry for smaller market participants.
- Consistency of customer protection arrangements across utilities (energy, telecommunications and water).

- Number and frequency of customer disconnections.
- Customer mobility (customer churn and non-churn, i.e. move-in/move-out arrangements).
- Licensing costs (i.e. system costs incurred by licensees, especially incumbents, in having to comply with new reporting and billing arrangements).

3.5 Conclusion

Based upon the Authority's review including its discussions with Eastern State Regulators, the Authority is of the view that there is a demonstrated need for gas licensing regulations, these regulations being the minimally necessary to achieve their regulatory objective. The proposed recommendations are generally consistent with Eastern State energy licensing frameworks and trends.

