

Ministerial Council on Energy

11 December 2003

Report to the Council of Australian Governments

Reform of Energy Markets

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Foreword

The Ministerial Council on Energy (MCE), established by the Council of Australian Governments (CoAG) in June 2001, has been charged with the following objectives:

- To provide national oversight and coordination of policy development to address the opportunities and challenges facing Australia's energy sector into the future.
- To provide national leadership so that consideration of broader convergence issues and environmental impacts are effectively integrated into energy sector decision making.

Membership comprises:

Ministerial Council on Energy

The Hon Ian Macfarlane MP
Minister for Industry, Tourism and Resources
COMMONWEALTH
(Chairman, Ministerial Council on Energy)

The Hon Paul Lucas MP
Minister with responsibility for Energy
QUEENSLAND

The Hon Frank Sartor MP
Minister for Energy and Utilities
NEW SOUTH WALES

The Hon Theo Theophanous MLC
Minister for Energy Industries and Resources
VICTORIA

The Hon Eric Ripper MLA
Deputy Premier; Treasurer
Minister for Energy
WESTERN AUSTRALIA

The Hon Patrick Conlon MP
Minister for Energy
SOUTH AUSTRALIA

The Hon Paul Henderson MLA
Minister for Business, Industry and
Resource Development
Minister for Energy
NORTHERN TERRITORY

Mr Ted Quinlan MLA
Deputy Chief Minister
Treasurer
AUSTRALIAN CAPITAL TERRITORY

The Hon Paul Lennon MHA
Deputy Premier
Minister for Economic Development, Energy and Resources
TASMANIA

Observers

The Hon Pete Hodgson
Minister of Energy
NEW ZEALAND

Hon Sir Moi Awei KBE MP
Minister for Petroleum and Energy
PAPUA NEW GUINEA

1. Background

At the CoAG meeting on 8 June 2001, all Australian Governments recognised that effective operation of an open and competitive national energy market contributes to improved economic and environmental performance, and delivers benefits to households, small business and industry, including in regional areas. CoAG agreed to a set of core national energy policy objectives and principles, as outlined at Appendix 1. At the same time, CoAG charged the MCE to address a series of priority tasks, specifically:

- likely energy use (supply and demand) scenarios facing Australia over the next decade and possible policy issues to be addressed;
- existing and potential gas and electricity market regulatory structures and institutional mechanisms, including the extent to which they facilitate an efficient and competitive energy sector with adequate investment and benefits to users;
- the potential for harmonising regulatory arrangements, removing inconsistencies and integrating networks;
- opportunities for and impediments to increasing interconnection and system security in gas and electricity; and
- ways of accelerating the delivery of improved consumer choice, providing better information and enhancing cooperative energy efficiency activities and decision making for demand side participation.

CoAG also agreed in June 2001 to an independent review of energy market directions, to identify the strategic issues for Australian energy markets and the policies required from Commonwealth, State and Territory governments. CoAG requested that the MCE oversee the review process. The final report of the review (the CoAG Review) was published on 20 December 2002.

In 2001, CoAG also acknowledged the convening of the National Electricity Market (NEM) Ministers Forum comprising Ministers from New South Wales, Victoria, Queensland, South Australia and the Australian Capital Territory with specific responsibilities for the NEM. CoAG requested that the Forum report to CoAG on its work program.

Since its establishment, the Forum has undertaken substantial work on reform of the NEM, in particular its framework for governance, regulation, transmission development, pricing and the facilitation of demand management, and has reported to CoAG on that work.

On 29 November 2002, following consideration of the draft report of the CoAG Review and a presentation to the MCE by the CoAG Review panel members, the MCE agreed to report to CoAG on energy market reform, addressing the MCE's priority tasks, the findings and recommendations of the CoAG Review, and the policy development work undertaken by the NEM Ministers Forum.

The MCE met on 13 June, 1 August and 11 December 2003, and has adopted this report. Several key agreements were announced following the June and August meetings. These have been further developed, and are incorporated in this report.

The MCE considers that the recommendations in this report constitute a substantial response to the CoAG Review, and provide the basis for development of a truly national and efficient energy market.

2. Summary of CoAG Review Findings

The CoAG Review found that substantial progress on energy market reform has been made in Australia, and that significant benefits have arisen from that reform. The MCE agrees with this finding. Since the reform program has commenced, there has been:

- Considerable integration of the wholesale electricity markets in Victoria, New South Wales, Queensland, the ACT and South Australia.
- Substantial investment in new electricity generation and gas production, and in electricity and gas transmission interconnection between States in eastern and south eastern Australia.
- A substantial productivity improvement through greater generator availability.
- Vigorous retail competition in the medium and large business sector (which has delivered significant benefits), and accelerating competition in the newly opened household and small business markets in NSW and Victoria.
- High levels of supply security, and improvements in network reliability.
- The pursuit of consistency with arrangements elsewhere by Western Australia, a non-interconnected jurisdiction, in reforming its electricity and gas markets.

Energy Ministers also concur with the CoAG Review that substantial policy issues remain to be resolved if the full benefits of market reform are to be realised. A second phase of market reform is required, involving co-ordinated action by the Commonwealth, States and Territories, to capture those benefits.

Ministers therefore agree that further reform should be undertaken to:

- Strengthen the quality, timeliness and national character of **governance** of the energy markets, to improve the climate for investment.
- Streamline and improve the quality of **economic regulation** across energy markets, to lower the cost and complexity of regulation facing investors, enhance regulatory certainty and lower barriers to competition.
- Improve the planning and development of **electricity transmission** networks, to create a stable framework for efficient investment in new (including distributed) generation and transmission capacity.
- Enhance the participation of **energy users** in the markets, including through demand side management and the further introduction of retail competition, to increase the value of energy services to households and business.
- Further increase the penetration of **natural gas**, to lower energy costs and improve energy services, particularly in regional Australia, and reduce greenhouse emissions.
- Address **greenhouse emissions** from the energy sector, in the light of concerns about climate change and the need for a stable long-term framework for investment in energy supplies.

This report agrees to principles and directions for reform in each of the above areas. It outlines the key issues that need to be resolved in finalising the details of the reform program, and the processes and timelines by which this is proposed to occur.

3. Summary of MCE Recommendations

The MCE recommends the following reform package to CoAG:

Governance of Energy Markets

- The Ministerial Council on Energy to subsume the NEM Ministers Forum on 1 July 2004, establishing a single energy market governance body. Transition measures to include:
 - Commonwealth and Tasmania to immediately join the NEMMF as full members;
 - WA and NT to participate in the NEMMF as observers.
- A national legislative framework to be agreed, and developed on a collaborative basis between the Commonwealth, States and Territories, under a new inter-governmental agreement.

Economic Regulation And Rule Making

- Two new statutory commissions to be established on 1 July 2004, funded by industry levy:
 - Australian Energy Market Commission (AEMC), with responsibility for rule-making and market development;
 - Australian Energy Regulator (AER), with responsibility for market regulation.
- The AER to be a constituent part of the ACCC but operate as a separate legal entity. State jurisdictions to appoint two AER Members, with the third drawn from the ACCC. Chair to be agreed by both the Commonwealth and majority of states/territories.
- The AEMC to also be a separate legal entity, accountable to and subject to the power of policy direction from the MCE. The AEMC to comprise three Members, with two (including the Chair) appointed by the states.
- The new bodies to initially be responsible for electricity wholesale and transmission in the connected (NEM) jurisdictions, extended in 2005 to include gas transmission for all other than WA (in accordance with the *CoAG Natural Gas Pipeline Access Agreement of 1997*). Provision to be made for WA and NT to join for electricity, and WA for gas under the AER, by agreement. NECA to be abolished after establishment of AER and AEMC.
- The ACCC to retain responsibility for competition regulation under Part IV of the *Trade Practices Act*, for competition-related code-change authorisations under Part VII, and for industry access code approvals under Part IIIA.
- The new regulatory arrangements to provide for consultation and cooperation between the AEMC, AER and ACCC. The code change and authorisation process to be streamlined, to avoid duplication. The AEMC and AER to have specific consultation obligations. End-user and industry consultation in developing code changes to be strengthened.
- Agreement in-principle to development of a national approach to energy access under the *TPA*, covering electricity and gas transmission and distribution, to be considered by the MCE in 2004. Streamlined procedures for ACCC approvals and acceptance of access-related code changes under Part IIIA of the *TPA* to be developed and agreed by the MCE.
- Agreement that the AER will be responsible for the regulation of distribution and retailing (other than retail pricing), following development of an agreed national framework. Work will commence on the national framework in 2004, and the MCE will consider the outcome in 2005. Following MCE agreement on the framework, the AER will assume responsibility for national regulation of distribution and retailing (other than retail pricing) by 2006. Any jurisdiction may, at their discretion, opt to transfer responsibility for retail pricing to the AER once it has assumed distribution and retail responsibilities.

Electricity Transmission

- A new NEM transmission planning function to be developed, including an Annual National Transmission Statement (commencing in 2004) and a last resort power to direct that a project be subjected to the regulatory test.
- A new regulatory test for transmission to include the full economic benefits of increased competition, to be implemented in July 2004.
- A new process to be developed for assessing wholesale market regional boundaries, while maintaining jurisdictional boundaries for retail customer pricing. Initial report in June 2004.
- Improvements to inter-regional financial trading arrangements, to be evaluated in conjunction with future arrangements for regional boundaries.
- Market-based incentives for transmission performance to be developed, by July 2004.
- Conclude the review of transmission pricing arrangements, for implementation in 2004.

- Removal of existing biases in favour of unregulated transmission investment, in mid 2004. The code changes to recognise and protect the rights of existing investors in market transmission services.

User Participation

- In all jurisdictions where full retail competition is operating, each jurisdiction to align their retail price caps with costs, and periodically review the need for price caps.
- The MCE to examine options for a demand-side response pool in the NEM, and consider the costs and benefits of introducing interval metering.

Natural Gas Penetration

- The MCE welcomes the Productivity Commission review of the National Gas Access Regime, and will be responding to the recommendations in 2004.
- The MCE notes the direction of the CoAG review to preclude future state exemptions from joint marketing provisions. Proponents of future arrangements for the joint marketing of gas, which raise competition concerns, may seek authorisation by the ACCC on a case by case basis. The Ministerial Council on Mineral and Petroleum Resources (MCMPR) is considering this issue.
- The MCE notes that the MCMPR is also considering the appropriate treatment of unproduced areas in existing production licences that are due for renewal, and to review the gas industry's principles for third party access to upstream facilities, and to advise the MCE of its conclusions.

Greenhouse Emissions

- The MCE to work closely with the CoAG High Level Group on Greenhouse to address greenhouse gas emissions from the energy sector on a national basis.
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4. Recommended Reforms

Ministers have agreed that reforms should be implemented on key national energy market issues, and that further work be undertaken on other matters, as outlined below.

4.1 Governance of Energy Markets

The successful functioning of Australia's energy markets requires sound policy oversight by the responsible governments. Responsible governance is required to develop and administer the legislative framework within which the markets operate and natural monopolies are regulated, to make appointments to statutory bodies that determine market rules and undertake regulation, and to provide policy direction where appropriate. Governments should not be directly engaged in the day-to-day operation of markets or the conduct of regulators, but must focus on longer-term, systemic and structural issues that affect the public interest.

The following proposed reforms will clearly establish MCE responsibility for national energy market institutional arrangements and policy.

(a) From 1 July 2004, the National Electricity Market (NEM) Ministers Forum, which currently provides policy and governance responsibilities for the NEM, is to be replaced by the Ministerial Council on Energy (MCE), thereby establishing a single energy market governance body. The voting rules and procedures will be agreed by all jurisdictions before the MCE assumes its expanded role. It is expected that only NEM jurisdictions will make legislative decisions on matters that solely impact on them.

(b) The existing legislative framework that gives effect to the rules of the National Electricity Market and the network access regimes for electricity and gas is to be simplified and amended to implement the agreed reforms, and to streamline arrangements wherever possible. This will require the introduction of an agreed national legislative framework for the Australian energy market, on a collaborative basis between Commonwealth, State and Territory governments, pursuant to a new inter-governmental agreement between all jurisdictions. The policy oversight legislative provisions recently considered by the NEMMF will be incorporated in the new national framework.

(c) In the period up to 1 July 2004, the work of the Ministerial Council on Energy in providing strategic direction for energy market reform and governance of the gas market is to be better coordinated with that of the NEM Ministers Forum in providing governance of the National Electricity Market, through the following measures:

- each jurisdiction will nominate the same Minister as its member of each body;
- the Commonwealth and Tasmania to become full members of the NEM Ministers Forum;
- the NEM Ministers Forum to invite Western Australia and the Northern Territory to participate as observers as soon as possible; and
- regular consultation on the work programs and meeting dates of the two bodies.

4.2 Economic Regulation

Effective economic regulation is a key to successful market reform. The regulation of network access (prices and standards) seeks to balance energy users' short-term interests in price benefits with their long-term interests in a reliable supply, service enhancements and timely investment in new capacity. The making of market and regulatory rules aims to provide reasonable stability to market participants, while ensuring that the rules can evolve to meet challenges that will inevitably arise. The enforcement of those rules maintains an important discipline on market conduct.

Sound economic regulation requires expertise, independence from commercial interests, and close consultation with affected parties. The processes must be made more efficient and streamlined, responsive to market developments, and occur within a clear framework of government policy. Regulation should be nationally uniform or consistent, as appropriate, to maximise competition and reduce the cost to business of operating across the markets.

The MCE proposes the establishment of two new statutory bodies to undertake these tasks. One body will focus on rule-making and market development, the other on network access regulation and market rule enforcement. The target date for the commencement of operation of these bodies is 1 July 2004.

These bodies will first be responsible for electricity wholesale and transmission within the connected (NEM) jurisdictions. These arrangements will subsequently be extended to include gas transmission, which will apply to all jurisdictions other than WA in respect to the access regulator, in accordance with the *CoAG Natural Gas Pipelines Agreement of 1997*. The new statutory bodies will not have jurisdiction in WA or the NT with respect to electricity, and gas as noted above, but provision will be made for them to join by agreement.

No changes are proposed to the core functions or structure of the National Electricity Market Management Company Limited (NEMMCO). Cooperative arrangements will be developed between all energy market bodies. In particular, a Memorandum of Understanding will be developed between the two new statutory bodies and the ACCC, for endorsement by the MCE, defining consultation, code authorisation and acceptance, information exchange, staffing and location arrangements.

The proposed new regulatory framework is outlined below, and described in more detail in Appendix 2. The MCE will periodically review the effectiveness of the new regulatory framework.

4.2.1 Rule-Making and Market Development

(a) An **Australian Energy Market Commission** (AEMC) will be established by 1 July 2004, accountable to and subject to the power of policy direction from the MCE. The core functions of the AEMC will include rule-making (code changes) and undertaking reviews, as directed by the MCE, including all code change and market development functions currently performed by the National Electricity Code Administrator, National Gas Pipelines Advisory Committee and the Code Registrar. The AEMC's role in market development will be further developed by the MCE. The Australian Energy Market Commission will have no regulatory enforcement responsibilities, and will not itself be able to initiate code changes other than of a minor administrative nature.

(b) The AEMC will be a statutory commission appointed by Ministers and funded through an MCE-approved industry levy. The AEMC will comprise three Members, with two (including the Chair) appointed by the states. Further details are in Appendix 2. Provision will be made for Western Australia and the Northern Territory to participate in the AEMC at a future time on electricity matters, on decision of each jurisdiction, in consultation with the MCE. All jurisdictions will be subject to the AEMC with respect to gas and broad energy review issues.

(c) The MCE will establish a more structured and transparent code-change process to be followed by the AEMC, in which market participants, end-users, the Australian Energy Regulator (refer to 4.2.2 below) and the Australian Competition and Consumer Commission (ACCC) will be involved, as outlined in Appendix 2. The AEMC may, in consultation with the ACCC, seek ACCC authorisation under Part VII of the *Trade Practices Act 1974*, of code changes that raise competition issues.

(d) The AEMC will focus initially on proposed changes to the National Electricity Code. It will take responsibility for the National Gas Code, following MCE consideration of the current review of the National Gas Access Regime (refer to 4.5 below).

4.2.2 Market Regulation

(a) An **Australian Energy Regulator (AER)** will be established by 1 July 2004, with initial responsibility for economic regulation of electricity wholesale and transmission networks and key rule enforcement functions. The AER will exercise powers under an agreed new national energy legislative framework, including the National Electricity Law and the National Electricity Code, and undertake the sector-specific regulatory functions of the ACCC and the National Electricity Code Administrator (NECA). NECA will be abolished after establishment of the AER and AEMC.

(b) Like the AEMC, the AER will be a statutory commission and funded through an MCE-approved industry levy. The AER shall comprise three Members, two appointed by the states and one from the ACCC. The AER Chair will be appointed by agreement of both the Commonwealth and a majority of the states/ territories, for an initial term of three years. The AER will be a constituent part of the ACCC but will operate as a separate legal entity. This means that the members that constitute the AER will, with respect to the functions conferred upon the AER, make the final decision. Provision will be made for Western Australia and the Northern Territory to participate in the AER at a future time on electricity matters, and also for WA on gas matters, on decision of each jurisdiction, in consultation with the MCE.

(c) The AER will operate within an enhanced framework of accountability to governments and market participants through clear consultation, reporting and transparency obligations and accessible avenues of appeal against regulatory decisions.

(d) The responsibilities of the AER are to be extended to include gas transmission within 12 months and by no later than 30 June 2005 (other than for Western Australia, as previously noted). Other regulatory responsibilities in regard to gas will be determined by the MCE following consideration of the review of the National Gas Access Regime.

(e) Ministers agree in-principle to development of a national approach to energy access, covering electricity and gas transmission and distribution, under the *Trade Practices Act 1974*, subject to consideration of the outcomes of the gas access review. Streamlined procedures for ACCC approvals and acceptance under Part IIIA will be developed under the MoU and agreed by the MCE. As currently provided for, the Federal Treasurer will consider any proposal to certify the NEM as an effective state-based access regime (similar to gas).

(f) Ministers agree that the AER will be responsible for the regulation of distribution and retailing (other than retail pricing), following development of an agreed national framework. Work will commence on the national framework in 2004, and the MCE will consider the outcome in 2005. Following MCE agreement on the framework, the AER will assume responsibility for national regulation of distribution and retailing (other than retail pricing) by 2006. Any jurisdiction may, at their discretion, opt to transfer responsibility for retail pricing to the AER once it has assumed distribution and retail responsibilities.

(g) The ACCC will continue to exercise its general competition regulatory powers under Part IV of the *Trade Practices Act 1974*.

4.2.3 Consultation and Cooperation

(a) The new regulatory arrangements will provide for consultation and cooperation between the AEMC, AER and ACCC, and will avoid the duplication of regulatory processes. The code change and authorisation process will be streamlined, with the cooperative arrangements specified in the Memorandum of Understanding. In considering applications for authorisation or approval of code

changes, the ACCC will have the discretion to use the AEMC's analysis, assessment and consultation process.

(b) The AEMC and AER will have specific consultation obligations, including for submissions, hearings, draft and final decisions. End-user and industry consultation in developing code changes will be strengthened. The AEMC will be required to consider the long term interests of consumers in making code change decisions. Further details on streamlining, consultation and cooperation are provided in Appendix 2.

4.3 Electricity Transmission

The transmission network provides a fundamental transportation function for electricity, and its effective operation is vital to competition in electricity generation and retailing. The transmission policy framework must strike a balance between system security, reliability, efficient investment and dispatch, while also allowing retail price outcomes and financial risks to be effectively managed.

The current regulatory arrangements have delivered high levels of transmission system reliability. Around 80% of transmission investment in the National Electricity Market (NEM) relates to the reliability of the networks, mostly within regions, providing a high degree of confidence in reliability-related investment. Some constraints have however persisted, which could be mitigated by additional transmission investment where this is the most efficient option. While transmission accounts for less than 10% of the total cost of delivered electricity, inadequate levels of transmission can result in inefficient energy price outcomes.

The MCE has adopted the following principles to underpin transmission policy in the NEM:

- The transmission system fulfils three key roles - it provides a transportation service from generation source to load centre, facilitates competition, and ensures secure and reliable supply.
- There is a central and ongoing role for the regulated provision of transmission, with some scope for competitive (market) provision.
- Transmission investment decisions should be timely, transparent, predictable and nationally consistent, at the lowest sustainable cost.
- The regulatory framework should maximise the economic value of transmission, including through the efficient removal of regional price differences in the operation of the NEM.

Within these principles, the MCE has agreed to a package of reforms addressing seven key transmission issues.

(a) National transmission planning. A new NEM transmission planning process will be established to improve consistency, transparency and economic efficiency, particularly for inter-connector development, comprising:

- An Annual National Transmission Statement (ANTS) which will detail the major national transmission flow paths, forecast inter-connector constraints, and identify options to relieve constraints. The ANTS will be developed by NEMMCO, in conjunction with market participants, with the first statement to be published in mid 2004.
- A last resort planning power, to be exercised by the AEMC, to direct that inter-connection projects be subjected to the regulatory test (revised, as below).

The transmission planning process will be developed in 2004 and then implemented by a panel of industry representatives, established by the AEMC with technical support from NEMMCO, following a code change process managed by the AEMC.

(b) New regulatory test. A new regulatory test will be implemented to recognise the full economic benefits of transmission including where transmission is the most efficient means of mitigating market power. The new test will remove inefficient impediments to regulated transmission in dispute resolution, and information requirements. The MCE will develop code changes for implementation in July 2004. These changes will take account of the ACCC's current review of the regulatory test.

(c) Regional boundaries. The MCE agrees that jurisdictional boundaries should be maintained for retail customer pricing. However, a new and more transparent process is required to enable assessment of regional boundary changes for the wholesale market to facilitate investment and more efficient operation of the NEM. This process will ultimately be managed by the AEMC. As a first step, the MCE will commission an independent economic study to develop the criteria and process for boundary changes, and initial boundary change options, to report to the MCE by June 2004. The boundary change process must include sufficient lead time to address commercial and economic considerations. This initial review will involve wide market consultation.

(d) Inter-regional financial trading. The MCE considers that the primary role of financial transmission rights (an inter-regional trading instrument) is to provide a risk management tool for energy trading, and that further development of such arrangements may be desirable. The MCE will direct NECA/AEMC to consider the requirement for and scope of enhanced inter-regional trading arrangements, in conjunction with the development of the future process for managing regional boundary changes. The AEMC, in consultation with market participants, will take into account the existing work of NEMMCO.

(e) Transmission availability incentives. Transmission companies are currently subject to service availability and capacity requirements. However, the MCE considers that there would be valuable customer and investor benefits in more closely aligning transmission performance measures with their market impact. The MCE supports the current consideration by the ACCC of incentives for availability. Incentive arrangements should analyse the actual cost of constraints, set targets for circuit availability, and reward or penalise transmission companies for diversion from those target levels. These arrangements should be implemented in 2004.

(f) Transmission Pricing. The previously established process for improving the structure of transmission pricing should continue through the AEMC, based on full consultation with market participants, for implementation in 2004.

(g) Regulation of new inter-connectors. The MCE believes that the current arrangements for the co-existence of regulated and market provision of transmission have not resulted in optimal outcomes, and supports removal of biases towards unregulated investment. The MCE will develop code changes that establish a level playing field between regulated and market transmission for implementation in July 2004. The code changes would recognise and protect the rights of existing investors in market transmission services.

(h) Facilitation of current projects. In order to facilitate existing projects between now and the establishment of the code changes referred to in paragraphs (b) and (g) above, the MCE agrees to seek derogations from the National Electricity Code to give interim effect to those changes.

4.4 User Participation in Energy Markets

The active participation of both energy users and suppliers is important to achieve effective competition and maximise the benefits of market reform. It is generally recognised that user participation in the energy market is currently less active than supplier participation.

In all jurisdictions where full retail competition is operating, transition measures have been applied to retail prices for households and small businesses, either to protect consumers entering the competitive market from the exercise of market power by retailers, or to achieve a measure of price equality between city and regional areas.

The MCE supports the further introduction of retail competition across the national energy market, noting that its implementation must be guided by local circumstances, particularly the need to protect consumers. In all jurisdictions where full retail competition is operating, retail price caps will be aligned with costs, and the need for the caps will be reviewed periodically.

Ministers will examine the scope for facilitating the commercialisation or establishment of a demand side response pool in the NEM, taking into account the CoAG Review's proposal for a 'pay-as-bid' mechanism and the aggregation facility trialled by the Energy Users Association of Australia. Ministers also noted the current work on the costs and benefits of interval metering in the NEM.

4.5 Natural Gas Penetration

Natural gas is expected to play a growing role in Australia's energy supply, due to its versatility in direct use, electricity generation and transport, its potential for lower transmission costs and its low greenhouse emissions relative to other fossil energy sources. Australia's gas markets are developing with the discovery of new reserves, increased exploration expenditure, and the construction of interstate pipelines. Further, the electricity and gas sectors are converging through the growing use of gas for electricity generation and the emergence of 'dual-fuel' retailing.

The MCE notes the national importance of gas supply in the national energy framework, and of policies which encourage efficient investment in Australian oil and gas exploration and development and which facilitate the creation of domestic gas markets. The medium to long term supply of gas to eastern Australia will be considered in the context of security of supply, greenhouse response and cost to consumers.

Investment in greenfield gas pipelines and networks is expected to be facilitated through the Productivity Commission review of the National Gas Access Regime, as announced on 13 June 2003. The Commission is to report within 12 months on:

- the benefits, costs and effects of the Gas Access regime, including its effect on investment in the sector and in upstream and downstream markets;
- improvements to the Gas Access Regime, its objectives and its application;
- how the Gas Access regime might better facilitate a competitive market for energy services;
- the appropriate consistency between the Gas Code, National Access Regime and other regimes;
- the institutional and decision making arrangements under the Gas Access Regime, and
- the appropriateness of including in the Gas Code minimum (price and non-price) requirements for access to users.

The MCE looks forward to responding to the Productivity Commission report in 2004.

MCE Ministers note the direction of the CoAG Review's recommendation to preclude states from exempting future arrangements for the joint marketing of natural gas from the competition rules of the *Trade Practices Act 1974*. Proponents of future arrangements for the joint marketing of gas, which raise competition concerns, may seek authorisation by the ACCC on a case by case basis. This issue is currently being considered by the Ministerial Council on Mineral and Petroleum Resources (MCMPR).

The MCMPR has agreed to consider the appropriate treatment of unproduced areas in existing production licences which are due for renewal, and to review the gas industry's principles for third party access to upstream facilities, and to advise the MCE of its conclusions.

4.6 Greenhouse Emissions from the Energy Sector

The energy sector is a significant contributor to Australia's greenhouse gas emissions profile. The MCE, in consultation with the CoAG High Level Group on Greenhouse, will be striving to address the greenhouse related aspects of further energy reforms, taking into account both the current and future needs of the energy sector and its stakeholders.

A holistic, integrated policy approach is required to give energy sector investors reasonable certainty about their greenhouse obligations, while maintaining the international competitiveness of Australian industry. Any abatement measures should be designed to be nationally consistent, and consistent with a future international scheme to the extent this can be predicted, and should utilise market mechanisms where this would be most efficient and effective.

A package of non-market abatement measures may be required to complement market measures, and sectoral differences may need to be recognised. Such measures need to be sufficiently balanced so as to achieve mitigation objectives while sharing the collective burden across all sectors of the economy.

The Mandatory Renewable Energy Target (MRET) scheme is currently the subject of a separate review, to be reported in January 2004. The review is examining a number of issues including eligible fuel sources and the size of the current target. The outcome of this review will have implications for the energy market, and the MCE will be closely monitoring the impact of the review on the stability of investment in the energy sector.

The States and Territories consider that the CoAG Review's proposed abolition of the MRET scheme is inconsistent with the requirement for reasonable stability in the investment framework, and propose that the Commonwealth clarify its position on the CoAG Review's proposal to abolish MRET through the current review of the scheme.

The MCE proposes to play an active role (in consultation with the High Level Group on Greenhouse) in advising CoAG on the options for and the implications of greenhouse abatement options for investment in the energy sector, given the implications for supply security, fuel mix and prices.

5. Timeline for Further Work

Ministers propose to initiate a substantive work program to implement the proposals in this report. Indicative timelines for key initiatives (refer to Section 4) and decision points are outlined below.

2003

Governance	Commonwealth and Tasmania to join NEMMF. WA and NT to become observers on NEMMF. Commence developing new intergovernmental agreement, including policy role of the MCE to replace the NEM Ministers Forum.
Regulation	Commence developing legislative and structural arrangements for: <ul style="list-style-type: none">• Australian Energy Market Commission (AEMC); and• Australian Energy Regulator (AER).
Transmission	Consider institutional and regulatory policy framework, including transmission planning and regional boundaries.
User Participation	Commence evaluation of costs and benefits of demand side response pool and interval metering in the NEM.
Distribution & Retailing	MCE to agree scope of task to develop national regulatory framework.
Gas Access Regime	Productivity Commission to commence review.
Gas Development	Ministerial Council on Minerals and Petroleum Resources to review treatment of licensed unproduced areas and access to upstream facilities.

2004

Governance	MCE to assume electricity market policy role of NEMMF.
Regulation	Implement legislative framework and establish AEMC and AER.
Transmission	Implement NEM transmission planning process, transmission performance incentives and transmission pricing arrangements. Consider boundary review report. Implement new regulatory test and remove market biases.
User Participation	Consider outcomes of NEM demand side response pool and interval metering reviews.
Distribution & Retailing	Commence development of a national regulatory framework.
Energy Access	Decide MCE response to recommendations of the Productivity Commission review of National Gas Access Regime. Consider development of a national approach to energy access.

2005

Gas Regulation	Extend responsibilities of AER to gas transmission (other than in WA), and any other functions as agreed.
Distribution & Retailing	Agree national regulatory framework.

2006

Distribution & Retailing	Implement agreed national regulatory framework. Transfer regulation (other than retail pricing) to AER.
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A detailed work plan has been developed and approved by the MCE to implement this program. Energy market stakeholders on both the supply and demand side, and market institutions including regulators, will be consulted on implementation of the reform program.

A National Energy Policy Framework

Governments agreed to establish a national energy policy framework to guide future energy policy decision-making by jurisdictions and to provide increased policy certainty for energy users, including households and small business, and for the energy sector.

Agreed Objectives

CoAG agreed to the following national energy policy objectives:

- Encouraging efficient provision of reliable, competitively priced energy services to Australians, underpinning wealth and job creation and improved quality of life, taking into account the needs of regional, rural and remote areas;
- Encouraging responsible development of Australia's energy resources, technology and expertise, their efficient use by industries and households and their exploitation in export markets; and
- Mitigating local and global environmental impacts, notably greenhouse impacts, of energy production, transformation, supply and use.

Agreed Principles

Consistent with these agreed objectives, and in light of their responsibilities under the Constitution, all Australian Governments agreed that their energy policies will:

- Recognise the importance of competitive and sustainable energy markets in achieving these objectives;
- Continuously improve Australia's national energy markets, in particular between and among jurisdictions and - recognising growing convergence between energy markets - between energy sources, and supply and demand side opportunities;
- Enhance the security and reliability of energy supply, encompassing resource availability, conversion, transportation and distribution, and recognising the impact of government policy and the regulatory environment on private sector investment and operation;
- Stimulate sustained energy efficiency improvements to technologies, systems and management proficiency across production, conversion, transmission, distribution and use;
- Encourage the efficient economic development and increased application of less carbon-intensive (including renewable) energy sources and technologies, including exploring opportunities for appropriate inter-fuel substitution;
- Recognise that Australia's energy markets operate in the context of world energy markets and seek to enhance Australia's international competitiveness in these markets;
- In view of the importance of long term investment in the energy sector, provide the degree of transparency and clarity in government decision-making required to achieve confidence in current and future investment decisions;
- Carefully consider the social and economic impacts on regional and remote areas, with particular regard to businesses, industries and communities; and
- Facilitate constructive, effective inter-jurisdictional co-operation and productive international collaboration on energy matters.

8 June 2001

Proposed New Regulatory Framework

1. Regulatory Bodies

- **Memorandum of Understanding.** A MoU will be established between the Australian Energy Market Commission (AEMC), Australian Energy Regulator (AER) and the Australian Consumer and Competition Commission (ACCC), to be endorsed by the MCE, addressing consultation, cooperation, code-change authorisation and staffing arrangements.
- **Establishment of the AER and AEMC as independent legal entities.** The AER and AEMC will be established as independent legal entities under an MCE agreement that involves amendments to the *Trade Practices Act 1974* to establish the AER under the umbrella of the ACCC. An agreed cooperative legislative framework will be enacted to legislate their powers, roles and responsibilities.
- **AER membership.** The AER will comprise three members, two appointed by the states and one drawn from the ACCC. Members will be appointed for a term of up to 5 years.
- **AER Chair.** The AER Chair will be appointed by agreement of both the Commonwealth and a majority of the states/territories, for an initial term of three years.
- **AER Responsibilities.** The AER will initially be responsible for electricity and gas transmission and matters covered by the electricity and gas codes. From 2006 the AER will also have responsibilities for electricity and gas distribution and retail regulation (other than retail pricing). An agreed framework will be developed to implement this.
- **AEMC membership.** The state jurisdictions will appoint a majority of the AEMC's members (two of the three AEMC members, including the chair). The remaining member will be appointed by the Commonwealth. Members will be appointed for a term of up to 5 years.
- **Location of the AER and AEMC.** To enhance their visibility the AER and AEMC will be located separately from the ACCC.
- **AER and AEMC staffing.** The proposed staffing arrangements will allow the AER and AEMC to be provided with the best available expertise from the ACCC, other regulatory bodies and elsewhere. AER staff will be employed directly by the ACCC. AEMC staff will be employed directly by the AEMC. Staff employed by the ACCC and required by the AER will be seconded by the ACCC to the AER on a straight cost recovery basis. The secondment arrangements, including senior management of the AER will be by mutual agreement between the AER and the ACCC. The CEO of the AER will be chosen by the AER Members, following agreement with the ACCC.
- **Funding.** Funding for the AER and the AEMC will be through appropriate industry levies, approved by the MCE.
- **Information exchange.** The MoU between the ACCC and the AER will determine the protocols for information exchange between the two entities.

2. Regulatory Procedures

The AEMC and the AER will operate within a clear framework of accountability, with no unnecessary duplication of regulatory procedures. The key features of that framework are:

- **Policy direction.** Ministers acting jointly will have power to issue binding policy directions on, and commission inquiries by, the AEMC.
- **Power to initiate amendments.** The AEMC will have no power to initiate amendments to market and regulatory rules – the National Electricity Code and the National Gas Code – other than those

of a minor or administrative nature, to ensure that rule making is responsive to the needs of the market.

- **Obligation to consider.** The AEMC will be bound to consider all developed proposals for rule changes that are submitted by market participants, user representatives, market operators and governments, and will have power to reject, amend or approve those proposals with written reasons.
- **Obligation to consult.** The AEMC and AER will have specific consultation obligations, in particular to invite submissions and hold hearings before issuing draft and final decisions on substantive rule changes and access determinations.
- **Working Groups.** The AEMC will be required to establish working groups to achieve maximum stakeholder agreement on contentious aspects of rule changes.
- **Net benefit test.** The AEMC will be required to apply a net benefit test based on the achievement of the market objectives, including the long term interests of consumers, in deciding whether to approve a rule change.
- **Penalties.** The AEMC will have no power to create or impose penalties for non-compliance with market rules.
- **AEMC to assess competition, access and consumer impacts.** The AEMC will be required, in making Code changes, to assess and report on the competition and access impacts of those changes, to assist the ACCC in considering whether to authorise Code changes under Part VII of the TPA and/or to approve access code changes under Part IIIA.
- **AEMC and AER to advise the ACCC.** The AEMC and AER will be required to advise the ACCC, on its request, on matters pertaining to the authorisation or approval of Code changes (subject to limitations on the disclosure of confidential data).
- **ACCC to have discretion not to conduct full consultation.** In considering applications for authorisation or approval of Code changes, the TPA will be amended to give the ACCC discretion not to seek submissions or undertake consultation, thereby allowing it to rely on the submissions received and consultation undertaken by the AEMC, in addition to any further advice it might specifically seek from the AEMC, AER or other party. The Memorandum of Understanding between the ACCC, AER and AEMC will, amongst other things, address the circumstances in which full consultation may be undertaken by the ACCC.

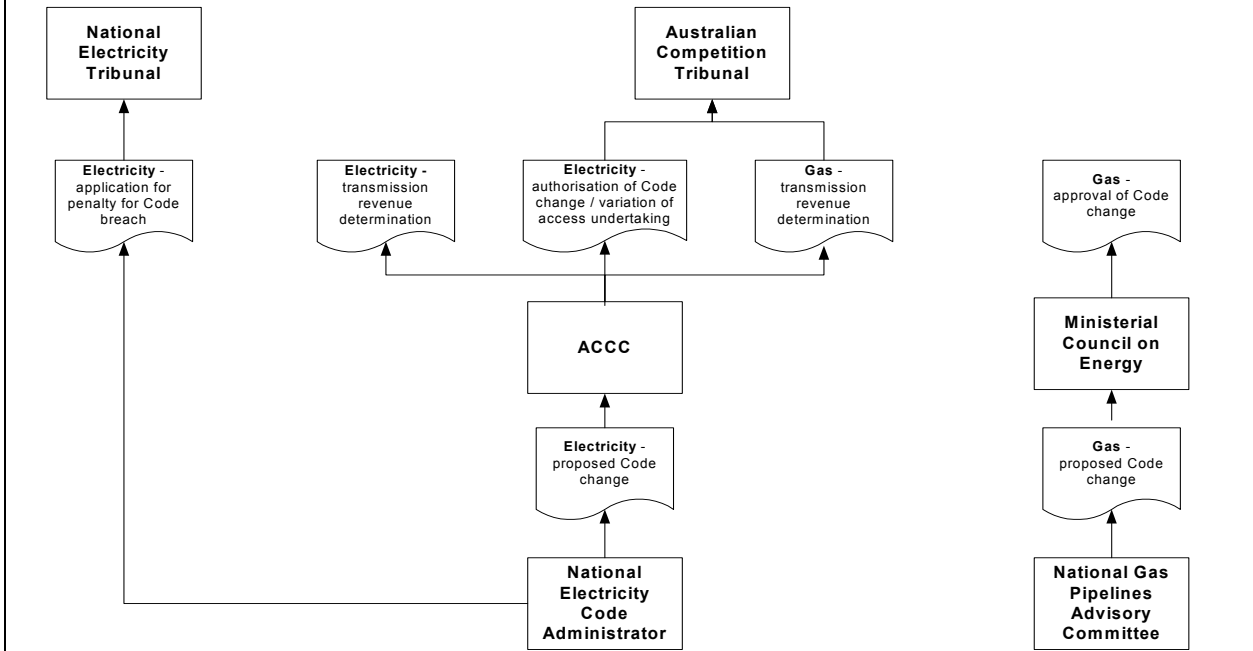
3. Rights of Review

- The right of **judicial review** on questions of law will be available for all decisions of the AER and ACCC.
- As appropriate, **market participants** will have access to funding to participate in regulatory proceedings, under arrangements to be determined by the MCE.
- The appropriate courts will apply **penalties** on application of the AER. The National Electricity Tribunal will be abolished, with transition arrangements to be established.

The existing and proposed new regulatory frameworks are outlined in the following diagrams.

Regulation of the energy markets - current model

3 December 2003



Regulation of the energy markets - proposed model

3 December 2003

