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Manager Energy Market Reform Team  
National Energy Market Branch  
Department of Industry Tourism & Resources  
GPO Box 9839  
CANBERRA ACT 2601

Dear Sir

**Exposure Draft of the Amended National Electricity Law**

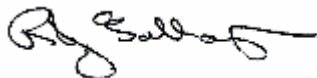
Thank you for the opportunity to comment on the exposure draft of the amended National Electricity Law ("NEL"). Please find attached comments and suggestions in relation to some high-level governance issues arising out of the proposed amendments to the NEL.

Some of the issues that I have addressed in these comments have already been raised previously and referred to senior government officials in the first report of the Market and System Operations Review Committee, which I chaired.

It would appear that the views and recommendations put forward in that report, which was prepared at the request of the participating jurisdictions and with considerable input from all sectors of the industry, have been either ignored or rejected. I urge the SCO to reconsider the MSORC's recommendations on those matters that are now being elevated into the NEL, including in particular:

- ⊗ The extent of NEMMCO's responsibilities for power system security; and
- ⊗ The membership, governance, powers and responsibilities of the Reliability Panel.

Kind regards



Jim Gallaughner  
Director

att.

## Exposure Draft of the NEL

### Governance & Liability Issues & Concerns

The purpose of the revised NEL (compared with the current legislation) appears to be confined to implementing the market governance arrangements involving the establishment of the MCE, AEMC and AER and at the same time extinguishing NECA and the NET. It also involves elevating some aspects of the current Code directly into the NEL.

In many respects this is a major overhaul of the NEM market governance, but at the same time, it fails to address some of the weaknesses in the current market governance arrangements that warrant further critical examination and overhaul.

It would be very useful for market participants and other key stakeholders (in particular, prospective private investors in new energy infrastructure) if the SCO/MCE were able to provide some guidance on current thinking on each of these matters, as part of the process of finalising the NEL.

Some of the issues discussed below can be deferred for more detailed consideration when the AEMC is fully established and/or when the NEL is subsequently amended to expand the role of the AER to provide coverage for electricity distribution and retailing. In some cases, they can probably be addressed without having to amend the NEL as currently drafted. However, in others, there would be merit in revising the current drafting of the NEL if the SCO/MCE accepts the views expressed below.

	Issue	Comments
1	Merits Based Review	<p>As a general principle, the accountability of organisations such as NEMMCO and the AER would be enhanced by at least some form of merits based review. Even the threat of a possible merits-based review has a quite sobering affect on decision-making bodies like NEMMCO, incentivising them to add rigour to their decision-making processes.</p> <p>There are ample safeguards that could be applied to ensure that the opportunity for such a review is not abused or over-used. For example, any merits-based review should not be able to consider new evidence not already available to the decision-making body when the initial decision is made, and substantial deposits that would not be refunded if the appeal were lost could also apply.</p> <p>It appears that SCO/MCE is prepared to contemplate further change to the NEL in relation to this issue when its response to the NPC Review of the Gas Access Regime has been</p>

	Issue	Comments
		finalised. In the meantime however, registered participants in the NEM will have suffered some diminution of their rights compared with current governance arrangements, particularly in relation to NEMMCO decisions and actions.
2	Limits on Liability	<p>The current regime for limiting NEMMCO's and market participants' liabilities seriously diminishes the accountabilities of service providers in the market and inefficiently allocates an undue amount of the risk of failure to supply onto electricity users.</p> <p>As a general principle, wherever possible, the obligation of any service provider to its recipient in the NEM, regardless of whether it is set by regulation or by contract, should have the force of contract where the rights and obligations of each party are quite explicit and enforceable. Consistent with this, any limits on liability should be set in a manner that is consistent with normal commercial practice in the supply of goods and services in other industries and markets. In particular:</p> <ul style="list-style-type: none"> <li>⊗ NEMMCO should be capitalised to enable it to accept liability in line with normal commercial practice;</li> <li>⊗ NSPs' obligation to provide reliable network services for each individual network user should be quite explicit and bilateral in nature (as opposed to being smeared across all users as applies under the current approach to incentive regulation); and</li> <li>⊗ Retailers should compensate their consumers for lack of generation causing supply interruptions unless the consumers explicitly agree by contract to waive their rights in this respect (presumably in exchange for a lower price)</li> </ul> <p>Only when all of the accountabilities and risk allocations throughout the supply chain are commercially robust can one expect the market to function efficiently, with private investors being able to enter the market in the knowledge that all the key players will act commercially and be incentivised financially to perform their proper role in the effective operation of the market and the power system</p>
3	NEMMCO's internal rules and procedures	As with the current Code, the Rules will provide for NEMMCO to make detailed operating rules and procedures governing many different aspects of its operations. Currently, NEMMCO has the power to make these rules and procedures

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		<p>unilaterally.</p> <p>The principles of sound governance suggest that the making of such detailed technical rules and procedures should be delegated to NEMMCO to develop in collaboration with the industry. However, just as the AEMC has stringent standards of behaviour imposed on it in the way it handles Rules changes, similar standards should also apply to NEMMCO, and importantly, its final proposals should be independently endorsed as being not only Rules compliant but also consistent with the general spirit and intent of the Rules. Arguably, some of NEMMCO's current operating procedures provide an undue amount of latitude and/or discretion to NEMMCO in this respect.</p>
4	Derogations	<p>While there is merit in making provision for both jurisdictional and individual participant derogations, derogations should be drafted in a way that provides the minimum amount of relief necessary from the Rules to achieve the desired objective of the derogation as opposed to granting a blanket relief from any of the Rules provisions. Ideally, the powers of any party to grant derogations should be restricted by statute in this respect.</p>
5	Market Objective	<p>Arguably, the market objective as currently defined provides considerable latitude for interpretation either by the MCE and/or the AEMC in its application under the NEL. Virtually all decisions by the AEMC will have impacts on consumers that:</p> <ul style="list-style-type: none"> <li>⊗ Are conflicting (e.g. improve service but raise price)</li> <li>⊗ May provide a net benefit for one consumer group but have a net detrimental impact on another group (e.g. facilitate relief of interconnector constraints which raises prices in the exporting region but reduces them in the importing region)</li> <li>⊗ Have long term benefit but at the same time have some short term adverse impacts, the materiality of which varies considerably from case to case</li> </ul> <p>The governance arrangements for the NEM should provide for a much more explicit and transparent statement of the way the MCE and the AEMC propose to interpret this market objective even if it is not included in the NEL itself</p>

	Issue	Comments
6	MCE's Policy Role	<p>The MCE's policy role as defined in the NEL empowers the MCE to impose very tight policy control over the AEMC, but it in no way obligates the MCE to establish the range of policy settings sought by potential new private investors in new NEM infrastructure.</p> <p>Unilateral policy decisions by jurisdictions in the NEM in respect of their electricity industry are having quite a profound impact on NEM operations and investment beyond their own borders. Yet Clause 4(5) of the NEL as currently drafted has very little practical value to prevent this. It involves the equivalent of the nuclear deterrent that, if applied, would possibly lead to mutual destruction (of the NEM). In this regard, it is also quite discriminatory insofar as it does not impose an identical standard of accountability on all of the participating jurisdictions. Ejecting for example either NSW or Victoria from the NEM would most likely be fatal for the NEM, whereas any one of the other 4 States and Territories could probably be ejected while still allowing the NEM to operate elsewhere, albeit in a more limited form.</p> <p>As a general principle, the commitment of all participating jurisdictions to making the NEM a truly national market that maximises the benefits of the market collectively across all jurisdictions should be a cornerstone of the NEM market governance arrangements, and the unilateral right of jurisdictions to deviate from national policy positions on key matters affecting the NEM should be by exception only, and with the express agreement of all of the other participating jurisdictions.</p>
7	Dual Licensing & Registration Regimes	<p>As a general principle, there should be no need for duplicate State-based licensing and national registration arrangements in NEM. However, the proposed changes don't seem to have addressed this issue. A commitment to this principle should mean an end to State-based licensing of generators and TNSPs as soon as the new Rules come into effect, with the eventual removal of all State-based licensing when the AER's coverage of economic regulation of distributors and retail market supervision takes effect.</p> <p>Consistent with this, any residual State-based regulatory coverage of the generation and transmission sectors should transition to AEMC and/or AER as appropriate as soon as practicable.</p>

	Issue	Comments
8	Sensitive Loads	<p>The concept of sensitive loads introduced by jurisdictions in the early drafting of the initial NEC is now redundant and should be removed.</p> <p>The existence of so-called sensitive loads in no way diminishes NEMMCO's obligation to maintain a secure power system and, if necessary, sensitive loads will be shed in order to achieve that. The real issue is the prioritisation of various loads within and between regions when involuntary load shedding must be initiated by NEMMCO.</p> <p>The following simple principles should apply:</p> <ul style="list-style-type: none"> <li>⊗ NEMMCO must develop and implement load shedding procedures commensurate with its obligations to maintain power system security</li> <li>⊗ NEMMCO's procedures should be developed and implemented in a way that is fair and equitable to consumers within and between jurisdictions</li> <li>⊗ When developing the procedures, NEMMCO must consult jurisdictional system security coordinators and NEMMCO must take their views and concerns into account</li> </ul> <p>Any jurisdictional concerns about so-called "sensitive loads" can be quite adequately addressed within the above framework without them being explicitly referred to in the NEL. As a practical matter, pre-notification by NEMMCO of plans to shed sensitive loads would rarely if ever be feasible. What is feasible however is agreement in advance with each jurisdictional system security coordinator what the priorities for load shedding are within the jurisdiction and how the load shedding schedule is to be rotated from time to time within and between jurisdictions.</p>
9	Boundary of NEMMCO's Control Area	<p>The current drafting of the NEL allocates responsibility to NEMMCO to maintain power system security for the entire national electricity system as defined in the law itself.</p> <p>In practice, NEMMCO's powers and responsibilities in this respect are confined to the "main power system" which does not include much of the sub-transmission and distribution networks or the behaviours of the electrical installations directly connected to those networks.</p>

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		<p>This issue was addressed at length in the MSORC process some years ago but as yet the jurisdictions have not responded to or acted on the keys recommendations arising out of that Review.</p> <p>At the very least, the current drafting of the NEL should be modified to acknowledge the true limits of NEMMCO's responsibilities before it is enacted. However, even to do this successfully, the jurisdictions would need to resolve the issue of how the boundaries of the "main power system" should be defined. Some of the work undertaken by MSORC may be quite instructive in this respect.</p> <p>Then, in due course either the MCE or the AEMC should turn their attention to what practical regime uniform across the NEM should apply beyond the "main power system".</p>
10	Access regime for generators under special circumstances	<p>The AEMC's rule making powers should be extended to enable the AEMC to include in the Rules provision for mandated access conditions to be imposed on generators in those circumstances where they have localised market power, and can substitute for what would otherwise be quite inefficient augmentation of the local network in order to provide a reliable supply to the local consumers. In this respect, the broadly accepted principle of the monopolistic nature of electricity networks should be extended under quite specific circumstances to generators.</p>
11	AEMC Rule Making Powers	<p>The current drafting of the NEL does not clarify whether the AEMC can modify or amend a proposed Rule change before making the change if, in its considered view, the contribution of the proposed Rule change to the achievement of the market objective could be further improved by such an amendment. This might be interpreted for example as the AEMC "initiating" a Rule change, and, in so doing, exceeding its statutory powers.</p>
12	Reliability Panel	<p>In essence, the Reliability Panel should be viewed as a single-purpose body, largely independent of the industry, that acts as a public watchdog on the overall performance of the NEM in terms of its delivery of a high quality, secure and reliable power supply to consumers. In this respect, it should be empowered to review any aspect of the policies, performance and behaviours of the industry, the market, participating governments, capital markets, and any one else who may impact on delivered supply to consumers. It should also play a</p>

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		<p>central role in setting the technical standards and operating principles that will play a key role in determining supply security and reliability performance.</p> <p>As such, it should be empowered to:</p> <ul style="list-style-type: none"> <li>⊗ Set standards</li> <li>⊗ Monitor performance</li> <li>⊗ Undertake reviews</li> <li>⊗ Oversee NEMMCO investigations into all major “system events”</li> <li>⊗ Make policy recommendations</li> <li>⊗ Request/instruct the AEMC to initiate the Rules change process in relation to security/reliability issues and concerns</li> <li>⊗ Refer Rules enforcement concerns to the AER for detailed investigation</li> <li>⊗ Publish reports</li> </ul> <p>While establishing the Reliability Panel as a statutory body is to be commended, given the above, there would be some merit in providing it with a degree of independence from (or substantially lessen the potential influence over it of any one of) the AEMC, the AER, NEMMCO, the jurisdictions and the industry in any or all of the following ways:</p> <ul style="list-style-type: none"> <li>⊗ It should have an independent and transparent budget setting process so that it does not have to compete internally within the AEMC for a reasonable budget allocation</li> <li>⊗ It should have amongst its members independent people with specialist expertise from academia and the like and not merely be a representative body</li> <li>⊗ It should have the power to decide on the appointment of external expert advisers (within the spending limits of its budget)</li> <li>⊗ Its membership should not be dominated by electricity</li> </ul>

	Issue	Comments
		<p>industry representatives; in fact, they should not make up more than 50% of its membership in total</p> <ul style="list-style-type: none"> <li>⊗ No member of the AEMC, AER, NEMMCO or public servant of any of the participating jurisdictions with responsibilities relating to the electricity sector should be eligible to be a member of the Panel</li> <li>⊗ It should have access to appropriate information discovery powers (for example, via the AER) commensurate with its role and responsibilities</li> <li>⊗ Not all members of the Panel should be appointed by the AEMC – some could be elected directly by industry sectors while independent members for example could be appointed from a list of nominees approved by the MCE, and the Chairperson could be appointed directly by the MCE</li> </ul> <p>The principal role of the AEMC should be to provide it with secretarial and administrative support, and the Panel should be accountable directly to the MCE (or the South Australian parliament but not the AEMC) for its overall performance</p>