



Hydro Tasmania

27 August 2004

NE Rule Change Process
C/- MCE Market Reform
Department of Industry, Tourism and resources
GPO Box 9839
CANBERRA ACT 2601

Dear Sir

Thank you for the opportunity to comment on the Proposed Rule Change Process.
Attached is Hydro Tasmania's submission.

If you have any queries, please contact the undersigned on 03-62305775.

Yours faithfully

David Bowker
Manager Regulatory Affairs

Attch.

Hydro Tasmania Submission on the Proposed National Electricity Rule Change Process

1 Executive Summary

There are several areas of concern in the proposal which we have highlighted in our submission. These include issues such as the assumption that it is feasible to remove discretion from the new rules, the possible constitutional issues, a lack of transparency in part of the Code change process and some Governance concerns.

Our main concern, however, which has a potentially much more serious impact, is the changes to the Market Objectives. Two significant changes have been made without any rationale being provided as to which shortcomings these proposed changes address and why they are needed.

Such a fundamental change deserves careful consideration and debate.

2 The Code as Law

2.1 Residual areas of Discretion

The approach proposed by the Ministerial Council on Energy entails converting the Code into a set of very specific mandatory obligations (with no discretion on market participants) so that there is no consensual arrangement between market participants capable of attracting the operation of Part IV of the TPA.

Any areas of discretion left within the rules may result in market participants having to obtain individual authorisations (based on their own assessment of TPA risk). This would place an undesirable time / cost burden on the market.

The workability of the proposal comes down to whether or not it is possible to remove all discretion from the present Code without significantly altering its operation. The legal opinion obtained by the MCE did not perform this analysis; it merely raised some questions about possible difficulties in relation to Chapter 3 (see paragraphs 127 – 129). Given the potential price fixing nature of Chapter 3 (recognised in the legal opinion), if it is not possible to remove all discretion from Chapter 3 without significantly altering its operation, then the proposal cannot be made to work effectively.

By the time the amended Code is available for review to allow an assessment of the issue, the jurisdictions will already be committed to enacting the Code as law.

2.2 Constitutional Issues

The legal opinion also raised potential constitutional issues (see paragraph 170) if a State law (the Code) required a corporation to take steps in breach of Part IV. The advice assumed that careful drafting could overcome these issues. Whether or not this is possible would need to be confirmed and consideration would need to be given

to the possibility that there would be challenges to test the drafting through the Courts. This will create regulatory uncertainty for the market.

2.3 Checks and balances

The new arrangements provide that there will be no merits review from AEMC and AER decisions (only judicial review). The effect of not using authorisation to address competition issues is to remove the Competition Tribunal merits review that currently applies to Code change authorisations.

Market participants overwhelmingly see merits review as important for investment. Merits review is one of the checks and balances that is the norm and there is no reason to dispense with this protection. It improves the quality, consistency, transparency and accountability of decision making and provides an environment of sufficient regulatory certainty to enable on-going investment to be made.

There is no inherent value in streamlining and shortening decision making processes if this comes at the expense of quality, consistency, transparency and accountability. Merits review becomes more important if streamlining and shortening the decision making process increases the risk of error or of decisions which are arbitrary, capricious or perceived as “anti-investment”.

2.4 Role of the Senior Counsel’s Advice

Whilst the SCO may take comfort in the Senior Counsel’s advice, it is not of any use to a participant who becomes the subject of litigation. Indeed, with the planned pace of implementation for this process, participants will not have time to seek an authorisation, if they need to, prior to the commencement of the new arrangements.

3 Code Change Process

3.1 Publication of Proposed Changes

The proposed process does not require the publication of a rule change proposal until after the advice of the ACCC and AER has been sought. In the interests of transparency it is important that participants should have access to the original proposal. This can be achieved in one of two ways. Firstly, a proposal could be published as soon as it is received by the AEMC and secondly, it could be required that the documentation associated with the public notice from Stage 2 should be required to include the original proposal details.

Hydro Tasmania prefers the former solution as it will also capture the issue where proposals are rejected. This information is important for participants and the volume of changes (based on recent experience) would not be onerously large.

3.2 AEMC Code Changes

Hydro Tasmania is still concerned at the AEMC’s dual role in relation to an MCE initiated market review. Aside from the Governance issues, it is much more efficient

for the MCE to commission a review by an organisation with specialist skills in the relevant area (as it has done for the regional review by Charles River Associates).

4 The Market Objectives

One fundamental change which is presented in this process is that the Market Objectives have been changed. Similar changes were proposed in the March Code Change Process Proposal but in both cases no discussion has been offered on why these objectives have been changed.

The current Market Objectives have been in place since the market started and Australia's electricity market is arguably the best in the world. Any change should be carefully considered and targeted to address specific problems.

It is unclear which problems the current changes address and the proposal replaces the primary objective with a new one. This is a serious step which has had no rationale presented.

In particular, the proposed primary objective is not well formulated and can be construed as two or three potentially conflicting objectives. The addition of the objective (b) relating to the use of infrastructure does not make clear which infrastructure and its impact on network investment approaches is unclear.

Previously it was implicitly assumed that an efficient market was in the long term interests of consumers. This understanding has been lost by the attempt to include the new first objective. Hydro Tasmania believes that the market objectives should remain unchanged.

The criteria for a change to the rules should then become a change which passes the net benefits test and is consistent with the market objectives. Even with this clarity, it is not obvious how a Rule change which allocates some costs more fairly between participants will generate a net benefit. In our submission to the March proposal, we commented on the need for a very clear test. The current proposal has shed no light on how this important test will be defined.

5 In summary

The revised process will lead to a greater regulatory risk for participants as the new arrangements cannot provide the level of comfort offered by an authorisation. The debate at present is in relation to whether this increase is material.

There has been insufficient analysis and debate about the advantages and disadvantages of authorisation versus statutory instrument, especially the impact on the market in terms of regulatory uncertainty and time / cost burden. Such an analysis can not be done until a revised Code is issued (or at least key chapters).

The market objectives have been modified with no clear rationale and should be retained in their original form.