

SYNOPSIS:

AUSTRALIAN ENERGY MARKET OPERATOR IMPLEMENTATION PLAN

1. Introduction

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. As part of this decision, COAG tasked the Ministerial Council on Energy (MCE) with developing, by the end of 2007, a detailed implementation plan. The MCE at its meeting on 13 December 2007 approved a detailed implementation plan, based on the work of the Market Operator Working Group and Transition Management Committee, and submitted it to COAG for consideration.

This document provides a summary of the plan including details of the key functions and governance arrangements for AEMO, implementation arrangements and timelines.

The plan is designed to fit with the 1 July 2009 timetable for the commencement of operation of AEMO agreed by COAG. The plan was developed with the following objectives in mind:

- ensuring continuity of electricity and gas market and system operation functions during the transition period;
- minimising the costs and risks of transition, and:
- positioning AEMO for long term sustainability by:
 - preserving and building on the existing stock of corporate skills and capabilities required for effective energy market operation; and
 - establishing an independent skills-based board with the requisite knowledge and expertise to undertake all of the duties and functions of AEMO from formal commencement of its activities.

To better guide the transition, these objectives have been elaborated by principles and proposals to guide the transition process. These are set out in **Attachment 1**.

2. Governance arrangements

Functions

COAG agreed that the functions of AEMO should encompass those carried out by the National Electricity Market Management Company (NEMMCO), the planned gas market operator (GMO) and the new national transmission planning function. COAG also noted that the GMO, if established, would be expected to subsume the gas market functions of Victorian Energy Networks Corporation (VENCorp), the Gas Market Company (GMC) and Retail Energy Market Company (REMCo), and have responsibility for the operation of the Bulletin Board (BB) and (if established) the Short Term Trading Market (STTM) for gas.

In light of the timetable constraint, MCE agreed not to establish the GMO as a separate entity, but for AEMO to pick up the proposed functions of the GMO. Given this, and other recent work and analysis, MCE further refined the proposed functions of AEMO, consistent with the COAG decision. The functional scope of AEMO is described in **Attachment 2**.

Board and accountability arrangements

At its meeting on 13 April 2007, COAG agreed AEMO have:

- strong stakeholder participation and responsiveness;
- governance arrangements that involve market participants in board appointment processes in a manner that preserves the board's independence from any particular market participant;
- a process for appointment of an independent skills-based Board with a balanced mix of industry and generalist expertise, appointed under statutory conditions by the MCE; and
- a Market Operations Panel (or panels) for electricity and gas be established to advise the AEMO Board.

MCE has addressed these requirements through the AEMO Board and accountability arrangement detailed in **Attachment 3** and reflected in the establishment activities noted below.

3. Implementation activities

Oversight and Management Arrangements

An Implementation Steering Committee (ISC) has been established to manage the process for transitioning to AEMO (with terms of reference at **Attachment 4**). This body is responsible for:

- facilitating the Board and Chief Executive Officer (CEO) appointment processes;
- overseeing the legislative processes;
- progressing the establishment of AEMO company arrangements;
- facilitating effective communication, including with the existing market operators;
- regular reporting to MCE; and
- engaging in stakeholder consultation and communication on development of the necessary legislation and AEMO company constitution.

Membership of this body includes senior jurisdictional representatives and the Chief Executive Officers (CEOs) of the existing gas and electricity market operators.

The CEO's also compose the Transition Management Committee (TMC). This body has been established to provide advice to the MCE Standing Committee of Officials (SCO) in relation to the effective management of the transition path to AEMO at an operational level. It will continue to undertake its function, predominantly as a constituent part of the ISC, in guiding the transition process prior to the appointment of the AEMO Board and subsequently work with the incoming Board to facilitate effective communication and transfer of resources from the existing market operators.

Board and CEO selection

Board selection

The first proposed major milestone is the establishment of an initial AEMO board of directors by 1 July 2008. This timing has been identified as the latest desirable date for appointment of the Board given the complexity and scope of tasks it will be required to undertake, if AEMO is to be fully operational by 1 July 2009.

Once appointed, the Board will be responsible for selecting a CEO and undertaking the development of the key operational aspects of AEMO, subject to any higher level principles or other decisions determined by MCE and COAG.

The initial board will be specifically tasked with working co-operatively with the existing market operators, government and industry to ensure the smoothest possible transition (minimising disruption and cost) to the new arrangements.

The early appointment of the Board gives responsibility and accountability to the incoming directors for the development and successful implementation of appropriate transitional measures and to ensure that AEMO can begin effective operation from its scheduled commencement date.

The appointment of the Board will require implementation of the activities outlined below.

Selection Panel process

An independent Selection Panel will be used to choose candidates for the AEMO Board. MCE will choose two members and an *ex-officio* chair for the Selection Panel. Industry (users and supply side participants) will appoint the two other members of the Selection Panel.

The skills matrix which has been developed (see **Attachment 5**), against which candidates for Board appointment are to be selected, is to be provided to the Selection Panel. *The skills matrix is to form the key reference point for the Selection Panel in making assessments of candidate adequacy.*

An executive search firm will be engaged to identify suitable candidates for appointment as directors on the AEMO board and for the CEO. The executive search firm will be responsible for developing a short list of Board members for consideration by the Selection Panel.

Once appointed, the Chair will have an advisory role in the appointment of the remaining directors.

The Selection Panel will make a recommendation to the MCE on the composition of the Board. The recommendation of the Selection Panel will be automatically approved unless, by a two thirds majority, MCE requests the Selection Panel to review its recommendation and submit a revised report.

CEO selection

Most of the operational aspects of the transition will be handled by an executive management team led by the CEO of AEMO. The appointment of a highly qualified CEO is required at an early stage and this will be the responsibility of the Board. The Board may choose to accept the Short List of suitable candidates for the CEO position, as recommended by the executive search firm, or may choose an alternative approach.

Board and CEO responsibilities

The Board and CEO will be responsible for managing the practical business aspects of the implementation process. This includes: management structures; operational decisions; insurance arrangements; staffing and accommodation, legal due diligence on the transfer etc. The Board, CEO and senior management team of AEMO will therefore need to:

- work with the board and management of the existing market operators;
- liaise with the AEMC on the process for incorporating the national transmission planning (NTP) function as decided by the MCE;
- liaise with the Gas Market Leaders Group on the development and incorporation of the BB, and of the STTM should MCE decide to proceed with this latter initiative;
- determine the composition and detailed arrangements for the Market Operations Advisory Panel(s); and,

- liaise with the ISC and report on progress against timelines.

Legislative Requirements

Legislation

A significant body of legislative changes will be required to implement arrangements for AEMO to meet the 1 July 2009 implementation date. Given the tight timetable, a 'minimal changes' approach will be adopted involving amendments to the national framework as well as to relevant state-based legislation.

New functions

The legislative package will include new functions, including those of the NTP for electricity; gas BB, STTM (if established) and proposed gas statement of opportunities. Development of these aspects of the legislation will require coordination with the AEMC and the Gas Market Leaders Group which have responsibility for developing these new functions.

Legislative steps

The key steps for setting the legal framework for AEMO are:

- review required legislative changes;
- drafting instructions;
- drafting legislation and legislative instruments;
- consultation, and
- review submissions/final changes.

A legal Working Group has been established to develop the required changes.

Transitional Arrangements and Establishing AEMO

Establishment of AEMO

MCE has agreed AEMO is to be a company limited by guarantee and is currently considering the most appropriate membership arrangements for AEMO.

AEMO Constitution

The ISC will oversight the development of the AEMO constitution with legal advice and drafting carried out by the Legal Working Group. An exposure draft of the AEMO constitution will be released for public consultation. The constitution will be subject to amendment by a 75% majority vote of the AEMO members.

4. Funding

AEMO will be established using seed funds provided by government to be repaid through participant fees over the three year period following AEMO establishment.

5. Key milestones

The key milestones for establishing AEMO are as follows.

Key milestone dates for AEMO establishment		
Start	Finish	
<i>AEMO Board Selection</i>		
Jan 08	May 08	Selection Panel to identify Board Members
Jun 08	Jul 08	AEMO Board appointed
Jun 08	Aug 08	Appointment of CEO
<i>Legislative Requirements for National Regime</i>		
Jan 08	Mar 08	Commence drafting instructions
Apr 08	Sep 08	Drafting of legislation and legislative instruments
Oct 08	Nov 08	Consultation
Nov 08	Dec 08	Revision
Jan 09	May 09	Parliamentary processes
	End Jun 09	State legislative requirements established
1 Jul 09		Legislation commences
<i>Establishing AEMO company and interim arrangements</i>		
Jan 08	Apr 08	Establish transition vehicle
Jun 08	Mar 09	Develop and finalise AEMO constitution
Apr 09		AEMO corporate entity established
Jul 09		Transfer of assets and liabilities to AEMO and commencement of operation.

Glossary of Terms/Acronyms

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
ASX	Australian Securities Exchange
BB	Bulletin Board
CEO	Chief Executive Officer
COAG	Council of Australian Governments
GMC	Gas Market Company
GMO	Gas Market Operator
GRMO	Gas Retail Market Operator
ISC	Implementation Steering Committee (comprises senior government officials and the CEOs of existing market operators)
MCE	Ministerial Council on Energy
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NTP	National Transmission Planner
REMC _o	Retail Energy Market Company
SCO	Ministerial Council on Energy's Standing Committee of Officials
STTM	Short Term Trading Market
TMC	Transition Management Company (comprises the CEOs of existing market operators)
VENC _o r _p	Victorian Energy Networks Corporation

Attachment 1 – Guiding Principles and Proposals to Manage the Transition to AEMO

- The Boards of the existing market operators to retain unfettered decision making power in respect to their entity until the winding up of that entity.
- The process of winding up existing market operator bodies to be a responsibility of governments and/ or the owners/members, boards and management responsible for those organisations as appropriate.
- Employees of NEMMCO and VENCORP transfer to AEMO in their current roles and locations and are to maintain overall terms and conditions of employment that are no less favourable in line with different awards, agreements, contracts and with accrued entitlements being preserved (e.g. leave).
- Current responsibilities and tasks of employees should remain unaltered by AEMO for a period of up to six months from commencement of its operation.
- AEMO should not during the transition and without agreement, recruit staff from existing market operators.
- Existing market operators should, wherever feasible, provide office facilities and other resources for AEMO.
- Current property arrangements be retained at the outset but be rationalised over time to meet the longer term needs of the organisation.
- Contracts held by existing market operators should be managed effectively to ensure they do not expire at the changeover date and expose the new organisation.
- The current market operators should not enter into new contracts, or renew existing contract for periods extending more than two years beyond the commencement of AEMO (i.e. no new contracts past 1 July 2011 except for Electricity Transmission Services or Gas Services in Victoria).
- Good communication arrangements should be instituted between the boards and management of AEMO and existing market operators to facilitate coordination of the transition.
- Early decisions to be taken by governments where functions are to be transferred to enable effective planning.
- No additional functions should be introduced to AEMO within the first six months of its operation.
- Contractual and other arrangements should be put in place to enable access to information necessary for existing market operators to be 'wound up'.
- The transfer of functions and staff from NEMMCO and VENCORP to AEMO should not be staggered but occur at the same point of time.
- The transfer of functions from REMCO and GMC should be achieved as rapidly as possible having regard to minimising the commercial consequences of the transfer.
- The fee base of existing market operators should establish the base line for AEMO fees with any departures, including fees for additional functions, to be justified.

- Fee arrangements be settled transparently in consultation with market participants.
- The costs of the transition be allocated equitably across the markets for which the AEMO becomes responsible.

Attachment 2 – AEMO Functions

1. AEMO will be empowered to:
 - a. carry out all current functions performed by:
 - i. NEMMCO;
 - ii. VENC Corp¹;
 - iii. GMC;
 - iv. Gas Retail Market Operator (GRMO); and
 - v. REMCo in South Australia; and
 - b. undertake the new functions of:
 - i. the national transmission planner for electricity, currently being developed by the AEMC and as decided by MCE;
 - ii. the gas BB;
 - iii. the gas STTM, subject to a decision to proceed and endorsement of the detailed arrangements;
 - iv. advice to the National Gas Emergency Response Advisory Council; and
 - v. a gas market statement of opportunities; and
 - c. take on additional transferred functions, subject to the agreement of the relevant jurisdiction, as provided for by the Australian Energy Market Agreement and appropriate jurisdictional funding, including those functions currently carried out by:
 - i. Electricity Supply Industry Planning Council;
 - ii. Independent Market Operator (Western Australia); and
 - iii. the functions of REMCo carried out in Western Australia.
2. 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:
 - i. appropriate mechanisms being established for the protection and use of commercially sensitive information, and
 - ii. the costs associated with a request being met by the requesting party or parties, where the advice or information sought requires a material commitment of resources.
3. AEMO will have the capacity to undertake additional related functions or to cease functions when proposed by the Board and supported by a 75 per cent majority of the Members; and provided the proposed functions or cessation of functions are not inconsistent with the Law and the Rules and do not compromise the existing statutory functions of AEMO.
4. AEMO will not have any capacity to authorise Rules, noting that it will have the capacity to develop rule change proposals and to submit them to the AEMC.
5. A process will be established to identify:

¹ Functions of VENC Corp other than gas market operation, such as jurisdictional network planning and network service procurement have been included by agreement of COAG but are to be treated as additional transferred functions for the purpose of funding.

- a. gas-related rules which may be classified as procedures and, therefore, be approved by AEMO, subject to an appropriate consultation process; and
- b. any regulatory or quasi regulatory functions which should more appropriately be the function of the AER.

Attachment 3 – Board and accountability arrangements

AEMO Board Arrangements

1. The Board to consist of up to 10 directors, comprising a CEO and up to 9 non-executive directors.
2. One of the non-executive directors to be the Chair of the Board and hold a casting vote.
3. The non-executive directors to have the responsibility to appoint the CEO.
4. The Chair be independent as defined by the Australian Securities Exchange (ASX) Corporate Governance Principles; the CEO cannot be the Chair.
5. A minimum of 3 and a maximum of 6 non-executive directors have relevant energy industry experience.
6. The majority of the Board be independent as defined by the ASX Corporate Governance Principles.
7. All non-executive directors (including the Chair) have a maximum three year period of appointment with an option of being appointed for one additional period of three years only.
8. One third of the non-executive directors of the Board retire by rotation each year.
9. In the initial appointment, directors' terms expire on a staggered basis with 3 directors to retire every year. (That is, 3 directors be appointed for 1 year, 3 directors for 2 years and 3 directors for 3 years.) The Chair be one of the directors appointed for 3 years. All directors be eligible to be re-appointed for a further 3 years. For the purpose of the staggered appointments, director terms begin from the commencement of operation of AEMO (that is 1 July 2009).
10. The remuneration of the Board be determined by the Members of AEMO on the basis of independent expert advice, having regard to the functions and skills involved.
11. A Selection Panel be established to select the AEMO Board of Directors.
12. The Selection Panel have 5 members, comprising 2 representatives appointed by industry, and 2 representatives and an independent *ex officio* Chair appointed by the MCE.
13. The process for selecting the industry representatives on the Selection Panel is:
 - a. 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
 - b. 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 energy industry knowledge, and an appreciation of how to select people to match the skill set nominated for the Board.
14. The *ex-officio* chair be appointed by MCE based on the basis that the person occupies an official position requiring a strong understanding of the principles of good corporate governance. The two government members of the Panel be chosen by unanimous agreement of the MCE.

15. In making subsequent Board appointments, the Chair of AEMO will have an advisory role to the Selection Panel (except where the position of Chair is under consideration) and be involved from an early stage of the process.
16. The Selection Panel base its assessments of potential directors by reference to the skills matrix at **Attachment 5** which is to be updated to reflect the changing needs of the organisation, with all changes agreed by 75% of Members.
17. Directors be subject to automatic disqualification on defined grounds as set out in the *Corporations Act 2001*.
18. In accordance with the *Corporations Act 2001*, directors may be removed through a simple majority vote of the Members.
19. A Market Operations Advisory Panel(s) be established, and assume an advisory role only, with the detailed arrangements for their formation, membership and interaction with the Board to be determined by the AEMO Board.
20. To ensure effective lines of accountability, the AEMO Board should be directly responsible for all functions to be carried out by the organisation.

AEMO Accountability Arrangements

1. AEMO be established as a not for profit company limited by guarantee.
2. Relevant accountability arrangements be set out in AEMO's constitution and the relevant legislation and Rules.
3. AEMO be required to operate in accordance with the National Electricity Law (NEL) and National Gas Law (NGL) objectives.
4. The limitations on AEMO's liability be the same as those that currently apply to NEMMCO under section 119 of the NEL and be replicated in the NGL.
5. AEMO must comply with all applicable *Corporations Act 2001* requirements, including:
 - a. financial and company reporting; and
 - b. auditing.
6. AEMO be required to prepare:
 - a. an annual budget in consultation with market participants; and
 - b. a Statement of Corporate Intent.
7. The ASX Corporate Governance Principles and Recommendations apply to AEMO where appropriate.
8. There be no change to merits or judicial review arrangements currently in place.
9. AEMO be required to develop, review and publish the structure of participant fees, in consultation with market participants, against the following criteria:
 - a. funding be on a cost recovery basis;
 - b. fees charged to particular persons be cost reflective of the service AEMO provides to each fee payer and be ring fenced for each function to the extent required;
 - c. fees be sufficient to enable AEMO to perform its functions;

- d. there be no cross subsidies across industries and jurisdictions;
 - e. fees be competitively neutral as between fee payers and foster economically efficient outcomes in the national energy market; and
 - f. the fee structure should be simple, to the extent that is consistent with the other principles.
10. Legislation prescribe that participants pay such fees as are established by AEMO.
11. The amount of the fees of the existing market operator organisations provides a benchmark for the costs of operating a particular market in a particular jurisdiction. AEMO is to explain and justify any departures (such as for additional functions) from this benchmark to market participants.

Attachment 4 – Implementation Steering Committee Terms of Reference

Terms of Reference

Implementation Steering Committee

For the establishment of the Australian Energy Market Operator

Background

The Council of Australian Governments (COAG) agreed at its 13 April 2007 meeting, to establish a single industry-funded national energy market operator for both electricity and gas, to strengthen the national character of energy market governance.

At its meeting on 13 December 2007, the Ministerial Council on Energy agreed to a detailed implementation plan for the establishment of a single national energy market operator for electricity and gas, to be called the Australian Energy Market Operator (AEMO). The detailed implementation plan has been submitted to COAG.

To manage the establishment of AEMO, the implementation plan identified the need to form an Implementation Steering Committee (ISC) comprising the Chief Executive Officers of the existing gas and electricity market operators and nominated jurisdictional representatives. The Implementation Plan approved by the MCE is the basis for the activities of the ISC.

Terms of Reference

The role of the ISC is to implement the plan by 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 carrying out this task, the ISC will be assisted by the Transition Management Committee which will have an advisory role and continue to take responsibility for operational matters. The ISC will have the same decision making authority as the Standing Committee of Officials. In carrying out its activities the ISC should:

1. Manage and direct the AEMO implementation processes in accordance with the plan, take responsibility for policy decisions and advise Ministers as appropriate.
2. Carry out the activities identified in the implementation plan in accordance with the timeline.
3. Form sub-committees, as necessary, to undertake tasks and manage delivery of the plan.
4. Reach decisions by consensus and where required, seek the agreement of Ministers.

5. Ensure necessary changes to legislation are effectively integrated with the MCE legislative timetable.
6. Coordinate actions with the Australian Energy Market Commission and Gas Market Leaders Group which have responsibility for developing new AEMO functions.
7. Operate transparently and engage in effective and timely communication and consultation with relevant stakeholders.
8. Provide regular reports to COAG, MCE and SCO on progress.

Attachment 5 – AEMO Skills Matrix

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 is to be used to populate a skills matrix to guide the selection of the board of directors 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 regular review by the Board.

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 National Electricity Market (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;

- 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

Additional skills required to govern the operation of Australian energy markets includes significant experience in:

- operation of the NEM;
- 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;
- 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 issues of particular relevance to remote areas; and
- 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.