

Australian Energy Market Operator Establishment

Legislative Framework:
Statement of Proposed
Approach

Ministerial Council on Energy
Australian Energy Market Operator
Implementation Steering Committee

August 2008

Consultation

The consultation paper has been prepared by the Australian Energy Market Operator (AEMO) Implementation Steering Committee (ISC). Its membership is comprised of the Ministerial Council on Energy (MCE) Standing Committee of Officials (SCO) and the Chief Executive Officers of the current market operators – that is, Gas Market Company (GMC); National Electricity Market Management Company (NEMMCO); Victorian Energy Networks Corporation (VENCorp); and, Retail Energy Market Company (REMCo).

On 13 December 2007, MCE agreed an implementation plan for the establishment of AEMO. It has decided that AEMO will be a not for profit company limited by guarantee, the members of which will be all governments other than (initially) Western Australia and the Northern Territory (60 per cent of membership rights) and energy supply side entities (40 per cent of membership rights). The paper does not discuss issues associated with the establishment, constitution or corporate governance of AEMO. (Those issues will be subject to separate consultation).

The paper sets out the ISC's suggestions and proposals for key elements of the regulatory framework within which AEMO will operate. The purpose of the paper is to facilitate discussion about this framework. The paper does not represent the final views of the ISC. The ISC is particularly keen to receive stakeholders' views.

Written submissions are sought by 19 September 2008 and should be addressed to:

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Information session

MCE ISC will conduct an information session at the **Holiday Inn, Melbourne Airport** on **19 August 2008** from 10am to 12 noon to explain key aspects of the proposed approach to interested stakeholders.

Stakeholders wishing to attend this session are asked to register their interest with MCE Secretariat at
MCE@ret.gov.au

The paper does not purport to address all regulatory design issues associated with AEMO. In particular, the discussion on the proposed National Transmission Planner (NTP) function is not complete. It is anticipated that the MCE will release its response to the Australian Energy Market Commission's (AEMC) report on the NTP function in the near future.

It should also be noted that relevant issues are discussed in this paper at a reasonably high level and will require further elaboration in a number of cases. It is anticipated that

the more detailed aspects of the framework will be developed during the drafting process, which will be the subject of separate consultation.

The paper should be read in conjunction with the AEMO Implementation Plan, which sets the parameters and context for this work. A Synopsis of the Plan was released in March 2008 and is available from the MCE website (www.mce.gov.au). For the avoidance of doubt, unless otherwise specified in this paper it can be assumed that the provisions set out in the Plan will be adopted.

Further detail about the context and the request for input is included in the introduction to the paper.

This document is for comment only and does not represent the final views of the ISC, the MCE, the governments of participating jurisdictions or any government officials.

Executive summary

What is the purpose of the paper?

The paper discusses key issues that arise in setting the legislative framework required for AEMO to act as the national energy market operator. For the purposes of facilitating discussion, the paper canvasses proposals for dealing with those issues. The proposals presented are not final.

The ISC is particularly keen to receive comments from interested stakeholders to inform its final position on key issues. The ISC recognises there is much work to be done to settle the detailed regulatory framework within which AEMO can successfully operate, and stakeholder feedback would be most valuable to facilitate this process.

Accountability framework

A robust accountability framework is one of the keys to confidence in AEMO's operation. The paper makes proposals in relation to the appropriate compliance, enforcement and dispute resolution framework within which AEMO will operate. The ISC proposes that the existing National Electricity Law (NEL) and National Gas Law (NGL) compliance, enforcement and dispute resolution framework should be maintained and relevantly apply to the regulation of AEMO functions. It is also suggested that the dispute resolution panel provided for in Chapter 8 of the National Electricity Rules (NER) and its procedures apply to disputes between businesses in relation to the proposed national gas retail rules and procedures. However, it is recognised that some modifications to the detailed procedures may be necessary or desirable.

Cost recovery

The NEL and the NGL will provide that AEMO is to operate on a cost recovery, not for profit basis and is required to set fees for its services and functions by reference to its budgeted revenue required to support forecast expenditure requirements. The ISC proposes that AEMO model its cost recovery arrangements on NEMMCO's current cost recovery arrangements (with relevant amendments). Briefly, this is that the NER and the National Gas Rules (NGR) should provide that AEMO must prepare and publish before the beginning of each financial year a budget of AEMO revenue requirements for that financial year. The budgeted revenue must take into account and separately identify projected revenue requirements for AEMO's identified lines of business including in relation to its proposed new functions such as the NTP function.

Costs attributable to AEMO's functions will be allocated where possible and recovered through the fees for each function. Shared overheads will be budgeted in accordance with the relevant share of each function to the whole.

Stakeholders should note the ISC's proposal that the budgets and costs for each of the market operators (for whose functions AEMO will assume responsibility) should, for the 2009/10 financial year and possible two subsequent financial years, form the benchmark for AEMO's budget and cost recovery in relation to those functions. The NEL and NGL will oblige AEMO, no later than three years after commencing its operations, to review its budget and cost recovery mechanisms to ensure they are efficient and as consistent with the fee structure principles as possible.

Information gathering powers

The ISC proposes that the NEL and NGL confer on AEMO relevant information gathering powers and information protection obligations. The various existing

requirements to provide information under the NER and gas retail and wholesale rules should be maintained.

Building on the AEMC's proposal in relation to the capacity of AEMO – for its NTP function – to request information from transmission network service providers (TNSPs), the ISC proposes that AEMO be able to make a Market Information Notice (MIN) and serve a Market Information Order (MIO). Taking into account the information that AEMO might require to usefully prepare its national transmission plan, the ISC is also minded to extend the potential recipients of a MIO or MIN to generators.

The ISC proposes that, initially, AEMO would only use MINs and MIOs to request information for its NTP and Gas Statement of Opportunities (GSOO) functions. The Rules (via a rule-change process) might supplement the circumstances in which AEMO might use a MIN or MIO to request information.

Reflecting some of the AEMC's reasoning in relation to the bodies who may be made subject to the information gathering powers it proposes for AEMO, the ISC is also conscious that it would be desirable that AEMO, in carrying out its NTP and GSOO functions, act co-operatively with businesses.

The ISC also proposes amendments of the NEL and NGL to include confidentiality provisions for AEMO, modelled upon those applying to the Australian Energy Regulator (AER). That is, where an information provider claims confidentiality in information AEMO can release the information to third parties (including Ministers) with consent, for judicial proceedings or where natural justice requires, or in a way that does not disclose identity, or where the detriment of disclosure does not outweigh the public benefit.

The persons to whom information may be provided notwithstanding any confidentiality claim will include the Australian Competition and Consumer Commission, AER, Australian Energy Market Commission, Western Australian Economic Regulation Authority, South Australian Electricity Supply Industry Planning Commission, energy industry ombudsmen, relevant jurisdictional regulators and any other person prescribed by regulation.

AEMO immunity and indemnity

The ISC proposes that AEMO be subject to, and have the benefit of, the existing NEL and NER immunity provisions applicable to NEMMCO. These relate to power system security and safety functions and more generally in relation to acts or omissions without bad faith or negligence (noting that negligence is a capped liability). Where AEMO carries out functions in relation to the Victorian electricity transmission system, it will also have the benefit of the existing immunities applicable to network service providers. The NGL and NGR immunity provision in relation to the Bulletin Board operator function should be maintained and extended to AEMO insofar as it carries out gas wholesale and retail functions.

Emergency management

Emergency management is a particularly complex issue for jurisdictions and market operators alike. Australian energy markets are designed to operate without government intervention and generally do so effectively. State and Territory governments have last resort emergency management powers, designed to be used after financial and market arrangements have been exhausted.

The ISC considers that the establishment of AEMO and its assumption of responsibility for gas and electricity functions create an opportunity for MCE to consider a legal framework within which national scale emergencies could be managed: for example,

where there is a serious threat to the supply of electricity and/or gas in more than one jurisdiction.

The ISC is proposing to establish a working group to assist it to review current arrangements and to consider the circumstances in which MCE might act and the action it might take. The working group will be comprised of officials from jurisdictions as well as from market operators. The working group will consult with interested stakeholders.

Gas retail market functions

In making its proposals for the regulatory framework within which AEMO will operate, the ISC has sought to balance the preferred minimalist change approach with the requirement that AEMO operate within a truly national framework.

In the case of existing gas retail rules obligations, the ISC suggests that an appropriate balance will be struck if the existing rules 'transfer' to the national framework rather than remain as jurisdictional instruments. However, the obligations the jurisdictional rules impose should remain unchanged, except where necessary to apply the national governance framework. Accordingly, the ISC proposes separate sets of rules apply in the relevant jurisdictions (one set each for New South Wales and the Australian Capital Territory, Victoria, Queensland and South Australia). AEMO will operate four separate gas retail markets. Similar principles will also be applied to the wholesale market in Victoria.

The ISC considers this is preferable to leaving the jurisdictional rules as jurisdictional instruments and preferable to the more onerous task of immediately seeking consistency across the rules. This is because it gives integrity to the claim that AEMO is a national energy market operator whilst recognising that jurisdictional regulation reflects the particular requirements of businesses and market structures in the relevant jurisdictions. It also gives scope, over time, to achieve greater national consistency and potentially reduce the regulatory burden on businesses.

The ISC has commissioned work to effect the transfer of the existing rules (as well as the Victorian wholesale market rules) into the framework of the NGL and NGR, and procedures made (or deemed to be made) under the NGR. The discussion on issues associated with gas retail and wholesale functions is therefore focussed on two issues that arise out of the ISC's proposal to transfer the existing gas market rules to the national framework. Those two issues are: a description of the principles to be applied in determining whether an existing rule should be reflected in the NGR or procedures; and the proposed procedure change process.

The ISC is conscious that other issues are likely to arise in relation to the transfer of these rules (including the treatment of REMCo's revenue) and these will also be addressed in the establishment of AEMO.

Transition of VENCORP's electricity transmission functions

The ISC recognises that the performance by AEMO of all of its proposed functions may increase the risk, or the perception, of potential conflicts of interest. This perception is perhaps most acute in relation to the combination of market operator functions with certain functions in relation to the Victorian electricity transmission system. The ISC considers that the AEMO Board is the most appropriate body for managing any perceived or real conflicts of interest, including potentially in relation to the simultaneous execution of relevant electricity transmission functions and market operator functions. Accordingly, the ISC suggests that the NEL and NGL include a requirement that the AEMO Board prepare and consult upon guidelines to manage any potential issues of conflict in the simultaneous execution of different functions.

It is not proposed that AEMO be required to register as a participant in any category. There will be specific provisions in the NER (with relevant empowering provisions in the NEL) setting out any obligations currently imposed on VENCORP by the NER as a network service provider and as a registered participant and that are identified as appropriate to continue to apply to AEMO. Work has commenced on identifying relevant obligations. There will be an opportunity to comment on the detail during the exposure draft process.

Finally, it is proposed that, for its electricity planning and procurement functions for the Victorian electricity transmission system, AEMO will continue to be required to submit a negotiating framework, negotiating service criteria and pricing methodology to the AER as part of the revenue reset process. It is not proposed, however, that AEMO be subject to a 5 yearly or annual revenue determination by the AER. Rather the ISC recommends that AEMO be required to publish a methodology for annually determining the aggregate annual revenue requirement to which the pricing methodology will be applied.

Transition of VENCORP's wholesale gas market and system operator functions

Work is being carried out in relation to the wholesale market and system operator functions currently carried out by VENCORP. A more detailed proposal in relation to that work is anticipated to be subject to subsequent consultation.

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Introduction

Background

1. At its meeting on 13 April 2007, the Council of Australian Governments (COAG) agreed to establish a single, industry-funded national energy market operator, to be called the Australian Energy Market Operator (AEMO), for both electricity and gas to strengthen the national character of energy market governance.
2. The Ministerial Council on Energy (MCE) has decided that AEMO will be a not for profit company limited by guarantee, the members of which will be all governments other than (initially) Western Australia (WA) and the Northern Territory (NT) (60 per cent ownership) and energy supply side entities (40 per cent ownership). The paper does not discuss issues associated with the establishment, constitution or corporate governance of AEMO.
3. AEMO will be the successor to the Gas Market Company (GMC), the National Electricity Market Management Company (NEMMCO), the Victorian Energy Networks Corporation (VENCorp), the Gas Retail Market Operator (GRMO) and the Retail Energy Market Company (REMCo) in South Australia. This means it will also become the gas market Bulletin Board (BB) Operator. Further, AEMO will assume the National Transmission Planner (NTP) function. Other functions may in due course be conferred on AEMO after its establishment.
4. The AEMO Implementation Steering Committee (ISC) is comprised of members of the MCE Standing Committee of Officials (SCO), as well as the Chief Executive Officers of the existing market operators. The ISC is tasked with overseeing and managing the tasks necessary for the establishment of AEMO in a manner that achieves a smooth transition from the existing institutional structure in accordance with the Implementation Plan agreed by the MCE on 13 December 2007.
5. Background to this initiative can be found in the AEMO Implementation Plan (the Plan) Synopsis and associated consultation documents available at www.mce.gov.au.

Purpose

6. The ISC has undertaken a review of the legislative changes required to enable AEMO to assume full market operation responsibilities by its scheduled commencement date of 1 July 2009.
7. This paper identifies the key legal and policy issues associated with the transfer of functions currently undertaken by the various market operators to a national regime administered by AEMO. It also presents the approaches that officials currently propose to adopt to resolve these matters.
8. The paper provides interested parties an opportunity to comment on the proposed approaches prior to the commencement of the legislative drafting process to amend the national gas and electricity laws and rules.
9. The ISC also proposes separate public consultation on legislative exposure drafts that result from the implementation of its proposals. However, it is hoped that the release of this draft proposed 'statement of approach' will provide stakeholders with the opportunity to comment on the ISC's proposed approach and to assist ISC to reach a final position on key issues associated with the regulatory environment within which AEMO will operate. This in turn will assist in ensuring that the drafting process is able to accurately reflect the intended outcomes. The objective is to arrive at the successful establishment of AEMO by 1 July 2009.

10. The ISC considers early stakeholder engagement to be especially important given the ambitious timeframes involved in establishing AEMO.
11. There are several further functions that are still to be incorporated into the national framework. MCE has agreed that AEMO will be responsible for the NTP, the Short Term Trading Market (STTM) for wholesale gas and the annual production of the Gas Statement of Opportunities (GSOO). These are not addressed in this document given the timing of decisions on these matters. These will be consulted upon separately and, depending on the timing of legislative processes, may be included in the final legislative package.

Approach

12. The ISC has established a Legal Working Group (LWG) to develop the legislative framework for AEMO. It is comprised of officers from jurisdictional governments and the relevant market operators.
13. The LWG has undertaken a stocktake of the legislative changes required for AEMO to function as the national market operator. Given the tight timetable, the MCE has agreed that a 'minimal changes' approach will be adopted involving amendments to the national framework as well as to relevant state-based legislation. It is envisaged consideration would be given, over the longer term, to achieving greater national consistency where feasible and potentially reduce the regulatory burden on businesses.
14. The LWG has concluded that the functions currently performed by NEMMCO can be readily transferred to AEMO using the existing legislative arrangements (generally by replacing references to NEMMCO with AEMO). Given these are straightforward 'machinery' changes that do not alter current arrangements, they are not discussed here.
15. Particular issues that the ISC considers to need separate attention include:
 - the accountability framework AEMO will apply in relation to compliance, enforcement and dispute resolution;
 - the information gathering powers AEMO is to have in its various capacities (e.g. as market operator and national electricity transmission planner);
 - the indemnity and immunity regime for AEMO;
 - cost recovery arrangements for AEMO; and
 - consideration of a legal framework within which national scale emergencies could be managed given the national and energy wide scope of AEMO operations.
16. The national regime will also need to be amended to accommodate the gas retail market operator functions to be performed by AEMO. In the context of MCE's commitment to a minimal changes approach and given the current jurisdiction-specific regimes are well functioning and well understood by the relevant market participants, it is proposed that the current arrangements be preserved, albeit within the national framework (i.e. AEMO to operate four separate retail gas markets). However, a common process for the change of procedures is required to ensure consistency with the National Gas Law (NGL). Part Two considers:
 - the principles on which to decide whether an existing rule will be a rule or a procedure in the national framework, and
 - the gas retail market procedure change processes.
17. Transitioning VENCORP's functions requires detailed consideration. VENCORP operates the Victorian gas transmission system and associated gas wholesale market and has a number of responsibilities in planning and managing Victoria's electricity transmission network. These activities are referenced in the national framework but only to the extent required to enable Victorian arrangements to function in conjunction with the national regime. In particular, the following issues arise:

- the incorporation of (certain) functions associated with the Victorian electricity transmission system and market operation activities within a single organisation (a real or perceived conflict of interest);
- mechanisms for subjecting (certain) functions associated with the Victorian electricity transmission system to regulation under the National Electricity Rules (NER);
- managing the transition of those functions from VENCorp (a current registered participant) to AEMO;
- managing AEMO's revenue associated with the performance of functions associated with the Victorian electricity transmission system; and
- bringing the rules for operation of the Victorian gas wholesale market and system into the national framework and transferring associated rights and obligations to AEMO.

These matters are presented in Part Three of this document.

18. Other issues that may arise will be dealt with during the drafting process.

Timeframes for consultation

19. Consultation on this paper will conclude on Friday, 19 September 2008. As noted above, these are ambitious timelines, but necessary to ensure a smooth transition to the new market operation arrangements.

Part 1 – Issues relevant to AEMO generally

General approach to managing the transfer of functions

20. The decision that AEMO is to be established as a company limited by guarantee means that it is unlikely that legislation dedicated to its establishment will be required. As such, it is intended that amendments will be made to the National Electricity Law (NEL) and the NGL and the Regulations and Rules made thereunder¹.
21. The NEL and NGL will also contain general empowerment provisions. For example, current references in the NEL to NEMMCO will be replaced with references to AEMO and the provisions in the *Gas Industry Act 2001 (Vic)* and the *Electricity Industry Act 2000 (Vic)* conferring functions, powers and duties on VENCorp will be replicated, as appropriate referencing AEMO, in the NGL and the NEL. There will be separate provisions in the NEL empowering AEMO to carry out its NTP functions².
22. Jurisdictional legislation will need to be amended. For example, references to NEMMCO in State and Territory legislation will be replaced with references to AEMO. Furthermore, detailed consideration will need to be given to other consequential amendments to State and Territory legislation particularly for Victoria as its legislation currently regulates VENCorp. These matters are not addressed here.
23. Legislation is also likely to be required to provide for the novation of contracts of the relevant market operators, for example VENCorp's service envelope agreement with APA GasNet or its Network Agreement with SP AusNet, and to provide for the transfer of other assets and liabilities. Employees will also need to be transferred. The existing liabilities and rights of current market operators will be assumed by AEMO.
24. Transitional arrangements will also be required. These will be identified as the detail of the proposed regulation of AEMO is settled.

MCE decisions

25. In the Plan, MCE set out a number of specific requirements for the governance of AEMO that are to be incorporated into the national framework. In particular, the Plan specifies that:

The establishing legislation for AEMO will empower governments (individually and collectively through the MCE) to:

 - a. *require AEMO to undertake certain actions during emergency situations; and*
 - b. *enable advice to be sought and information requested from AEMO on matters related to its functions, subject to:*
 - *appropriate mechanisms being established for the protection and use of commercially sensitive information, and;*
 - *the cost associated with a request being met by the requesting party or parties, where the advice or information sought requires a material commitment of resources.*
26. In meeting these and other requirements the frameworks within which these instruments will reside have been reviewed to ensure that the broad public interest is appropriately considered. These reviews are presented in the following chapters:

¹ The paper assumes a working knowledge of the national framework by which electricity and gas supply are regulated. For more information on that framework see generally the Ministerial Council on Energy website (www.mce.gov.au).

² The ISC notes the AEMC's final report on its recommendations for the proposed arrangements in relation to the NTP.

accountability; cost recovery; information provision; indemnities and immunities; and emergency management.

Chapter 1 – Accountability framework

27. The establishment of AEMO will involve significant amendments and additions to the national energy legislation including the introduction of a range of obligations that have not previously existed in national legislation. One of the key issues associated with its establishment relates to the accountability framework within which it will operate.
28. This chapter is concerned with the relevant compliance, enforcement and dispute resolution framework. It does not address other accountability mechanisms including AEMO's corporate structure and governance. It is also not concerned with the application of the *Trade Practices Act 1974 (Cth)* to AEMO, nor judicial nor merits review. Each of these issues was addressed by the Market Operator Working Group's Public Consultation Paper on Governance Arrangements for the Proposed Australian Energy Market Operator³.
29. Like SCO's Policy Response Paper 'A National Framework for Regulating Electricity and Gas (Energy) Distribution and Retail Services to Customers'⁴, the ISC recognises that a robust comprehensive compliance and enforcement regime is an integral part of a well functioning regulatory framework. A weak enforcement framework undermines public confidence in the regulatory regime and may create perceptions 'that an otherwise appropriate regulatory tool is not working properly'.
30. It is equally as important that the regulatory framework provide an opportunity for relevant parties to resolve disputes between themselves efficiently and effectively.
31. Accordingly, it is important that the proposed establishment of AEMO is supported by an appropriate national compliance and dispute resolution framework, which does not diminish existing rights.

Issues

32. In light of this, this chapter first sets out what the ISC is proposing will be the general features of the national compliance and enforcement framework. The NER Dispute Resolution Panel (DRP) arrangements are also considered. The chapter then addresses how each of these arrangements applies to existing national electricity and gas functions, noting that the latter does not currently include gas retail functions.
33. After concluding that it seems reasonable and appropriate that the regulation of AEMO's functions to be subject to these arrangements, the chapter addresses the question of how the compliance and enforcement and dispute resolution framework might be applied to the new national gas retail procedures.

Compliance and Enforcement in the NEL and the NGL

34. The NGL and NEL currently contain effective enforcement frameworks to ensure compliance with the Law and Rules. The current enforcement framework for the national energy regimes consists primarily of:
 - an obligation for the Australian Energy Regulator (AER) to monitor compliance with the Law, Regulations and Rules and investigate breaches;

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<http://www.mce.gov.au/assets/documents/mceinternet/AEMO%5FGovernance%5FMOWG%5FConsultation%5FPaper20071005100235%2Epdf>

4

<http://www.mce.gov.au/assets/documents/mceinternet/MCE%5FSCO%5FNational%5FFramework20080613111731%2Epdf>

- an ability for the AER to issue guidelines on its enforcement strategy;
- AER information gathering powers (search warrants for breaches, a general power to obtain existing information from any person and regulatory information instruments in respect of network service providers (NSP's) and their related service providers);
- the ability for the AER to seek a range of remedies in Supreme Courts and the Federal Court to enforce the obligations in the regime (eg. injunctions and declarations);
- civil penalties applicable to specified provisions of the Law and Rules (attracting a maximum penalty of \$100,000 for a corporation – other than rebidding);
- the ability of the AER to serve an infringement notice for breach of a civil penalty provision which, if paid, would avoid Court proceedings (currently at \$20,000 for a corporation);
- an access dispute framework allowing the enforcement of regulated access terms and conditions (access disputes);
- a dispute resolution framework for disputes between registered participants in the National Electricity Market (NEM);
- dispute resolution mechanisms created by access arrangements to allow users and networks to enforce contractual obligations owed to each party;
- the AER is the sole enforcer of obligations, so there is a general prohibition on any party taking civil legal action to enforce obligations under the Law, Regulations or Rules, subject to limited exceptions;
- conduct provisions allowing limited private enforcement rights of specified provisions of the NGL and National Gas Rules (NGR) in gas; and
- a very limited number of criminal penalties (e.g. obstructing a witness in an access dispute) in the NGL and NEL.

35. As part of SCO's proposed National Energy Customer Framework, it is proposed that these powers be supplemented by:

- compliance monitoring, allowing the AER to require relevant businesses to report on their compliance with the Law and Rules;
- an ability for the AER to accept enforceable undertakings in a way similar to the Australian Competition and Consumer Commission (ACCC) (modelled on s 87B of the *Trade Practices Act 1974* (Cth)); and
- the introduction of conduct provisions to electricity regulation.

Dispute resolution

36. Additionally, the NER contain separate dispute resolution arrangements for resolving disputes between registered participants about matters concerning the application or interpretation of the NER (Chapter 8 of the NER). The procedure is adapted to resolve Business to Business (B2B) Determination Disputes. The Chapter 8 dispute resolution process utilises procedural provisions of State and Territory commercial arbitration acts (s 69A of the NEL), can be appealed on questions of law (s 71 of the NEL) and obligations to make payments as a result of a decision can be enforced in a Court (s 72 of the NEL).

37. The Chapter 8 NER dispute resolution process is in two potential stages. The AER appointed Adviser (requiring a detailed understanding and experience of alternative dispute resolution practice and procedures) is required to first try and settle any dispute. If the parties agree and if the Adviser considers that any attempt to resolve the dispute is unlikely to result in resolution of the dispute within a reasonable time the dispute may

be referred to the DRP. The NER provide for the composition of the DRP, the parties to proceedings, how proceedings are to be conducted and how the DRP makes decisions and what those decisions might be. There is also provision for the payment of costs.

38. The key features of the Chapter 8 NER DRP are:
- generally, it comprises three members who are members of a pool established by the Adviser and who are (in the reasonable opinion of the Adviser) either expert in the field to which the dispute relates or experienced or trained in dispute resolution techniques;
 - among other things, the DRP has jurisdiction over disputes about the interpretation or application of the rules, the failure of Registered Participants to reach agreement on a matter where the Rules require agreement or require the parties to negotiate in good faith to reach agreement; and
 - the DRP may settle disputes with an order to pay compensation, or with an injunction ordering a person to do or refrain from doing something.

Current Arrangements for compliance with NER and NGR

39. The proposed AEMO functions are currently performed by a range of bodies with various different compliance and dispute resolution arrangements.

Electricity functions

40. The AER has a range of options available to it to legally enforce the Law and Rules.
41. Compliance with subordinate instruments such as 'Procedures' created under the NER is managed by a separate requirement in the NER that participants must comply with the relevant 'Procedures'. In some cases, the Rule requiring compliance is prescribed by the NEL as a civil penalty provision (such as rule 3.19(c) requiring compliance with Market Management Systems Access Procedures, rule 7.2.8(d) requiring compliance with Market Settlement and Transfer Solution Procedures and rule 7.4.2(bb) about compliance by metering providers with various procedures). In other cases the Rule requiring compliance is not a civil penalty (such as 7.2A.4(i) requiring compliance with B2B procedures).
42. The SCO proposal that some NER provisions be 'conduct' provisions gives scope for identified rule obligations to be enforced between relevant parties.

Gas functions

43. The establishment of AEMO will see it carry out functions under the existing jurisdictional gas retail rules and the Victorian Market System and Operation Rules (MSOR), collectively referred to as the gas market rules. Chapter 6 proposes that the gas market rules will be incorporated into the national framework as part of the NGR and as a new set of procedures made under the Rules.
44. Currently there is a range of different enforcement mechanisms for the gas retail rules including a 'contractual' requirement in the governing documentation of some existing market operators for members to comply with the relevant rules.
45. However, the jurisdictional frameworks for dispute resolution are broadly similar. In particular, the state regimes are based around expert DPRs that are empowered to determine disputes between parties governed by the rules and to impose financial penalties or grant injunctive or compensatory relief. These regimes are broadly similar to the dispute resolution process under Chapter 8 of the NER. The NER Chapter 8 DRP is not, however, designed to impose civil penalties for breaches of the rules.
46. The NGL and NGR do not currently include anything similar to the jurisdictional DPRs.

Proposed approach

47. It seems reasonable and appropriate that the regulation of AEMO's functions be subject to the current national compliance and dispute resolution frameworks. This will involve applying the NEL and NGL compliance and dispute resolution frameworks (as supplemented by the reforms proposed by SCO's National Energy Customer Framework) to all of AEMO's functions.
48. This will mean that, for some participants in the gas retail markets, obligations will no longer be imposed as a matter of their contractual obligations as members of a company or be imposed as a condition of a licence. The NGR will be the relevant instrument by which obligations will be imposed. How this is proposed to work is set out in paragraph 51.
49. The ISC also notes that AEMO will, by virtue of its operations, be involved in monitoring compliance. Consideration is being given to continuing the requirement that participants report to AEMO their own non-compliance and instances of non-compliance with the Procedures by other participants, as is currently required by gas retail rules operating in South Australia (SA). The ISC is also considering requiring AEMO to report all breaches to the AER and advise the market that a matter has been referred to the AER.
50. The issue, however, given that many of the current gas market rules will be contained in the new gas procedures, is what compliance and dispute resolution mechanisms should apply to these Rules and Procedures.
51. There are two complementary proposals that are consistent with the existing national electricity framework. The first proposal is to specify in the NGR a requirement that relevant participants are required to comply with particular procedures. Those NGR requirements might be prescribed as civil penalty or conduct provisions.
52. The second proposal is to provide for a new national dispute resolution process in the NGR (authorised by the NGL) including the establishment of a DPR (based on the existing jurisdictional arrangements) to specifically cover disputes arising under the gas market rules and procedures. This is discussed more fully below.

Dispute resolution panel

53. This proposal is based on the approach used by all jurisdictions for dealing with disputes in relation to the gas market rules and procedures. It is also based on Chapter 8 of the NER.
54. The dispute resolution panel for resolving disputes in relation to the operation of the gas market rules and procedures could be modelled on the Chapter 8 NER DRP. The AER would appoint an Adviser who would be responsible for establishing and maintaining a pool of persons from which members of the DRP may be selected. The dispute resolution process would be in two stages. The first stage would involve relevant participants referring disputes to the adviser for resolution. In the case of failure to resolve the dispute the Adviser would be empowered to establish the DRP. The process for determination of the parties to the dispute, how the proceedings are conducted and resolved might be modelled on the Chapter 8 NER process. However, this would be subject to any changes to the detailed procedural requirements that may be necessary or desirable to reflect differences in gas and electricity market operations, or identified process efficiencies.
55. The DPR would be empowered to resolve disputes between parties including AEMO about the operation of the gas market rules and procedures. The DPR would not, however, be able to impose penalties. Consistent with the electricity model, provisions that require AER enforcement would be placed in the Law or Rules. The advantages of this proposed approach are it:

- uses an established approach to enforcement that has proven to be effective and is widely accepted by participants;
- could be established relatively easily by appropriately adapting the jurisdictional approaches or the process in Chapter 8 of the NER;
- is consistent with the NER, Victoria’s MSOR and various models under existing gas retail market with only one difference (in the case of the latter), that is that the proposed DRP cannot impose civil penalties; and
- accords with the intention to transition with minimal change while, simplifying regulation, where possible.

56. The disadvantages are it:

- introduces a new enforcement mechanism into the NGL that is not currently provided for; and
- might exclude the AER from disputes under the procedures where there is no rule which supports a particular obligation.

57. The ISC proposes to implement a DRP process for gas disputes.

58. Consistent with the Chapter 8 NER DRP the proposed national gas DPR will be limited in its role to resolving disputes. It is not proposed that it will have an enforcement function. Enforcement will remain the function of the AER.

Recommendations

1. The existing NEL and NGL compliance and dispute resolution frameworks (as supplemented by the reforms proposed by SCO's National Energy Customer Framework) should be maintained and relevantly apply to the regulation of the functions AEMO will carry out under the NEL, NGL and the NER and NGR.
2. The Rules should specify the extent to which participants are obliged to comply with a particular procedure or part of a procedure. Particular Rules may be made a civil penalty or conduct provision by prescribing them in the Regulations.
3. The NGR should provide for the constitution of a panel for resolving disputes arising under the new gas market rules and procedures. The panel will have no enforcement function.

Chapter 2 – Cost recovery

59. This chapter considers the regulatory arrangements that will need to be in place to implement the MCE endorsed decisions in relation to revenue and cost allocation for AEMO.

Issues

60. The AEMO Implementation Plan included decisions in relation to cost recovery, namely that:
- AEMO is to be funded by industry rather than by government budget appropriations;
 - AEMO is to be responsible for developing, consulting and setting participant fees for its various functions; and
 - in setting fees AEMO is to observe the following principles:
 - funding be on a cost recovery basis;
 - fees charged to particular persons be cost reflective of the service AEMO provides to each fee payer and be ring fenced⁵ for each function to the extent required;
 - fees be sufficient to enable AEMO to perform its functions;
 - there be no cross subsidies across industries and (for gas) across jurisdictions;
 - fees 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.
61. Given this, the key task is to identify the provisions required to empower AEMO to manage AEMO's revenue and to set and collect participant fees.
62. MCE has agreed that funding arrangements for AEMO should broadly reflect the current arrangements in relation to each of the bodies whose functions it will assume.
63. Analysis of the funding arrangements for the existing market operators reveals a generally consistent approach to cost recovery. In particular:
- **Funding Principles:** The majority of the current market operators are required to set a fee structure under a set of explicitly stated funding principles. Primary principles are that:
 - funding arrangements should be sufficient to recover the operator's budget;
 - they should be simple (both to understand and implement); and
 - the structure should only require identified classes of payers to pay for particular services used.
 - **Operation as not-for-profit:** Each market operator is operated on a not-for profit basis and fees are levied on a fee for service basis. There is provision for the recovery of fees for costs incurred through the initial establishment of each market operator, as well as for ongoing operation and maintenance. Whilst some

⁵ In this context, 'ring-fencing' relates to accounting practices that ensure cost separation rather than the usual regulatory meaning.

components of the budget of the existing market operators are set through regulatory determination, it is not expected that this situation will continue. See the separate discussion in Part Three dealing with VENCORP.

- **Special Market Operation Costs:** There is provision for each current market operator to recover costs from appropriate classes of payer in relation to functions carried out separately to the ongoing operation functions of the market. For example, GMC is currently providing services to the New South Wales (NSW) government as part of that jurisdiction's Gas Supply Continuity Scheme. Cost-recovery for the operation of this service is to be borne by the Scheme participants, that is, shippers (and not all GMC members).
- **Industry Consultation:** Consultation with prospective fee payers is a required facet of each current market operator's cost recovery mechanism.
- **Dispute Resolution:** There is scope for prospective NEMMCO fee payers to resort to a dispute resolution mechanism to resolve disputes relating to the setting of the fee structure. In the case of some market operators other than NEMMCO, there is regulatory oversight of the applicable fees.

Proposed approach

64. To ensure minimal disruption to the market during the initial years of AEMO operation it is proposed that the cost recovery framework of the existing market operators be retained for up to three years. AEMO will be required to review these arrangements by no later than three years from the date it commences its operations.
65. Notwithstanding the above, for the purposes of providing a coherent legal basis for cost recovery, the ISC proposes adopting a single cost recovery framework. This is in the context that funding arrangements for the market operators are generally consistent and that MCE has requested a minimal changes approach be adopted.
66. The functions covered in this chapter are generally market operation roles. In respect of these it appears to the ISC that the NEMMCO cost recovery and allocation framework provides reasonably comprehensive arrangements for delivering efficient and transparent fee arrangements and could be the basis on which AEMO's cost recovery framework might be modelled. (It should be noted that the BB functions are not addressed in this framework given they are determined through Rules). The ISC proposes supplementing the existing framework with a proposal that AEMO have the capacity to set fees on a rolling three or five year basis to ensure that there are no cost shocks to participants.
67. It is intended that this framework apply to the revenue derived from VENCORP's functions in relation to the Victorian electricity transmission system (albeit in a modified form). This represents a departure from current arrangements which involve AER oversight and regulation of revenue collection. This change has been made on the basis that regulatory oversight does not deliver superior outcomes relative to the cost recovery arrangements that will be administered by AEMO. (The setting of charges will, however, be undertaken by AEMO according to a pricing methodology approved by the AER). The reasons for this shift are explained in detail in chapter 10.

9. The NER and the NGR will specify the person or classes of person that will be required to pay the fees. In the case of the NER, Registered Participants will continue to be fee payers for relevant services. In the case of the NGR, fee payers for services currently provided by jurisdictional market operators will be specified so as to capture current payers of the relevant fees. Other potential payers are users of special/project services e.g. the MCE and individual Ministers.
10. Transitional measures will be established to the effect that:
 - a. costs for particular functions (e.g. for NEMMCO and for each of the retail market operators) will be recovered in the same way in 2009/10 as in the past; and
 - b. by no later than three years from commencing operations AEMO will undertake consultation with industry to review cost recovery rules that are consistent with the principles set out above.
11. The NEL and the NGL should include in the AEMO fee structure a dispute resolution mechanism for disputes relating to the fee structure. The AEMO dispute resolution mechanisms should probably be modelled on the NEMMCO's existing dispute resolution arrangements (r 8.2). This means the AER will appoint a Dispute Resolution Adviser who can establish a DRP. There will be a two stage dispute resolution process, as is currently provided for in r 8.2 of the NER.
12. AEMO should be generally required to publish a statement of how costs are allocated to the various functions of AEMO which are to be recovered by different fee mechanisms.

Recommendations

1. AEMO should be substituted for NEMMCO in NEL ss 116, 119 and 120. Save as noted below in respect of an equivalent for clause 3.17.2 of the NER, there should be no other amendment to the sections. Nor should there be any amendment to the caps in regulation 14 of the *National Electricity (South Australia) Regulations*;
2. A provision in similar terms to clause 3.17.2 of the NER should appear in the NEL to give AEMO, its contractors, agents and employees a complete immunity as against market participants in respect of the software used to operate the market. Clause 3.17.2 could then be removed from the NER;
3. A provision in similar terms to s 120 of the NEL should be added to the NGL (to apply in lieu of clause 1.2.2 of the MSOR) for AEMO performing the wholesale market operations functions that VENCORP now performs with respect to the Victorian wholesale gas market. A regulation should be added to the *National Gas (South Australia) Regulations* setting the caps for the purposes of this provision. The amount of the caps can be decided at the time that regulation is drafted;
4. There should be no change to the BB Operator immunity provisions (s 221 of the NGL and regulation 11 of the *National Gas (South Australia) Regulations*);
5. There should be an exclusion of all liability of AEMO, its employees and agents including in relation to its gas retail market functions, except in the case of bad faith or negligence. Liability for negligence will be capped. This will be modelled on s 119 of the NEL and s 221 of the NGL read with the relevant regulations; and
6. The immunities that REMCO has in SA should continue as applied to AEMO performing gas retail market functions in that State but be elevated into the NGL.

