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NE Rule Change Process
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Dear Sir/Madam

Submission on Proposed Electricity Rule Change Process Consultation Paper

Please find attached a short submission from Clayton Utz on some procedural aspects of the proposed rule change proposed.

Please contact me if we can expand on any of the matters dealt with.

Yours sincerely

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attachment

Submission on Proposed National Electricity Rule Change Process

As part of its work in advising clients across a range of regulated industries, Clayton Utz has had a broad exposure to a range of regulatory structures in a large number of jurisdictions inside and outside Australia.

This experience has highlighted the need for careful design of the relevant regulatory structure as deficiencies in market design can create substantial costs for market participants in either implementing a flawed market design under which their roles and responsibilities may be unclear or through the cost of challenging administrative decisions taken under an uncertain framework.

In light of this experience, Clayton Utz believes that there are a number of concerning features of the proposed national electricity rule change process set out in the Ministerial Council on Energy Standing Committee of Officials' Consultation Paper (the "**Consultation Paper**"). In particular, there are 3 aspects of the proposed regime which we consider may cause difficulty in the future.

These are:

- a potential conflict inherent within the proposed new primary market objective;
- the inability of the AEMC to fully take account of matters raised in submissions as part of the rule change process; and
- the lack of a "fast track" code change process other than with market unanimity.

(a) **Conflict in Primary Market Objective**

The Consultation Paper sets out that a new primary market objective is to be introduced into the National Electricity Law (the "**NEL**"). This is:

"to promote the long term interests of consumers of electricity with respect to price, quality and reliability of electricity services, and economically efficient investment and innovations."

Potentially, there is an inherent conflict between the first and second halves of this objective. While in a perfectly competitive market the long term interests of consumers would align with efficient investment and innovation, in a market which is not perfectly competitive not all of the benefits of the investment or innovation would necessarily flow to consumers. As a result, the separate reference to each of these matters appears to create an inherent conflict within the primary objective.

This distinction has been highlighted by the ACCC in its recent decision on the revised regulatory test where the Commission stated:

"If the writers of the Code had intended that reduced prices for consumers were to be an over-riding objective, then that would have been expressly stated. It is likely that they considered the promoting efficiency would provide the benefits of the market as a whole. That is, with greater efficiency, benefits would accrue to both consumers and producers of electricity, not just consumers."

As no guidance is given as to which of these is to be given weight, it is unclear how this will be resolved. However, it appears to create substantial uncertainty. Given the importance of this objective in the rule making process, a lack of clarity in this objective will make it difficult for the AEMC to perform its functions. Additionally, it will make it very difficult for Market Stakeholders to ensure that the AEMC is appropriately accountable in performing its functions.

(b) **Decision Criteria**

Under the proposed regime, the AEMC will be required to accept a rule change if the proposal made by the proponent of the rule change (the "**Rule Change Proposal**") would be consistent with the market

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objectives set out in the NEL. This analysis proceeds on a "with" or "without" basis, that is, on the basis that the AEMC will be required to examine the National Electricity Rules as amended by the Rule Change Proposal against the National Electricity Rules if the proposal did not proceed.

This test is apparently based on the AEMC not having a market development role (in that it either accepts a proposal or rejects it and does not in general develop its own proposals). However, it is unclear how potential improvements to a Rule Change Proposal contained in submission or submissions that suggest a different way of achieving the same end can be accommodated by the AEMC in the process for the consideration of a Rule Change Proposal.

Under the structure set out in the Consultation Paper, the "Rule Change Proposal" is the proposal made by the person requesting the change to the rules. While the AEMC is responsible for the drafting of the relevant rule change, from the Consultation Paper it appears that the AEMC will be required to ensure that the proposed wording is consistent with the proposal made by the proponent of the Rule Change Proposal. Further, while the AEMC can reject a proposal it appears that it will have no power to amend a proposal.

As a result, it appears that the AEMC will be bound to proceed with a proposal which delivers a net benefit against the market objectives even if submissions on a proposal suggest that the proposal could be substantially improved or that the objectives behind the proposal could be achieved in an alternate way which delivers greater benefit. This is because the sole test to be applied is whether the Rule Change Proposal itself results in the better achievement of the market objectives. This would be the case even if the benefits from a Rule Change Proposal would be substantially increased if the suggestions made as part of the submissions process were adopted.

Not only does this appear to raise substantial issues as to the utility of the consultation process, as there would seem little incentive for participants to suggest improvements to proposals, but it would also seem to have the potential to create a large number of Rule Change Proposals given that any person who feels that a Rule Change Proposal could be improved will be required to submit a fresh Rule Change Proposal to achieve this objective.

(c) **Lack of a Fast Track Rule Change Process**

Under the proposed rule making process set out in the Consultation Paper, the AEMC will be able to expedite a Rule Change Proposal where the AEMC considers that the proposal is of a minor or administrative nature or to correct a manifest error or that it is likely to be unopposed.

As currently set out in the Consultation Paper, there is to be no ability to expedite a rule change in other circumstances no matter how urgent the situation. In our experience, during the operation of the market to date there have been a number of circumstances where difficulties have emerged (often through no fault of the party concerned) where in the absence of an amendment to the Code, parties would be forced to act in manner that breaches the Code.

One recent example of this is the transmission pricing derogation which had effect from 1 July 2004 to address delay in the finalisation of TransGrid and EnergyAustralia's revenue cap. Given this delay, TransGrid, EnergyAustralia and the ACCC all agreed that the most appropriate way forward was for the relevant prices to be set on the basis of the ACCC's draft decisions (with any under or over-recovery resulting from differences between the draft and final decisions addressed through the Code's "unders and overs" mechanism).

The derogation was put in place not only to address the risk that in adopting this approach TransGrid and EnergyAustralia could be found to set prices on a basis contrary to chapter 6 of the Code but also to remove any resultant uncertainty as to the enforceability of those prices.

While the first of these risks could potentially have been addressed by TransGrid and EnergyAustralia seeking assurances from NECA that no action would be taken in relation to any breach of the Code which resulted from them setting transmission prices in the manner proposed, this course of action would not

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have removed the risk of challenge to TransGrid and EnergyAustralia's transmission prices by a third party.

These issues could also arise if there were long term disruptions to the market which meant that the market could not be operated in the manner required by the rules.

Similar consideration may arise under the new Rule Change Process. While participants may be able to receive adequate assurances that they will not be exposed to penalty for acting in a manner contrary to the National Electricity Rules, these assurances will not protect them if their dealings with third parties are based on the matters regulated by the rules. These difficulties may be particularly acute in circumstances where the third party has a commercial incentive to challenge the action taken by the relevant participant.

While it may be thought inappropriate for the AEMC to have the power itself to approve fast tracked rule changes, a mechanism to potentially address this issue could be for the AEMC to seek the approval of the MCE to fast tracking a rule change where the AEMC believes that the matter is urgent (potentially through a process broadly similar to that adopted for the making of jurisdictional derogations under chapter 9 of the Code).

To ensure that contentious matters are not permanently dealt with in this manner, provision could be made for the rule change to have temporary effect while the full rule change process is followed (in the same way as the ACCC provides interim authorisation to proposed Code changes under the current structure).

This type of process would appear to allow for urgent matters to be dealt with while at the same time ensuring that the interests of those subject to the rules are not overlooked

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