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NE Rule Change Process  
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The Energy Users Association of Australia (EUAA) appreciates the opportunity to provide comments on the Ministerial Council of Energy and Standing Committee of Officials Consultation Paper, *Proposed National Electricity Rule Change Process*.

The EUAA is a non-profit organisation focused entirely on energy issues on behalf of end users. The EUAA represents the views of approximately 80 large business end users of electricity and/or gas. Membership ranges across a number of sectors, including mining, manufacturing, construction, commercial property and service sector. Many of the EUAA's members operate across States.

EUAA members made input into the COAG Energy Markets Review (Parer Review) one of the Association's top priorities for 2002. The EUAA was pleased that the Ministerial Council of Energy (MCE), established by COAG to champion energy sector reform, has picked up many of the Parer Review's recommendations as announced in their December 2003 *Communiqué*, including streamlining the process of making changes to the National Electricity Code (the Code).

The Consultation Paper outlines a proposed code change model with the objectives of addressing the concerns about authorization of the Code, maintaining a streamlined code change process and being consistent with the revised electricity market legislative and regulatory framework.

The EUAA is pleased to submit its comments on the Consultation Paper. There are two parts to the EUAA submission with the first section providing some general comments and section two focusing on specific sections of the Consultation Paper.

## **1. General Comments**

The EUAA supports the general thrust of the MCE work program on the governance and institutional arrangements for the energy sector.

Greater transparency and clarity of the roles of regulatory bodies, streamlining of the Code change process and transferring of retail and distribution regulation to the newly formed Australian Energy Regulator (AER) will improve the ability of end users and their representatives to participate in energy sector decision making and should reduce the time and cost involved with end user participation.

The EUAA would envisage that the levy to fund the operations of the AER and Australian Energy Market Commission (AEMC) (which will be part of future MCE discussion) should reflect the cost savings we achieve from combining a variety of State base regulators into one national energy regulator.

### *1.1 Funding of Advocacy*

While the Consultation Paper outlines a process that the AEMC should follow in examining a Code change proposal, there is no reference on how end users and their representatives should be resourced to participate in the Code change process.

We are aware of the Allen Consulting report on *National Energy Market Consumer Advocacy*. However, we consider the contents and recommendations of the report need further discussion and consideration before a final decision on end user advocacy funding arrangements is made by the MCE. Importantly, the Report is very narrowly focussed on the alleged needs of household and small business end users and little consideration is given to large business users. For instance, Allens Consulting never approached the EUAA (nor any other large business end user group as far as we are aware) to gain the views on either the effectiveness of the current NECA Advocacy Panel structure, the level of funding support business users have to carry out advocacy on behalf of business users, or the rationale for funding advocacy on behalf of ALL types of consumers. Indeed, this broad-based advocacy was one of the main planks and advantages of the current advocacy scheme approved by both the ACCC and NECA.<sup>1</sup>

### *1.2 Reviewing Code Operations*

The EUAA is disappointed that SCO did not take the opportunity in streamlining the Code change process to also simplify the Rules and tighten the Rules and penalties for breaches. When the ACCC originally authorised the Code they specifically mentioned that an objective should be to simplify the Code. NECA has this as a specific objective for several years. Nearly six years later, no action has been taken on this matter.

The EUAA believes that the strength of the Rules and penalties entrusted to AEMC under the Rules will be critical to the issue of whether the Rules provide acceptable outcomes for end users.

End users believe that there is prima facie evidence that the Code is currently flawed in a number of areas. For example:

- The Code Rules governing market power abuse are too weak to have any real impact and, combined with less than desirable competition in the generator sector, have led to higher than necessary volatility on the NEM pool and higher risk premiums, the costs of which are ultimately borne by end users.

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<sup>1</sup> The EUAA has a long track record in advocacy and its funding. We were one of the main initiators of the need to advocacy in the NEM. We would be happy to share this knowledge with the SCO and MCE.

- Network pricing principles also need to be addressed. NECA has examined this area of the Code but as yet no effective reform has been forthcoming. Tariffs need to be more cost reflective so that users pay for the capacity of the system that they use. This is how gas users pay and it seems to make sense. In addition, the implementation of the ‘beneficiary pays’ principle, one outcome of an early NECA review on network pricing, has never been completed.
- The current quantum of penalties the Code allows NECA to impose is paltry and not commensurate with the economic gain market participants are able to obtain by taking advantage of weak Code rules. The only action NECA has taken against generators bidding practices was in 2003 when they found Macquarie Generation had breached the market rules governing rebidding and the use of despatch inflexibility (Code clause 3.8.22) and imposed a \$10,000 civil penalty.
- The EUAA believes that presently large end users are loath to participate in the NEM for a number of reasons, being:
  - The current NEM is unnecessarily volatile (as per bullet point one);
  - The current Rules are too complex;
  - Registration requirements and costs are far too high for end users; and
  - Prudential requirements are too expensive.

This limits the degree of end user participation in the NEM.

Hence, while we welcome the streamlining of the Code change process, we do not believe reform of the Code has gone far enough. The Code has now been in operation for close to six years and it would be timely for the MCE to instruct the newly formed AEMC to undertake a comprehensive review of the Code as one of its first priorities.

## **2. Specific Comments**

The following section outlines EUAA’s specific comments on various sections of the Consultation Paper.

### ***2.1 Potential options to Streamline and Manage TPA Risks***

The EUAA supports the proposition of streamlining the Code change process if it results in net benefits to NEM market participants and end users.

In recommending the preferred option – changing the Code to a set of statutory rules - SCO has assumed that this will result in the least transitional cost to market participants and provide the best outcome in streamlining the process.

From the Consultation Paper, it is unclear that the alternative of maintaining the Code in its current format but making relevant Code changes to achieve the same streamlining outcome as the preferred Option, has been considered. If this option has been considered, SCO should outline their deliberations on the option.

The Consultation paper states that under Option 1 (Authorisation of all Code changes) the current model “does not clarify the current ambiguity about the legal status of the NE Code”. The EUAA questions the high level of risk assumed by SCO on the legality of the Code. The Code has been in operation for close to six years and, as yet, no party has seen fit to question the legal validity of the Code. Hence, we doubt that this factor is a major risk.

Further, the Hutley SC opinion is based on an assumption, that for the purpose of negating the effects of anti-competitiveness, the relevant agreement is the Code to which the market participants are in some way parties. However, as a matter of history this seems quite unlikely.

The Code’s origin stems back to Inter-Governmental Agreements on electricity reform between the Federal and State Governments. As part of these Inter-Governmental Agreements, the Federal and State Governments agreed to establish a National Electricity Market. Hence, the opinion does not seem to take into account the several NEM Inter-Governmental Agreements of the late 1990s and the new Australian Energy Agreement of 30 June 2004, also between governments.

The Code is not a consensual document developed by market participants but rather the Inter-Government Agreements objective of establishing a national wholesale electricity market led to the creation of the Code. Market participants were part of the consultation in the drawing up of the Code, but they were not the originators of the Code. Importantly, market participants are required to adhere to the Code if they want to participate in the wholesale electricity market.

Hence, the TPA consequences for corporations (like NEMMCO, retailers and generators) that have to give effect to the actual agreements are not considered.

Further, end users support the objective of developing the best possible system for trading electricity. Under the current approach, the Federal and State Governments are the architects of the AEMC rules, functions and procedures. However, some state governments, in particular, have a vested interest in the operation of the NEM as electricity asset owners. Unfortunately, they face a conflict of interest in managing these assets.

The conflict arises from the fact that State governments try to achieve the best financial outcomes for the State and may therefore compromise on the most efficient outcome for electricity users. Often the pursuit of revenue as the core objective means electricity users are forced to settle for second best policy outcomes with respect to the market development of the NEM. An example of this is the ETEF Scheme in NSW where NSW owned generators ‘game’ the current NEM structure to gain access to ETEF and provide NSW Treasury with best possible dividend payment, whilst imposing higher prices on electricity consumers.

SCO also argues (based on Hutley SC opinion) that switching from a Code to statutory rules will not increase the risk profile of any market participants. However, SCO also states that the language of the Code will need to be tightened up under a statutory rule system. However, the very nature of changing wording assumes a level of risk with respect to the meaning and subsequent interpretation of the new terminology and this matter needs to be thoroughly investigated.

We also understand that some market participants have reservations about the move from the Code to Rules.

## **2.2 *Functions of the AEMC in Rule Making***

The EUAA supports the rule-making function of the AEMC as set out in the consultation paper.

However, we believe greater clarity needs to be outlined as to the position of the AEMC in initiating rule changes under their market development function. Section 5.2 of the Consultation Paper seems to suggest that AEMC will be able to initiate rule changes as part of its market development function. Specifically, the Consultation Paper states that the AEMC will be able to:

1. Review the operation of the NE Rules, and to undertake any analysis and studies in relation to the performance and efficiency of the NE Rules consistent with the Market Objectives;
2. Monitor the NE Rules in relation to the efficient achievement of the Market Objectives; and
3. Make recommendation for a Rule change proposal to the MCE from these market development functions.

Section 7.1.2 of the Consultation Paper clearly states that the AEMC will not be allowed to initiate NE Rule changes except where the change is of a minor or administrative nature.

The EUAA recommends that Section 5 of the Consultation Paper should be amended to make it clear that the AEMC's Market Development Function does not empower it to initiate NE Rule changes as outlined in points one and three.

The EUAA would support that the AEMC monitor, review and report on the efficiency of the NE Rules with respect to the Market Objectives. However, the EUAA recommends that it should be up to MCE, market participants and other interested parties to evaluate the AEMC reports and recommend NE Rule changes. The AEMC should not be allowed to recommend Rule changes as a consequence of their reviews.

This process ensures that there is no conflict in the function of the AEMC of rule-maker as outlined in section 7 of the Consultation paper.

## **2.3 *Rule-Making Criteria***

The EUAA supports the application of a 'net benefit' test based on the achievement of the Market Objectives.

However, we believe that the AEMC should be given an outline of principles to follow in applying the 'net benefit' test. A set of principles will provide market participants and other interested parties with greater clarity in the application of the test. A set of policy principles will also assist market participants and other interested parties in preparing a proposed NE Rule change.

Section 6.2 flags the option of the MCE issuing Statements of Policy Principles. The EUAA strongly recommends that the MCE exercise this power and issue Policy Principles with respect to the application of the ‘net benefit’ test. The need for policy principles from the MCE in this case is even more imperative given that the AEMC is a new body and will need policy guidance in its infancy to ensure consistency in decision-making.

The alternative is for the MCE to direct that the AEMC should develop a set of such principles.

Either way, there needs to be consultation with end users on these principles before they are implemented.

#### ***2.4 The Proposed Rule Change Process***

##### *2.4.1 Any person can initiate a rule change proposal*

The EUAA supports the broadening of category of people that can initiate Rule changes. It is imperative that the AEMC (and other regulators and policy-makers) is exposed to the views of end-users and their representatives, as they are an important part of the energy market. This will ensure more acceptable, robust and durable outcomes within a more collaborative environment.

##### *2.4.2 AEMC will not be able to initiate a Rule Change proposal*

The EUAA supports the proposal that the AEMC will not be able to initiate a rule change except where it is of a minor or administrative nature.

However, we recommend that minor or administrative changes need to be clearly ring-fenced. At the 13 August meeting of SCO and industry representatives in Melbourne, it was suggested that minor or administrative changes would involve proposed changes that are unchallenged. While we support fast-tracking un-opposed Rule changes, we do not think this definition is adequate for minor or administrative changes.

##### *2.4.3 Grounds for AEMC to reject an application for a Rule Change Proposal*

In the interest of fairness, we believe that an independent appeals system needs to be established to allow market participants and other interested parties to have a rejected application reviewed.

An appeal system is particularly important in an environment of judicial review but no merits review. Participants that propose rule changes should be given an opportunity to appeal a decision to an independent umpire. This should create a robust system whereby AEMC decisions will be subject to independent scrutiny and therefore introduce an appropriate level of discipline by AEMC of Rule change proposals.

While the SCO and MCE have stated they will evaluate the virtues of including a merits review process in energy sector regulatory decisions, the EUAA would like to make the following preliminary comments for consideration.

Merits review processes are an important ingredient in an industry with significant natural monopolies and hence economic regulation. Merits review process acts as an important discipline for regulators in ensuring they undertake a robust and transparent evaluation. However, it is also important to develop a ‘sound’ and ‘fair access’ merits review process.

If the process is not sound, it provides opportunities for market participants to ‘cherry pick’ aspects of a Regulator’s decision they do not particularly agree with. The process also needs to be cost effective so that it provides fair access to market participants and end users, and/or their representatives.

The EUAA is currently exploring these matters and will provide more concrete findings and recommendations during the MCE gas review process in 2005.

#### *2.4.4 Working Groups*

The EUAA supports the proposal to allow the AEMC to convene Working Groups to consider a Rule Change proposal.

However, it is important that market participants and other interested parties (specifically end users and/or their representative organisations) have equal representation on the Working Groups. Representation of both the market participants and end user representatives is imperative for the AEMC to obtain all relevant feedback in determining the implications of Rule change proposals.

#### *2.4.5 Timeframe for Rule Change Proposal*

The EUAA supports the 4-week statutory **minimum** time period for submissions and the 4-week **maximum** period for preparation of a draft determination of the AEMC.

Once again, thank you for the opportunity to comment on the Ministerial Council of Energy and Standing Committee of Officials Consultation Paper, *Proposed National Electricity Rule Change Process*. If you have any queries regarding our comments you can contact Con Hristodoulidis, EUAA Director Policy and Regulation on telephone number (03) 9898 3900 or e-mail [con.hristodoulidis@euaa.com.au](mailto:con.hristodoulidis@euaa.com.au).

Yours sincerely

[signed]

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**Executive Director**