

## OFFICE OF ENERGY SUBMISSION:

### ECONOMIC REGULATION AUTHORITY – BEST PRACTICE UTILITY LICENSING

#### 1. Licensing Objectives

Licensing is acknowledged as an effective and appropriate form of market intervention so long as the market failure has been clearly identified and the costs and benefits of licensing have been quantified and assessed against other, less intrusive forms of market intervention.

There needs to be a transparent and outcome-based process for determining what activities should be licensed, and if so, whether there is a net benefit in licensing all parties that undertake the activity or only those able to exert significant impact in the market. Licensing regimes impose significant administrative and compliance costs on both the licensor and the licensees, and there are circumstances where it may be more appropriate to simply regulate the behaviour of persons engaging in an activity rather than license them.

The existence of "asymmetric information" is not, of itself, adequate justification for licensing. Such asymmetry is inherent in the supply of any specialist service, yet many industries supplying such services (eg accountancy services, engineering services, car mechanic services, naturopath services) function effectively without the need for a licensing regime. If consistently applied on such grounds, it would be difficult to demonstrate a net benefit in licensing all suppliers of services where the seller has better information than the buyer.

Frameworks of industry self-regulation and consumer protection legislation are in many cases a less costly and equally effective alternative to licensing, offering fewer barriers to competition and a lower administrative burden. Regular review of licensing regimes is essential to ensure that licensing remains the most effective remedy to the perceived market failure and to evaluate the relative costs and benefits of alternative remedies.

It has become apparent that existing licensing arrangements in the energy industry have had unintended practical consequences. In particular, the current licensing regime inadvertently captures "incidental" distributors and sellers of electricity and gas such as owners/managers of commercial/industrial complexes (eg. shopping centres, ports, office blocks) and group housing facilities (eg. caravan parks, aged care facilities, apartment blocks). It would be appropriate for the Authority to formally bring such matters to the attention of the Government to address through policy and legislative amendment rather than generate a significant level of demand for licence exemptions.

There are many disadvantages in using licence exemptions to compensate for unnecessary or inappropriate licensing requirements, especially when some form of consumer protection in the form of exemption conditions is required. Exemptions in such cases become a form of "defacto" licensing but without effective means of enforcement and many negative flow-on effects for consumers.

There is a need to consider the disadvantages and advantages of relying on general consumer protection laws as opposed to using energy-specific licensing requirements to achieve a desired objective. At the current stage of market development, in terms of actual competition, and the relative level of experience

consumers have in contracting for energy services; it is suggested that an energy-specific approach is more appropriate for the time being. However, such an approach might be to regulate the behaviour of "incidental" energy suppliers through regulation rather than licensing.

## **2. Characteristics of an Effective Licensor**

The Office of Energy regards the Economic Regulation Authority as an important contributor to the electricity and gas sectors and acknowledges the importance of maintaining its independent status.

It is agreed that the effectiveness and credibility of a licensing regime is enhanced by its administration by an independent regulator. The Office of Energy agrees with the Authority's statement that "the principle of independence in the regulation of utilities may be compromised where the licensing and policy setting function both reside in the same Government agency".

There is a need to make a clear distinction between the role of Government as the body responsible for the development of high-level policies that determine the scope of rights and obligations under the licensing regime; and the role of the regulator who administers and enforces the licensing regime.

It is essential that an independent regulator enforces regulation transparently and objectively, "without fear or favour". It is equally essential that Government does not abrogate its responsibility to govern by delegating to the independent regulator decision-making powers that more properly should be exercised by Government and subjected to public scrutiny. Ideally, the independent regulator should enforce standards and conditions that are set by the Government acting in the public interest.

It is recognised that the Authority, in undertaking its licensing functions, seeks to act in the long-term interests of consumers, but there is no discussion in this paper of how these interests are determined or by whom.

While the Authority's contention that Governments may sometimes give priority to short-to-medium term policy objectives may have some legitimacy, it is not reasonable to assume that those objectives are necessarily inconsistent with the long term interests of consumers. Indeed, the Government has a responsibility to develop and implement policies to achieve long term objectives in the interests of consumers, and has demonstrated its commitment to these interests by the establishment of the Economic Regulation Authority and the Energy Ombudsman. This is in addition to the full framework of consumer protection legislation administered by the Department of Consumer and Employment Protection.

The Office of Energy believes that the determination of what is in the long-term interests of consumers should be the responsibility of Executive Government, which is able to balance competing objectives to achieve a net public benefit. The Government is held directly accountable for its decisions through Parliament and the electorate. The Authority may be accountable for its decisions via a review by an independent appeals body when a party affected by a decision institutes an appeal. However, the Authority is not held directly accountable by the public.

Finding the appropriate balance between prescribing the Authority's functions and factors to consider while acting as licensor, and providing a degree of discretion to the Authority to allow it to respond to emerging needs in an efficient and effective manner; can only be achieved over time. Given that the gas and electricity markets are still in their early stages of development, in terms of actual levels of competition, the Office of Energy believes that this is still an evolutionary process.

It is likely, in the implementation of its functions, that the Authority will discover areas where there is a need to develop policy that balances potentially competing needs of different stakeholders, or a need to make subsidiary legislation that will have significant impacts on energy consumers, suppliers or the welfare of the State. For example, the Authority's Recommendation Report for its Review of Gas Trading and Distribution Licences suggests the creation of a consolidated Energy Code for the supply of gas and electricity for small-use customers.

In such cases, the appropriate course would be for the regulator to advise the Government that there is a need for policy clarification or regulatory amendment. Such clarification or subsidiary legislation would then be developed in accordance with the usual processes of Government. This will avoid the risk of the regulator making decisions and approving subsidiary legislation that unintentionally thwart Government policy objectives, introduce policy conflicts, or expose the Government to significant funding liability without the appropriate checks and balances provided by the Cabinet and Expenditure Review Committee processes.

Once the Government has undertaken the appropriate analysis and consultation, it can develop a clear policy and regulatory response for the regulator to implement.

### **3. Characteristics of Effective Licensing**

#### *Service Standards*

Where licensing is undertaken as a way of enforcing particular service standards, understanding the cost impact of such standards is fundamental to making effective decisions. Where a regulator is in a position of determining both licence conditions, including service standards, and regulated revenue (e.g. through Access Codes) it is important that the licensing function responsible for determining and enforcing service standards consults with the revenue determination function to ensure a balance between standards and costs to consumers.

It is not in the long term interests of consumers to increase service costs by demanding unreasonably high standards that provide real benefits to only a minority of consumers. Standards should be outcome-focused and provide practical "value for money" to consumers.

#### *Consistency*

Consistency of levels and standards of regulation across sectors may be a desirable outcome, where it can be demonstrated that this will provide enhanced levels of certainty and predictability.

Duplication should be avoided where practicable. However, it should be noted that duplication is not necessarily undesirable unless it truly creates increased burdens and/or inconsistency.

If consistent with their generic sources, the duplication of consumer protection measures in energy-specific subordinate regulation will not impose any additional burden on a licensee. The advantage of this approach is that it provides industry and consumers with a single, consolidated reference for customer protection and marketing conduct, rather than a series of cross-references to numerous provisions within legislation and/or subordinate regulation. In this sense, duplication can make such items of regulation more self-explanatory and easier to understand and interpret.

### *Consultation*

In areas where the Authority must make decisions on licensing matters that require consultation, it is important that the consultation process results in advice to the Authority that is independent of the Authority.

It is desirable for the Authority to obtain a wide cross-section of views to inform balanced decision-making and to reduce any possible distortion resulting from excessive influence by particular stakeholder groups.

However, ultimately, the Authority, like the Government, must make its decisions based on a variety of sources, including independent research and analysis. A negotiated outcome may not deliver the best result when the negotiations are held between a limited number of parties representing only some of the stakeholders who will actually be affected.

### *Minimising Compliance Costs*

Where an issue under consideration can be regarded to be relatively minor (e.g. a name change for a licensee) and will have little impact on services and/or consumers; there is a need to ensure that the licensing processes are timely, as these matters can affect a business' ability to conduct its operations. This may require reconsideration of which aspects of the licensing process acquire additional value through consultation processes, and in which cases such processes merely add to the cost and time required to make relatively minor changes to licences without compensating value in terms of public input.

There is a need to ensure that the license fee structure does not have perverse incentives (i.e. those that may discourage expansion) and recognises the profitability or otherwise of the industry. For instance, making the fee structure consistent between gas and electricity licences would not recognise that there may be differences in profit margins from retailing electricity to residential customers as compared to retailing gas to residential customers.

On the other hand, there should not be cross-subsidy between one industry and another with respect to licensing administration costs.

If the costs of licensing increase to the point where the licence fees necessary to cover those costs start to impose a significant burden on the industry, then the Authority should revisit the cost/benefit considerations of licensing those businesses.

Where licensing costs can be passed through to customers, then the additional cost to consumers should be outweighed by the benefits to those consumers of the licensing regime. Where increased licence costs can not be passed through to customers (eg in a capped tariff environment), then there may be a significant disincentive to expanding services, which itself may not be in the long term interests of consumers. It may prove to be more practical and cost effective not to licence these entities but to simply regulate their behaviour.

The Authority's current procedures for the notification of its reviews, release of its papers and decisions and publication of submissions is appropriate.

#### *Conclusion*

The Office of Energy agrees with the Authority's conclusion on best practice utility licensing. It supports the Authority in its endeavours to ensure that this best practice is implemented in Western Australia with respect to energy supply.