



Strategic Government Response to the Review of the *Essential Services Commission Act 2001*

March 2007

Introduction

In August 2006, the Government commissioned Mr Roger Beale, AO, to conduct a review of the *Essential Services Commission Act 2001* (the ESC Act). Section 66 of the ESC Act stipulates that the review had to be undertaken by 31 December 2006. Mr Beale received various submissions and consulted widely with relevant stakeholders during his Review. Mr Beale reached 15 conclusions and made 28 recommendations in his report to the Government.

Victoria leads in the economic regulation of essential services

For many years Victoria has played a leading role in both determining competition reforms and in implementing them. The Essential Services Commission (the Commission) and its predecessor, the Office of the Regulator General, have been integral to delivering improved essential services to Victorians at minimal cost. In its 2005 *Review of National Competition Policy Reforms*, the Productivity Commission noted that gas and electricity prices have fallen in Victoria since the introduction of an independent regulator and the relative price fall was larger in Victoria than other jurisdictions. In 2006, Access Economics evaluated the design of economic regulation of key infrastructure and ranked Victoria as the best jurisdiction in Australia.

The Commission regulates a number of industries including gas, electricity, water, ports, rail, grain handling, insurance and transport. Over the past few years, there have been some major developments in the national approaches to regulation of these industries. The details of many of these reforms are still to be determined.

In February 2006, the Government signed the Council of Australian Governments' *Competition and Infrastructure Reform Agreement* (CIRA). Through a number of reforms, this agreement provides for a simpler and consistent national system of economic regulation for nationally-significant infrastructure, including for ports, railways and other export-related infrastructure.

In addition, the Government is committed to the broad ranging reforms being progressed by the Ministerial Council on Energy, including the transfer of transmission, distribution and retailing of electricity and gas to the Australian Energy Market Commission and the Australian Energy Regulator from 1 January 2008. National legislation to give effect to these changes is expected to be introduced into Australian Parliaments in the second half of 2007.

The Government has also agreed, through the Council of Australian Governments, to the National Water Initiative, which sets a wide range of measures and desired outcomes for the management of water allocation and distribution. These measures include the use of independent bodies to set and review water prices, a role performed in Victoria by the Commission.

Background to the Review of the ESC Act

Mr Beale was required to assess whether the objectives of the ESC Act are being achieved and are still appropriate and whether the ESC Act requires amendment to further facilitate the objectives. Mr Beale concluded that "...Victoria can be proud of its regulatory framework, including the ESC Act and the work of the Commission under that Act. Consumers have benefited from falls in the real price of essential services and in many cases improved quality and reliability."

While the Review concluded that the objectives of the ESC Act are being achieved, Mr Beale recommended a series of changes to the ESC Act to assist the Commission in continuing to achieve its objectives. Mr Beale's recommendations were also directed to ensure that the Commission has adequate guidance in forming its decisions and the necessary powers to gather critical information and enforce its decisions.

The Government considers it important to maintain regulatory certainty for regulated industries. With the changing regulatory environment nationally, the Government will wait for certainty on key issues nationally before proceeding with regulatory changes in Victoria, to ensure consistency is maintained and that industries have minimal changes to absorb. The Government also considers input from consumer groups vital when making the scope of changes recommended by Mr Beale.

The Government is keen to formulate a response to the Review which takes into account the following objectives:

1. Enhance Victoria's leadership in economic regulation across the States.
2. Continue to give priority to the needs of low-income and vulnerable customers.

3. Reduce the cost burden of economic regulation on regulated industries and, consequently consumers.
4. Preserve the independence of the Commission with an appropriate legislative framework which enables the Commission to perform its functions in a timely and effective manner.

The Government recognises the merit of many of Mr Beale's recommendations, several of which are primarily technical in nature and in line with good regulatory practice. The Government welcomes comments on all of the recommendations and conclusions made by Mr Beale, but specifically seeks comment on those discussed below.

Issues for Stakeholder Engagement

A new objective and pricing principles to replace facilitating objectives

Mr Beale has recommended a new objective for the ESC Act, which is more focussed on achieving efficiency (Recommendation 1), and replacing the facilitating objectives with a set of pricing principles (Recommendations 2 and 3).

In determining its position on these recommendations, the Government will examine the applicability of the objects clause and pricing principles developed in the CIRA. It is noted that the objects clause and pricing principles as recommended by the Review are drawn from the draft national energy legislation.

One implication of adopting literally Recommendations 1-3 or the CIRA text is the potential omission of a reference to the interests of "low-income or vulnerable customers". The Government is disinclined to remove the specific reference to "low-income or vulnerable customers" as inclusion of this wording in the ESC Act represented an important advance in the economic regulation of essential services in 2001.

The Government seeks the views of customers, stakeholders and regulated industries on these matters.

Providing the Commission with code-making powers

The Commission currently specifies obligations on regulated entities largely through the issue of codes. The Commission creates codes for the water industry through the *Water Industry Act 1994* and for the energy industries as part of the terms and conditions of licences. The Review has recommended that the Commission be given the explicit power to create relevant codes, and the power to apply appropriate penalties for breaches of these codes (Recommendation 5). The Review has also recommended that the Commission's code-making powers be subject to certain aspects of the regulatory oversight under the *Subordinate Legislation Act 1994* (Recommendation 5).

The intent of this recommendation is recognised as its adoption would lead to greater transparency and oversight of the Commission's regulatory powers.

The Government notes that under the rule-making power granted to the Commission under the *Victorian Renewable Energy Act 2006* the Commission is required to follow the consultation process outlined in its *Charter of Consultation and Regulatory Practice* and the rules are not subject to a regulatory impact statement process.

The Government welcomes views from customers, stakeholders and regulated industries on the impact this recommendation may have on the operations of regulated businesses.

Providing the Commission with access to third party and related contract information and clarifying release of commercial-in-confidence information

Recommendations 15 and 16 allow the Commission to gain information from entities associated with regulated businesses, and require businesses to demonstrate why commercial-in-confidence information should not be publicly released by the Commission (currently, the Commission has to demonstrate why it is in the public interest to release commercial-in-confidence information).

The Review's recommendations are consistent with the powers that the new Australian Energy Regulator will have, and are also consistent with information gathering provisions for the Australian Competition and Consumer Commission contained in the *Trade Practices Act 1974*.

The Government supports the intent of these recommendations, and considers it important that the Commission is provided with sufficient powers to achieve its objectives. However, the Government recognises that these recommendations could impact on regulated industries and seeks the views of customers, stakeholders and regulated industries on their possible impact and the best way to implement these recommendations.

Allowing limited merit appeals and requiring an appeal panel to be chaired by someone with judicial experience

In line with recent Council of Australian Governments' agreements and national energy legislation, the Review has recommended that limited merit appeals be allowed (Recommendation 19). To support this recommendation, the Review has also recommended that an appeal panel be chaired by someone with experience in contested hearings (Recommendation 20), and that the time for lodgement of an appeal be extended (Recommendation 22).

While the benefits of merit appeals have been thoroughly debated in the development of the national energy legislation, the Government believes it is important to review the benefits with regard to other regulated industries.

An increase in scope for appealing Commission determinations and decisions would involve many implementation issues, including a rethink of the current appeal panel pool arrangement. A high level of expertise would be required in an appeal panel that is expected to assess the Commission's application of complex methodologies. There would be cost implications for all parties, and possible time delays for Commission decisions.

The Government seeks views of customers, stakeholders and regulated industries on the appropriateness of merit appeals for regulated industries, any possible implementation issues and whether the benefits of changing the grounds for appeal outweigh the potential costs of implementation.

The Review's Recommendations

Towards a simpler legislative framework

Recommendation 1

Amend the primary objective in the ESC Act:

To promote efficient investment in, and efficient operation and use of, resources utilised by regulated industries for the long term interests of consumers with respect to price, quality, safety, reliability and security of supply,

to bring it into harmony with the provisions proposed for the National Gas and Electricity Laws.

Recommendation 2

Repeal section 8(2) of the ESC Act to remove the facilitating objectives.

Recommendation 3

Amend sections 33(3) and 33(4) of the ESC Act to replace the current provisions with provisions reflecting a requirement that in making pricing determinations the Commission:

- provide a reasonable opportunity for a regulated entity to recover at least the efficient costs of providing services that are the subject of the determination and complying with any regulatory obligation (including environmental, health and safety);
- provide effective incentives to a regulated entity to promote economic efficiency in the provision by the regulated entity of services that are the subject of a determination, including:
- the making of efficient investments in the assets owned, controlled or operated by the regulated entity and used to provide services that are the subject of a determination;

- the efficient provision by the regulated entity of services that are the subject of a determination; and
- the making of efficient use of existing assets and proposed new assets that are, or are to be, used to provide services that are the subject of a determination;
- make allowance for the value of assets, and the value of proposed new assets, that are, or are to be, used to provide services that are the subject of the determination;
- have regard to any valuation of the assets used to provide the subject services that has been applied in any relevant determination or decision;
- have regard to the economic costs and risks of:
 - the potential for under-investment and over-investment in assets by the service provider; and
 - the potential for under-utilisation and over-utilisation of the capacity of assets forming part of the service, and the capacity of proposed new assets; and
- not allow a vertically integrated service provider to set terms and conditions that discriminate in favour of its associated businesses in upstream or downstream markets, except to the extent that the cost of providing access to non-associates is higher.

Recommendation 4

Amend the ESC Act to require the Commission to have regard to the following factors in determining the form of regulation to be applied when making price determinations, determinations in relation to non-price terms and conditions of service and in providing advice on whether an essential service should be, or continue to be, regulated:

- barriers to entry;
- service externalities;
- countervailing market power;
- substitution possibilities;
- information asymmetry; and
- other factors considered relevant by the Commission.

Recommendation 5

Amend the ESC Act to provide the Commission with a power to make codes, as well as appropriate penalty provisions for their breach. The process for creating a code should be consistent with the Victorian *Subordinate Legislation Act 1994* requirement for the creation of statutory rules. This includes ensuring all new codes and amendments to existing

codes made pursuant to the ESC Act are subject to the normal regulatory impact statement process, and that they are disallowable by Parliament.

Recommendation 6

Repeal part 6 and sections 10A and 10B of the ESC Act and broaden section 41(1) to enable the Commission to provide advice to any Minister, after that Minister has obtained the written agreement of the Minister for Finance, and clarify that there is no restriction on industries or services on which the Commission may be required to give advice.

Recommendation 7

Amend section 44 of the ESC Act to allow the Minister referring an inquiry for research purposes or an inquiry not related to a regulated industry to determine the powers available to the Commission in conducting the inquiry.

Procedural requirements

Recommendation 8

Retain the power in the ESC Act of the Commission to adopt 'fit-for-purpose' approaches to price determinations and decisions.

Recommendation 9

Amend the ESC Act to include the following minimum procedural guarantees in the making of pricing determinations:

- the entitlement of the regulated entity to make a proposal in relation to revenue/pricing/non-price access conditions;
- the time within which any such proposal must be made;
- publication of the proposal and related information;
- an opportunity for stakeholder submissions in relation to the proposal and related information;
- publication of a draft decision and the giving of reasons by the regulator;
- the entitlement of the regulated entity to make submissions in relation to the draft determination which may include a revised proposal;
- an opportunity for stakeholder submissions in relation to the draft determination and any revised proposal; and
- the holding of a pre-determination conference.

Information gathering powers

Recommendation 10

Repeal section 36 of the ESC Act as it adds to the confusion about which information gathering powers apply to which regulated entities.

Recommendation 11

Insert a new section 36 into the ESC Act that enables the Commission to require regulated businesses to maintain and provide general regulatory information required by the Commission to carry out its functions. This would be similar to the provision currently contained within licence conditions that are in industry acts:

Regulated entities are to provide, in the manner and form specified by the Commission, such information as the Commission may from time to time require.

Recommendation 12

Clarify section 37 of the ESC Act to ensure that the detailed information gathering powers in section 37 apply to all regulated businesses, including licensees. This could be achieved by amending section 37 as follows:

...has reason to believe that a person (including a regulated entity)...

Recommendation 13

Amend the penalty provisions in section 44 of the ESC Act to ensure they are consistent with the penalty provisions in section 37.

Recommendation 14

Amend the ESC Act to require the Commission to have regard to:

- the relevance of the information it requires to be provided and the costs incurred by the information provider; and
- to the efficiency and effectiveness of the regulatory process and its objectives.

Recommendation 15

Amend the ESC Act to enable the Commission to obtain information from any person who may be able to provide information relevant to the functions of the Commission. This could be achieved by adding a sentence to the end of section 37 (1) stating:

This includes, but is not limited to, all regulated entities and associates of regulated entities.

Recommendation 16

Amend section 38 of the ESC Act to provide equivalent protection to that provided by section 95(ZN) of the *Trade Practices Act 1974*:

(1) *This section applies if a person claims that disclosure of the following information would damage the competitive position of the person:*

(a) *information made available, or to be made available, by or on behalf of the person (whether in oral evidence or in a written statement, submission or other document) at the hearing of an inquiry by the Commission or another body;*

(b) *information given, or contained in a document produced, by the person under section 95ZK to the Commission or another body.*

Commission or other body to take confidentiality steps

(2) *If the Commission or other body, as the case may be:*

(a) *is satisfied that the claim is justified; and*

(b) *is not of the opinion that disclosure of the information is necessary in the public interest;*

The Commission must take all reasonable steps to ensure that the information is not disclosed, without the consent of the person, in the proceedings or by it, to a person other than:

(c) *in relation to the Commission:*

(i) *a member of the Commission or an associate member of the Commission; or*

(ii) *a member of the staff of the Commission who receives the information in the course of his or her duties; or*

(d) *in relation to the other body:*

(i) *the person presiding at the inquiry concerned; or*

(ii) *a person providing assistance in the inquiry to the other body.*

Add a requirement that the Commission inform in writing the person supplying information for which a claim of confidentiality or commercial sensitivity is made if it wishes to disclose that information. The person should then have recourse to appeal the Commission's decision in accordance with the standard appeal provisions.

Recommendation 17

Amend the ESC Act to include a provision to enable the Commission to specify a closing date for submissions when making a determination or conducting an inquiry. Provide discretion for the Commission to consider submissions received after the specified closing date.

Recommendation 18

Amend section 37 of the ESC Act to give the Commission the power to compel a person to appear before it in relation to any matter that is subject to determination or inquiry – consistent with the *Trade Practices Act 1974*.

Appeals process

Recommendation 19

Amend the ESC Act to:

- allow the conduct of merit-based reviews in price and access determinations; and
- restrict admissible evidence to an appeal panel to evidence provided to the Commission prior to the deadlines set by the Commission during the course of its original inquiry; and

In this context, repeal regulation 15(3) of the ESC Regulations.

Recommendation 20

Amend section 56(1) of the ESC Act to require the three member appeal panel to be constituted of:

- a chairperson who has experience running contested hearings; and
- at least one member that has technical or industry experience relevant to the appeal.

Recommendation 21

Legislative amendments should be considered if they are necessary to allow consumer and user groups to initiate and intervene in an appeal, subject to leave of the appeal panel.

Recommendation 22

Amend section 55(3)(a) of the ESC Act to extend the time for lodgement of an appeal from 7 days to 14 working days in the case of an appeal under section 55(1)(a) or 55(1)(b) and from 14 to 21 working days for an appeal under section 55 (1)(c).

Recommendation 23

Amend section 56 of the ESC Act to extend the power of appeal panels to vary section 37 information requests from the Commission.

Recommendation 24

Amend the ESC Act as necessary to:

- clarify the status of a determination subject to an appeal during the conduct of an appeal;
- clarify the suspension rather than expiry of an information notice issued by the Commission prior to the conduct of an appeal; and
- extend the obligations to provide information upon request from an appeal panel from the Commission to other parties to appellants and other parties to the appeal.

Enforcement and compliance issues

Recommendation 25

Amend the ESC Act to ensure the Commission's enforcement powers are consistent across industries and for different regulatory functions.

Recommendation 26

Amend section 53 of the ESC Act to enable the Commission to attach proportionate penalties to breaches of licence conditions, codes and determinations and otherwise enforce codes in a proportionate manner.

Miscellaneous issues

Recommendation 27

Amend sections 14(1), 34, 53 and 55 of the ESC Act to clarify that they apply to both a determination and a decision of the Commission.

Recommendation 28

Amend section 66 of the ESC Act to require the ESC Act, as necessary, to be reviewed again within ten years (by 31 December 2016).

Going Forward

The Minister for Finance will write to regulated industries and other interested parties shortly to seek their views on the issues identified for stakeholder engagement above. Further details will be available on the Department of Treasury and Finance's website:

<http://www.treasury.vic.gov.au/escactreview>

The Government plans to introduce detailed changes to the ESC Act to Parliament in 2008. These changes will incorporate not only the majority

of recommendations by Mr Beale, but any changes pursuant to Victoria's commitments in national agreements on competition policy and infrastructure reform.

