

Market Operator Working Group

# Public Consultation Paper on Governance Arrangements for the Proposed Australian Energy Market Operator

October 2007

This Consultation Paper has been developed for the purpose of providing interested parties an opportunity to comment on issues surrounding development of a model for the establishment of the Australian Energy Market Operator (AEMO). The consultation paper has been prepared by the Market Operator Working Group (MOWG) which was established to provide advice to the Standing Committee of Officials (SCO) of the Ministerial Council on Energy (MCE). Comments on all aspects of the paper are sought with particular emphasis on possible governance arrangements for AEMO. While interested parties are welcome to provide comment on any part of the paper, MOWG has sought specific comment on particular aspects of the paper to help guide submissions.

Submissions will be taken into account by MOWG in formulating its recommendations on an AEMO implementation plan to SCO. The MCE is expected to consider the AEMO implementation plan in December 2007.

**Written submissions are sought by Thursday 25 October and should be addressed to:**

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This consultation paper is for comment only and does not represent the final views of MOWG, the MCE, the SCO, the governments of participating jurisdictions or any government officials. Where preferences of the MOWG are outlined in this paper they generally reflect the views of the majority of industry representatives on MOWG.

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## ACRONYMS

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AAR	Allens Arthur Robinson
AEMO	Australian Energy Market Operator
ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ANTS	Annual National Transmission Statement
APRA	Australian Prudential Regulatory Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATPR	Australian Trade Practices Reports
B2B	Business to Business
BB	Bulletin Board
CAC	Commonwealth Authorities and Companies
CEO	Chief Executive Officer
COAG	Council of Australian Governments
CRF	Consolidated Revenue Fund
DOFA	Department of Finance and Administration
ERIG	Energy Reform Implementation Group
ESIPC	Electricity Supply Industry Planning Council
EUAA	Energy Users Association of Australia
FRC	Full Retail Competition
GMC	Gas Market Company
GMLG	Gas Market Leaders Group
GMO	Gas Market Operator
GRMO	Gas Retail Market Operator (Queensland)
IMO	Independent Market Operator (Western Australia)
MCE	Ministerial Council on Energy
MEU	Major Energy Users
MOWG	Market Operator Working Group
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Energy Market Management Company

NEMO	National Energy Market Operator
NGL	National Gas Law
NGERAC	National Gas Emergency Response Advisory Committee
NSW	New South Wales
NT	Northern Territory
PJM	Pennsylvania/Jersey/Maryland
Qld	Queensland
REMCo	Retail Energy Market Company Ltd
SA	South Australia
SCO	Standing Committee of Officials
STTM	Short Term Trading Market
Tas	Tasmania
TMC	Transition Management Committee
TPA	Trade Practices Act
VENCorp	Victorian Energy Network Corporation
Vic	Victoria
WA	Western Australia

# CHAPTER ONE

## INTRODUCTION

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### 1.1. COAG DECISION

On 13 April 2007, the Council of Australian Governments (COAG) agreed to establish a single industry funded energy market operator for both electricity and gas to strengthen the national character of energy market governance. COAG tasked the Ministerial Council on Energy (MCE) with developing, in consultation with stakeholders, a detailed implementation plan by the end of 2007 for establishing the energy market operator. The timeline for establishment of the market operator set by COAG is June 2009.

Although referred to by COAG as the National Energy Market Operator (NEMO), it is proposed that the term Australian Energy Market Operator (AEMO) be adopted, to be consistent with the name of other energy market institutions – the Australian Energy Regulator (AER) and the Australian Energy Market Commission (AEMC). The term AEMO has been used in this paper.

### 1.2. APPROACH

#### 1.2.1. Market Operator Working Group

The MCE Standing Committee of Officials (SCO) established the Market Operator Working Group (MOWG) and asked it to prepare advice on the establishment of AEMO. The Terms of Reference of MOWG is at [Attachment A](#).

The MOWG has broad industry and government representation. For the purpose of this consultation paper, the term 'industry' is taken to mean the supply side of the energy market as well as energy end users. A list of members of MOWG is at [Attachment B](#).

To ensure that all interested parties have an opportunity to voice their views, it has been agreed that this paper be released for public consultation.

MOWG will draw upon the response to this paper and its own deliberations to prepare a final report to SCO. The report will be used by SCO in formulating its advice to the MCE on the AEMO implementation arrangements.

In formulating its advice, MOWG will take into account jurisdictional approaches to market operation and other energy market institutional arrangements. In this regard, policy decisions in relation to these matters may change the final arrangements for AEMO. In particular, MOWG notes:

- the policy position of the Victorian government is that all functions currently undertaken by the Victorian Energy Networks Corporation (VENCorp) should be transferred to AEMO;
- the governments of Western Australia and the Northern Territory will consider the adoption of national institutions at their discretion, consistent with the Australian Energy Market Agreement;
- consistent with the point above, no decision has been contemplated, for instance, in relation to a possible transfer of market operation functions of the Independent Market Operator (IMO) in Western Australia to AEMO, at a future date;
- Western Australia has not taken a decision on the possible transferral of the gas retail functions of the Retail Energy Market Company (REMCo) to AEMO, and has expressed the view that this is a matter for consideration by Western Australian REMCo market participants consistent

with the existing framework for the operation of gas retail market schemes in Western Australia<sup>1</sup>; and

- no decision has been taken on the possible incorporation of the functions of the Electricity Supply Industry Planning Council (ESIPC) in South Australia in the national transmission planner. The detailed design of the national transmission planner, which will be a function of AEMO, is under development by the AEMC.

### 1.2.2. Transition Management Committee

On 27 July, SCO agreed to establish a Transition Management Committee (TMC). This body is responsible for providing advice to SCO on the management of the transition path to the establishment of AEMO. The key focus of this committee is at an operational level to ensure the smoothest possible transition to AEMO. The TMC reports directly to SCO but will liaise with MOWG where appropriate. Membership of the TMC comprises the chief executive officers of the existing electricity and gas market operators (National Electricity Market Management Company (NEMMCO), VENCop, Gas Market Company (GMC), and REMCo) and the chair of MOWG. The Terms of Reference for the TMC are at [Attachment C](#).

### 1.2.3. Interim Gas Market Operator

Following on from recommendations by the Gas Market Leaders Group (GMLG) for establishment of a Gas Market Operator (GMO), COAG asked MCE to give consideration to staging the establishment process for AEMO with a transitional GMO, based on consultation with stakeholders. The MOWG considered this issue as part of its terms of reference and agreed an interim GMO would not be worthwhile for the following reasons:

- it requires a two stage legislative process; first to establish a GMO and later to establish the AEMO with consequential amendments to the law and rules in both instances;
- it imposes additional resource constraints as two bodies would need to be set up and could impact on the tight timetable set by COAG to establish AEMO;
- it creates additional financing, wind down, transfer and re-establishment costs associated with a two-step process;
- it creates challenges for attracting and retaining competent staff due to the temporary nature of an interim GMO; and
- the costs of establishing an interim GMO seem to far outweigh the benefits that may accrue to market participants, particularly if AEMO is operational by the target date set by COAG of June 2009.

MOWG agreed the implementation plan should be developed on the basis that AEMO would incorporate all of the functions that COAG had expected to be included in the GMO. The GMLG, which had previously recommended the establishment of a GMO (prior to the COAG decision to establish a combined gas and electricity operator), has expressed support for this position.

## 1.3. THE CONSULTATION PAPER

This paper sets out a number of options for AEMO governance in the Chapters that follow.

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<sup>1</sup> The *Energy Coordination Act 1994* ('ECA') provides the legal framework for the establishment and operation of gas retail market schemes in Western Australia. The ECA requires that gas retail market schemes are open and effective, efficient, and fair to gas market participants and their customers. The ECA provides that the members of a retail market scheme must apply to the Economic Regulation Authority ('ERA') for approval of any amendment to the retail market scheme. The market operator must consult with relevant parties before submitting any amendments to the ERA.

In the development of this paper there has been consensus between market participants, consumers and governments in relation to some issues. At the same time there are other areas where there are divergent views. Some of the main differences arise in relation to the ownership structure of AEMO and what constitutes “industry”. For the purposes of ownership, “industry” is defined in Chapter 5 to include the supply side and end users. Where MOWG industry representatives have come to a consensus view in certain areas these are generally noted in the paper.

Overall the views and issues presented in this consultation paper are not intended to lead to any conclusion, but to promote discussion of the benefits and detriments of each of the alternatives being considered.

To facilitate a response by interested parties, MOWG has requested comment on a number of specific areas. However, interested parties should feel free to comment on any issue relevant to the establishment of AEMO. All submissions will be taken into account by MOWG in developing its final report to SCO.

The consultation paper is structured as follows:

**Chapter 2** details the proposed and possible functions of AEMO. This includes functions that already exist in the gas and electricity sectors as well as new functions that COAG has agreed would be performed by AEMO, such as transmission planning. AEMO's functions will accordingly encompass administration of the wholesale spot market and operation of the national grid in the National Electricity Market (NEM) and the functions of the planned GMO. It is possible that, subject to the advice put forward by MOWG, the functions of AEMO may be expanded further.

**Chapter 3** relates to the AEMO board including its selection, appointment, size, composition, tenure and remuneration processes.

The accountability framework for AEMO is discussed in **Chapter 4** for both potential structural options of a company limited by guarantee and a statutory authority.

**Chapter 5** discusses different ownership models for AEMO, including government ownership, industry ownership and joint ownership between government and industry.



## CHAPTER TWO

# AUSTRALIAN ENERGY MARKET OPERATOR EXPECTED FUNCTIONS

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### SUMMARY

This Chapter considers the functions the Australian Energy Market Operator (AEMO) would potentially undertake.

Consistent with the decisions taken by the Council of Australian Governments (COAG), AEMO will undertake all the functions currently performed by the National Electricity Market Management Company (NEMMCO) in the electricity sector.

It will also undertake the gas functions recommended by the Gas Market Leaders Group (GMLG) for a Gas Market Operator (GMO), including:

- the functions of the Gas Market Company (GMC), Retail Energy Market Company (REMCo) and the Victorian Energy Networks Corporation (VENCorp);
- the wholesale gas market functions being developed by the GMLG would also be included – namely the bulletin board (BB) and short term trading market (STTM); and
- an information gathering function in support of the National Gas Emergency Response Advisory Committee (NGERAC) during gas emergencies.

COAG has also specified AEMO will incorporate the National Transmission Planning function for electricity being developed by the Australian Energy Market Commission (AEMC).

There are a number of other market operation functions AEMO could potentially undertake that are currently performed by other bodies. These include functions undertaken by:

- the Independent Market Operator (IMO) in Western Australia;
- the Electricity Supply Industry Planning Council (ESIPC) in South Australia; and
- the residual functions of VENCorp not included in those listed above, notably those relating to transmission planning and procurement. It is noted that the Victorian Government has requested these functions be transferred to AEMO to avoid the need to retain them within a Victorian entity.

A number of members of MOWG support the transfer of all the market operation and network planning functions identified above to AEMO given assumed potential cost savings and other operational efficiencies, subject to the agreement of the relevant jurisdictions as provided for in the Australian Energy Market Agreement. The AEMO design must therefore be sufficiently flexible to enable the accommodation of these and possibly other functions at some future time.

MOWG understands that individual governments and ministers are likely to require independent advice on market issues relevant to their jurisdiction and that governments need to retain the capacity to intervene in the operation of energy markets in emergency situations, subject to various intergovernmental agreements and co-ordination arrangements. MOWG has considered the need to preserve these functions in the future including the specific arrangements that would apply to such powers.

Gas market operators currently have rule development processes which differ from the rule making process that applies in the electricity sector. MOWG notes a view that these processes appear to be more efficient and effective than those in the electricity sector, while noting the different scope of the rules in the two sectors. MOWG has considered whether different approaches are warranted in the future.

## 2.1. INTRODUCTION

This Chapter sets out the breadth of functions that might be undertaken by AEMO.

COAG agreed, on 13 April 2007, that the functions AEMO will undertake would include:

- responsibility for the day to day operation and administration of the power system and electricity wholesale spot market in the National Electricity Market (NEM) (as currently performed by the NEMMCO);
- the new national transmission planning function for electricity; and
- the planned GMO;
  - noting that the GMO would have been expected to subsume the gas market functions of VENCORP, the GMC and REMCO and have responsibility for the operation of a bulletin board and short term trading market for gas.

The Chapter also explores additional market operation and other functions which might, for various reasons, sensibly be carried out by AEMO.

The functions of all existing market operators that could potentially form part of AEMO are set out in [Attachments D and E](#). [Attachment D](#) provides a tabular summary of functions and [Attachment E](#) provides a text based description.

## 2.2. SCOPE OF FUNCTIONS AGREED BY COAG

The transfer of functions to AEMO, as agreed by COAG, represents a change in institutional arrangements and will not result in a change to the functions themselves.

### 2.2.1. Electricity

The transfer of NEMMCO functions to AEMO will not change the scope of NEM operation functions, which are currently undertaken on a consistent basis in the NEM, which covers all jurisdictions except Western Australia (WA) and the Northern Territory (NT).

### 2.2.2. Gas

Gas market operation is currently jurisdictionally based. GMC operates in New South Wales (NSW) and the Australian Capital Territory (ACT), REMCO in WA and South Australia (SA), VENCORP in Victoria (Vic) and in Queensland (Qld) where it contractually provides services as the Gas Retail Market Operator (GRMO). Tasmania (Tas) has an immature gas market with ultra-light regulatory regime and does not have a market operator at this time.

In most jurisdictions, market operation is focused on facilitating retail market competition and administering associated rules. AEMO would undertake these retail market operation activities on a national basis but apply rules differentially (i.e. those that would otherwise be applied by the current gas market operator in their relevant jurisdiction). Centralising these activities in a single organisation may provide further impetus to rationalisation so that gas market functions are performed on a more consistent national basis and promote greater convergence between energy markets. The new National Electricity Law (NEL) and National Gas Law (NGL) will also play a role here. Such rationalisation would be consistent with the thrust of reform in other areas and should be pursued provided it results in costs savings for industry.

The proposed gas market BB and STTM are intended to develop the gas market by improving information flows and trading options in the wholesale market. (More detailed information is in section six of [Attachment E](#)). Once established, the proposed BB will operate on a national basis providing similar information in all jurisdictions. It is noted that the application of the BB and related design issues are subject to more detailed stakeholder consultation in WA and NT. The STTM (if approval is given for it to proceed by the MCE) would be designed to enhance trading arrangements

on the interconnected gas pipeline system (i.e. within NSW, ACT, Vic, SA, Tas and at some future point, Qld) and would be administered by AEMO on this basis. It would initially apply in NSW and SA, with the option for all jurisdictions to participate in future. VENCORP currently operates the gas transmission system and an intra-day spot market for gas in Victoria. The STTM is intended to be compatible with, but not a substitute for, the Victorian spot market.

A further function expected to be undertaken by AEMO is the production of an annual Gas Statement of Opportunities that emulates the purposes and elements of existing opportunities produced in the electricity and gas sectors. This is consistent with the annual gas supply and demand statement recommended by the GMLG and is supported by the Joint Working Group on Natural Gas Supply established by the Ministerial Council on Energy and Ministerial Council on Mineral and Petroleum Resources. It is expected that an annual Gas Statement of Opportunities would provide a long-term outlook, over 5-10 years, of demand forecasts and supply capabilities, highlighting where potential supply shortfalls or transmission constraints may occur in the future. Its purpose would be to assist existing participants and potential new entrants to identify investment opportunities and manage their positions in the market. It would also be available as an information tool for policy makers examining the projected short and long-term reliability of the nation's gas supply.

### 2.2.3. Electricity transmission planning

The function of the national electricity transmission planner is to provide for an enhanced planning process to ensure a more strategic and nationally coordinated approach to transmission network development across all jurisdictions in the NEM. The national transmission network development plan would replace the Annual National Transmission Statement (ANTS) prepared by NEMMCO.

The electricity transmission planning function is being developed by the AEMC. Accordingly, MOWG has not considered the transmission planning function in detail.

## 2.3. OTHER MARKET OPERATION FUNCTIONS

There are a number of other bodies which also carry out market operation functions. While these functions vary considerably across jurisdictions, there may be cost savings and other benefits in providing AEMO with the flexibility to carry out these functions.

### 2.3.1. Independent Market Operator (IMO)

IMO operates the Western Australian Wholesale Electricity Market. The institutional arrangements of the AEMO should be designed in a manner which enables IMO functions to be readily accommodated by AEMO, should such a decision be taken by the WA Government in the future. This approach is consistent with the terms of the Australian Energy Market Agreement (6.3(c)(ii)) which provides for Western Australia to participate in the national legislative framework for the energy market at its discretion.

### 2.3.2. Electricity Supply Industry Planning Council (ESIPC)

ESIPC prepares and reviews electricity transmission augmentation proposals in the South Australian network. No decision has been made to incorporate these functions within AEMO. The functions of ESIPC may, at least in part, overlap with those of the national transmission planner. There may be benefits in AEMO carrying out all of the functions of ESIPC.

### 2.3.3. VENCORP

COAG was silent on the transfer to AEMO of certain aspects of VENCORP's functions. The Victorian government has signalled an unwillingness to split the functions of VENCORP across different organisations on efficiency and effectiveness grounds. In principle, MOWG supports the transfer of all VENCORP functions to AEMO noting that a policy decision on this matter will be required by the MCE.

Although the electricity transmission procurement function for Victoria is wider than for other states, MOWG sees no reason why AEMO should not be capable of accommodating this difference.

#### 2.3.4. Jurisdictional functions

Adopting a national approach to market operation raises questions concerning the way in which ministers are able to gain independent advice about energy markets, including within their respective jurisdictions, and to request the market operator to undertake certain activities. MOWG notes that the MCE, in its 11 December 2003 report to COAG, stated that governments should not intervene in the day to day operation of energy markets.

#### 2.3.5. Information provision and advice

NEMMCO, VENCORP, ESIPC and other market operators provide information and advice, as required by law or on an informal basis, to governments from time to time on matters related to their functions and the operation of the market. The drought report developed by NEMMCO at the request of the MCE is a recent example. This requirement enables ministers to discharge their portfolio responsibilities appropriately.

MOWG supports the concept of jurisdictional ministers having the ability to seek independent advice and information from AEMO on issues relevant to the operation of gas and electricity markets, including on a jurisdictional basis. Such provisions should contain protection mechanisms in relation to commercially sensitive information. Where such information has broader value for all market participants it should be publicly available. Where the provision of the information or advice involves a material cost for AEMO, this should be met by the requesting party.

The liability of the AEMO arising from the provision of information or advice to third parties (such as Ministers) must also be considered and protected. This can be achieved either through statutory provisions which would, to the extent legally permissible, limit the AEMO's liability, or through insurance.<sup>2</sup>

#### 2.3.6. MCE directions

MOWG has considered the scope of powers of governments to direct AEMO to do certain things. Such powers would be expected to fall broadly within two categories as outlined below:

*Emergency management* – Governments have a role to play in managing emergency situations, if the market has failed or is about to fail, and require defined powers to give directions. The powers of governments to intervene in emergency situations are already set out in State and Territory laws and MOWG is not anticipating any major changes are required due to the establishment of AEMO.

*MCE directed reviews* – MOWG notes that the MCE has a capacity, under Division 4 of Schedule 1 of the *National Electricity (South Australia) Act 1996*, to direct the AEMC to undertake reviews of the national energy market. There may be value in a similar power in relation to AEMO given the expertise likely to reside within that organisation. The undertaking of reviews may also warrant cooperation between several market institutions.

*MOWG seeks comment on the desired scope of powers of direction for the MCE to request AEMO to undertake reviews.*

Any such direction by ministers may involve material cost for AEMO.

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<sup>2</sup> This is particularly important under an industry ownership model where the viability of the company could be jeopardized by real or potential liabilities arising from the provision of advice.

*MOWG seeks comment on potential rules to govern the most appropriate allocation of costs particularly between governments and market participants including in circumstances where information is requested by government and is valuable and subsequently made available to the wider market.*

## 2.4. POSSIBLE FUTURE FUNCTIONS

*MOWG is seeking stakeholder views on whether AEMO should be provided with the capacity to add additional functions beyond those described earlier in this Chapter.*

MOWG considers that the choice is between providing the AEMO Board with the flexibility to add new functions that are not inconsistent with legislated functions, and confining AEMO functions to those specified in legislation.

A number of MOWG members have supported enabling AEMO to undertake additional functions. This would provide AEMO with the capacity to respond promptly to changing market circumstances and take advantage of opportunities as they arise.

At the present time, NEMMCO can be authorised to carry out additional functions. The NEMMCO Members' Agreement enables the NEM Ministers to agree, by a 75 per cent majority, to add or cease functions (although it is not able to stop performing functions required under the NEL and its subordinate Rules). This flexibility has enabled NEMMCO to undertake functions in addition to those set at market start, including managing meter information for wholesale market settlements and the operation of gas business-to-business (B2B) infrastructure. REMCo and GMC can similarly take on additional functions by way of a resolution at a general meeting of members, although any change to the REMCo Constitution is a change to the Retail Market Scheme in Western Australia and must be approved by the Economic Regulation Authority. VENCORP has the same discretion with Ministerial approval such as the power to tender for carrying out additional activities (and not necessarily on a not-for-profit basis). An example was the successful tender for the gas retail market operator function in Qld.

Others have argued that although expedient, such an approach for AEMO may be inconsistent with the existing national energy market architecture. Providing AEMO with the discretion to add to or otherwise alter its functions constitutes a significant power, which might be seen as a means of undermining the AEMC rule change process (noting that it is always open to Government to subsequently bring any such function within the power of the AEMO through legislation).

In undertaking new functions, AEMO may be competing with the private sector. A monopoly service provider undertaking functions on a not-for-profit basis in areas that might attract private sector competitors raises competitive neutrality issues. AEMO competing with the private sector may also have *Trade Practices Act 1974* (TPA) implications. Section 46 provides that a corporation with a substantial degree of market power may not use that power for certain purposes, directed at either damaging or eliminating competitors or preventing or deterring competitive conduct. However, section 46 does not prohibit the exercise of regulatory functions. Accordingly, AEMO may be exposed to some risk of breaching section 46 where it voluntarily undertakes functions outside the statutory framework which could impact on the ability of businesses in the market to compete. Of course, such risks would be mitigated by appropriate Board decisions which comply with all regulatory constraints including the TPA.

*MOWG seeks comment on whether or not AEMO should be able to extend its functions and, if so, what conditions should apply – the existing conditions for NEMMCO are a useful base point.*

## 2.5. RULE DEVELOPMENT AND COMPLIANCE MONITORING

There are also some existing and proposed functions which cannot be readily adopted by AEMO without deviating from the national energy market institutional architecture.

### 2.5.1. Rule development

GMC, VENCORP and REMCO have a rule development function which is carried out in consultation with market participants and other stakeholders and accepted as rule changes by the Board of directors (in the case of GMC) and by the jurisdictional regulator (in the case of VENCORP and REMCO). The gas industry in those jurisdictions has found this arrangement to be expedient and efficient.

Such a rule making development power for AEMO is inconsistent with the institutional architecture for the national energy market in which the rule making function is explicitly the role of the AEMC.

If the AEMC was to have sole responsibility for the rule change function once AEMO was established, the fast-track rule change process would be available. The 'fast track' procedure will enable designated bodies (including market operators) to contribute to the AEMC's rule making process by developing a comprehensive application for a rule change. The minimum requirement before the AEMC can 'fast track' (i.e. to go straight to a draft determination) such an application is for these bodies to demonstrate that the public, not just relevant stakeholders, was consulted.

The minimum time for a 'fast track' rule change process to be completed is seventeen weeks. Gas market stakeholders have raised concerns that this process would not be as efficient as existing arrangements and that the establishment of AEMO would therefore reduce the effectiveness of gas market operation in this area.

The Australian Energy Regulator (AER) and NEMMCO have the power, under certain rules, to develop procedures and guidelines in accordance with the requirements of a rule. It is noted that many of the current gas market rule changes are technical in nature and may be more appropriately categorised as procedures and guidelines, making them amendable to flexible alteration without resorting to a formal rule change process. An assessment is required of the gas rules to determine which should be categorised as procedures and guidelines.

*MOWG seeks comments on the different approaches to rule making between gas and electricity and whether a continuation of the current approach to gas rule making should be allowed, or whether the fast track process and categorisation of certain matters as procedures and guidelines provide adequate flexibility.*

### 2.5.2. Monitoring and compliance

The gas market operators generally monitor compliance with gas market rules and in certain circumstances initiate or undertake compliance and enforcement functions. NEMMCO also has various roles in identifying potential breaches of certain rules. AEMO would initially undertake these activities.

It is noted however, that under the national energy market model, the AER has the role of compliance monitoring and enforcement. Possible breaches could, of course, be referred to AER by AEMO or by any participant.

*MOWG seeks views on whether these compliance and other quasi regulatory functions should be reviewed to determine whether they might be more appropriately undertaken by the AER as the energy market regulator.*

# CHAPTER THREE

## AUSTRALIAN ENERGY MARKET OPERATOR BOARD

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### SUMMARY

In this Chapter the Market Operator Working Group (MOWG) has considered the appropriate structure of the Board for the Australian Energy Market Operator (AEMO) and the appointment process for Board members.

In MOWG's view, a balanced Board structure and robust appointment process are crucial to guaranteeing good governance and confidence in AEMO operations and therefore in the Australian energy market. This is true regardless of the structural form that AEMO may assume (i.e. company limited by guarantee or statutory authority). Accordingly, and taking into account the fact that there are mechanisms available in each structural form to achieve the intended outcomes, the issues are canvassed independently of a consideration of that structural form.

The proposals regarding Board structure and the selection process for Board members are made in accordance with MOWG's views on the need for the Board to:

- be independent of particular interest groups, including government and industry sectors;
- possess an appropriate mix of skills; and
- act in accordance with clear objectives and powers;

whilst including sufficient skills and expertise from across the electricity and gas market supply chains (e.g. production, transmission, distribution, retail and users).

In summary, MOWG proposes:

#### Board size, tenure, composition and remuneration

- The Board will comprise up to ten members, including a non-executive Chair and eight other non-executive directors and the chief executive officer (CEO).
- The chief executive officer will be appointed by the non-executive directors.
- Board members (other than the CEO) will have a maximum three year period of appointment with an option for renewal of three years.
- One third of the Board will retire by rotation each year.
- In the light of the above proposals, a staggered appointment tenure for the initial Board is required, with three members each being appointed for initial periods of one, two and three years respectively (all appointments with an option for a three year renewal period). So the maximum term of initial Board appointments would be four (for three directors), five (for three directors) and six years (for three directors) respectively.

#### Appointment process

- The Board, other than the CEO, will be appointed on the recommendation of a five member selection panel consisting of two government appointed members, two members appointed by industry and an independent Chair, which should be an *ex-officio* appointment based on that person occupying a position requiring a strong understanding of the principles of good corporate governance. Examples of relevant positions may be the Chair of ASIC or the Chair of the Institute of Company Directors.

- The panel will be required to appoint the directors based on an assessment of applicants against a skills matrix, change to which should be affected through a defined and consultative process.
- The panel will separately, based on the additional skills desired of this position, identify a director it will recommend as the Chair of the Board. The Chair will be one of the directors appointed for an initial term of three years. The Chair should have a role on the selection panel for all subsequent appointments, the exact nature of which is a matter for consultation.
- The panel selection process will apply to Board appointments subsequent to the initial Board appointments.

#### Remuneration

- The remuneration of the Board will be determined on the basis of independent expert advice, having regard to the functions and skills involved.

#### Disqualification and removal of directors

- Directors will be subject to automatic disqualification on defined grounds similar to those set out in the *Corporations Act 2001*.
- If AEMO is a company limited by guarantee, the power to remove a director will rest with the members by resolution.

#### Role of the Ministerial Council on Energy (MCE) in appointment of Board members

- MOWG members considered different options on the extent of MCE involvement in the selection and appointment of Board members. Industry members propose that in developing a process for an independent skills-based Board, the involvement of the MCE should be limited to selecting two 'government appointed' panel members and, and that final Board selection decisions should be made in accordance with the selection panel recommendations.
- Another option is that MCE could have a broader role in the selection process. In particular, under a government-owned model, the members of the MCE would be expected to play a more significant role in Board selection.

#### Market operations advisory panels

- The market operations advisory panels will assume an advisory role only, with the detailed arrangements for their formation and interaction with the Board to be determined by the AEMO Board.

## 3.1. INTRODUCTION

### 3.1.1. Background

The Council of Australian Governments (COAG) April 2007 Communiqué endorsed a number of the recommendations of the Energy Reform Implementation Group (ERIG) to further improve energy market governance through:

- "establishing a National Energy Market Operator" (NEMO); and
- "ensuring the governance arrangements for the NEMO [AEMO] involve market participants in Board appointment processes, in a manner that preserves the Board's independence from any particular market participant.

To implement this decision, COAG tasked the MCE with developing:

- "a process for appointment of an independent, skills-based NEMO [AEMO] Board with a balanced mix of industry and generalist expertise, appointed under statutory conditions by the MCE".

### 3.1.2. Governing principles for board arrangements

The Board arrangement proposals outlined below have been developed in accordance with good governance principles and with regard to the parameters of the decision made by COAG. The section draws upon material from the following:

- National Electricity Market Management Company (NEMMCO): Governance Arrangements (Firecone Ventures, 2006);
- Corporate Governance Principles and Recommendations (2<sup>nd</sup> Edition, Australian Securities Exchange (ASX) Corporate Governance Council, 2007)<sup>3</sup>;
- Governance Arrangements for Australian Government Bodies (Department of Finance and Administration, (DOFA, 2005))<sup>4</sup>;
- Review of the corporate governance of statutory authorities and office holders (Uhrig Review, 2003)<sup>5</sup>; and
- *Corporations Act 2001*.

In particular, the proposals have regard to the need for a well qualified, skills-based Board with an appropriate level of independence from any particular interest group. At the same time the arrangements form part of the broader governance framework for AEMO, designed to ensure appropriate levels of accountability and independent and transparent decision making. The organisation must also be responsive to the needs of stakeholders and be capable of carrying out its functions in an efficient and effective manner. These features of good governance are explained in more depth in Chapters 4 and 5.

## 3.2. BOARD STRUCTURE

### 3.2.1. Board size, composition, tenure and remuneration

It is proposed that the size of the AEMO Board would be limited to a maximum of ten persons, which includes an independent Chair (who would hold a casting vote) and the CEO. The

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<sup>3</sup>[http://www.asx.com.au/supervision/pdf/corp\\_governance\\_principles\\_recommendations\\_2nd\\_edition.pdf](http://www.asx.com.au/supervision/pdf/corp_governance_principles_recommendations_2nd_edition.pdf)

<sup>4</sup> <http://www.finance.gov.au/FinFramework/docs/FMR2.pdf>

<sup>5</sup> [http://www.finance.gov.au/GovernanceStructures/docs/The\\_Uhrig\\_Report\\_July\\_2003.pdf](http://www.finance.gov.au/GovernanceStructures/docs/The_Uhrig_Report_July_2003.pdf)

CEO could not also be the Chair. Membership of the Board by the CEO would improve effective communication between the Board and management. A Board of ten is at the upper bound of what the Uhrig Report states is considered to be best practice in the private sector (including a managing director). The size of the Board should take into account the size, complexity and risk of the operations of the entity. An upper limit provides flexibility while the size of the Board at any one time will depend on an objective assessment of the breadth of skills required.

MOWG has also given detailed consideration to the attributes required of a skills-based AEMO Board. Outlined at [Attachment F](#) is a draft skills matrix for AEMO Board members as envisaged by MOWG. Irrespective of the overall arrangements used to appoint Board members, it is envisaged that the process require reference to such a matrix. This is designed to facilitate a Board with the requisite skills to carry out their responsibilities, in keeping with the COAG decision.

Of the nine non-executive directors, it is further proposed that a minimum of three and a maximum of six be drawn from 'industry'. The definition of a director drawn from 'industry' would mean that the candidate has current knowledge of and active experience in, the energy sector. However it must be stressed that the selection process does not directly select directors on a sectoral basis, although the outcome of the selection process might be that some directors might have a sectoral association.

The ASX corporate governance principles recommend that the majority of the Board be made up of independent directors. An independent director is defined as one who is "not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgement". MOWG agrees that it would be appropriate to adopt the specific requirements articulated by the ASX Corporate Governance Council for assessing the independence of directors. The practical application of this principle would mean that independent status would only apply to those applicants who are not a substantial shareholder, or have not had a contractual, professional, supplier or employment relationship in the past three years with an energy industry participant. MOWG considers that this definition should not of itself disqualify 'independent' directors of existing market operators.

A more restrictive approach is the Pennsylvania/Jersey/Maryland (PJM) market model in the United States which requires that the ten member Board can have no personal affiliation or ongoing professional relationship with, or any financial stake in, any PJM market participant. MOWG does not support adopting this definition of independence as it may be too restrictive for a small market like Australia. Furthermore, in the Australian situation, the obligations placed on directors by the *Corporations Act 2001* (assuming this is the form the AEMO would take) reinforce the obligation on directors to act in the best interests of the AEMO. Similar outcomes can be achieved for a statutory authority by placing obligations on the directors in the establishing legislation for the body. It is proposed that AEMO would apply the ASX corporate governance principles and develop a code of conduct covering the exercise of independent judgement by the Board; public disclosure of material relationships that might interfere with (or be perceived to interfere with) the exercise of independent judgement; promote ethical and responsible decision making at all levels of the AEMO.

The period of tenure of directors also has an influence on independence. MOWG proposes directors not have indefinite tenure but be eligible for appointment for no more than two three-year terms (or a total of six years). This is consistent with the findings of the Uhrig Review.

To maintain continuity and retention of corporate knowledge, MOWG proposes there be provision for one third of the Board (excluding the CEO) to retire by rotation each year. In practical terms, three members of the initial Board would be appointed for a period of one year with an option to extend for three years, three members would be appointed for a period of two years with an option to extend for three years and three members would be appointed for three years with an option to extend for three years. This means that there will be three

members each with a maximum period of appointment of four years, five years and six years respectively. It is suggested that the Chair would be appointed for an initial term of three years.

*MOWG seeks comments on the proposed composition of the AEMO Board.*

### 3.2.2. Chair

A skilled Chair is essential, particularly for an organisation such as the AEMO in its formative years. Often the directors select the chair from among their number. However, it is proposed that the AEMO Chair be specifically chosen in the selection process based on skills and experience identified as necessary to undertake this role. The Chair would be an independent director and not be drawn from industry. It would be up to the Board to fill the position of Chair from among their number in the event of a casual or short term vacancy. Any permanent replacement would be subject to the Board selection process outlined below.

### 3.2.3. Chief Executive Officer

The powers of the Board should include the appointment and removal of the CEO. For a Board of directors to be effective, it must have the full power to act, including the ability to appoint, supervise and remove senior management as well as to approve strategy. The arrangement is supported by the findings of the Uhrig review and is the case for most corporations.

### 3.2.4. Remuneration

Remuneration of directors of statutory authorities is normally determined independently, usually by a remuneration tribunal (for example the Commonwealth Remuneration Tribunal established under the *Remuneration Tribunal Act 1973*). For corporations, remuneration may be determined by members or where members have delegated the relevant decision, the directors themselves.

If AEMO is established as a corporation, it is proposed that the constitution prohibit members from delegating to the Board its own remuneration. In its place it is proposed that company members determine Board remuneration after taking into account independent advice. This process would be similar to that used by NEMMCO: shareholders decide remuneration after taking into account market-based advice of a human resource consultant.

## 3.3. BOARD SELECTION

COAG requested the MCE "develop a process for appointment of an independent skills-based NEMO [AEMO] Board....appointed under statutory conditions by the MCE". In response, MOWG has considered issues regarding Board selection processes and how they contribute to a sound governance framework consistent with the COAG decision.

### 3.3.1. Board selection process

MOWG proposes the establishment of a five person selection panel, to be responsible for appointing Board members. The five member selection panel would comprise two government appointed members, two members appointed by industry and an independent chair, which should be an ex-officio appointment where the person occupies a position requiring a strong understanding of the principles of good corporate governance. Relevant positions may be Chair of ASIC or their nominee, or a person appointed by the Chair of the Institute of Company Directors. The independent chair would exercise a casting vote if

required. The panel members would have ongoing tenure and any vacancies in the selection panel would be filled in the same manner as the original appointment process.

As a single, discrete, decision making process, this model is likely to be most effective in ensuring the nominated appointees collectively possess an appropriate mix of skills. As the panel arrangement has an independent chair and includes representatives of industry and government in the selection process, it avoids a perception that any Board member is 'representing' either a specific government or section of industry. At the same time it gives both government and industry a role in the establishment of a body charged with operating the gas and electricity market arrangements.

The selection panel could be required to follow certain guidelines, for example, a requirement to make selections for Board appointments based on an assessment of applicants against a defined skills matrix. The agreed process could be set out in the company constitution (for a corporation) or in the law (for a statutory authority). [Attachment F](#) to this Chapter contains a draft skills matrix.

*MOWG seeks comments on the draft skills matrix to be used in the selection process for AEMO Board members.*

*MOWG also seeks comments on any process that may be necessary to refine the skills matrix over time. It is suggested that this be done only with the approval of the members of AEMO and be affected through a defined and consultative process.*

It would be up to the MCE to determine how its two appointees to the selection panel would be chosen. It may mean that MCE members agree to two members with expertise in energy market operations to represent a consensual government view on the panel.

Industry members of MOWG have agreed that the two industry-appointed panel members will be appointed according to the following process.

- energy industry associations including end user associations such as Major Energy Users and Energy Users Association of Australia would join together to form an appointment committee to select two appointees; and
- each association would have equal standing in the process, and the representatives will be appointed by consensus, accepting the principle that it is desirable to have senior, knowledgeable and experienced appointees with the requisite experience and industry knowledge, and an appreciation of how to select people to match the skill set nominated for the Board.

There appears to be no strong policy reason for having a different process for Board selection for the initial Board appointment and ongoing appointments. In particular, using the panel approach maintains industry and government involvement in the selection process and provides for ongoing independence and transparency.

Consideration was given to passing responsibility for subsequent appointments to the Board. While this proposal was seen as efficient and simple, it did not provide for the same level of transparency and independence as the selection panel approach. Additionally, it potentially denies the ongoing participation and input of industry and government.

For statutory authorities, the Uhrig Review describes the possible interaction of the Minister with the Board and the chair with regard to ongoing appointments. The Uhrig Review recommends that the responsible Ministers discuss with the chair the needs of the Board.

Similarly, the MOWG considers there are obvious benefits in ensuring an appropriate level of interaction between the Chair of AEMO and the selection panel and process. Such

interaction would be for the purpose of ensuring the panel is apprised of Board performance and skills and that all new appointments remain relevant to the current and future needs and obligations of the organisation. One option is for the Chair of AEMO to assume the role of chair of the selection panel, except when the appointment of the chair of AEMO is being considered. Another option would be for the chair of AEMO to be a sixth member of the selection panel or to otherwise have some other means of interacting with it.

*MOWG seeks comment on the proposed selection panel arrangements and on potential involvement of the AEMO Chair.*

### 3.3.2. Director removal

The power to remove directors is an important consideration and an essential element of good governance practice. Its significance, however, may be reduced where there is a robust and independent appointment process in place.

For corporations, the *Corporations Act 2001* contains triggers for automatic disqualification of directors, including conviction of certain offences, bankruptcy and upon some court orders. Further grounds for disqualification may be set out in the constitution of the organisation. Similar provisions are normally contained in the establishment legislation for statutory authorities.

The arrangements for the Victorian Energy Networks Corporation (VENCorp), the Australian Competition and Consumer Commission (ACCC) and the Australian Energy Regulator (AER) for example, provide for termination of appointment in the event of such things as: bankruptcy; failure to comply with certain statutory obligations; engagement in paid employment without consent; unexplained leave of absence for an extended period; failure to attend a specified number of consecutive meetings without approval; conviction of an indictable offence. A director may resign from a position at any time by giving notice in writing.

More generally, the power to remove a director from a corporation rests with the members and this arrangement cannot be overridden (s 203D of the *Corporations Act 2001*). Decisions are made by a simple majority of the members.

In the case of a statutory authority, the directors may be removed by the Governor-General (or Governor in Council as the case may be) if the legislation so provides.

### 3.3.3. Role of MCE

COAG's decision is that an "independent skills-based" NEMO [AEMO] Board "be appointed under statutory conditions by the MCE".

Industry members of MOWG are of the view that the selection panel process outlined above is robust and will deliver an AEMO Board that is skills-based and independent. Any potential to alter the recommendations of the panel, by MCE or any other party, would undermine the benefits of the proposed selection process and reduce stakeholder confidence in the operations of the AEMO. Importantly, it may reduce confidence in the Board selection process among potential applicants who may be less inclined to apply in the first place thereby risking a reduction in the quality and diversity of skills among Board members.

Additionally, MCE's role in appointing the two government members of the selection panel would give MCE involvement in the process and comfort in the appointments; given the COAG decision requirement that this process deliver an independent skills-based Board. Additionally, the proposed appointment of the independent chair of the panel should ensure a person of standing and expertise to guide the selection process.

Nonetheless, the Standing Committee of Officials (SCO) has asked MOWG to consider mechanisms by which MCE may assume involvement in the selection and appointment

process. Options could range from requiring the MCE to appoint the Board in accordance with stated principles, to requiring the panel to consult with the MCE on the candidates short listed for interview. The MCE could have the ability to reject short listed candidates (for example, according to predefined criteria) and to add additional names to the list. The final selection would nonetheless be a matter for the selection panel, with the members appointing the Board.

The appointment process outlined above may be utilised regardless of the ownership arrangements for AEMO. Nevertheless, MOWG recognises that if AEMO were to be government owned (ownership issues are set out in Chapter 5), then there would be an expectation that governments, through the MCE, would select the Board. How that might best be done is open to consultation.

*MOWG seeks stakeholder views on the selection and appointment process and specifically what role, if any, MCE should play, including under different ownership models.*

### 3.4. MARKET OPERATIONS PANEL

To strengthen stakeholder participation and responsiveness, COAG asked MCE to develop a Market Operations Panel (or panels) for electricity and gas, to advise the AEMO Board.

Mechanisms providing for stakeholder participation in the management of the current market operators have been in place for some time.

- **NEMMCO** – NEMMCO has established a Participant Advisory Committee in consultation with the NEMMCO Board to provide a mechanism for market participants to comment on the business and affairs of NEMMCO for the information of the Board.
- **VENCorp** – VENCorp directors are drawn from industry and independents, and this has provided a considerable degree of stakeholder satisfaction with the company's performance (as reported in the recent VENCorp Review). The VENCorp Board has also established a Gas Market Consultative Committee as a consultative forum of gas industry participants to consider and make recommendations to it on issues relating to the development or operation of the Victorian Gas Market and Rules.
- **REMCo and GMC** – Accountability of the Gas Market Company (GMC) and Retail Energy Market Company (REMCo) to their market participants is managed directly through industry ownership and Board representation.

In each of the above cases, the Board is ultimately responsible for taking decisions and the industry panels have an advisory capacity only. This arrangement should be maintained for AEMO, especially given the Board is intended to act independently and is properly accountable for the decisions it makes.

The way in which the Market Operation Panel(s) are constituted is largely a matter for the Board. It would be premature to set the structure of these Panels and determine how market participants might be represented, without pre-empting the decisions the AEMO Board will make about the most efficient and effective way of structuring the organisation and its industry consultation arrangements.

*MOWG seeks stakeholder views on the arrangements for the Market Operation Panel(s)*

## CHAPTER FOUR

# ACCOUNTABILITY MECHANISMS FOR THE AUSTRALIAN ENERGY MARKET OPERATOR

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## SUMMARY

### Accountability

The two alternative structural models considered for the Australian Energy Market Operator (AEMO) are a statutory authority or a company limited by guarantee. In this Chapter, a comparison is made between the accountability arrangements that might be expected to apply under each of these models.

The Market Operator Working Group (MOWG) has given detailed consideration to accountability measures that might be applied to AEMO (regardless of its structure) to deliver an effective and efficient body operating in accordance with the principles of good governance. MOWG concludes that it is possible to develop and apply particular accountability mechanisms to either a statutory authority or a company limited by guarantee so as to deliver an equivalent framework within which AEMO will operate. The detail of the relevant measures is set out in Part One of this Chapter.

Similarly, the accountability arrangements may be structured in such a way so that their design is largely indifferent to whether AEMO is owned and controlled by government, by industry, or jointly by government and industry.

Accordingly, MOWG considers the decision about the most appropriate structure for AEMO is driven by issues other than accountability measures.

### *Trade Practices Act 1974, (TPA) review mechanisms and dispute resolution*

#### The TPA

The TPA will apply to AEMO if it is a company limited by guarantee. It is assumed that the TPA will also apply to at least some activities of AEMO as a statutory authority. To the extent that AEMO carries out activities under mandatory statutory obligations it will not contravene the TPA. Where, however, AEMO is not acting pursuant to mandatory statutory obligations, for example where AEMO enters into an agreement permitted or contemplated by the Rules, there may be a risk of contravention of the TPA. To the extent that AEMO takes action as required by the Law or Rules, it will not misuse its market power contrary to s 46 of the TPA.

#### Merits review

Having regard to the very recent and detailed MCE consideration of merits review within the gas and electricity framework (and without making any comment on the Ministerial Council on Energy (MCE) position), MOWG does not propose recommending AEMO decisions, additional to those proposed by MCE and set out in the National Electricity Law (NEL) and the National Gas Law (NGL), that would be subject to merits review.

#### Enforcement

MOWG considers that the Australian Energy Regulator (AER), as the national regulator, should continue to enforce compliance with the Law, Regulations and Rules. While the AEMO's functions necessitate that it will continue to work with the industry and AER with regard to enforcement issues, MOWG does not suggest AEMO assume any enforcement

functions or be given any additional powers in this area, beyond any currently undertaken by existing market operators<sup>6</sup>. However, consideration will need to be given to whether, under the design of the institutional arrangements, enforcement functions under the gas rules should all be transferred to the regulator.

## Funding

The funding arrangements for AEMO are expected to broadly reflect the current arrangements in relation to each of the bodies whose functions it will assume. The magnitude of the fees of the existing market operator organisations should provide a benchmark. Provision will need to be made for new functions including the gas bulletin board and gas short term trading market as well as the national transmission planner for electricity. The expectation is that efficiency gains and synergies arising from a single market operator will result in some overall cost savings. These savings may take time to identify and then realise and are unlikely to be significant.

It is feasible for either a company limited by guarantee or a statutory authority to be funded by industry. The latter requires appropriation structures to be developed (such as those used for the Australian Prudential Regulatory Authority (APRA)).

Fee setting should be at the discretion of the Board subject to guiding principles issued by the MCE or expressed in the Law and Rules. Also, it is expected that there be consultation with industry prior to any fee changes, as is the case for the current operators.

MOWG suggests industry input and review of the AEMO fee setting process provides a robust oversight and review mechanism. Regulatory oversight of AEMO fees was considered. The benefits likely to accrue from the application of an intensive price review process, which is predicated on achieving efficiency gains against a target, are not proven. This is because a 'not for profit' organisation recovers the costs actually incurred regardless of whether expenditure is more or less than forecast. In addition, there are no comparable bodies against which to benchmark AEMO.

In general, whilst recognising that MCE will want to set its own principles to guide the Board in setting fees, MOWG considers the following key principles should drive the framework for AEMO funding:

- funding should be on a cost recovery basis and also so as to provide for the AEMO's budgeted revenue;
- the fees charged to particular persons should be reflective of the service AEMO provides to each fee payer, so costs should be ring fenced for each function to the extent reasonably feasible;
- there should be no cross subsidies across industries and jurisdictions;
- the fees should be competitively neutral as between each fee payer and foster economically efficient outcomes in the national energy market; and
- the fee structure should be simple, to the extent that is consistent with the other principles.

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<sup>6</sup> REMCo and GMC have enforcement roles in relation to compliance with the relevant gas retail market rules in SA, WA, NSW and ACT.

## 4.1. INTRODUCTION

This Chapter is arranged in three sections.

The first section sets out the key accountability arrangements for AEMO and compares them against the two main structural forms: a statutory authority and a company limited by guarantee. A comparison of the key accountability measures is set out in the table at the end of Part One. The table provides some capacity to objectively assess whether there are weaknesses or gaps in the accountability arrangements and whether this might influence the choice of structural form of AEMO. Some assessment is made as to whether these accountability arrangements are affected by ownership considerations.

The second section considers the broader regulatory framework within which MOWG is to operate. This includes the application of the TPA, the application of judicial and merits review and the process by which disputes will be settled.

The third section looks at funding arrangements for AEMO as part of the broad accountability framework for the organisation.

## 4.2. PART ONE – KEY ACCOUNTABILITY MECHANISMS

The first part of this Chapter discusses what accountability arrangements might apply to AEMO if it assumes a particular structure. It is intended to assist consideration of the extent to which accountability mechanisms influence the choice of whether AEMO should be a statutory authority or company limited by guarantee and also assesses how accountability mechanisms might be influenced by ownership considerations for a company limited by guarantee.

### 4.2.1. Accountability and good governance

The decision of the Council of Australian Governments (COAG) to establish AEMO reflects a desire to improve energy market governance arrangements and explicitly recognises the convergence of electricity and gas markets.

Arrangements for Australia's energy market institutions should follow good governance principles. Accountability is a key principle of good governance. Accountability is about establishing a framework of rules, relationships, systems and processes through which: functions and roles are clearly defined; risks are monitored, assessed and managed; decision makers are held to account; and performance is optimised and independently evaluated.

MOWG expects the operation of AEMO will be guided by the national gas and electricity market objectives set out section 21 of the draft NGL and section 6 of the draft amendments to the NEL, respectively.

The National Gas Market Objective is:

*... to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.*

The National Electricity Market Objective is:

*... to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security.*

AEMO will be expected to operate in accordance with these objectives in carrying out its functions, and to comply with the NGL and the NEL and the subsidiary Rules, each of which gives detailed expression to these objectives.

#### 4.2.2. Structural form and accountability

The table at the end of this Part compares standard arrangements for accountability of the Board and Management to the owners that might be applied to AEMO under either the statutory authority or company limited by guarantee models. The manner in which these accountability arrangements can be applied to the organisation vary somewhat, in respect of each model.

For a statutory authority, the accountability requirements are generally set out in the legislation establishing the entity (for example the *Australian Energy Market Commission Establishment Act 2004* (South Australia) in relation to the Australian Energy Market Commission (AEMC)). The establishment act is usually supported by other legislative instruments. For example, in the case of Commonwealth bodies, either the *Financial Management and Accountability Act 1997* (for departments and agencies) or the *Commonwealth Authorities and Companies Act 1997* (for bodies legally separate from the Commonwealth) applies, and Commonwealth bodies, departments and agencies are also generally subject to the *Public Service Act 1999*. Statutory authorities are also accountable through a single minister (owner) and to a Parliament.

For a company limited by guarantee, the *Corporations Act 2001*, the company's constitution and members' agreement (if any) contain the relevant accountability arrangements. They may be further supplemented by specific legislation.

MOWG is of the view that the table indicates that although the legislative and other tools for achieving accountability vary between the two models, the outcomes, as far as making the Board and Management accountable to the owners, generated by appropriately designed accountability mechanisms are broadly equivalent.

#### 4.2.3. Ownership and accountability

The accountability arrangements for both a statutory authority and company may be structured to broadly deliver equivalent outcomes with respect to the accountability of the Board and Management to the owners. Additionally, the framework within which the AEMO will operate, the Law, Rules and Regulations, will be the same regardless of its structural form. In this case, the issue that arises is whether there is some basis other than the relevant accountability mechanisms for preferring one model or the other.

Ultimately, an organisation is accountable to those who either created it (Parliament through the relevant minister in the case of a statutory authority) or own it (members in the case of a company limited by guarantee). However, organisations can also be accountable to outside bodies for the purposes of, for example, compliance with relevant laws and rules.

The ownership models for a company limited by guarantee contemplated by MOWG include:

- government(s);
- industry (market participants and major users); or
- joint ownership by government(s) and industry.

The options and issues associated with ownership are considered in more detail in Chapter 5.

Although the different structures may shape the form of particular accountability arrangements, the outcome of those particular arrangements identified by MOWG is largely divorced from the form of the entity (i.e. the identity of its creators or its owners). This is because many accountability arrangements do not involve a specific decision to be made, either by the minister in the case of a statutory authority, or by the members of a company. For example, annual report and audit arrangements are requirements laid out in legislation or other instruments and may be structured so that they are uniform in their application regardless of whether AEMO is a company or statutory authority.

Sensitivity to the identity of the persons to whom each structure is ultimately accountable is therefore only expected to arise where the minister or the members have an explicit decision making role.

In respect of AEMO, regardless of its ownership MOWG considers that a decision making role would only be expected to be required in relation to:

- the appointment of the Chair and directors;
- the remuneration of directors;
- the removal of directors; and
- powers of the members (company limited by guarantee model only) – in relation to amending the constitution and to allow the entity to undertake additional activities.

MOWG has already addressed, in Chapter 3, robust and independent mechanisms for the appointment of directors, rendering that process largely indifferent to ownership considerations.

The remuneration of directors can be referred to an independent process for determination under either a company or statutory authority (e.g. an independent remuneration body like the Commonwealth Remuneration Tribunal or a consultant as is the case for the National Electricity Market Management Company (NEMMCO)).

There is potential for a significant difference between a company and a statutory authority in terms of the process for removal of directors. In the former, directors can be removed by resolution of the members, but in the latter there is likely to be a requirement for some ministerial or parliamentary process. This difference should be mitigated by a robust independent selection process in the first place.

This leaves, in relation to a company, the issue of the power of the members to alter its constitution or to provide for AEMO to exercise functions and powers not provided for in the Law and the Rules. The power of the members to alter functions was discussed in Chapter 2 where some considerations for how this might be handled have been set out.

The capacity of the members to alter the constitution or the functions of AEMO are capable of being addressed in a manner that should not give rise to concerns in relation to the influences that might be exerted by certain ownership arrangements or ownership classes. It is proposed that all such changes are subject to a requirement that they receive the support of a 75 per cent majority of the members.

#### 4.2.4. Measures and Mechanisms for Accountability

NOTE: This table assumes the adoption of the Board selection arrangements proposed by MOWG in Chapter 3.

	STATUTORY AUTHORITY	COMPANY*
<b>DIRECTORS</b>		
Composition of the Board	Standard terms	Standard terms
	<p>Legislation by which the statutory authority is established can specify the composition of the Board and the requisite directors' skills and term of appointment for each director. For example, the <i>Gas Industry Act 2001</i> (Victoria (Vic)) prescribes the number of directors that will compose the Victorian Energy Networks Corporation (VENCorp) Board and the relevant expertise required (ss 165 and 166). Appointment is for a maximum term of three years with an option for renewal and on terms and conditions determined by the Minister (s169 of the <i>Gas Industry Act 2001</i> (Vic)).</p> <p>The Board of VENCorp appoints the chief executive officer (s 179 of the <i>Gas Industry Act 2001</i> (Vic)).</p>	<p>A public company must have at least 3 directors, two ordinarily residing in Australia (s 201A).</p> <p>The constitution will usually specify the maximum number of directors who may be appointed.</p> <p>The constitution usually fixes the term of appointment. But a members' agreement may also do that (although a members' agreement is unlikely to be a suitable instrument for a company with a large and diverse membership).</p> <p>Section 248E of the <i>Corporations Act 2001</i> is a replaceable rule providing for the directors to elect a director to chair their meetings and may determine the period for which the director is to be Chair. The Chair will also be responsible for chairing general meetings of members, be the company's main spokesperson and do whatever the Board delegates her or him to do.</p> <p>The replaceable rule may be displaced and the constitution may provide that the Chair is appointed by another means. See further the discussion under appointment mechanism for Directors.</p>

	STATUTORY AUTHORITY	COMPANY*
Composition of the Board	MOWG suggested approach	MOWG suggested approach
	<p>Legislation by which the statutory authority would be established would require there to be a Board of directors of up to ten members comprising nine non-executive directors and the chief executive officer.</p> <p>The legislation would also prescribe that the chief executive officer is appointed by the non-executive directors.</p> <p>The maximum period of appointment for each director is three years with an option for a renewal of three years. In order to provide for a staggered appointment process, initially, periods of appointment will be for 1, 2 or 3 years only (all with an option for three renewal period).</p> <p>The Board would be required to (as a whole) demonstrate a particular skill set.</p> <p>A minimum of 3 and a maximum of 6 directors would be drawn from industry, meaning that the candidate has current knowledge and expertise in the energy sector experience. As a whole the majority of the Board would be required to meet the Australian Securities Exchange (ASX) Corporate Governance Principles and Recommendations meaning of independence: 'not a member of management and who is free of any business or other relationship that could materially interfere with - or could reasonably be perceived to materially interfere with the independent exercise of their judgement.' See further the discussion on the appointment process.</p>	<p>The constitution would contain similar provisions to those proposed to be included in the establishment legislation of the statutory authority. See further the discussion under the appointment mechanism for Directors.</p>

	STATUTORY AUTHORITY	COMPANY*
Appointment of Directors	Standard terms	Standard terms
	<p>Usually directors are appointed by the Governor-General/Governor in Council (and perhaps on terms and conditions set by the Minister).</p> <p>Legislation by which the statutory authority is established can specify the mechanisms for appointment of the Board as well as the precise parameters in relation to appointments. The membership of the AER, for example, is set out in Part IIIAA of the TPA. The Australian Energy Market Agreement includes further detail about the appointment process.</p>	<p>The mechanism of appointment could be in various instruments including the constitution, a members' agreement or legislation conferring relevant functions on AEMO.</p> <p>Subsequent appointments could be made by the members in a general meeting (see replaceable rule set out in s 201G of the Corporations Act) unless this is excluded by legislation, the constitution or members' agreement. Directors may also appoint a director (s 201H) but this is subject to subsequent confirmation by members.</p>
Appointment of Directors	MOWG suggested approach	MOWG suggested approach
	<p>As noted above, appointment would be made subject to the Board composition meeting specified criteria (i.e. the skills matrix).</p> <p>The establishment legislation would enshrine the selection panel process for the appointment of directors. Appointments would be made by the MCE accepting the advice of a statutorily authorised selection panel consisting of 2 'industry' members, 2 government members and an 'independent' chair, selected on an ex-officio basis.</p> <p>Another alternative, building on the process established for the AER (ss 44AM(3) and 44AP(3) of the TPA), would be to subject eligibility for appointment to nomination in accordance with a specified MCE agreement. The agreement would evidence the above process.</p> <p>The selection panel process would also provide for</p>	<p>The company's constitution or perhaps members' agreement would enshrine the selection panel process for the appointment of directors in the same way as described for a statutory authority.</p> <p>Another alternative is to legislatively prescribe the appointment process for the AEMO: the authority for the company to operate as AEMO would be contingent upon AEMO adopting and maintaining specified constitutional provisions for the appointment of Board members.</p>

	STATUTORY AUTHORITY	COMPANY*
	<p>the Chair of the Board to be specifically chosen.</p> <p>The Panel process would be maintained for Board appointments subsequent to the initial Board.</p>	
Removal of Directors	Standard terms	Standard terms
	<p>The establishment legislation may also set out the circumstances for vacancies, resignations and removal of directors (for VENCorp see s 172 of the <i>Gas Industry Act 2001</i> (Vic)).</p> <p>Under the ABC Act, the Governor-General may remove a non-executive director on specified grounds (s 18) including failure to comply with obligations, misbehaviour, bankruptcy, or absence from duty for a prolonged period.</p> <p>An AER member's appointment is terminated on a number of grounds including (among other things) physical or mental incapacity, bankruptcy and failure to disclose interests in accordance with s 44AY of the TPA (s 44AAB of the TPA).</p>	<p>The removal of directors of public companies is governed by the <i>Corporations Act 2001</i>. Nothing in the constitution of the company or any agreement can override its operation. A director cannot be removed by any resolution or action of the other directors. The removal takes effect by a resolution of the company, that is a resolution passed by a simple majority of those present and voting at a meeting (s 203D).</p> <p>The constitution usually also deals with retirement of directors by rotation at annual general meetings.</p> <p>There are various grounds for disqualification of a person from holding the office of director including conviction of certain offences (s206B(1)), bankruptcy (s 206B(3)) and upon some court orders (ss 206C, 206D and 206E).</p>
Removal of directors	MOWG suggested approach	MOWG suggested approach
	<p>Legislation establishing AEMO would provide for the circumstances for vacancies, resignations and removal of directors.</p>	<p>The <i>Corporations Act 2001</i> provides for the rights of members to remove a director as well as grounds for disqualification. MOWG does not suggest a departure from this. The constitution would also provide for vacancies and resignation of directors.</p>

	STATUTORY AUTHORITY	COMPANY*
Directors' remuneration	Standard terms	Standard terms
	<p>Legislation by which the AEMO is established may provide for the circumstances of Board members' remuneration.</p> <p>Generally, Board members of a Commonwealth authority are paid in accordance with a Remuneration Tribunal determination (see, for example, s 44AT of the TPA providing for the remuneration of AER members). For non-Commonwealth and non-Territory bodies, remuneration might be in accordance with a determination or advice of the State equivalent of the Remuneration Tribunal, for example, in Victoria the State Services Authority.</p> <p>VENCorp Board members are paid in accordance with terms and conditions determined by the Minister (s 168(2) of the <i>Gas Supply Act 2001</i> (Vic)).</p>	<p>Directors are only entitled to remuneration if there is express provision for this in the constitution (Hutton v West Cork Railway Co (1883) 23 Ch D 654).</p> <p>Subsection 202A(1) of the <i>Corporations Act 2001</i> is a replaceable rule that provides directors are to be paid the remuneration that the company determines by resolution. For other companies, remuneration is authorised by the constitution or by resolution of shareholders.</p> <p>Either the constitution or shareholders resolution may delegate the amount and form of remuneration to the Board.</p> <p>Chapter 2E of the <i>Corporations Act 2001</i> makes special provision for the payment of remuneration of directors.</p> <p>Members are able to obtain information about remuneration paid to directors.</p> <p>NEMMCO's Members' Agreement provides for the members to resolve directors' remuneration (cl 4.5 and see cl 4.3 of the articles of association). In practice, NEMMCO directors' remuneration is determined after members' consideration of a report by a human resource consultant.</p>
Director's remuneration	MOWG suggested approach	MOWG suggested approach
	<p>Legislation establishing the authority would provide for remuneration in accordance with a determination or advice of the Remuneration Tribunal or equivalent State body.</p>	<p>The constitution (or perhaps members' agreement) would provide for directors' remuneration to be decided by members after taking into account an 'independent' report. Independence may be clarified</p>

	STATUTORY AUTHORITY	COMPANY*
		to mean the report of a firm of human resource consultants.  There should be a prohibition on delegation to the Board of the right of members to decide remuneration.
Directors' responsibilities and powers	Standard terms	Standard terms
	The legislation by which the authority is established can expressly provide for directors' duties. The <i>Gas Industry Act 2001</i> (Vic), for example, requires, among other things, VENCORP directors to act honestly and to exercise a reasonable degree of care and diligence at all times (s 169). A full time AER member is prohibited from engaging in paid employment outside the duties of his or her office without the Minister's consent (s 44AX of the TPA).	Directors are directly liable under the <i>Corporations Act 2001</i> for their handling of the company's affairs. Obligations include the duty of care and diligence (s 180), the duty of good faith (s 181), and the proper use of position (s 182).  NEMMCO's articles of association make provision in relation to 'interested directors' (cl 4.5).
Directors' responsibilities and powers	MOWG suggested approach	MOWG suggested approach
	Legislation establishing the authority would expressly provide for the directors' duties. One option would be to require directors to be bound by the directors' duties set out in the relevant provisions of the <i>Corporations Act 2001</i> .	Specific provision in the <i>Corporations Act 2001</i> for directors' duties obviates the need for particular provision for the AEMO. However, MOWG considers the constitution should also include provisions dealing with circumstances in which directors may have a conflict of interest.
Board Meetings	Standard terms	Standard terms
Decisions of the Board are expressed as resolutions.	The authority's establishment legislation may provide for Board proceedings. Section 173 of the <i>Gas Industry Act 2001</i> (Vic), for example, prescribes what constitutes, for VENCORP, a quorum, how Board resolutions are to be made and that minutes	The company's constitution may prescribe who has the power to call a Board meeting and what constitutes a quorum. The 'replaceable rules' prescribe that a directors' meeting may be called by a director giving reasonable notice individually to

	STATUTORY AUTHORITY	COMPANY*
	must be kept. For the AER, see s 44AAD of the TPA.	every other director and that a quorum is constituted by two directors (see 'replaceable rules' 16 and 18, ss 248C and 248F of the <i>Corporations Act 2001</i> ).  Resolutions are required to be recorded in the minutes of each meeting (s 251A(1)).  The constitution may also provide for the making of Board resolutions. Section 248G is a replaceable rule that provides that a resolution of the directors must be passed by a majority of the directors entitled to vote on the resolution.
Board meetings	MOWG suggested approach	MOWG suggested approach
	Legislation establishing the authority would expressly provide for the procedure to be adopted at Board meetings. One alternative may be to apply the relevant <i>Corporations Act 2001</i> replaceable rules to the authority.	The constitution would adopt the relevant replaceable rules as outlined above.
<b>GENERAL OTHER</b>		
Power to alter functions	Standard terms	Standard terms
	Legislation will provide for an authority's functions in accordance with the Rules. Under this model, depending on the detail of a proposed additional function, legislative amendment or changes to the Rules may be required.  Sections 15 and 29 of the National Electricity Law set out the functions of the AER and the AEMC. (Also see ss 44AH and 44AI of the TPA).	A company's objectives and functions may be set out in the constitution.  A company may modify or repeal its constitution by special resolution passed by members in general meeting (s 136(2)). The constitution may require compliance with a further requirement (s 136(3)). For example, the resolution may require a greater majority than for a special resolution (i.e. greater than 75%) or require the consent of certain persons.  There are some limits on altering the constitution including that they must be consistent with the

	STATUTORY AUTHORITY	COMPANY*
		<p><i>Corporations Act 2001</i> and, for listed companies, the listing rules. The constitution cannot impose duties or confer rights on outsiders. Variation or cancellation of the rights of a particular class of shareholders can only occur after following the procedure set out in s 246B.</p> <p>In addition to the functions conferred on it by s 49 of the NEL, NEMMCO's Members' Agreement provides for its objectives (cl 2.1) and the circumstances in which the Board requires the approval of three quarters of the members to carry out particular functions (cl 5.3 and also see cl 11(e)).</p> <p>There is scope to manage a company's functions by prescription by restrictive provision in the constitution: for AEMO, the functions would be as set out in legislation and Rules. Additionally, as in the case of the statutory authority, it may be solely managed by legislation and supplemented by the Rules. On this model, functions might only be altered by legislation or a rule change by the AEMC.</p> <p>NEMMCO, Gas Market Company (GMC) and Retail Energy Market Company (REMCo) all have the capacity to alter their functions by agreement of the membership. Although REMCo must seek approval from the ERA in WA to changes to the Constitution.</p>
Power to alter functions	MOWG suggested approach	MOWG suggested approach
	Legislation establishing the authority should exclusively provide for the functions of the AEMO in	Whether members should have the power to authorise AEMO to undertake new functions, or alter its existing functions is something on which MOWG

	STATUTORY AUTHORITY	COMPANY*
	accordance with the Rules.	is seeking views. This issue has been discussed in more detail in Chapter 2.
Members' meetings	Standard terms	Standard terms
This is only relevant for a company.	Not applicable	<p>General meetings and class meetings are governed by the constitution (or replaceable rules where companies elect to have them apply).</p> <p>Meetings may be convened by the Board of directors, individual director, court or members of the company.</p> <p>The chair of an annual general meeting must allow a reasonable opportunity for the members 'as a whole' to ask questions about or make comments on the management of the company (s 205S).</p> <p>There is similar provision in relation to questioning the auditor (s 205T) and in relation to director's remuneration report (s 250S).</p>
Members' meetings	MOWG suggested approach	MOWG suggested approach
	Not applicable	There appears to be no reason to depart from the <i>Corporations Act 2001</i> provisions.
Liability	Standard terms	Standard terms
	<p>The legislation may provide for the immunity of the statutory authority, its directors and employees from any common law action (excluding criminal law action) that might otherwise be brought against them.</p> <p>Another option is to cap the amount of damages</p>	<p>Legislative provision similar to that discussed for a statutory authority may be made in relation to a company limited by guarantee.</p> <p>Section 119 of the NEL limits liability of NEMMCO, an officer or employee to circumstances where they have acted in bad faith or for negligence. Section</p>

	STATUTORY AUTHORITY	COMPANY*
	<p>payable by the authority for the damage caused. See the discussion for a company.</p> <p>Consideration might also be given to providing an indemnity to the authority, its officers and employees for any successful damages claims. However, significant issues often arise in relation to the scope of indemnities and the power of governments to give them in particular cases.</p>	<p>119 caps the liability of NEMMCO or an officer or employee of NEMMCO done or made through the negligence by regulation.</p> <p>REMCo enjoys liability limitations and indemnity provisions contained in Rules 377 and 377A of the RMR7.</p> <p>GMC enjoys similar liability limitations and indemnity provisions under the Service Receiver Agreements it has with parties to whom it provides retail market services.</p>
Liability	MOWG suggested approach	MOWG suggested approach
	MOWG considers it is appropriate to legislatively provide for the limitation of liability of the AEMO in terms equivalent to s 119 of the NEL. MOWG	MOWG's considerations in relation to the liability provisions for a company limited by guarantee are

<sup>7</sup> **377 – REMCo's limitation of liability**

- (1) To the extent permitted by law, REMCo its officers, employees and agents will not be liable for any direct, indirect, incidental, special or consequential damages or loss of profits or revenue claims of any kind which result from any breach, unlawful act or negligent act or omission of REMCo, its officers, employees or agents in performing its obligations under these rules.
- (2) Where liability under these rules cannot by law be excluded, REMCo's liability (including any liability of its officers, employees and agents) to participants, pipeline operators or prescribed persons in respect of any breach of REMCo's obligations under these rules is (at REMCo's option) limited to:
  - (a) supplying the services again; or
  - (b) paying the cost of having the services supplied again.
- (3) In this rule "agent" includes contractors and third parties engaged to provide goods or perform services relating to REMCo's obligations under these rules for or on behalf of REMCo.

**377A. Indemnifying REMCo**

- (1) Each participant, pipeline operator and prescribed person ("indemnifying party") must indemnify and keep indemnified REMCo from all losses, costs (including legal costs on a solicitor client or full indemnity basis, whichever is the greater), expenses, claims (including third party claims, claims in respect of loss of revenue or profit or claims for punitive or consequential damage), demands, proceedings or liability suffered or incurred by REMCo arising directly or indirectly from or as a consequence of any or all of any breach, unlawful act, or negligent act or omission of the indemnifying party, or its officers, employees or agents, in carrying out its obligations under these rules.
- (2) The maximum aggregate amount payable by a party under rule 377A(1) is limited to \$10,000,000.

Each participant, pipeline operator and prescribed person must be insured in respect of potential liability, loss or damage, arising under rule 377A(1), for a minimum aggregate liability of \$10,000,000, and must maintain such insurances during the period that it is operating under these rules and for a period of 7 years thereafter.

	STATUTORY AUTHORITY	COMPANY*
	seeks views on other possible models including the REMCo model.	the same as for a statutory authority.
Winding up	Standard terms	Standard terms
	The legislature may, at any time, terminate a statutory authority's existence. Implications for affected persons would require detailed consideration.	An insolvent company may be wound up either under court order or in a creditor's winding up. The liquidator takes over from the directors as the person to administer the company's property. A members' meeting may only be held if the court so requires. Members may be liable to be called upon up to the limit of their guarantee (s 517 of the Corporations Act).
Winding up	MOWG suggested approach	MOWG suggested approach
	There does not seem to be a need to depart from standard arrangements.	There does not seem to be a need to depart from standard arrangements.
<b>REPORTING REQUIREMENTS#</b>		
Financial Report	Standard terms	Standard terms
Financial statements consist of a profit and loss statement for the year, balance sheet as at the end of the year, and a statement of cash flows for the year.	The required content of an authority's annual or financial or operational report may be set out in legislation. Generally a report would be required to be provided to the Minister and tabled in Parliament.  VENCorp is required to provide an annual report for a financial year under Part 7 of the <i>Financial Management Act 1994</i> (Vic) (s 185 of the <i>Gas Industry Act 2001</i> (Vic).	The financial report is provided to members and lodged with the Australian Securities and Investment Commission (ASIC) (ss 314, 315(1), 317 and 319 of the <i>Corporations Act 2001</i> ). The financial report is a public document that is generally available on a website. It must comply with accounting standards (s 296(1)). The financial statements must give a true and fair view of the financial position and performance of the relevant entity (s 297). The financial report must include the directors' declaration (s 295(4)).

	STATUTORY AUTHORITY	COMPANY*
Financial Report	MOWG suggested approach	MOWG suggested approach
	Legislation establishing the authority would set out the requirements in relation to reporting. One alternative is to replicate the <i>Corporations Act 2001</i> requirements for a company.	The <i>Corporations Act 2001</i> provisions are appropriate.
Directors' Report	Standard terms	Standard terms
Review of operations and principal activities, and of any matters that have arisen that may affect operations in future financial years.	See the discussion under Financial report.	A directors' report must be attached to the annual financial report for each financial year and must include both general and specific information. (ss 292, 298-299A). It is provided to members and lodged with ASIC.
Directors' Report	MOWG suggested approach	MOWG suggested approach
	See the recommendation under Financial report	The <i>Corporations Act 2001</i> provisions are appropriate.
Auditors' Report	Standard terms	Standard terms
	See the discussion under Financial report.	A public company's auditor must report on the financial report for both a financial year and a half year (ss 308 and 309). It is provided to members and lodged with ASIC. A company limited by guarantee is a public company.
Auditors' Report	MOWG suggested approach	MOWG suggested approach
	See the recommendation under Financial report	The <i>Corporations Act 2001</i> provisions are reasonable and appropriate and should apply.

	STATUTORY AUTHORITY	COMPANY*
Budget	Standard terms	Standard terms
	<p>A Commonwealth statutory authority is funded by budgetary appropriation (which would probably be equal to the sum of market participants' fees in the case of AEMO). A state statutory authority may be directly funded by market participants' fees.</p> <p>VENCorp must prepare a corporate plan each year. The corporate plan must include a statement of corporate intent, a business plan and relevant financial statements (ss180 and 181 of the <i>Gas Industry Act 2001(Vic)</i>). The Board is required to consider comments (if any) from the Treasurer and the Minister on the proposed plan if made within 2 months after the plan was submitted to the Treasurer and the Minister.</p> <p>The Australian Prudential Regulation Authority (APRA) is funded primarily through levies imposed on the industries it supervises. While these levies, known as the Financial Institutions Supervisory Levies, are administered transactions collected on behalf of the Government and paid into the Consolidated Revenue Fund (CRF), an amount equal to the net levy revenue, less an amount specified by the Minister in an annual determination made under subsection 50(1) of the <i>Australian Prudential Regulation Authority Act 1998</i> (APRA Act), is payable to APRA as a Special Appropriation, in accordance with subsections 50(2), (3) and (5) of the APRA Act. The amounts specified in the Minister's Determinations are retained in the CRF to cover the costs of providing market integrity and consumer protection functions for prudentially</p>	<p>A company would be funded by market participant fees. The Board will control expenditure. Board accountability is managed by the <i>Corporations Act 2001</i> requirements to provide annual and half yearly financial reports and directors' reports. The constitution or members' agreement may impose additional requirements.</p> <p>Under NEMMCO's Members' Agreement, the Board must prepare and submit to the members a draft annual budget for their comment, one month before commencement of the financial year. The draft budget sets out, among other things, the projected income and expenses of NEMMCO, and cash flow projections, together with a projected closing balance sheet. The Board must consider any written comments received within one month after the commencement of the financial year from members on the draft budget. The Budget must be adopted within three months after commencement of the financial year.</p> <p>In carrying out its activities for the financial year, NEMMCO must use reasonable endeavours to comply with the budget for that financial year.</p> <p>The REMCo Board establishes the capital and operating budget on an annual basis. Management prepares a bottom up cost forecast for the operation of the SA and WA gas markets, including any suggested capital investments. This forecast is used to establish the fees for the forthcoming financial year in May (so as to provide the required 40 business days notice of the fees to participants</p>

	STATUTORY AUTHORITY	COMPANY*
	regulated institutions, functions that are conducted by other Australian Government entities.	prior to the change over of the financial year). In June, the forecast is updated with any new information gathered since the fees were set and this is presented to the Board for approval as the budget for the following financial year.  The REMCo Board approves the budget.
Budget	MOWG suggested approach	MOWG suggested approach
	Standard provisions would apply.	Standard provisions would apply. The NEMMCO arrangements in relation to budgets (set out above) should apply to AEMO. The AEMO processes should be timed so as to provide sufficient notice to the participants of any change to the fees before the changes take effect (40 days is considered appropriate for the SA and WA gas markets).
The Corporate Plan/Statement of Corporate Intent	Standard terms	Standard terms
<p>Sets the strategic direction of AEMO (outlining objectives, functions, risks and shareholder reporting) and monitors its performance against pre-determined goals, ensuring that both the internal controls and reporting procedures are adequate and effective, and establish appropriate ethical standards.</p> <p>Allows oversight of broad corporate strategy, without requiring direct ongoing operational involvement of ministers.</p>	<p>A statutory authority may be required to provide to the Minister a statement of corporate intent or a corporate plan – see, for example, s 31A of the <i>Australian Broadcasting Corporation Act 1983</i> (ABC Act). The ABC Act also requires the ABC Board to notify the Minister if the Board forms the opinion that, among other things, matters have arisen that may prevent the achievement of the corporate plan (s 31D).</p> <p>VENCorp is required to provide a corporate plan to the Minister and the Treasurer on or before 31 May each year (s 180 of the <i>Gas Industry Act 2001</i> (Vic)). The plan must include a statement of</p>	<p>A company may be required, by its constitution or members' agreement to provide a statement to its members and the public generally. It may be published and available electronically on a website.</p> <p>NEMMCO is required by the Members' Agreement to submit to the Members a draft written Statement of Corporate Intent not later than one month before the commencement of each Financial Year. The Board is required to consider any comments on the draft Statement of Corporate Intent. A final statement must be given to the Members within three months after the commencement of the Financial Year. The Statement may be modified at</p>

	STATUTORY AUTHORITY	COMPANY*
	corporate intent, a business plan and financial statements. Section 181 of the <i>Gas Industry Act 2001</i> (Vic) sets out the required contents of the statement of corporate intent.	any time by written agreement of three quarters in number of the Members. The agreement provides for the content of the Statement and, among other things, includes objectives, main undertakings, nature and scope of activities to be undertaken.
The Corporate Plan/Statement of Corporate Intent	MOWG suggested approach	MOWG suggested approach
	Establishment legislation would require a statement of corporate intent and reporting against it including notification to the Minister of departures from the plan. Ministerial approval may or may not be required.	The NEMMCO arrangements in relation to the Statement of Corporate Intent (set out above) should apply to AEMO.
Other Requirements	MOWG suggested approach	MOWG suggested approach
Since January 2003 each listed company has been required to include in its annual report a disclosure of the extent to which it has followed the ASX Best Practice Corporate Governance recommendations.	Consideration be given to requiring compliance with ASX LR 4.10.3 concerning reporting against the ASX Best Practice Corporate Governance recommendations where appropriate. If the authority has not followed the recommendations, it must identify those recommendations and give reasons for not following them (ASX LR 4.10.3).	AEMO should be required to comply with ASX LR 4.10.3 concerning reporting against the ASX Best Practice Corporate Governance recommendations where appropriate. If the company has not followed the recommendations, it must identify those recommendations and give reasons for not following them (ASX LR 4.10.3).

\* If the company is a Commonwealth company it will have to comply with the *Commonwealth Authorities and Companies Act 1997 (CAC Act)*. A Commonwealth company means a *Corporation Act* company in which the Commonwealth has a controlling interest. However, it does not include a company in which the Commonwealth has a controlling interest through one or more interposed Commonwealth authorities or Commonwealth companies (s 34 of the *CAC Act*).

# Generally the financial report, directors' report and audit report are included in the one document known as the annual report. Matters that may be reported include: Financial Summary, Operational Summary, Overview of NEM, Chairs' report, Message from Managing Director and Chief Executive Officer, Board of Directors, List of Registered Participants, AEMO Senior Management, AEMO Performance, Advisory Committee, Performance Management, Review of Operations, Internal Efficiency, Electricity Market & Power System and Operations, Electricity Market and Power System Development, Gas Market & Power System and Operations, Gas Market and Power System Development, Corporate Governance, Financial Statements, Statement of Financial Performance, Statement of Financial Position, Statement of Cash Flows, Directors' Declaration, and Independent Audit Report.

### 4.3. PART TWO – TRADE PRACTICES ACT, REVIEW MECHANISMS AND DISPUTE RESOLUTION

Discussion to this point in this Chapter has focussed on structuring the relative accountability measures that might be applied to a statutory authority and company limited by guarantee to achieve equivalence: a body bound by open, transparent and effective governance. Broad equivalence of the framework within which AEMO operates suggests that the choice of appropriate structure is likely to be made on other grounds.

This part of the Chapter deals with other measures of accountability that might uniformly apply to either structure: the application of the TPA, the application of merits and judicial review of decisions of AEMO and dispute resolution procedures.

#### 4.3.1. The application of the TPA

Part IV of the TPA prohibits anti-competitive trade practices such as anti-competitive agreements (s 45), misuse of market power (s 46) and exclusive dealing (s 47). Part V of the TPA deals with consumer protection. This part of the paper only deals with the application of Part IV of the TPA to the activities of AEMO.

#### 4.3.2. Application of the TPA to AEMO as a statutory authority

The TPA will apply to AEMO established as a company limited by guarantee.

There is, however, an issue whether the TPA will apply to AEMO established as a statutory authority. Generally, the TPA will apply to a statutory corporation of the Commonwealth or a State or Territory so far as it is "carrying on a business" (under ss 2A and 2B, although the application to corporations of a State/Territory is limited to Parts IV, VB and XIB of the Act).

Section 2C of the TPA specifies certain activities that will not constitute 'carrying on a business'. Among these activities are imposing and collecting levies or fees for licences (ss 2C(1)(a)(ii) and (iii)), neither of which would appear to capture the collection of market participant fees. Further the specific exemptions provided in s 2C are not exhaustive (s 2C(2)).

For the purposes of the following discussion, it seems reasonable to assume the TPA applies to at least some activities of AEMO as a statutory authority.

#### 4.3.3. AEMO activities carried out under mandatory statutory obligations do not contravene the TPA

The Australian Government Solicitor has advised that to the extent that certain activities undertaken by AEMO might otherwise contravene Part IV of the TPA, some comfort may be drawn from the statutory basis for those activities. This is because many of the prohibitions contained in Part IV of the TPA are conditioned on the finding of a contract, arrangement or understanding underlying the impugned conduct. Absent this, no contravention will be established. For this reason, to the extent that AEMO is acting pursuant to mandatory statutory obligations, its conduct is unlikely to attract the prohibitions in Part IV of the TPA. This issue was canvassed by the MCE SCO with industry in 2005 after receiving advice from Mr Noel Hutley QC and Ms Sarah Pritchard<sup>8</sup>.

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<sup>8</sup> The advice is available at <http://www.mce.gov.au/assets/documents/mceinternet/NationalElectricityMarketRulesAdvice2004081214141420041124121714%2Epdf>

#### 4.3.4. AEMO activities carried out other than under mandatory statutory obligations

Where, however, AEMO is not acting pursuant to mandatory statutory obligations, for example where the AEMO enters into an agreement permitted or contemplated by the Rules, there may be a risk of contravention of the TPA. The Hutley QC advice identified some possibly relevant examples in the National Electricity Rules: agreements for the provision of non-market ancillary services; and system operation agreements<sup>9</sup>. Liability will turn on whether the particular agreement contains an exclusionary provision, exclusive dealing provision or provision substantially lessening competition.

This circumstance exists today for REMCo and GMC. Each company has different operating conditions which have led to a different approach to the management of this risk. REMCo sought and received an authorisation from the Australian Competition and Consumer Commission (ACCC) for certain conduct it undertakes as the Retail Market Administrator of the South Australian and Western Australian gas markets. GMC did not consider an authorisation necessary. The approach taken by the company in each case was determined by a decision of the Board of directors based on independent legal advice.

The REMCo authorisation was for a period of 5 years from commencement of operations. This will cease in mid 2009.

#### 4.3.5. Misuse of market power – s 46 of the TPA

Section 46 prohibits particular conduct of a corporation that has a substantial degree of market power. Generally, s 46 does not apply where the power being used is not market power but is the exercise of a regulatory function conferred upon it by the legislature in the public interest (*Stirling Harbour Services Pty Ltd v. Bunbury Port Authority* (2000) 22 Australian Trade Practices Reports (ATPR) 41-783). It is the nature of the power being exercised that is determinative (whether market or regulatory), not simply that the conduct of the authority is supported by statutory authority. Further, the body must take advantage of that market power for a particular prohibited purpose – i.e. for the purpose of eliminating or damaging a competitor or of preventing the entry of a person into the market or of deterring or preventing a person from engaging in competitive conduct.

To the extent that AEMO exercises regulatory powers in the public interest either operating the National Electricity Market or in carrying out its other functions it will not misuse its market power contrary to s 46 of the TPA.

An assessment of issues arising under the TPA also needs to take into account the operation of s 51 of the TPA, which deals in part with actions authorised by legislation.

#### 4.3.6. The application of merits and judicial review of decisions of AEMO

The issue of review schemes within the gas and electricity frameworks has been the subject of extensive consultation and consideration by the MCE following the release of the Productivity Commission 'Review of the Gas Access Regime' in June 2004. In particular the MCE SCO has released both a discussion paper in October 2005 and a decision paper in May 2006<sup>10</sup>. The following discussion draws heavily from those papers.

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<sup>9</sup> See pages 44-46 of the Hutley QC advice.

<sup>10</sup> See the MCE SCO discussion paper 'Review of Decision-making in the gas and electricity regulatory frameworks' dated 10 October 2005 (available at <http://www.mce.gov.au/assets/documents/mceinternet/GasElectricityRegulatoryFrameworkDiscussionPaperOct0520051010115146%2Epdf>) and the MCE SCO decision paper 'Review of Decision-making in the gas and electricity regulatory frameworks' dated May 2006 (available at <http://www.mce.gov.au/assets/documents/mceinternet/FINALMeritsReviewDecision20060602101741%2Epdf>).

Merits or judicial review is not an end in itself, but a means to ensure accountability for decision-making. Review is part of a broader regulatory framework providing for accountability of bodies entrusted with exercising regulatory functions and powers.

#### 4.3.6.1. Judicial review

Statutory bodies, such as the AEMC and AER, as well as bodies performing public and quasi-regulatory functions such as NEMMCO, must make decisions and take actions that are within the statutory and regulatory powers conferred by the law. These bodies are held accountable for failure to do so by a person seeking judicial review of a given decision. As a Commonwealth body, the AER is subject to judicial review both under the *Administrative Decisions (Judicial Review) Act 1977* as well as under s 75(v) of the Constitution and s 39B of the *Judiciary Act 1903*. Any ambiguity as to whether the decisions of NEMMCO or AEMC are reviewable has been removed by s 71 of the NEL which explicitly provides for judicial review of AEMC and NEMMCO decisions in State or Territory Courts.

The grounds of standard judicial review are directed to finding whether the statutory entity or other decision maker has acted within the scope of its statutory powers, and whether there has been any denial of procedural fairness in the decision-making process. The issue is whether the discretion has been exercised rationally in a legal sense rather than is correct in a technical sense. The court cannot substitute what it considers to be the correct or preferable decision; it is confined to deciding whether the decision maker has acted lawfully.

The powers of a court to make orders to correct any errors of law are generally limited to setting aside or quashing the original decision, remitting the decision to the original decision maker to reconsider according to any directions of the court and making declarations and giving directions.

Judicial review is a well established and sound means of providing for accountability in decision making. There does not appear to be any sound reason why decisions of AEMO should not be subject to judicial review.

#### 4.3.6.2. Merits review

Merits review can work alongside judicial review and involves more than just whether a decision contains an error in law. Generally, merits review considers whether the decision under review is the "correct and preferable" decision and can be based on the facts, the policy, the reasoning and the law. The reviewer stands in the shoes of the original decision maker and makes the decision again. The objective of merits review is not only to ensure that a decision is legal, but also to ensure that it is fair for all affected persons thereby improving the quality and consistency of the decisions of primary decision-makers.

The MCE has decided that several decisions within the gas and electricity framework would be subject to merits review (including pricing and revenue determinations for transmission and distribution in electricity). MCE also decided to apply a detailed and limited merits review model to cater for issues surrounding the particular decisions being reviewed. This model may not necessarily be appropriate for other types of decisions such as those it is envisaged will be made by AEMO.

The MCE recognised that decisions about whether a merits review framework is needed in addition to judicial review framework need to consider the nature of the decision being reviewed, the impact of the decisions on those affected by the decision, how a merits review process would work within the particular decision making framework and the other accountability requirements on the decision maker that are likely to lead to good decision making.

As part of its deliberations on the NEL and associated Rules the MCE considered the decisions that were previously reviewable on the merits under the old NEL and the National Electricity Code by the National Electricity Tribunal. The MCE declined to include those

decisions as reviewable on the merits. In particular, MCE declined to include on that list NEMMCO determinations on who may participate in the NEM via a registration process under Part 2 of the National Electricity Rules. This was on the basis that those decisions were relatively straightforward and judicial review was regarded as an adequate safeguard. The MCE SCO has recently confirmed this decision in the response to submissions on the proposed Amendments to the NEL.

The MCE SCO has also recently confirmed its decision to apply a limited form of merits review in respect of the following decisions related to access to gas pipelines<sup>11</sup>:

- ministerial decisions in relation to coverage of gas pipelines (including 15-year no-coverage determinations but not price regulation exemptions);
- decisions by the AEMC on the form of regulation for individual covered pipelines (price regulation by access arrangement or light regulation);
- AER decisions to draft and approve (or revise) access arrangements;
- AER ring fencing decisions including approval of associate contracts; and
- ministerial decisions to revoke greenfields pipeline incentives for misrepresentation.

These decisions have been identified by the MCE as being suitable for a form of merits review on the basis that (i) they may have a substantial impact on the economic viability of network and service providers and (ii) the decision-making power may involve the exercise of significant amounts of discretion. However, all of these decisions go well beyond the types of decisions to be made by AEMO.

Having regard to the very recent and detailed MCE consideration of reviews within the gas and electricity framework (and without making any comment on the merits of the MCE position), MOWG does not propose re litigating those decisions. On this basis it is not suggested that decisions, additional to those proposed by MCE and set out in the NEL and the NGL, be subject to merits review.

#### 4.3.7. Enforcement and dispute resolution

The AER was established under Part IIIAA of the TPA in 2004 as the enforcement body for all of the Australian Energy Market Legislation. It has the power to take court action in relation to breaches of the Australian Energy Market Legislation in the TPA itself (see s 44AAG) and in the NEL and the NGL (see, for example, s 61 of the NEL).

As noted in Chapter 2, the gas market operators generally monitor compliance with gas market rules and in certain circumstances initiate or undertake compliance functions.

Allens Arthur Robinson (AAR) comprehensively dealt with issues concerning enforcement including dispute resolution in the national framework for electricity and gas in the consultation paper on the national framework for non-economic distribution and retail that it prepared for the MCE's Retail Policy Working Group (released in June 2007)<sup>12</sup>.

The AAR paper noted:

Under section 15 of the NEL, the AER's functions include monitoring compliance with the NEL, the Regulations and the National Electricity Rules, investigating breaches of these

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<sup>11</sup> See in particular the SCO explanation of the gas legislative package (dated November 2006) (<http://www.mce.gov.au/assets/documents/mceinternet/Explanation%5Fof%5Fthe%5Fgas%5Flegislative%5Fframework%5FNov0620061107113652%2Epdf>) and the SCO response to submissions on the first exposure draft of the <http://www.mce.gov.au/assets/documents/mceinternet/SCO%5FResponse%5Fto%5Fissues%5Fraised%5Fin%5Fsubmissions%5Fon%5FNGL20070301103008%2Epdf>

<sup>12</sup> Available on the MCE website at <http://www.mce.gov.au/assets/documents/mceinternet/National%5Fframework%5Ffor%5Fnon%5Feconomic%5FDistribution%5Fand%5FRetail%5FRegulation20070619165729%2Epdf>

instruments (other than criminal breaches) and instituting enforcement action. The proposed amendments to the NEL and new NGL will allow the AER to initiate action on the limited number of criminal provisions in the laws but also explicitly precludes criminal sanctions from being included in Rules (see new ss 15 and 34A of the NEL amendments). The legal architecture proposed for the new national distribution and retail regulation will involve substantive regulatory obligations being incorporated in the Law or Rules, so that the current formulation in the NEL will extend the AER's responsibilities to the new regulatory obligations<sup>13</sup>.

MOWG agrees that the AER as national regulator should continue to enforce compliance with the Law, Regulations and Rules. While the AEMO's functions necessitate that it will continue to work with the industry and AER with regard to enforcement issues, MOWG does not suggest AEMO assume any enforcement functions or be given any additional powers in this area.

An alternative approach would be to continue the compliance functions of the existing gas market operators under their respective Rules, and vest in the AER the role of compliance with the Law and Regulations.

In addition to court or tribunal based enforcement mechanisms, infringement notices and administrative remedies AAR made reference to the dispute resolution procedure provided for in Chapter 8 of the National Electricity Rules:

Among other things, the dispute resolution procedures apply to disputes about:

- the application or interpretation of the Rules;
- the failure of Registered Participants to reach agreement on a matter where the Rules require agreement or provide for the Registered Participants to negotiate in good faith with a view to reaching agreement;
- the payment of monies under or concerning any obligation under the Rules;
- any other matter relating to or arising out of the Rules to which a contract between two or more Registered Participants provides that the dispute resolution procedures under the Rules are to apply<sup>14</sup>.

We note that NEMMCO is deemed to be a registered participant for the purposes of the Chapter 8 procedure.

In principle, AAR saw no strong argument for excluding the application of Chapter 8 to the new Rules. However, AAR was cognisant of the difference between the gas and electricity sectors this would create. MOWG agrees with AAR's views and that, for the purposes of Chapter 8, AEMO be treated similarly to NEMMCO. Any consideration of this issue should take place at the drafting stage for the non-economic distribution and retail package. Any dispute resolution arrangements for gas market issues (including gas retail issues) will need to be further considered in the relevant work streams.

#### **4.4. PART THREE – FUNDING**

The remaining key issue for the broad accountability framework in which the AEMO will operate is in relation to its funding requirements.

At its meeting on 13 April 2007, COAG agreed "to establish a single industry funded national energy market operator [AEMO], for both electricity and gas..."

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<sup>13</sup> Ibid p 91

<sup>14</sup> Ibid, p 100

The main feature of this decision is that AEMO is to be funded by industry rather than purely by government budget appropriations. This is in keeping with the arrangements in place for existing market operators as outlined below.

MOWG has given preliminary consideration to the current funding arrangements in relation to each of NEMMCO, VENCORP, GMC and REMMCO and key principles by which arrangements in relation to funding should be set.

In principle, MOWG considers that generally arrangements in relation to fees should reflect these current funding arrangements. MOWG suggests also that AEMO have the capacity to provide, on request, advice to governments on a cost recovery basis (see Chapter 2 dealing with AEMO functions).

Although MOWG considers the body best placed to consider and develop the detail in relation to AEMO's funding requirements is the initial Board, this should ideally be done within the context of a clear and structured framework set by the MCE (including by the Law and Rules). Accordingly, MOWG suggests that the issue of funding be left to the Board in accordance with key principles settled by the MCE. MOWG supports the industry consultative process in place for NEMMCO and suggests similar arrangements should apply to AEMO.

MOWG considered it useful to set out existing funding arrangements and some suggested key principles that might be applied to guide the Board when addressing this issue.

*MOWG seeks comments on the funding arrangements for AEMO.*

#### 4.4.1. Existing funding arrangements

##### 4.4.1.1. NEMMCO funding arrangements

NEMMCO is a public company limited by guarantee and is operated on cost recovery, not-for-profit basis.

Section 2.11 of the National Electricity Rules requires NEMMCO to develop, review and publish the structure of participant fees. This is required to be carried out against four key principles:

- fee arrangements should be simple;
- provide for cost recovery on a specified basis;
- be cost reflective; and
- not unreasonably discriminate.

The fees charged by NEMMCO are divided into a number of components as follows:

- *general fees component* – apportioned on the following basis:
  - 70% representing an allocated cost component which is further subdivided as follows:
    - 55% to market customers; and
    - 45% to generators and market network service providers; and
  - 30% representing fees for administration and other costs which cannot be directly allocated; and
- full retail contestability (FRC) fees – for FRC administration;
- incremental services component – a service fee or charge for additional services obtained by a market participant over and above others in the relevant class; and

- participant compensation fund component - charged to scheduled generators and scheduled network service providers.

NEMMCO consults with market participants on the design of the fee structure.

#### 4.4.1.2. VENCORP funding arrangements

VENCORP is a statutory authority funded by the industry it serves through a number of different mechanisms:

- market participants fund its statutory gas functions through fees regulated by the ACCC/AER;
- full retail contestability activities are funded by fees regulated by the Essential Services Commission;
- electricity functions are funded through transmission use of service charges which are calculated in accordance with the National Electricity Rules; and
- non-statutory functions are provided on a fee-for-service basis, which provide VENCORP with the flexibility to undertake commercial functions in other jurisdictions, a recent example of which is the administration of full retail contestability in Queensland.

#### 4.4.1.3. Gas Market Company (GMC) funding arrangements

The Gas Market Company (GMC) is a public company limited by guarantee and is operated on a not-for-profit basis.

The Board of the GMC determined that the most efficient and cost effective approach to operating the New South Wales and Australian Capital Territory Gas Retail Market was to outsource its key roles and functions to service providers rather than developing internal capabilities.

Under the GMC Constitution and the service receiver agreements between gas suppliers and GMC, members of GMC agree to a set of "funding principles" which set out the basis on which the total costs of establishing, operating and maintaining the company (total costs) will be recovered from members. The funding principles are set out in full in the Schedule to the Constitution. In summary, the total costs of GMC, (excluding some specific costs associated with "user pays" services under the Business Rules) are recovered from members as follows:

- 10 per cent of the total costs of GMC are recovered from members (both gas suppliers and reticulators (network operators) in equal shares (the standing charge);
- up to 45 per cent of the total costs of GMC are recovered from members who are gas suppliers, based on the proportion of gas delivery points that are allocated or transferred to them in a calendar month as compared with the total number of delivery points of all gas suppliers at the end of that calendar month (transaction rate charge); and
- up to 45 per cent of the total costs of GMC are recovered from members who are gas suppliers, based on their market share (i.e. the proportion of gas delivery points for which the gas supplier is responsible compared to the total number of delivery points of all gas suppliers (market share charge).

GMC operates on a cost recovery basis only, specifically not generating surpluses year on year. Any excess surplus from operations is returned to members as a reduction in fees in the following year.

GMC is currently developing a Gas Continuity Scheme, which will apply to shippers, pipeline operators and retailers, and will be funded in the design, implementation and operational phases by shippers and pipeline operators. The cost allocation methodology has not yet been finalised.

#### 4.4.1.4. REMCo funding arrangements

REMCo is a public company limited by guarantee and is operated on a not-for-profit basis.

REMCo generates revenue to cover its capital and operational costs associated with administration of the rules from its members in three forms:

- a joining fee;
- an annual fee; and
- a market share charge.

This approach to cost recovery is defined in the Retail Market Rules and is based on the following principles:

1. in recovery of its costs, the charges imposed by REMCo on users, who are REMCo members, shall not be such as to create a material barrier to entry for new entrants;
2. fees and terms and conditions should be simple to understand and implement;
3. to the extent that is administratively feasible, the fee set should provide efficient market signals;
4. the costs are to be clearly identifiable;
5. costs may be recovered in such a way as to ensure account is taken of the time value of money;
6. any shared or common costs relating to REMCo's establishment or operation in both jurisdictions must be allocated between jurisdictions in proportion to the total number of commissioned and decommissioned metering installation registration numbers registered in the REMCo registry for each jurisdiction;
7. material costs attributable to REMCo's establishment or operation in only one jurisdiction, including a jurisdiction-specific change to the rules or to another instrument comprising the retail market arrangements operated by REMCo in the jurisdiction, however initiated, must be recovered only from that jurisdiction; and
8. reasonable costs may include any revenue offsets from the commercialisation of the REMCo information system and software which accommodate the full contestability of retail gas markets, including any discretionary services in excess of standard services.

These principles ensure that REMCo's costs are only recovered from the parties that truly benefit from the activity that the cost relates to.

These fees are set by the REMCo Board.

The joining fee and the annual fee are levied on all members. These fees are set low enough so as not to create a barrier to entry for new participants, but sufficient to ensure that members are serious about operation in the market. In 2007/08 the joining fee is \$10,798 (plus GST) and the annual fee is \$16,197 (plus GST).

The revenue from the market share charge makes up the largest proportion of the cost recovery and is only levied on members that are gas retailers. This fee is levied monthly and is based on the retailers' market share, determined by the number of delivery points a retailer is responsible for in the jurisdiction. The market share charges are different in Western Australia and South Australia due to the different costs of operating the markets as a result of the cost allocation principles stated above. In 2007/08 the market share charges are:

- SA – \$0.616/MIRN/month, and
- WA - \$0.4970/MIRN/month.

REMCo operates on a cost recovery basis only, specifically not generating surpluses year on year. Any excess surplus from operations is returned to members as a reduction in fees in

future years or, as has been the practice in the last two years, as a rebate on the market share charges to gas retailers during the year. To assist the members, in particular retailers, in managing their annual cash flows, REMCO attempts to maintain a stable fee base through each year. However, REMCO reserves the right to adjust these fees in order to match actual costs incurred.

#### 4.4.2. Funding arrangements for AEMO

The funding arrangements for AEMO are expected to broadly reflect the current arrangements in relation to each of the bodies whose functions it will assume. The magnitude of the fees of the existing market operator organisations should provide a benchmark for the costs of operating a particular market in a particular jurisdiction. Provision will need to be made for new functions including the gas bulletin board and gas short term trading market as well as the national electricity transmission planner. The expectation is that efficiency gains and synergies arising from a single market operator will result in some overall cost savings. These savings may take time to identify and then realise.

Whilst some components of the budget of the existing market operators are set through regulatory determination, it is not expected that this situation will continue.

The fee setting should be at the discretion of the Board subject to guiding principles issued by the MCE, including through the Law and Rules. To discharge its responsibilities effectively, the Board requires the capacity to set fees in accordance with its assessment of the needs of the organisation, taking into account an appropriate balance between cost minimisation and prudent risk management requirements.

There is an issue of whether wider regulatory oversight or review of fees by the AER is necessary.

MOWG considers there are very good arguments that the accountability arrangements outlined elsewhere in this paper provide for effective scrutiny and accountability on the part of stakeholders, including through mechanisms such as the advisory panels. Industry membership, either on the Board or as shareholders of AEMO (as a company limited by guarantee) could be a particularly pertinent and relevant measure for achieving what regulatory oversight has to date sought to achieve: careful scrutiny of fees. Indeed, an industry role is possibly a more effective accountability measure. Further MOWG considers that incentive regulation is not appropriate to the kind of body it is contemplated AEMO will be.

Accordingly, MOWG suggests industry membership is sufficient oversight of AEMO fees and regulatory oversight is not necessary. If AEMO is a statutory authority, MOWG considers that the accountability framework can be designed to provide sufficient protection without AER oversight.

In general, whilst recognising that MCE will want to set its own principles to guide the Board in setting fees, MOWG considers the following key principles should drive the framework for AEMO funding:

- funding should be on a cost recovery basis and also so as to provide for the AEMO's budgeted revenue;
- the fees charged to particular persons should be reflective of the service AEMO provides to each fee payer so should be ring fenced for each function to the extent required;
- there should be no cross subsidies across industries and jurisdictions;
- the fees should be competitively neutral as between fee payers and foster economically efficient outcomes in the national energy market; and
- the fee structure should be simple, to the extent that is consistent with the other principles.



## CHAPTER FIVE

# OWNERSHIP OPTIONS FOR THE AUSTRALIAN ENERGY MARKET OPERATOR

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### SUMMARY

Different ownership options for the Australian Energy Market Operator (AEMO) have been evaluated, taking into account arrangements for Australia's existing market operators and international experience.

During the Market Operator Working Group (MOWG) deliberations, three basic structures were discussed – 100% government ownership, 100% “industry” ownership, and joint ownership shared between government and “industry”. In this context, industry is defined as energy market participants (gas producers, generators, transmission, distribution and retailers) and end users of energy.

There were differing views during deliberations in MOWG on the most appropriate ownership structure.

- Energy supply industry members of MOWG considered that AEMO should be fully or at least part owned by industry.
- Energy user members supported government ownership or at least part ownership by government.

The energy supply industry supports a model in which industry has an ownership stake, as it is claimed to result in: AEMO having a greater degree of accountability to those who use and pay for its services; improved responsiveness to the needs of market participants; enhanced transparency; and greater independence from any particular market participant or government.

By contrast, there has been a view expressed that government ownership could provide improved accountability to end users who are the ultimate beneficiary of AEMO's services; and greater independence from any particular market participant. Energy user members also support government ownership as they considered this was necessary to ensure the interests of all users, particularly small energy users, are protected.

It is noted that the importance given to ownership is discounted somewhat, given the relatively restricted nature of owner responsibility and authority. Moreover, appointment of board members based on a skills matrix will ensure effective AEMO performance.

MOWG considers that a company limited by guarantee is the better structural model for an industry owned AEMO, or a joint industry and government owned AEMO and that such a model can be established with a robust accountability framework, in keeping with the findings set out earlier in this paper (Gas Market Company (GMC) and Retail Energy Market Company Ltd (REMCo) are industry owned companies). Alternately, if AEMO is to be government owned, it could be established as a statutory authority (as is the Victorian Energy Network Corporation (VENCorp)) or a company limited by guarantee (as is the National Energy Market Management Company (NEMMCO)).

## 5.1. INTRODUCTION

To put the AEMO ownership issue into context it is worth noting that the responsibilities and authority of the owners of AEMO are relatively restricted. As stated in Chapter 4, regardless of AEMO's ownership, MOWG considers that a decision making role of the owners would only be expected to be required in relation to:

- remuneration of directors;
- removal of directors; and
- powers of the members (company limited by guarantee model only) – in relation to amending the constitution and to allow the entity to undertake additional activities.

Usually the owners of an entity would appoint the directors, but for AEMO, MOWG has proposed that this be the responsibility of a selection panel (see Chapter 3).

Hence, in practical terms AEMO's owners have few "responsibilities".

The term 'owners' might be referred to more correctly as members (though the term "owner" is used throughout this document).

The alternative ownership and structural arrangements for AEMO are broadly capable of falling within one of the models described in the table below.

<b>Form (Structural Arrangements)</b>	<b>Ownership Options</b>
Statutory Body	Commonwealth
	States (single jurisdiction)
Corporations Act	Commonwealth
	States (single jurisdiction)
	Commonwealth and States
	Joint Government and Industry
	Industry

The previous Chapter indicated that arrangements for accountability of the Board and Management to the owners are capable of being structured so that there is little practical difference in the content of accountability arrangements between an AEMO established as a company limited by guarantee or as a statutory authority. Each structural model is capable of providing a robust accountability framework in keeping with good governance principles.

This Chapter seeks to build on the previous Chapter to better assess the value of ownership in determining the preferred AEMO governance model.

From an ownership perspective, the models in the table above readily cascade into three alternatives: the government owned model (either a statutory authority or a government owned corporate body); the industry owned model; and the joint industry/government-owned model. This Chapter gives consideration to each of these alternatives.

## 5.2. GOVERNANCE MODELS FOR MARKET OPERATORS

A wide variety of structural and ownership models for energy market operators can be found both in Australia and overseas. A comparison of these alternative models can assist consideration of the arrangements that should apply to AEMO.

In Australia, the gas market operators GMC and REMCo are both owned by retailers and network operators in the relevant jurisdiction (but ownership does not include all market participants and excludes consumers) and are companies limited by guarantee; NEMMCO by comparison is also a company limited by guarantee but is owned by state and territory governments of the national electricity market; while VENCORP is a statutory authority owned by the Victorian government.

Overseas comparisons are not straightforward as market operators in some countries vary considerably in the scope of functions they carry out. In many instances their functions include rule making and enforcement, which, in the eastern states of Australia, have been deliberately placed in separate organisations. In other examples, the role of power system operation is part of the responsibility of the transmission network service providers.

Firecone Ventures Pty Ltd (Firecone) was commissioned by the Energy Reform Implementation Group to examine governance arrangements for NEMMCO. As part of its report, Firecone briefly reviewed governance arrangements in overseas market operators and observed that:

"...[there is] no single, well-established governance model. Rather, tailored arrangements in each jurisdiction allow for industry participation and control, while retaining Government checks and balances".

"...market participants play a significant role in the governance of all electricity markets that we reviewed, other than in New Zealand." [In New Zealand, many of the functions undertaken by NEMMCO in Australia are procured by the New Zealand Government through competitive tender.]

These observations expressed by Firecone are consistent with the findings of the Allen Consulting Group (hereafter referred to as 'Allens') as outlined in its report "Statutory Review of the Victorian Energy Networks Corporation" prepared for the Victorian Government. Allens notes that a particular feature of the institutional arrangements of VENCORP highly valued by industry market participants is the degree of representation on its Board and its major consultative committees. It observed that:

"...industry representation at the Board level and/or through consultative and advisory committees provide important scrutiny of a not-for-profit entity's performance. More importantly, however, directors with industry experience are able to inform decision-making through respective knowledge and expertise."

Furthermore, Allens noted:

"Stakeholders view this as an important mechanism for imposing discipline on VENCORP's operating costs, ensuring it acts transparently, is aware of the impact of its decisions on market and industry participants and does not respond to incentives other than those that are consistent with the requirements of the Victorian industry and community."

In commenting upon the existing governance arrangements for NEMMCO, Firecone observed:

"the government ownership of NEMMCO and control of the Board appointment appears unusual in comparison with international practice"; and

"appointment of Board members by individual jurisdictions risks creating a perception that these members are in some way accountable to State Governments".

For its part, the GMLG, in its National Gas Market Development Plan, proposed the establishment of a gas market operator separate from NEMMCO. It made this recommendation on the basis of, among other things:

"the jurisdictional-based governance structure of NEMMCO is not attuned to serving the interests of the gas industry"; and

"the gas industry is concerned that there may be a tendency to impose existing electricity industry systems and processes that may not be optimal or cost effective".

The ownership arrangements for NEMMCO were established in 1996 when electricity assets, with the exception of Victoria, were in government hands. The perception of electricity as an 'essential service' may also have been a factor in the government ownership of NEMMCO. Whether the current situation where virtually all gas assets and an increasing proportion of electricity assets are privately owned is relevant to those arrangements should be considered by respondents. The recent (September 2007) report of Professor Anthony Owen "Inquiry into Electricity Supply in NSW" has recommended the sale or long term lease of NSW generation and retail assets.

The establishment of AEMO provides an opportunity for governance and institutional arrangements to be reviewed in a similar way that revisions have been made to governance arrangements for rule making (Australian Energy Market Commission (AEMC)) and regulation (Australian Energy Regulator (AER)). In particular, the design of the arrangements for AEMO should take into account the greater relevance of gas in the national energy mix and seek to put in place arrangements suited to the whole energy market.

*The commentary above raises questions in relation to actual and perceived conflicts of interest that may be exhibited by AEMO under different ownership models. MOWG seeks views on governance issues associated with ownership and the impact this has on market participants.*

### 5.2.1. Industry ownership model

Industry places a significant emphasis on good governance which it sees as comprising of three elements:

- an independent skills based Board – addressed in Chapter 3;
- robust and effective accountability arrangements – addressed in Chapter 4; and
- governance arrangements to establish appropriate lines of accountability through industry ownership of a corporate entity – addressed in this Chapter.

Although ownership forms only one part of this governance model, importance has been attached to it by industry.

As the services provided by AEMO are paid for by industry, there is a view that best practice governance and performance are considered more likely to be achieved through industry ownership. It makes AEMO more directly accountable to those who use and pay for its services.

The governance arrangements are further supported by the legal framework. The Laws and Rules will provide the operating framework for AEMO and ensure its functions are undertaken consistent with the economic efficiency objective of the Laws. The AEMO is not able under these circumstances to discriminate in favour of one set of market participants.

Under an industry ownership model some governments would be explicitly excluded where they no longer own any part of industry, whilst others would retain an indirect stake through asset ownership. Further, given that industry is defined to include large end users only, small end users would be excluded.

The main advantages, seen by industry members of MOWG, in relation to industry ownership of AEMO are that it can improve governance and efficiency in the national energy markets, by:

- increasing the accountability of AEMO to the users of its services, thereby providing better incentives for cost effective delivery of AEMO functions; and
- providing greater separation of energy market policy and operation, consistent with the objectives of the governance arrangements established by COAG for the national energy markets.

Industry members considered that under industry ownership there would be greater market participant certainty for future investment in industry assets because this ownership structure would:

- remove perceived sovereign issues associated with governments having the sole responsibility for making board appointments while also owning assets in competition with the private sector; and
- increase gas industry confidence in the development of the gas market bulletin board and short term trading market.

Disadvantages of the Industry Ownership Model include:

- the difficulty in defining what “industry” is and what role the different sectors of industry should play in the ownership of AEMO and the possible complexity involved in these arrangements;
- the capacity of small end users to be effectively represented;
- what degree of individual membership or representative membership there should be and for what class or sector of industry;
- the significant public interest aspect of government in terms of power system operations (e.g. reliability) which may become subservient to the interests of industry; and
- government interest in continuation of energy supply to consumers under market failure or emergency situations may not be well defined.

#### 5. 2.1.1. Industry definition and representation of small consumers

As indicated earlier in this paper, industry is taken to include the supply side and larger users. It was suggested that under this model, membership of AEMO would be open to all energy participants (production, transmission, distribution and retailers) and energy end users consuming more than 160 MWh of electricity per annum (or an equivalent amount of gas).

Such a model, nevertheless, raises issues in relation to the effective capacity for small consumers to be represented. Some MOWG members see partial or full government ownership of AEMO as being an effective mechanism for achieving small consumer representation. Still others argued that the retail sector is responsive to the needs of end-users and therefore would provide an effective voice on the part of small consumers.

#### 5.2.2. Government ownership model

The principal argument for a government owned AEMO has been raised in relation to functions which are perceived to be in the public interest. Firecone suggested that power system operation involves a significant level of discretion on the part of the market operator and that a government role in this context appears desirable, particularly in the light of political accountability for the reliability of power supply.

However, it is noted that market participants bear the financial risks of market operation and are as interested as governments in the orderly operation and performance of the energy supply system. Furthermore, market participants directly fund the AEMO operations through payment of the AEMO fees, and take the commercial risk of cost recovery in the competitive market.

Given the industry involvement in the operation of the market, it would nevertheless be important for industry to have some form of participation in the governance arrangements in a government ownership model. Market operation should be independent and government should not have a role in the day to day operation of the market. It is important to note that the public policy objectives of governments are best achieved through their policy and law making role, not through the AEMO governance arrangements.

In a broader context, AEMO will be compelled to act in the public interest in a transparent manner, consistent with the market objective and regardless of its ownership. The mandate for AEMO operation will be specified in legislation. Accordingly, the key issue is the effectiveness with which this mandate is applied in practice. If the Board is independently selected on the basis of the skills required, and an appropriate accountability framework is in place, the Board should ensure the market is operated consistent with the energy market objectives and provide independent and objective information and advice.

The main advantages of a government owned AEMO model include:

- significant public interest is represented in the aspects of power system operations relating to reliability of supply under all circumstances;
- greater ministerial responsibility and accountability for the operation of the market;
- government (MCE) would be accountable for appointment and dismissal of board members if they are underperforming;

The disadvantages of a government owned AEMO model include:

- possible perceived sovereign risk in terms of the impact of government decision making where they are also asset owners;
- it disregards the benefits of industry ownership identified for this model; and
- potentially low risk approach to operations to ensure reliability of supply may not drive efficiencies such as industry ownership could afford.

### 5.2.3. Joint ownership model

A model which more explicitly provides for government and industry ownership may provide an appropriate balance between the benefits and challenges associated with alternative wholly government or industry owned models.

The advantages of the joint ownership model are that it:

- gives representation to all stakeholders;
- does not compromise the incentives derived from some industry ownership;
- leaves open the prospect of moving to a fully industry owned model in the future if market circumstances warrant it;
- may provide a good balance between low risk approach to ensuring reliability of supply and driving efficiencies in the market; and

- preserves the benefits of privately owned services delivery, while accommodating the needs of jurisdictional owners.

The disadvantages of a joint model include:

- possible ongoing perceptions of sovereign risk in terms of the impact of government decision making on commercial markets.

A joint ownership model is consistent with the views expressed by Firecone which suggested it might be desirable, in the longer term, to consider changes to the ownership of the market operator to give industry stronger rights.

*MOWG seeks views on the relative merits of the three different AEMO ownership models.*

### 5.3. CONFIGURING THE OWNERSHIP MODELS

Each of the different corporate ownership models can be configured in a variety of ways in relation to the relative shares of different classes of owners.

In relation to the industry owned model, the MOWG industry representatives propose AEMO would be held through voluntary membership by market participants and end users (above 160 MWh per annum of electricity or gas equivalent), with each ‘member’ having a single vote (i.e. unweighted representation). In this way, any changes, for example to the constitution would require agreement of 75 per cent of ‘members’ and, hence, would require a substantial degree of support across the membership.

MOWG suggests that the ownership arrangements for a jointly owned AEMO provide for the 50 per cent ownership rights accorded to industry be apportioned in the same way as described above for a fully industry owned AEMO. The 50 per cent government ownership share would require governments to determine membership amongst each jurisdiction.

In both the joint and industry ownership models described above, no single party or group would be in a position to bias or control AEMO or its decision making. Although, given the limited responsibilities and authority of the owners, it is questionable whether a government owned model would have any greater risk of bias or ‘monopoly’ control.

Governments have yet to consider how ownership might be allocated under a government owned model.

*MOWG seeks views on the most appropriate way in which the AEMO ownership models might be configured.*

*MOWG also seeks views on the proposed voting arrangements for an industry owned model.*

### 5.4. PREFERRED OWNERSHIP AND STRUCTURAL MODEL

The main issue addressed in this Chapter is the three alternative ownership models for AEMO – government ownership, industry ownership or joint government and industry ownership.

As noted above, the suggested preference of industry members of MOWG is for an industry owned AEMO, although a joint industry and government owned model for AEMO is also an acceptable arrangement.

There was a preference for 100% government ownership by some consumers and some government representatives have also indicated a preference for this model.

The only structural form that is flexible enough to support all three ownership models is the company limited by guarantee, as it can readily accommodate a large number of different parties as owners within a robust governance framework. A government owned AEMO can be either a company limited by guarantee or a statutory authority. A statutory authority model effectively limits ownership to one government.

MOWG notes a five year review of AEMO operations is likely to provide a useful mechanism for assessing the effectiveness of ownership arrangements. Such a review would likely take place in 2014. A number of significant market developments will occur during the intervening period, including the introduction of an emissions trading scheme, the potential further sale of government-owned electricity assets and the potential phasing out of retail price caps.

MOWG has concluded ownership arrangements need to be as streamlined as possible from day one, to enable AEMO to address these issues with minimum disruption to the market. Detailed consideration would also need to be given to the parameters of a review to ensure any potential for impacts on the market are minimised. Although, given the limited role of the owners a review of this component would be unlikely to have significant implications for market operations.

*MOWG seeks comments on the various ownership and structural models and the merits and/or risks of a five year review.*

# MARKET OPERATOR WORKING GROUP: TERMS OF REFERENCE

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## Background

COAG agreed at its 13 April 2007 meeting to establish a single industry funded National Energy Market Operator (NEMO), for both electricity and gas, to strengthen the national character of energy market governance.

The creation of the NEMO recognises the convergence of regulatory frameworks for gas and electricity as well as the economies of scale and scope arising from a single interface with energy industry participants. COAG agreed with the Energy Reform Implementation Group (ERIG) that the NEMO should include stronger stakeholder participation and responsiveness. Functions of a NEMO are to encompass:

- a. responsibility for the day to day operation and administration of the power system and electricity wholesale spot market in the National Electricity Market (NEM) (as currently performed by the National Electricity Market Management Company (NEMMCO));
- b. the planned Gas Market Operator (GMO), subsuming the operations of the Victorian Energy Networks Corporation (VENCorp), the Gas Market Company (GMC) and the Retail Energy Market Company (REMCo), and also including operation of the proposed gas market Bulletin Board, design of the Short Term Trading Market and support to the National Gas Emergency Response Advisory Committee (NGERAC); and
- c. the national electricity transmission planning function.

COAG has tasked the MCE with developing, in consultation with stakeholders, a detailed implementation Plan by the end of 2007. Consistent with this decision, officials agreed to establish a Market Operator Working Group (MOWG) to undertake this work with membership drawn from a wide cross section of industry as well as government officials. The MOWG replaces the Gas Market Operator Working Group (GMOWG).

## Terms of Reference

1. Consistent with the directions set by COAG, identify, consider and make recommendations on governance, operational and other issues and tasks necessary for the establishment of the NEMO by June 2009.
2. Provide MCE SCO with a detailed implementation plan for the establishment of a NEMO, including milestones and a budget, by September 2007.
3. Identify, in a timely manner, regulatory, rulemaking and other requirements which jurisdictions may need to put in place in order to facilitate implementation of the plan.
4. Seek and respond to direction from the MCE/SCO in relation to all critical decisions and milestones.
5. Examine and report on the need for a transitional GMO.
6. Form sub-committees, as necessary, to undertake tasks and manage the delivery of the implementation plan.
7. Liaise and consult with relevant stakeholders, as appropriate.
8. Provide regular updates of MOWG work and meetings to the MCE Energy Market Reform Working Group (EMRWG).

## Attachment A

9. Issues on which MOWG is to provide advice should include:
  - (a) Organisation form (e.g. company or statutory authority)
  - (b) NEMO Board composition and the appointment mechanism
  - (c) NEMO accountability and liability
  - (d) Government role, e.g. powers of direction
  - (e) Relationship with AEMC and AER, and Economic Regulation Authority of WA
  - (f) Incorporation of the transmission planner
  - (g) NEMO role in rule development
  - (h) Organisational structure including advisory panels
  - (i) NEMO funding
  - (j) Transfer from existing bodies to new entity
  - (k) Organisation functions and objectives
  - (l) Establishment and supporting legislation – law and rules
  - (m) Trade Practices Act issues
  - (n) Compliance, judicial and merits review, dispute resolution
  - (o) Any other issues that are considered appropriate
  
10. The MOWG and its committees should be guided by the following principles in the establishment of the NEMO. The NEMO should:
  - be national (noting that WA and NT can consider joining the national arrangements, as stated in the COAG Communiqué of 13 April 2007);
  - be responsive to and reflective of the needs of the market;
  - be cost effective;
  - be industry funded;
  - be technically proficient;
  - be independent from individual market participants and jurisdictions while recognising jurisdictional market differences;
  - minimise the need for government intervention in the operation of NEMO and the energy markets;
  - manage conflicts of interest;
  - have a skills-based Board including a mix of industry and generalist expertise;
  - promote open access and open trade between sectors and regions;
  - enable an orderly transition with minimal disruption to ongoing operations;
  - provide for a low-cost transition;
  - appropriately recognise differences between the gas and electricity sectors;
  - be transparent;
  - be organisationally sustainable; and
  - have appropriate allocation of costs to functions, to avoid cross-subsidies.
  
11. The MOWG will also need to consider, in carrying out this work:
  - the principles under which NEMMCO, REMCo, GMC and VENCORP operate; and
  - MCE's gas and electricity market objectives.

# LIST OF THE MEMBERS OF THE MARKET OPERATOR WORKING GROUP

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## Industry

- Australian Pipeline Industry Association
- Energy Retailers Association of Australia
- Energy Supply Association of Australia
- Energy Users Association of Australia
- Gas Market Company
- Gas Market Leaders Group
- Major Energy Users
- National Electricity Market Management Company
- National Generators Forum
- Retail Energy Market Company
- Victorian Energy Networks Corporation

## Governments

- Australian Government (**Chair of MOWG**)
- New South Wales
- Victoria
- Queensland
- Western Australia
- South Australia
- Tasmania
- Australian Capital Territory



# AUSTRALIAN ENERGY MARKET OPERATOR TRANSITION MANAGEMENT COMMITTEE: TERMS OF REFERENCE

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## Background

COAG agreed at its 13 April 2007 meeting to establish a single industry funded national energy market operator for both electricity and gas in order to strengthen the national character of energy market governance.

COAG tasked the MCE with developing, in consultation with stakeholders, a detailed implementation plan by the end of 2007. To implement this decision, officials formed the Market Operator Working Group (MOWG) to provide advice to SCO on the establishment of the Australian Energy Market Operator.

SCO, at its meeting on 27 July, considered a paper from the MOWG on processes and arrangements for the appointment of the initial board to the proposed Australian Energy Market Operator (AEMO).

Following consideration of the MOWG paper, SCO agreed to request the CEOs of the existing electricity and gas market operators (NEMMCO, VENCORP, GMC, REMCO) and the chair of MOWG to form a Transition Management Committee, to provide advice to it on the management of the transition path to the establishment of AEMO. The key focus of this committee will be to manage the transition path at an operational level to ensure minimal disruption.

## Terms of Reference

1. Provide advice to SCO on the effective management of the transition to the establishment of the Australian Energy Market Operator.
2. Develop advice and recommendations on operational, functional, legal and financial issues in order to minimise disruption to existing market operations.
3. Liaise with the MOWG where appropriate.
4. Establish and facilitate cooperative and consultative arrangements between the boards and management of existing market operators.
5. To cooperate, where practicable, with the initial AEMO board to assist it in understanding the operation of various markets and in identifying the necessary skills required for its senior management team.
6. Respond to requests for advice from SCO.
7. Liaise and consult with relevant parties as appropriate.



## FUNCTIONS MATRIX: ACTIVITIES UNDERTAKEN BY EXISTING MARKET OPERATORS

Potential AEMO functions as performed by existing institutions Function/Organisation (✓ = current function; ○ = similar but not equivalent function)	NEMMCO	NTP (COAG)	REMCO	VENCORP	GMC	ESIPC	GRMO (VENCORP)	IMO (WA)	NT
<b>Electricity – Market Operation</b>									
▪ Registering participants (including exemptions) and accrediting metering data providers	✓							✓	
▪ Operation of network control centres	✓							✓	
▪ Forecasting demand	✓			✓		✓		✓	
▪ Scheduling	✓							✓	
▪ Co-ordinating transmission and generation outages	✓			○				✓	
▪ Operating, developing and certifying the NEM Dispatch Engine	✓							○	
▪ Pricing at regional nodes (and for inter-regional losses)	✓								
▪ Development of power system operation capability	✓			○				○	
▪ Medium and long term analysis of power system developments, including	✓							○	
○ Formulate constraint equations	✓			✓					
○ Determine transmission loss factors	✓			○					
○ Determine level of ancillary services required (incl. procurement of these services)	✓			○					
▪ Planning: Publish PASA, SOO, ANTS	✓			○		○		○	
▪ Managing prudential risks	✓							○	
▪ Metering, billing and financial settlement of NEM wholesale trade	✓							○	
▪ Settlement residue auctions	✓								
▪ Market development (incl. metrology and B2B procedures, retail competition, wind generation)	✓			○		○		○	
▪ Stakeholder liaison and response	✓			✓		✓		✓	

**Attachment D**

<b>Potential AEMO functions as performed by existing institutions</b> <b>Function/Organisation</b> (✓ = current function; ○ = similar but not equivalent function)	NEMMCO	NTP (COAG)	REMCO	VENCORP	GMC	ESIPC	GRMO (VENCORP)	IMO (WA)	NT
<b>Electricity – Transmission Planning &amp; Procurement</b>									
▪ Produce a Transmission Network Development Plan / APR	○	✓		✓		○			
▪ Prepare or review proposals for future augmentations and extensions to the transmission network				✓		✓			
▪ Procure transmission network services				✓					
▪ Procure transmission network augmentation				✓					
<b>Electricity – Emergency Response</b>									
▪ Coordinate national emergency response, incl. load shedding	✓			○		○			
<b>Electricity – Reporting</b>									
▪ Reporting and responding to MCE requests (e.g. Drought Reports, Wind Generation implications)	✓								
▪ Reporting and responding to individual jurisdiction Ministerial requests	✓			✓		✓		○	
<b>Electricity – Market Rules and Compliance</b>									
▪ Develop and amend market rules and procedures	○							✓	
▪ Monitor compliance and initiate enforcement actions for non-compliance with rules								✓	
<b>Electricity – Other</b>									
▪ B2B Communication Hub Provision	✓								
▪ Communication Standards (aseXML)	✓								
▪ Wind Energy generation forecasting project (for Australian Green House Office)	✓								
▪ Demand management facilitation				✓					
▪ TUOS Pricing				✓					
○ Connection Enquiries / Applications				✓					
○ Technical Standards – Advice & Settings	✓			✓					
<b>Gas – Market Operation</b>									
▪ Registering participants and accrediting metering data providers			✓	✓	✓		✓		

<b>Potential AEMO functions as performed by existing institutions</b> <b>Function/Organisation</b> (✓ = current function; ○ = similar but not equivalent function)	NEMMCO	NTP (COAG)	REMO	VENCORP	GMC	ESIPC	GRMO (VENCORP)	IMO (WA)	NT
▪ Operation of a bulletin board				✓					
○ Provision of market information				✓			✓		
▪ Operation of a short-term trading market – wholesale/retail market				✓					
○ Pricing				✓					
○ Managing prudential risks				✓			○ <sup>15</sup>		
○ Metering, billing and financial settlement			✓	✓	✓		○ <sup>16</sup>		
○ Market development (incl. metrology and B2B procedures)			✓	✓	✓		✓		
○ Forecasting Gas Demand			○	✓					
○ Scheduling				✓					
○ Co-ordinate Gas Plant Outages				✓					
○ Operate and Certify Market Clearing Engine				✓					
▪ Operation of Gas B2B infrastructure			✓	✓			✓		
▪ Delivery point management			✓	✓	✓		✓		
• Stakeholder liaison and response			✓	✓	✓		✓		
<b>Gas – Retail Functions</b>									
▪ Implementation/operation of arrangements for full retail contestability			✓	✓	✓		✓		
<b>Gas –Planning</b>									
▪ Statement of Opportunities – APR / Pipeline capability & capacity				✓					
▪ Annual/regular supply/demand statement (short/medium term)				✓			✓		
▪ Assessment of augmentation proposals				✓					

<sup>15</sup> Limited to review at time of registration

<sup>16</sup> GRMO facilitates physical balancing other than financial balancing

**Attachment D**

<b>Potential AEMO functions as performed by existing institutions</b> <b>Function/Organisation</b> (✓ = current function; ○ = similar but not equivalent function)	NEMMCO	NTP (COAG)	REMCO	VENC Corp	GMC	ESIPC	GRMO (VENC Corp)	IMO (WA)	NT
<b>Gas – Transmission</b>									
▪ Operation of gas transmission system and control centre				✓					
<b>Gas – Gas Continuity Scheme</b>									
▪ Operation of gas continuity scheme for shippers and pipeline operators					✓				
<b>Gas – Rule change</b>									
▪ Facilitate rule change proposals			✓	✓	✓		✓		
▪ Monitoring compliance with rules			✓	✓	✓		○ <sup>17</sup>		
▪ Enforcement of compliance with rules			✓		✓				
<b>Gas – Emergency Response</b>									
▪ Coordinate response to gas emergencies				✓					
▪ Provide support to NGERAC				✓	✓		✓		
<b>Gas – Reporting</b>									
▪ Reporting and responding to MCE requests									
▪ Reporting and responding to individual jurisdiction Ministerial requests				✓			✓		

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<sup>17</sup> GRMO monitors compliance with some balancing rules only

## DESCRIPTION OF MARKET OPERATION FUNCTIONS TO BE ADDRESSED BY AEMO

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The following provides a brief description the activities undertaken by existing energy market operators and the new functions proposed for the gas and electricity markets. This description is supported by a functions matrix which is intended as a quick reference guide. These items seek to represent the current state of play in energy market operation and not the constellation of activities AEMO is to deliver. The scope and range of expected AEMO functions is addressed in the main text above.

The information is presented by organisation and where appropriate, by function. This is in recognition that: NEMMCO has sole responsibility for electricity market operation; VENCORP undertakes gas market operation and additional electricity functions; gas market operation is evolving to incorporate retail and wholesale components; electricity transmission network planning is to become national in scope; and ESIPC and the IMO will not initially be part of AEMO arrangements.

## A.1. NEMMCO – OPERATION OF THE NATIONAL ELECTRICITY MARKET

NEMMCO undertakes the NEM functions outlined in s49 of the National Electricity Law as follows:

- to operate and administer the wholesale exchange (for example, power system operations and planning, short and long-term planning, generator dispatch and system operations, and pricing);
- to promote the development and improve the effectiveness of the operation and administration of the wholesale exchange (for example, market operations and development, metering and settlements, the settlement residue auctions, prudential management, metrology, full retail competition and wind generation);
- to register persons as Register Participants in accordance with the Law;
- to exempt certain persons from being registered as Registered participants;
- to maintain and improve power system security;
- to undertake the coordination of the planning of augmentations to the national electricity system; and
- any other functions conferred on it by the Law.

Chapter 3 of the Electricity Rules establishes the first market design principle, to “minimise NEMMCO decision making to allow market participants the greatest amount of commercial freedom to decide how they will operate in the market”.

The main power system and electricity market functions undertaken by NEMMCO include:

### A.1.1. Power system operations

- Operation of the two National Dispatch and Security Centres, which:
  - monitor and control the security of the power system;
  - monitor power system reserves and advise the market
  - direct parties to maintain a secure and reliable power system as required
  - maintain accurate representation of system capability and operate the NEM Dispatch Engine;
  - dispatch all scheduled generating units, and report on their compliance with dispatch instructions;
  - acquire and utilise ancillary services
  - forecast demand, approve transmission outages,
  - manage system emergencies
- Analysis of the performance and capability power system in the medium and long-term, including:
  - Expressing the power system's physical capabilities in constraint equations;
  - Determine transmission loss factors;
  - Determine the level of ancillary services needed to ensure that the power system and electricity market operate as intended and contract for non market services.
- Investigate and report on power system incidents
- Assess and register generator technical performance standards
- Publication of projected assessments of system adequacy (PASA)

### A.1.2. Planning

- Development of power system analysis tools

- Determination of system performance requirement and reserve levels
- Provision of planning and system data
- Co-ordination of inter-regional transmission planning
- Publication of the annual Statement of Opportunities and the Annual National Transmission Statement.

#### A.1.3. Market operations

- Design of the Dispatch engine (NEMDE)
- Market event analysis and reporting
- Settlement residue auction processes
- Metering, billing, prudential management and financial settlement of wholesale trade in the NEM
- Retail transfer processes and systems (MSATS)
- Retail of last resort processes
- NEM Education

#### A.1.4. Development

- NEM development to improve the effectiveness of the operation and administration of the NEM;
- Retail competition development, involving co-ordination and development of retail competition processes

#### A.1.5. Market systems

- Information system provision to all NEMMCO functions
  - Energy management systems
  - Market management systems
  - Retail transfer and B2B systems
  - Office systems.
- Communications and technical infrastructure including control centres

#### A.1.6. Corporate services and communications

- Registration of NEM Participants
- Dispute management
- Power system emergency media communications.

## A.2. VENCORP – OPERATION OF THE VICTORIAN GAS MARKET AND PROVISION OF ELECTRICITY AND GAS NETWORK SERVICES

### A.2.1. Gas market operation

Gas wholesale market operation – VENCORP operates and administers the Victorian wholesale gas spot market to facilitate the flow of gas in the transmission network, in accordance with the Market System and Operation Rules (MSOR), which outline the rights, obligations and powers of all system participants, including VENCORP. The market provides a mechanism for market participants to trade gas to meet their own requirements.

Gas transmission system operation – VENCORP is also the day-to-day operator of the gas transmission system. This function involves the scheduling of withdrawals from and injections into the system to ensure its security, subject to network capacity and specification of network security standards, including gas quality standards. Therefore, the system operation role is related to the market operation role, i.e. the operation of the market provides a mechanism for keeping the PTS in balance.

### A.2.2. Gas market planning

Gas planning – VENCORP monitors the capacity of the gas system, subject to demand forecasts, and provides information to the market via the Annual Planning Reports, which contain a statement of opportunities for the principal transmission system, forecasts of gas supply and demand and transmission system capacity for the next five years, with more detailed forecasts for the coming 12-month period. (VENCORP does not procure or direct augmentation of the transmission network. Rather, it facilitates the market through the collection of data through its various functions and dissemination of that data to market participants and other interested parties).

Gas transmission augmentation assessment – A related activity is to undertake an independent assessment of applications to the AER by pipeline owners, such as GasNet, under the National Gas Access Code, for approval to invest in transmission capacity and recover cost through regulated charges, i.e. expansion of the pipeline owner's regulated asset base.

### A.2.3. Retail gas market functions

Gas retail market operation – VENCORP is responsible for facilitating the implementation and operation of arrangements for full retail contestability (FRC) in the gas industry.

Gas rule development – The two sets of rules that relate to the markets that VENCORP operates are the MSOR and Retail Rules. VENCORP has a development function with respect to these rules, which involves identifying the need for rule changes, drafting, technical analysis and consultation of proposed amendments with market participants.

Gas rules compliance monitoring – A related function for VENCORP is the monitoring of compliance by market participants with the MSOR and Retail Rules. This involves the issue of directions where potential rule breaches have occurred or are occurring, investigation and reporting on potential breaches of rules and annual publication of details of VENCORP's decisions in relation to enforcement (such as the provision of information to the ACCC for the purposes of formal sanctions).

### A.2.4. Auxiliary gas functions

Gas emergency response – VENCORP has an important function in the management of gas emergency situations related to its functions as system and market operator. Activities include liaison with and

provision of advice and information to the Government and to other agencies, such as EnergySafe Victoria, the conduct of a series of gas emergency exercises throughout the year and contributions to the National Gas Emergency Response Advisory Committee (NGERAC).

Gas industry information to Government – VENCORP provides information and advice on an ad hoc basis to the Government on matters related to its various functions and activities.

Government directed gas activities – VENCORP responds to directions made by the Minister to undertake ‘non-commercial’ functions, such as any function deemed to be in the public interest but with the potential to cause financial detriment to VENCORP.

#### A.2.5. Electricity transmission planning and procurement

Electricity transmission service provision – VENCORP is the designated Transmission Network System Provider (TNSP) for the Victorian transmission network in line with the National Electricity Rules.

Electricity transmission planning – As the designated TNSP, VENCORP is also responsible for identifying potential system constraints ahead of anticipated increases in demand and the availability of generation capacity. VENCORP has developed planning criteria to ensure the planned capacity of the transmission network is sufficient to meet actual demand. This involves load shedding arrangements and development of a methodology for identifying the need for transmission system augmentation (and the volume of any augmentation).

Electricity transmission network augmentation – VENCORP has a function to procure transmission augmentation through the management of contestable tender processes. This is a more active role than VENCORP undertakes with respect to gas transmission augmentation assessment.

#### A.2.6. Auxiliary electricity functions

Electricity emergency coordination – VENCORP’s function with respect to electricity emergency response has two elements. Firstly, the National Electricity Rules provide for VENCORP, in its appointed role of Responsible Officer and Jurisdictional Co-ordinator, to advise NEMMCO of its arrangements for responding to emergency situations.

Secondly, VENCORP enters into agreements with distributors and retailers for load shedding when there is a threat or likely threat to the balance of electricity supply and demand. VENCORP is then able to issue directions to industry participants in line with those arrangements.

Electricity industry information to Government – VENCORP provides ad hoc information and advice to Government on electricity related matters with which it is involved.

Government directed electricity activities – VENCORP responds to directions made by the Minister to undertake ‘non-commercial’ functions, such as any function deemed to be in the public interest but with the potential to cause financial detriment to VENCORP.

Electricity demand management facilitation – VENCORP also has a statutory function to manage the demand for electricity by facilitating the development of arrangements with industry participants and by entering into agreements and arrangements relating to the development and implementation of proposals to manage demand.

### **A.3. GMC – OPERATION OF THE NEW SOUTH WALES AND AUSTRALIAN CAPITAL TERRITORY GAS MARKETS**

Gas retail market operation – GMC is responsible for facilitating the implementation and operation of arrangements for full retail contestability (FRC) in the gas industry in NSW and ACT.

Gas Balancing – GMC operates the gas balancing mechanism for the balancing of gas deliveries into the sub-networks in NSW and ACT.

Gas Continuity Scheme – GMC is responsible for the development and implementation of a gas continuity scheme for shippers and pipeline operators to meet the objectives established by the NSW Government

ROLR and User Exit Processes – GMC is responsible for implementing a ROLR scheme for below 1tj customers and a user exit scheme for all other customer in NSW, including suspending a defaulting retailer from the market, and transferring or disconnecting customers.

Information System Provision – GMC and REMCo provide information systems to support their market operational functions.

Admission and Suspension of Members – GMC administers processes to admit market participants to membership of the market operator and appropriate schemes, and to suspend or expel market participants from membership.

Gas Rule Development – GMC has a development function with respect to their respective gas market rules (Rules), which involves identifying the need for rule changes, drafting, technical analysis and consultation of proposed amendments with market participants and other stakeholders, and acceptance of rule changes by the Board of Directors.

Gas Rules Compliance – GMC is responsible for ensuring compliance with the Rules. The Board of Directors makes a decision on whether to refer alleged breaches to the Independent Compliance Panel established by the market operator, and the Panel is empowered under the Rules to impose fines and to require action from market participants.

## **A.4. REMCo – OPERATION OF THE SOUTH AUSTRALIAN AND WEST AUSTRALIAN GAS MARKETS**

**Gas retail market operation** – REMCO is responsible for facilitating the implementation and operation of arrangements for full retail contestability (FRC) in the gas industry in SA and WA.

**B2B operation** – REMCo is responsible for the establishment and operation of B2B processes and systems to support the processes in the gas industry in SA and WA.

**Gas Balancing** – REMCo operates the gas balancing mechanism for the balancing of gas deliveries into the sub-networks in SA and WA.

**Information System Provision** – REMCo provides information systems to support the market operational functions.

**Admission and Suspension of Members** – REMCo administers processes to admit market participants to membership of the market operator and appropriate schemes, and to suspend or expel market participants from membership.

**Gas Rule Development** – REMCo has a development function with respect to the gas market rules (Rules), which involves identifying the need for rule changes, drafting, technical analysis and consultation of proposed amendments with market participants and other stakeholders, and acceptance of rule changes which are then submitted to the jurisdictional regulator for approval.

**Gas Rules Compliance** – REMCo is responsible for enforcing compliance with the Rules. REMCo makes a decision on whether to refer alleged breaches to the Independent Compliance Panel, and the Panel is empowered under the Rules to impose fines and to require action from market participants.

## **A.5. GAS RETAIL MARKET OPERATOR (GRMO) – OPERATION OF THE QUEENSLAND RETAIL GAS MARKET**

The functions of the GRMO are to provide gas retail market services in accordance with industry codes and to administer the parts of any industry code that provide for the following matters: MIRN registration, customer transfers, information exchanges, metering, gas balancing, business to business transactions information transfers under the code, any other matters prescribed under a regulation. The GRMO also will give QCA advice on request about issues relating to reticulated processed natural gas markets, recommend to QCA changes to the provisions of an industry code that provide for any of the matters and perform other functions relating to industry codes delegated to it under section 321A of the Gas Supply Act 2003.

The Minister may appoint 1 or more advisory committees to support the GRMO. The functions of the committee's are to:

- (a) advise the GRMO on the administration and operation of reticulated processed natural gas markets; and
- (b) make suggestions to the GRMO about changes to its functions.

The GRMO is required to consider, but is not obliged to accept, any advice given to it by an industry advisory committee.

VENCorp undertakes a number of functions on behalf of GRMO.

## A.6. GAS MARKET OPERATION

The expected gas functions of the AEMO are those outlined in the Gas Market Leaders Group (GMLG) report, *Gas Market Development Plan*. These include:

- operation of Bulletin Board;
- operation of Short-Term Trading Market;
- annual Supply/Demand Statement;
- responsibility for gas retail market functions of the Retail Energy Marketing Company (REMCo), the Gas Marketing Company (GMC) and the Victorian Energy Networks Corporation (VENCorp); and
- provide support to National Gas Emergency Response Advisory Committee (NGERAC).

The key elements relevant to the development of the wholesale market are the Bulletin Board (BB) and Short Term Trading Market (STTM).

### Bulletin Board

The BB is to be a single electronic communications system (a website) that provides real-time information on the overall physical condition and capacity of the supply and pipeline system to meet projected demand. Information on the BB will cover:

- all major gas production fields, major demand centres and transmission pipeline systems, including the interconnected systems of South Australia, Victoria, Tasmania, NSW and the ACT;
- non-interconnected pipeline systems operating in Queensland, Western Australia and if practicable, the Northern Territory;
- contact details for key industry participants; and
- not cover pipelines serving single users or small demand centres.

### Short-Term Trading Market

The Short-Term Trading Market (STTM) will establish a mandatory price-based balancing mechanism for gas delivered to, and withdrawn from, defined market hubs, replacing existing gas balancing arrangements applicable at delivery points within the hubs. Daily operation of the STTM will include:

- facilitation of participant interfaces;
- daily collection of bids/offers and forecast withdrawals;
- construction of the daily bid-stacks;
- setting the daily clearing prices;
- notifying shippers of cleared delivery and withdrawal quantities;
- collection of metering data and/or overseeing delivery and withdrawal allocations to shippers and users;
- monitoring of market exposures and management of prudential requirements;
- financial settlement of the market; and
- collection, assimilation, publication and distribution of system and market information (including aggregation of demand information where appropriate and practical, in order to provide commercial confidentiality to single large end-users).

## A.6. TRANSMISSION PLANNING FUNCTIONS

### A.7.1. National Transmission Planner

The AEMO will encompass the new national transmission planning function. This would require development of a strategic National Transmission Network Development Plan (NTNDP), which replaces the current Inter Regional Planning Committee and Annual National Transmission Statement.

The NTNDP will:

- outline the broad development of the power system, including the current and planned future capability of the national transmission network and development options;
- contain a minimum outlook of ten years and be updated annually; and
- provide information on the longer term efficient development of the power system in order to guide network investment decisions and provide signals for efficient generation investment.

## A.8. POSSIBLE FUTURE FUNCTIONS

### A.8.1. Independent Market Operator (Western Australia)

The IMO's main responsibilities are:

- administration of the market rules,
- operation of the Wholesale Electricity Market (WEM); and
- facilitating the provision of sufficient generation capacity and demand side management to meet expected load.

These facilitate the IMO to facilitate the ongoing development of, and changes to, the WEM with the objective of continually improving its performance to ensure that the market is efficient and effective.

Functions are conferred on the IMO by:

- the Wholesale Electricity Market Rules (the "Market Rules"); and
- the Electricity Industry (Independent Market Operator) Regulations 2004 (the "IMO Regulations")

Under Market Rule 2.1.2 of the Market Rules, the specific functions of the IMO are to:

- administer the Market Rules;
- operate the Reserve Capacity Mechanism (RCM), the Short Term Energy Market (STEM) and the balancing process;
- settle such transactions as required under the Market Rules;
- carry out a Long Term Projected Assessment of System Adequacy (PASA) study and to publish a Statement of Opportunities Report;
- administer tender processes for Network Control Services where required by the Market Rules and to enter into Network Control Service Contracts;
- process applications for participation, and for the registration, de-registration and transfer of facilities;
- release information required to be released by the Market Rules;
- publish information required to be published by the Market Rules;
- develop amendments to the Market Rules and replacements for them;
- develop Market Procedures, and amendments and replacements for them;
- where required by the Market Rules, make available copies of the Market Rules and Market Procedures, as are in force at the time;
- monitor the compliance with the Market Rules of other Rule Participants, investigate potential breaches of the Market Rules, and if thought appropriate, initiate enforcement action under the Regulations and the Market Rules;
- support the Economic Regulation Authority (ERA) in its market surveillance role, including providing any market related information required by the ERA;
- support the ERA in its role of monitoring market effectiveness, including providing any market related information required by the ERA; and
- carry out any other functions conferred, and perform any obligations imposed, on it under the Market Rules.

In addition to providing for the functions of the IMO to include the specific roles imposed by the Market Regulations and the Market Rules, the general functions provided for under the IMO Regulations include:

## Attachment E

- undertaking, maintaining and operating any system, facilities or equipment required for, or in connection with, the performance of its functions;
- doing anything that the IMO determines to be conducive or incidental to the performance of its functions; and
- doing anything that it is authorised to do by any other written law.

### A.8.2. Electricity Supply Industry Planning Council (South Australia)

Under section 6E of the *Electricity Act 1996* the ESIPC has the following functions:

- to develop overall electricity load forecasts; to review and report to the Minister and the Essential Services Commission of South Australia (ESCOSA) on the performance of the South Australian power system;
- to advise the Minister and the ESCOSA on matters relating to the future capacity and reliability;
- to prepare or review proposals for significant projects relating to the transmission network in South Australia;
- to advise the Minister and the ESCOSA, either on its own initiative or at the request of the Minister or the ESCOSA, on other electricity supply industry and market policy matters;
- to publish an annual review of the performance, future capacity and reliability of the South Australian power system;
- to carry out any functions appointed to ESIPC under the National Electricity Code;
- to publish from time to time such information relating to the matters referred to above as ESIPC considers appropriate; and
- to perform any other function prescribed by regulation or assigned by or under any other Act.

ESIPC has a further role in relation to network planning as specified in the *National Electricity Code*. ESIPC is registered as a NEM Participant for this purpose.

## AEMO SKILLS MATRIX

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The appointment of a skill based board enables the application of independent expertise across the range of activities undertaken by the organisation. This annex considers generic skills required to effectively govern an organisation and then supplements this with an account of those skills specific to AEMO.

This information can then be used to populate a skills matrix which guides the selection of board members so that it has ongoing access to a balanced portfolio of appropriate expertise. The skills matrix is useful only to the extent it reflects organisational needs, and therefore, requires constant review.

### The role of the board

The role of a board under Principle 1 of the ASX's Principles of Good Corporate Governance and Best Practice Recommendations is described as:

- oversight of the company, including its control and accountability systems;
- appointing and removing the chief executive officer (or equivalent);
- input into and final approval of management's development of corporate strategy and performance objectives;
- reviewing and ratifying systems of risk management and internal compliance and control, codes of conduct, and legal compliance;
- approving and monitoring financial and other reporting; and
- monitoring senior management's performance and implementation of strategy, and ensuring appropriate resources are available

In addition, the role of the board of the AEMO must include:

- establishing the corporate governance agenda and ensuring that it remains properly focused and balanced across all areas requiring consideration by the board;
- reporting to and interacting with key stakeholders to inform them of achievements and ensuring that they have input into determining strategic goals and direction;
- determining matters of a major or unusual nature where AEMO is asked by participant groups or government through the MCE or individual jurisdictions to provide additional functions and services; and
- monitoring the prudential requirements for the NEM.

### Generic Skills

The Australian Institute of Company Directors recommends core skills that should be represented on any board. These include:

- *strategic expertise* – the ability to review the strategy through constructive questioning and suggestion;
- *accounting and finance* – the ability to read and comprehend the company's accounts, financial material presented to the board, financial reporting requirements and some understanding of corporate finance;
- *legal* – the board's responsibility involves overseeing compliance with numerous laws as well as understanding an individual director's legal duties and responsibilities;
- *managing risk* – experience in managing areas of major risk to the organisation;

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- managing people and achieving change;
- experience with financial markets; and
- *industry knowledge* – experience in similar organisations or industries (see the following section extrapolating industry knowledge for the AEMO).

Additional core skills appropriate to AEMO are:

- *information technology* – the ability to govern significant investment in IT to ensure appropriate capital and operational expenditures in line with the company's strategic intent; and
- *economics and public policy*.

### Specific Skills

Energy specific skills are a requirement for at least some directors. The additional skills required to govern the operation of Australian energy markets include:

### Operational

Experience in the electricity and gas industries from operational and developmental aspects, including:

- operation of the National Electricity Market;
- operation of the various gas markets in Australia;
- understanding of the planned reforms to the electricity and gas markets in Australia and the reform agenda of COAG and the MCE;
- energy systems planning;
- power and gas system security;
- prudential management;
- forecasting and reliability in relation to supply / demand; and
- application of the various regulatory regimes to the market operator and the markets generally, including the National Electricity Law, the National Gas Law, the Rules under those Laws and the procedures adopted by the market operators, and the context of the regulatory framework for the gas and electricity industries.
- Incident investigation
- Experience in the operation of market administrators and operators in the electricity and gas industries, and the need to develop a “customer focussed” organisation
- Experience in and understanding of the usage and issues of the various classes of consumer of gas and electricity, including an ability to develop competing positions into a hierarchy of needs
- Experience in the operation of regulated entities
- Understanding of the government and political processes in the energy industry
- Understanding of the particular requirements for stakeholder engagement in an energy market operator, where stakeholders include governments through COAG, MCE and individual jurisdictions, market participants, energy users and regulators.