



EnergyAustralia™

EnergyAustralia's submission to

Ministerial Council on Energy
Standing Committee of Officials

Response to Consultation Paper:
Proposed National Electricity Rule
Change Process

Energy

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INTRODUCTION

In designing any legislative and regulatory framework, it is important to give the regulator powers to do the job the legislative framework requires it to do. Similarly, it is important not to overly constrain the regulator such that it is incapable of performing its duties.

This is often a delicate balance.

Part of the regulator's powers are to exercise discretion where the legislative framework requires it.

However, where the regulator is given discretion to perform tasks in the fulfilment of its responsibilities, the scope for that discretion should be sufficiently defined to reduce the risk that the discretion could inadvertently be exercised in a way that is inconsistent with the policy intent.

In this submission, EnergyAustralia has attempted to focus on those features of the proposed legislative and regulatory framework where the regulator's discretion has not been well defined and where further consideration may be required to enable the balance between empowerment and constraint to be struck. While this submission focuses on the Rule change process in response to the subject consultation paper, many of the comments can be interpreted to apply more broadly to the framework issues.

This submission comments first on the more general framework issues relating to the Rule change process, then focuses on the process issues surrounding Rule changes.

EnergyAustralia would also like to take this opportunity to raise several comments and queries in relation to several aspects of the Information Paper on the Legislative and Regulatory Framework.

Finally, EnergyAustralia would like to raise several points regarding anomalies in the drafting of Chapter 5 of the National Electricity Code. These are outlined in an attachment to this submission.

1. FRAMEWORK

1.1. CONVERTING THE CODE TO RULES

The purpose of converting the Code to Rules is to enable the rule change process to be more streamlined than that which occurs under the National Electricity Code, and to manage the Trade Practices Act risks for those activities under the Code that had previously been authorised under Part VII of the TPA. As discussed in the Hutley advice, this will remove the need for the ACCC to authorise Code (Rule) changes and streamline the Code (Rule) change process.

However, the MCE SCO acknowledges that converting the Code to Rules will not streamline the Code (Rule) change process for Access related changes. If the Rules continue to function as an Access Code under the TPA, these will still be required to go through an ACCC process under Part IIIA of the TPA. Accordingly, it could be argued that network businesses have little to gain from the conversion process.

EnergyAustralia recognises that there are significant benefits to streamlining the Code change process for market participants more generally. At the same time, there is potentially a need for the network businesses to have an Access Code or equivalent regime, a role which is currently filled by the National Electricity Code.

EnergyAustralia sees that there are three potential approaches to converting the relevant sections of National Electricity Code to the National Electricity Rules:

- 1) divide the Code into separate market and access sections, and then establish Rules for the relevant market sections at risk of breach of Part IV of the Trade Practices Act;
- 2) transfer the entire Code into Rules (with necessary consequential changes), recognising that the access related sections may need to operate as an access Code or may later need to be re-translated back into a Code; and
- 3) transfer the entire Code into Rules (with necessary consequential changes), and not carry over the role of the Code as an Access Code, but ensure that the Rules can perform the same function as an Access Code.

Approach 1 provides benefits to market participants in streamlining the market related Code change process, but does not aid the network businesses for Access related Code changes. However, it does not harm the network businesses except to the extent that it creates another layer to the regulatory framework, contrary to the objective of streamlining and simplifying the regulatory framework and rule change process.

Approach 2 allows a sober review of the Code to ensure that only those things that should be governed by legislation are put into the Rules. However, this review process takes time, and this would delay the benefits of the streamlined process to other industry participants.

Approach 3 provides for one complete set of Rules to apply to participants in the National Electricity Market with a clear status, and one body responsible for their development and administration. It could be argued that placing the access provisions of the NE Code into NE

Rules leaves the network businesses without an Access Code, and therefore subject to declaration under Part IIIA of the TPA. EnergyAustralia sees this as a low risk consequence.

On balance, EnergyAustralia supports the proposal to convert the Code to Rules as outlined in the consultation paper. However, EnergyAustralia urges that consideration be given to whether it is necessary for the Rules to operate as an Access Code for the purposes of Part IIIA of the Trade Practices Act, given that appropriate “access” objectives could be provided for in the National Electricity Rules.

EnergyAustralia is somewhat concerned at the short time frame available to convert the Code to Rules following passage of the National Electricity Law amendments in the Spring sitting of the South Australia Parliament. EnergyAustralia welcomes the undertaking during the recent industry briefings that consultation would occur on the Ministerial Order to transfer the Code to Rules. EnergyAustralia would value the opportunity to review the draft Rules to ensure there are no inadvertent changes to the substance of the Rules before they are effected by Ministerial Order.

EnergyAustralia would also urge the MCE to authorise clarifications to the existing rules as part of the Ministerial Order process to ensure that existing problems are not carried over into the new National Electricity Rules. EnergyAustralia has identified a number of significant anomalies in Chapter 5 of the Code relating to the network planning and development obligations of DNSPs. A short paper which outlines these anomalies is attached to this submission for consideration. These difficulties have also been identified by the ACCC in its recent final decision on the “Review of the Regulatory Test for Network Augmentations”, in particular see pages 27-30. The ACCC has indicated that it intends to raise these issues with NECA; EnergyAustralia also proposes to forward this paper to NECA.

1.2. AEMC MARKET DEVELOPMENT FUNCTION

The AEMC is charged with a market development function (s5.2). However, the AEMC is currently barred from proposing Rule changes, except where those changes are of an administrative nature or to correct a manifest error (s7.1.2).

It appears incongruous that the AEMC should have responsibility to develop the market but not the capability to make changes to the market Rules. It would seem possible that, in fulfilling a market development role, an ability to promote rule changes would be a prerequisite. EnergyAustralia questions whether the AEMC should be able to propose Rule changes consistent with its market development functions where it is clear that the market is not delivering the intended results.

However it is acknowledged that any process by which the regulator could initiate and approve its own Rule change would conflict with the stated policy principle, “that the initiator of a rule change should not also decide if the rule change should be made” (s7.1.2).

If the AEMC is to be given powers to propose Rule changes consistent with its market development function, there is a need to place clearly defined limits on the regulator’s discretion and powers.

Whilst EnergyAustralia accepts that the responsibility for maintaining the “vision” of the market rests appropriately with the Ministerial Council on Energy, we are concerned that the AEMC may not be equipped to deliver this “vision” in the most efficient manner. We are also concerned that the AEMC may be “hobbled” if it does not in some way operate as surrogate for government in terms of being able to assume some responsibility and operate as the “guardian” of the effective operation of the Rules. We therefore suggest that it may be appropriate for the AEMC to be given more autonomy to promote and initiate Rule changes whilst maintaining accountability through the MCE.

Practically speaking, if the AEMC finds that a rule change is needed, and makes a recommendation to the MCE, this essentially constitutes both a rule initiation and a rulemaking function. In a sense, the AEMC will be approving its own recommendations, under its rule making role in conjunction with its market development role.

An alternative process may be possible, under which the AEMC is allowed to progress a Rule change proposal with the approval of the MCE, rather than simply recommending the change to the MCE and relying on the MCE to propose the required Rule change. A further mechanism could be available for the AEMC to notify the MCE of the proposal and proceed subject to no objection being raised by the MCE within a period of 14 days. This would go some way towards striking a balance between the autonomy needed for the AEMC to oversee the effective operation of the market rules and for accountability to the policy makers and avoids concerns about the AEMC exercising an unfettered discretion.

1.3. RULE MAKING CRITERIA

In making a decision on a Rule Change Proposal, the AEMC is to apply a net benefit test based on the achievement of the Market Objectives. A decision of the AEMC is expected to be consistent with the Market Objectives (which are to be included in the NEL) and with any MCE Statement of Policy Principles.

The net benefits test is to be conducted on market benefits assessed using a with/without analysis. Needless to say, the market benefits must be assessed relative to the market objectives.

EnergyAustralia considers that the Market Objectives need to be sufficiently clear and explicit as to allow a meaningful conduct of the with/without analysis. If the market objectives are not clear and measurable, then the net benefits test cannot be conducted with any degree of rigour.

The AEMC also needs clear, focused and unambiguous market objectives in order to fulfil both its rule making duties and its market development duties.

EnergyAustralia is concerned that the proposed market objectives, being the existing market objectives and an additional primary objective, are not sufficiently focussed or detailed to provide a meaningful or workable criteria for assessing the often detailed and complex rule change proposals which arise under the current market arrangements. EnergyAustralia suggests that each subject area of the National Electricity Rules should have a specific set of objectives as an additional to guide to rule change proposals in relation to that subject area.

In addition EnergyAustralia requests that further consideration be given to the meaning of the proposed new primary objective:

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.

Whilst, at face value, this objective appears entirely appropriate, on a closer look there would seem to be potential conflict between the first half of the objective and the second half. What is expressed to be a single objective, it can be read as two, or perhaps three, separate objectives. It is not clear how the long term interests of consumers would not be served by efficient investment and innovation. The separate reference to each of the matters would appear to indicate that there are circumstances when the long term interests of consumers and efficient investment do not lead to the same outcome.

EnergyAustralia requests that careful consideration be given to the meaning and intent of this objective.

One issue where we would like to see further clarification and more detail is the relevance of the MCE Statement of Policy Principles, and their role as one of the joint limbs of the Rule Making Criteria. EnergyAustralia proposes that the AEMC be required to demonstrate that its decisions are consistent with both the Market Objectives and with any Statement of Policy Principles.

Given the importance of this criteria, important enough that Market Objectives are enshrined in the NEL, we are concerned that the second and equally vital component of the criteria is not going to be defined up-front, or at least ahead of proposed rule changes. Accordingly, since these policy statements will be instrumental in shaping the future direction of the code change process and in setting policy parameters, their value in guiding future market development seems self-evident and fundamental.

The use of terminology such as, “the MCE may issue” and the “MCE will be required to publish such statements” (both in 6.2), suggests that the development of these statements appears to be ongoing and therefore uncertain in their nature. It would be inappropriate if these Policy Principles were defined at the point of making a Rule change, without due market consideration, in order to justify a Rule change. EnergyAustralia submits that all policy statements should be available and understood well before they applied to any rule change proposals.

1.4. MARKET OBJECTIVES

A common theme of this submission is that the AEMC needs clear instructions and objectives to exercise its function as ‘custodian’ of the rules. As we have indicated else where in this submission, EnergyAustralia is very concerned that the market objectives are not sufficiently developed or detailed to articulate and define the discretion of the AEMC in its rule making function.

The clarity of these market objectives will act as the foundation of the with/without test and also for any judicial review process. To the extent there is ambiguity or conflict within the market objectives, the guidance to the AEMC and AER will be weaker.

EnergyAustralia emphasises the need for a clear set of market objectives in order to provide clear guidance to the AER and AEMC in the conduct of their duties, and also to ascertain whether the AEMC has acted consistently with them.

As discussed in section 3 below, it will be important not to confuse the market objectives with the objectives of the regulatory bodies. The market objectives should be the same for the AEMC and AER, as they are the objectives of the market. However, it would be reasonable to expect the objectives of the two organisations to be different, aligning with their roles in the process.

Also as discussed in section 3 below, EnergyAustralia is strongly of the view that there is a need to allow merit based review of regulatory decisions. Again, to the extent there is conflict or ambiguity in the objectives the agency is striving to meet, it will be more difficult for any independent reviewer to ascertain whether the agency has met its responsibilities to the market.

1.5. MCE STATEMENT OF POLICY PRINCIPLES

EnergyAustralia supports the role of Government to make and articulate policy, and accordingly supports an explicit MCE Statement of Policy Principles. Further, EnergyAustralia applauds the MCE in providing additional certainty to the industry through the discipline of publishing that policy framework in the gazette.

While EnergyAustralia takes some comfort that the Statement of Policy Principles must be consistent with the market objectives, we remain concerned that those market objectives are too broad.

EnergyAustralia remains concerned that the policy objectives are not currently articulated. As the policy framework is required to be consistent with the market objectives, EnergyAustralia proposes that a forum be held for further consultation to assist the MCE in further clarifying the market objectives toward developing that policy framework.

1.6. MCE POLICY MAKING CRITERIA

While EnergyAustralia takes comfort that the policy framework must be consistent with the market objectives, and published in the South Australia gazette, we remain somewhat concerned that the policy making criteria has not been adequately articulated by the MCE. Neither has the process for determining that policy.

EnergyAustralia proposes that this could be discussed a forum in which there could be further public consultation on the market objectives and policy statements.

2. RULE CHANGE PROCESS

2.1. RULE MAKING PROCESS

The AEMC, having just been formed, has not decided its rule making process. It is important that this process, as well as the related Memorandum of Understanding between the AEMC, the AER and the ACCC be consulted on and developed as a matter of priority.

It will also be important to clarify the extent to which these rules are subject to MCE policy statements. While the consultation paper states that, under the NEL, the AEMC will be required to have regard to MCE policy Statements in carrying out its functions, it is not clear what priority these policy statements will be given in the case of ambiguity or conflict.

2.2. AEMC AS GATEKEEPER OF PROPOSED RULE CHANGES

The regulatory framework envisions that the AEMC should not propose rule changes, except for minor administrative matters (or, as discussed above, consistent with its market development function). This effectively constrains the extent to which the AEMC can modify a proposal before releasing it to market for consultation.

As a result, it will be necessary for each proposed Rule change to undergo a 'quality control check' before the consultation process can begin.

EnergyAustralia is comfortable with the AEMC fulfilling this role, as it is best placed within the framework.

Practically speaking, we would anticipate that the AEMC would work with Rule change proponents to ensure that the Rule change, when proposed, has been adequately developed. It should be a rare circumstance where the AEMC feels it necessary to rely on its powers to reject a proposed Rule change.

As discussed below, this gatekeeper role must focus on the extent to which the Proponent has adequately articulated and developed the proposed Rule change, with the AEMC taking primary responsibility for the clarity and consistency of drafting the proposed revised Rule.

EnergyAustralia considers that a consistent approach would require that Rule changes proposed by the MCE should be subject to the same quality control procedures as changes proposed by industry participants.

2.3. ACCC, AER AND NEMMCO ADVICE

The start of the process envisions that the AEMC will seek the advice of the AER and the ACCC on the proposed Rule change. However, it does not envision that the AEMC will consult with NEMMCO. EnergyAustralia is of the view that NEMMCO may have valuable input to a number of Rule changes which would assist the AEMC in completing its functions, and

therefore should be part of that initial inter-agency consultation process. If it is not appropriate that NEMMCO be party to the Memorandum of Understanding between the agencies which defines this consultation process, then consideration should be given to ensuring that the AEMC gives some consideration to whether NEMMCO should be consulted on the Rule change at the same time as the ACCC and the AER.

To add transparency to the decision making, and aid in the consultation process, the AER, ACCC and NEMMCO advice should be published as part of the consultation process on the proposed Rule change, particularly where it is likely that working groups will be established or submissions will be called.

2.4. PUBLIC NOTICE OF THE RULE CHANGE PROPOSAL

EnergyAustralia notes that clause 7.2.4 of the paper indicates a range of matters that the AEMC will invite stakeholders to comment on in submissions. The first of those matters is whether the proposed rule change might result in a contravention of a provision of Part IV of the Trade Practices Act. EnergyAustralia queries the scope for there to be such a contravention of the Trade Practices Act given the analysis contained in the Hutley advice that compliance with mandatory rules will not give rise to a breach of Part IV of the TPA.

2.5. SCOPE TO IMPROVE A RULE CHANGE PROPOSAL

The consultation paper and the industry briefing sessions characterised the proposed Rule change process as a binary accept/reject model. Within the proposed approach, there appears to be no scope for the AEMC to accept proposed enhancements to the proposal, even where those proposed amendments are consistent with the “substance” of the original proposal.

As alluded in our comments on the AEMC gatekeeper role, this approach places immense focus on the rigour of the proposer’s development and articulation of the proposed Rule change.

EnergyAustralia considers that the purpose of the consultation process is to harness the considerable intellectual horsepower distributed throughout the industry and stakeholder groups. The proposed approach disadvantages itself by disallowing access to this wealth of knowledge and experience through strict adherence to an accept/reject model.

Where improvements to the original proposal are developed through the consultation process, the current approach suggests that there are only two ways to access the suggestions for improvement:

- Accept the original proposed Rule change as originally proposed (notwithstanding the suggested improvements arising from the consultation process), and rely on another proposal to come forward to change the (recently changed) Rule to incorporate the suggested improvements arising from the consultation process. This second proposal would then be subject to the full Rule change process; or

- Reject the original proposal, and start the process afresh with a participant proposing a new Rule change incorporating the comments generated through the consultation process. It should be noted that this rejection may not be possible under the accept/reject model where the original proposal passes the net benefits test.

EnergyAustralia considers that neither of these options delivers a satisfactory outcome, in that they will impose delays on the Rule change process.

It may be necessary to modify the proposed process to accommodate those valid change recommendations received through the consultation process.

EnergyAustralia considers that, where the recommended improvements are minor in nature, the AEMC should be empowered to implement those minor changes in the proposed rule circulated in its draft Determination. This approach would be consistent with the AEMC's powers to make rules of a minor or administrative nature.

On the opposite end of the spectrum, where there are significant amendments to the originally proposed rule change that broaden the scope of the original proposal, the AEMC would be acting beyond its powers by accepting the proposed Rule including the proposed amendments. In this case, the AEMC would be required to resort to the accept/reject model. The likely outcome appears to be, if the originally proposed rule passed the net benefits test, to accept the original proposal and call for further proposals to effect the recommended enhancements.

The more difficult situation arises where the consultation process proposes valuable enhancements that go beyond minor or administrative changes, but do not broaden the scope of the original proposal. In this case, EnergyAustralia suggests that there should be a process that would enable the market to comment on the proposal as enhanced, without having to recommence the process. One option might be to allow the AEMC to re-advertise the enhanced proposal and recommence the consultation process; that is, resort back to the public notice stage of the Rule change process with the enhanced proposal.

It should be noted that EnergyAustralia's informal discussions with Officials indicate that those Officials expect that there will be scope for the AEMC to modify a Rule change proposal through the consultation process. However, this expectation is not articulated in the consultation paper, and was not articulated in the industry briefing sessions. EnergyAustralia therefore seeks clarification on this issue.

2.6. EXPEDITION

EnergyAustralia considers that there is value in any process that expedites a Rule change. However, EnergyAustralia is somewhat concerned about the short time frames inherent in an expedited process.

EnergyAustralia considers that early notice of an intent to expedite would be helpful to stakeholders in developing their positions. In this regard, EnergyAustralia recommends that the AEMC, in the Public Notice on the proposed Rule change, could flag whether, on initial consideration, the AEMC sees the proposed Rule change as one which would be considered for expedition (or indeed one for which the AEMC considers that the expedition would not be appropriate).

EnergyAustralia considers that the proposed criteria outlined in the second part of section 7.2.4 of the consultation paper are sensible criteria on which to make a decision to expedite. The AEMC should address these criteria in any decision to expedite.

Consistent with the AEMC's powers to reject a Rule change proposal that is misconceived or not adequately developed, EnergyAustralia supports the parallel approach allowing the AEMC to reject an expedition objection on the grounds that it is misconceived or lacking in substance (section 7.2.2).

However, we are concerned that this is an area where there is not sufficient criteria to guide the exercise of both the objection to expedition and the veracity of that objection. The most likely reason for objecting to expedition is that the proposal gives rise to issues which require more detailed consideration and consultation. It would seem illogical for parties to be required to present detailed submissions to support this contention.

EnergyAustralia suggests that, given the short time allowed to file an objection to expedition, a process be developed to allow industry participants to file an initial objection (supported by a brief statement of the basis for the objection) within the allowed 14 days. This would 'stop the clock' for up to 7 days during which time the AEMC should indicate whether it requires further material to support the objection. Pragmatically, if the AEMC received numerous initial objections, it might elect to proceed to a full consultation process and waive the requirement for well-reasoned objection documentation.

2.7. WORKING GROUPS AND PUBLIC HEARINGS

Consistent with its view on its required scope for discretion, EnergyAustralia is of the view that the AEMC needs the discretion to set up working groups or hold public hearings depending on the nature of the proposed Rule change.

Procedurally, the AEMC should remain open to informal communication in deciding whether it is necessary to establish a working group or hold public hearings in respect of a particular proposed Rule Change.

2.8. DRAFT DETERMINATION

Further to the discussion on the scope for the proposed Rule change to evolve through the consultation process, the draft Determination must be able to manage any such evolution, while remaining true to the substance of the proposed Rule change originally submitted to the AEMC.

In particular, the AEMC should be required to consider whether the draft Determination remains consistent with the original public notice.

As discussed above, it may be necessary to allow the AEMC to issue its draft Determination as a "new proposal" or a "revised proposal" (on the strength of the original proposal) where the draft Determination proposes to accept a significantly enhanced Rule change relative to that originally advertised in the public notice.

2.9. TIMING TO FINAL DETERMINATION

The Consultation Paper provides for a Guideline of 28 days for the AEMC to issue a Final Determination on the proposed Rule changes.

However, this is just a Guideline, recognising that some issues, depending on their complexity, may require longer than 28 days. EnergyAustralia is comfortable with a certain degree of flexibility in this timetable.

We are understanding of the need to extend the consideration time for complex issues. However, we are worried about the process that has occurred in the context of the Gas Code, where a decision to extend the time frame must be published (the objective being to shame the regulator into doing its job), and this has run into a series of extensions. We would draw the MCE's attention to the Productivity Commission recommendation that an extension should be granted only once (Recommendation 11.1). However, EnergyAustralia notes that the Productivity Commission did not recommend sanctions on the regulator for not meeting its statutory timetable

2.10. PRE DETERMINATION HEARING

Consistent with our views on the flexibility on discretion to hold working groups or public hearings, EnergyAustralia considers that the AEMC needs the discretion as to whether or not to hold a pre-determination hearing.

Where the Rule change has been supported in the consultation process and has proceeded with very little change, it may not be necessary to hold a pre-Determination hearing. A requirement to hold such a hearing where none is required would tend to extend the process rather than streamline it.

Similarly, where the proposed Rule change has undergone significant enhancement through the consultation process, a pre-Determination conference may well be prudent.

Also, the AEMC should remain open to informal communication with stakeholders to aid it in deciding whether it is necessary to hold a pre-Determination hearing, based on the input of interested parties.

2.11. ACCC APPROVAL OF AEMC DECISIONS

EnergyAustralia consider that, where ACCC approval is required for a Rule change (for example if the Rules continue to operate as an Access Code), the AEMC should manage the ACCC process in its role as rule maker.

This is particularly appropriate as the proposed Rule change process removes the concept of a Rule change proponent, who would be the other logical choice to assume responsibility for the ACCC processes.

EnergyAustralia considers that the source of much of the inefficiency of the current Code change process is in NECA's referral of all access related issues to the ACCC for authorisation. The proposed Rule change process does not address this fundamental issue. For a network business, the resulting process does not appear to deliver any substantial benefits relative to the current process.

To expedite the process, the AEMC should involve the ACCC in the process as it proceeds, and this ongoing involvement should be incorporated in the inter-agency Memorandum of Understanding.

Moreover, where a proposed Rule change relates to Access issues, and will require the ACCC's approval, the AEMC and ACCC should coordinate their approaches to allow the ACCC to undertake its processes in parallel to the AEMC's deliberations on the Rule change.

This will require a high degree of cooperation and coordination between the agencies, particularly where the Rule change consultation process results in amendments to the proposed Rule change.

3. LEGISLATIVE AND REGULATORY FRAMEWORK

EnergyAustralia would also like to raise several comments and queries in relation to several aspects of the Information Paper on the Legislative and Regulatory Framework.

3.1. MINOR CLARIFICATIONS

In the description of the functions of the AER, the first dot point states that the AER will initially be responsible for the economic regulation of the wholesale electricity market and electricity transmission networks in the National Electricity Market jurisdictions.

It is not clear what is meant by economic regulation of the wholesale electricity market. The only economic regulation which occurs in the NEM is in relation to the transmission and distribution networks.

A similar comment applies to the statement in the third paragraph that, by no later than 31 December 2006, the AER will assume responsibility for economic regulation of the National Electricity Market and gas distribution and networks and retail markets (other than retail pricing). It is not clear what is meant by economic regulation of the NEM retail markets. Again the only “economic regulation” which occurs in the NEM is in relation to the transmission and distribution networks.

3.2. REGULATORY TEST FUNCTIONS OF THE AER

In relation to the regulatory test required by clause 5.6.5A of the Code, page 10 of the paper indicates that the AER will have the function of applying tests in respect of augmentation to networks (including the regulatory test referred to in clause 5.6.5A of the NEC).

Under the current Code arrangements the ACCC has a very limited role in “applying” the regulatory test in relation to the planning and development of networks by network service providers. The ACCC has the role of promulgating the test which is then “applied” by network service providers during the development of network augmentation proposals.

The ACCC only becomes involved in “applying” the test when there is a dispute as to whether an augmentation which is a new large network asset and which is not a reliability augmentation satisfies the regulatory test. In that case, the TNSP is required by clause 5.6.6(m) of the Code to apply to the ACCC for a determination whether the new large network asset satisfies the regulatory test prior to construction.

In light of this EnergyAustralia seeks clarification of the role of the AER in relation to the promulgation of the regulatory test.

3.3. ECONOMIC REGULATION FUNCTIONS OF THE AER

Page 10 of the Information Paper outlines that the AER will be guided by the same market objectives as the AEMC, being the current market objectives plus a new primary objective, when carrying out its economic regulation functions. The paper also indicates that these general market objectives will be supplemented by other more specific objectives such as those set out in the existing clause 6.2.2 of the NEC.

As we have discussed in an earlier section of our submission on the proposed National Electricity Rule Change process, we have no objection to the application of market objectives and indeed support their purpose. However, EnergyAustralia is very concerned that the current regime of principles and objectives set out Chapter 6 of the Code, in particular clauses 6.2.2, 6.2.3 and part of 6.2.4 (for transmission networks) and 6.10.2, 6.10.3 part of 6.10.5 (for distribution networks) do not provide a clearly articulated and well defined basis for the exercise of discretion by the economic regulators.

The current provisions present a range of often competing or inconsistent principles and objectives, which can leave regulators with the impression that they can subsume or override the entitlement of DNSP businesses to a sustainable commercial revenue stream which includes a fair and reasonable rate of return on efficient investment.

This is a fundamental flaw in the present Code, and presents a number of problems for both regulators and the businesses subject to regulation. In particular, from a business perspective, the current framework does not provide an adequate basis upon which the exercise of discretion can be assessed, judged or (in particular) appropriately tested and challenged.

This situation has the potential to severely limit the basis for judicial review of AER decisions, which the paper states will be available for the review of AER decisions. EnergyAustralia is of the strong view that this should be addressed now, at the same time as the AER is being established and the first set of National Electricity Rules is being developed.

EnergyAustralia would be very willing to engage in further work with the MCE process to develop an appropriate and well-defined basis for economic regulators to carry out their functions.

3.4. APPEALS

Consistent with its past submissions, EnergyAustralia repeats its call for an appropriate merits review of the decisions of economic regulators.

EnergyAustralia notes the intention for this to be addressed as part of the consideration of gas reforms early in 2005, and is very pleased that a merits review of AER decisions has not been precluded.

EnergyAustralia notes and supports the findings and recommendations of the Productivity Commission's Report on the Review of the Gas Access Regime which calls for the restrictions on merit appeals to be removed (Recommendation 11.4). EnergyAustralia submits that an appropriately developed and resourced right to merits review is an essential part of the

regulatory framework, and that the national framework for electricity should be aligned to those for gas, to provide clear rights of review of regulatory decisions.

ATTACHMENT: DRAFTING ANOMALIES AND INCONSISTENCIES IN CHAPTER 5 OF THE CODE

Scope of obligation on TNSPs and DNSPs to analyse future operation of their networks.

Clause 5.6.2(a) imposes an obligation upon NSPs to analyse the expected future operation of their transmission or distribution networks respectively over "an appropriate planning period". From its location in the Code immediately preceding the provisions dealing with the annual planning review, it would appear that this obligation is intended to be discharged by the TNSPs and DNSPs individually, as a preliminary step to the joint annual planning review. In addition it appears that the intended use for the results of this analysis is as an input to the joint annual planning review. This is also supported by clause 5.6.2A(a) of the Code which requires a TNSP's Annual Planning Report to set out the results of "the annual planning review" conducted in accordance with clause 5.6.2(a) and (b).

Clarification required:

Confirmation that the TNSPs and DNSPs each have an obligation under 5.6.2(a) to analyse the expected future operation of their network separately from the annual planning review and that the results of this analysis are intended to be an input to the joint annual planning review

Scope of obligation to identify and notify forecast constraints on Network

Clause 5.6.2(e) of the Code requires NSPs to extrapolate and analyse the forecasts provided by Code Participants for the purpose of planning when the relevant technical limits of the transmission and distribution systems will be exceeded. This is not an obligation which is to be performed jointly by DNSPs and TNSPs, but rather must be performed by each individually. It is not clear, however, whether this extrapolation and analysis:

is an obligation which can be discharged as part of the annual planning review; or

is an ongoing obligation which must be performed independently of the annual planning review; and

whether this analysis is intended to be carried out for the minimum planning period specified in clause 5.6.2(d).

Where the analysis performed for the purposes of clause 5.6.2(e) indicates that any relevant technical limits of the transmission and distribution systems will be exceeded, either in normal conditions or following the contingencies specified in schedule 5.1, the NSP must notify any affected Code Participants and advise those Code Participants of the expected time required (the "**corrective time period**") to allow the appropriate corrective network augmentation or non-network alternatives, or modifications to connection facilities (collectively referred to in this paper as "**corrective solutions**") to be undertaken (5.6.2(e)).

¶ Given that the balance of clause 5.6.2 deals with the consultation and other steps which a DNSP must undertake to implement corrective solutions, it seems logical that the analysis performed for the purposes of 5.6.2(e) is intended to form part of the annual planning review.

¶ The Code does not specify what consultation and other analysis is to be performed in respect of augmentations which are not identified through the annual planning review.

Clarification required:

Confirm that the obligation imposed by clause 5.6.2(e) is able to be discharged once a year by involvement in the annual planning review, except where sudden changes in network conditions mean that a need for augmentation is identified outside the parameters of the annual planning review, in which case the process set out in clause 5.6.2(f) and following should be followed by the DNSP.

Confirm that the analysis carried out under clause 5.6.2(e) is for the periods specified under clause 5.6.2(d).

Scope of DNSP obligations to consult in respect of network augmentations.

Prior to implementation of the NDR Code Changes, clauses 5.6.2(f)-(m) of the Code set out what both DNSPs and TNSPs were required to do to progress augmentation or non-network alternatives as corrective solutions. The NDR Code Changes effectively transferred TNSPs' obligations for progressing network planning alternatives from clause 5.6.2 to clauses 5.6.6, 5.6.6A and 5.6.6B, although clauses 5.6.2(l) and (m) continue to impose obligations on TNSPs. Clauses 5.6.2(f)-(m) continue to apply to DNSPs in relation to their progression of augmentation and non-network alternatives identified by the annual planning review. However, the NDR Code Changes did not make all necessary amendments to create a "clean split" of DNSP and TNSP development obligations between clause 5.6.2 on the one hand and clauses 5.6.6, 5.6.6A and 5.6.6B on the other. This has resulted in some apparent inconsistencies in interpreting a DNSP's obligations under the balance of clause 5.6.2.

Where the need for a corrective solution has been identified under clause 5.6.2(e), the relevant DNSP must, within the corrective time period:

- carry out an economic cost effectiveness analysis of possible options to identify options that satisfy the regulatory test and meet the technical requirements of schedule 5.1 of the Code (5.6.2(g)); and
- "consult" with affected Code Participants and interested parties on the possible options, including but not limited to demand side options, generation options and market network service provider options to address the projected limitations of the relevant distribution system, together with the economic cost effectiveness analysis and allocation. (5.6.2(f))

Clause 5.6.2(f) provides that a NSP does not need to consult on a network option which would be a new small network asset. A "new small network asset" is defined in Chapter 10 of the Code to be a certain type of transmission network asset, and therefore it is incongruous that it be referred to in the context of a DNSP's consultation obligations. This is an anomaly appears to have resulted from the NDR Code Changes. Prior to those Code Changes, clause 5.6.2(f) applied to both DNSPs and TNSPs, in which context it made sense to carve-out a consultation obligation in respect of an NSP's new small transmission network asset. As the clause now just applies to DNSPs, the carve out should apply in respect of new small distribution network assets. However changing clause 5.6.2(f) to refer to new small distribution network assets will not completely solve the anomaly. Chapter 10 defines a *new small distribution network asset* as follows:

A new small network asset which forms, or will form part of a distribution system.

A new small network asset is defined by reference to being an asset of a Transmission Network Service Provider. Consequently the anomaly needs to be addressed by amending the definition of *new small distribution asset* so it is defined by reference to an asset of a Distribution Network Service Provider in relation to which the Distribution Network Service provider has estimated it will be required to invest a

total capitalised expenditure in excess of \$1mil. A consistent change would be required in relation to the definition of *new large distribution network asset* and the reference to new large network asset in clause 5.6.2(i).

These issues have also been identified by the ACCC in its Decision on the Review of the Regulatory Test for Network Augmentations- 11 August 2004 at pages 29 and 30. The ACCC has proceeded on the basis that DNSPs will be required to apply the regulatory test analysis to new small distribution network assets and new large distribution network assets but has indicated that it is not in a position to resolve the Code anomalies which make this unclear and has indicated that it proposes to raise the matter with NECA.

Clarification required:

Clause 5.6.2(f) should be amended to refer to "new small distribution network asset" instead of "new small network asset".

The definitions of "new small distribution network asset" and "new large distribution network asset" should be amended so that they refer to assets of a DNSP, but have the same value thresholds as the current definitions for transmission assets.

In addition, clause 5.6.2(f) provides an exception from the obligation to consult in that clause for "relevant options" which would be "new small network assets". From the wording of the clause, it is not clear whether an NSP is required to consult on non-network options which would be "new small network assets".

Not only would it be anomalous for an NSP to be required to consult on non-network options but not on network options, it would also mean that the exception becomes meaningless for projects where there were potential non-network options the obligation to consult on the non-network options would mean that the network options would also be the subject of consultation (since in discussing non-network options, possible network options would need to be discussed).

Clarification required:

Clarify that the exception in clause 5.6.2(f) applies to all options which would be new small network assets.

Application of Regulatory Test analysis to DNSP augmentations

In relation to a distribution network augmentation being analysed under clause 5.6.2, the "regulatory test" previously promulgated by the ACCC required a DNSP:

- in respect of an augmentation proposed to meet an objectively measurable service standard linked to the technical requirements of Schedule 5.1 of the Code, to analyse the available options to determine the options that minimise the net present value of the "cost" (as defined in the regulatory test) of meeting those standards; or
- in respect of augmentation not proposed to meet an objectively measurable service standard linked to the technical requirement of Schedule 5.1 of the Code, to analyse the available options to determine the options that maximise the net present value of the "market benefit" (as defined in the regulatory test) of meeting those standards.

The ACCC has reviewed the regulatory test and on 11 August 2004 released its final decision on that review and promulgated a new regulatory test, referred to in that decision as Regulatory Test – Version 2.

At page 28 and 29 of its decision the ACCC explains that it has had to word the regulatory test so that it does not refer to "reliability augmentation" as that term is defined in the Code to only apply to TNSPs. In its draft decision that ACCC had proposed using the term "reliability augmentation" to neatly refer to augmentations carried out by both DNSPs and TNSPs which are necessitated by the inability to meet the minimum network performance requirements set out in Schedule 1 of the Code or in the relevant legislation, regulations or any statutory instrument of a participating jurisdiction. The ACCC has addressed this problem by not using the term reliability augmentation in the Regulatory Test- Version 2. Notwithstanding this, consideration should be given to whether the definition of reliability augmentation should be amended to refer to both DNSPs and TNSPs.

Further, the current definition of reliability augmentation refers, amongst other things, to an inability to meet "the minimum network performance requirements set out in schedule 5.1". At present clause s5.1.2.2 provides:

"The amount of *network* redundancy provided will be determined by the process set out in clause 5.6.2 of the *Code* and is expected to reflect the grouping of *generating units*, their expected capacity factors and availability and the size and importance of *Customer* groups.

The standard of service to be provided at each *connection point* must be included in the relevant *connection agreement*, and will include a *power transfer capability* such as that which follows:

- (a) In the *satisfactory operating state*, the *power system* must be capable of providing the highest reasonably expected requirement for *power transfer* (with appropriate recognition of diversity between individual peak requirements and the necessity to withstand *credible contingency events*) at any time.
- (b) During the most critical single element *outage* the *power transfer* available through the *power system* may be either:
 - (1) zero (single element *supply*);
 - (2) the defined capacity of a backup supply, which, in some cases, may be provided by another *Network Service Provider*;
 - (3) a nominated proportion of the normal *power transfer capacity* (eg 70 percent); or
 - (4) the normal power transfer capacity of the power system (when required by a Code Participant)."

As a result, while schedule 5.1 provides a process to determine the level of network redundancy provided, it does not actually set out what the performance standard is.

Clarification required:

Definition of "reliability augmentation" needs to be amended so that it applies to both DNSP and TNSP obligations and refers to performance requirements determined in accordance with schedule 5.1 as well as those set out in that schedule.

Clause 5.6.2(g) provides for DNSP to carry out an economic cost effectiveness analysis of possible options to identify options that satisfy the regulatory test. The clause appears to apply to all DNSP augmentations and not just small and large distribution network assets. This would appear incongruous given that regulatory test analysis appears intended to not be required for TNSP projects which are not small or large network assets, ie those having a capitalised value less than \$1mil. Pending clarification

of this obligation a reasonable approach would be to only carry out an economic cost effectiveness analysis in respect of new small and new large distribution network assets.

Clarification required:

Clause 5.6.2(g) should be amended so it is clear that economic cost effectiveness analysis need only be carried out in relation to new small and new large distribution network assets ie not in relation to assets valued at \$1million or less.

Requirements of Report under clause 5.6.2(h)

Clause 5.6.2(h) provides for a report to be prepared by DNSPs following conclusion of the process outlined in clauses 5.6.2(f) and (g). Subclause 5.6.2(h)(1)-(4) sets out the matters which must be addressed in the report. 5.6.2(h)(2)(A) and (B) refers to clauses 5.6.2(g)(1) and (2) respectively but these clauses do not exist; the reference should be to clause 5.6.2(g).

Clarification required:

Clauses 5.6.2(h)(2)(A) and (B) should be amended to remove the references to 5.6.2(g)(1) and (2) respectively and to replace each reference with "5.6.2 (g)"

Entitlement to bring Disputes under clause 5.6.2(i)

Under clause 5.6.2, Code Participants may dispute the recommendation of the corrective action report within 40 business days after the report is made available in respect of a proposal:

- that is a new large network asset; or
- is reasonably likely to change the DUOS charges applicable to that Code Participant by more than 2% at the date of the next price review (clause 5.6.2(i)).

"New large network asset" as currently defined means transmission network assets over a certain size.

However, prior to the NDR Code changes, the expression referred to both transmission and distribution network assets over a certain size. It is therefore not clear whether the right to dispute the recommendation of a corrective action report:

- only exist in respect of proposal that is reasonably likely to change the DUOS charges applicable to the complainant by more than 2% at the date of the next price review; or
- exist in respect of both proposals that are reasonably likely to change the DUOS charges applicable to the complainant by more than 2% at the date of the next price review or are a new large distribution asset based on the repealed definition of that term (being an asset of the DNSP on which work commenced after 1 July 2000 and in relation to which the DNSP has estimated it would be required to invest a total capitalised expenditure in excess of \$10 million, unless IPART publishes a requirement that a new large network asset will be distinguished from a new small network asset if it involves investment of a total capitalised expenditure in excess of another amount, or satisfaction of other criteria and the asset falls within those parameters).

It would appear that the intention is for the right to dispute to exist with respect to new large distribution network assets. Consistent with the approach advocated above in relation to new small network assets,

the reference to new large network asset in clause 5.6.2(i) should be to a new large distribution network asset, defined by reference to distribution assets.

Clarification recommended

Confirm that Code Participants have the right to dispute distribution network proposals put forward by DNSPs which are new large distribution network assets by amending the reference to "new large network asset" in clause 5.6.2(i) to "new large distribution network asset"

Obligation to have assets in services under clause 5.6.2(k)

Under clause 5.6.2(k) a DNSP is required to arrange for relevant options recommended in the report made in accordance with clause 5.6.2(k) to be available to service by the "agreed" time.

The reference to the "agreed" time appears to be a reference to the outcome of negotiations under clause 5.6.2(j). However, the time by which an asset should be in service can be set in three ways, namely:

- (a) if the recommendation of the report prepared under clause 5.6.2(b) is not disputed, by the date set out in that report;
- (b) as a result of negotiations under clause 5.6.2(j); or
- (c) through the resolution of a dispute in accordance with clause 8.2(f) of the Code.

In addition, the Code presently makes no allowance for disputes to be resolved in the time allowed for assets to be in service. As the SNI appeals process shows, this process can take some time.

Clarification required:

Clarify that the time by which network options must be in service is the time recommended under clause 5.6.2(b) or any time determined as a result of the resolutions of a dispute raised under clause 5.6.2(i).

Provide for an extension of time by which assets need to be in service to allow for time taken to resolve disputes raised under clause 5.6.2(i).

Development of New Small Network Assets by TNSPs

On one reading of clause 5.6.2A(b)(5), a TNSPP must apply the regulatory test to a "new small network asset" as soon as the need for that asset is identified.

However, this would require the regulatory test to be applied more than once to a particular project (if the constraint was identified some time before corrective action needed to be taken) and out of sequence from the proper planning and development of a project. This problem could be overcome if clause 5.6.2A(b) were amended so that a TNSP need only take the steps outlined in that clause in preparation of the annual planning report where the construction of a project is intended to commence in the first year covered by that annual planning report.

Clarification required

Clarify that the steps outlined in clause 5.6A(b)(5) need only be undertaken for the preparation of an annual planning report for new small network assets, the construction of which will commence in the first year to which that annual planning report relates

Development of New Large Network Assets- Clause 5.6.6

Clause 5.6.6 of the Code refers to "applications" to establish a new large network asset. The wording of clause 5.6.6(a) appears to indicate that the obligation to follow the process set out in clause 5.6.6 is only triggered in circumstances where such an "application" is made by an "applicant". In the context of clause 5.6.6 of the Code, the only "application" to which the clause could be referring is an "application" to connect to a network under clause 5.3 (or to modify such a connection). So when a TNSP is developing its own network and all of the development is within the TNSP's network, it is under no obligation to "apply" to anyone to construct the asset.

While it is likely that the drafter of clause 5.6.6 of the Code might have intended a broader interpretation, the ordinary and natural meaning of the words of clause 5.6.6 do not appear to impose an obligation on TNSPs who are not applicants.

Clarification recommended

The use of the term "applicant" in clause 5.6.6 should be reviewed to ensure that it effectively imposes obligations upon TNSPs developing assets on their own networks. The references to "application" could be replaced with a reference to "proposal" and the references to "applicant" could be replaced with references to "person".