

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

Dear Sir/Madam

Proposed National Electricity Rule Change Process

The National Generators' Forum is writing in response to the Consultation Paper *Proposed National Electricity Rule Change Process* released on 9th August 2004 by the Ministerial Council on Energy's Standing Committee of Officials. The Consultation Paper outlines a new model for administering changes to the rules governing the National Electricity Market, including the making of policy affecting those rules.

All systems of exchange require the confidence of their participants for success. If participants are to have confidence in a complex planned system such as the NEM then political and regulatory risk ought to be minimised. The NGF believes this goal can be achieved through sound policy and rule-making processes and certainty that participants' compliance with the rules does not place them in jeopardy. The NGF has assessed the proposal against these tests. It considers that a number of revisions to the proposal and further information are needed before participants can have confidence in the proposed policy and rule-making processes.

The Statutory Rules and the *Trade Practices Act 1974*

The NGF believes that placing the rules for the NEM in a statutory instrument might leave participants exposed to actions for breaches of the restrictive trade practices provisions of the *Trade Practices Act 1974*. Currently, the National Electricity Code is authorised by the ACCC under the general authorisation provisions of the TPA, ensuring that participants following the Code do not infringe the TPA. Given that NEM participants are required to make very large investments – often in the order of thousands of millions of dollars to enter the market – this protection is reasonable. Further, authorisation as part of the rule-making process also protects the employees of participants who trade in the NEM and implement the Code.

The NGF understands the SCO's view that making the Code a statutory instrument will mean that participants complying with the rules will be obeying the law and not engaging in conduct prohibited by the TPA. Nonetheless, even if the SCO has legal opinions supporting its view, the NGF believes that participants and their employees are entitled to a degree of legal certainty that is equivalent to that presently provided.

If governments do not take steps to provide this certainty, individual participants may seek TPA authorisation of the rules to ensure they are protected. What happens if the ACCC refuses to grant an authorisation because it found there would be no net public benefit from the thing for which authorisation was sought? This would lead to conflicting positions being adopted by different regulators and create even more uncertainty for market participants.

The NGF would appreciate the opportunity to review and comment on the drafting of the market rules which governments propose to make into law. This will allow practical discussion between officials and NGF representatives about whether the draft statutory rules will afford participants the appropriate TPA immunity while enabling the market's smooth operation.

Standing to initiate rule change proposals

It is proposed that the Australian Energy Market Commission is to adopt a role as "gatekeeper" to "ensure that only adequately developed Rule Change Proposals go forward". However, as the AEMC will be an administrative body, it will be subject to judicial review of each decision it makes, including acceptance of a rule change proposal as well as its final determination on a rule change proposal. For example, if "any person" makes an application for a rule change and the AEMC in its "gatekeeper" role rejects that application, that decision will be capable of being subject to judicial review. Although any person will be able to initiate a rule change proposal it is market participants who actually bear the consequences and risks of those proposals. In considering the issue of standing to initiate a rule change proposal, governments must ensure that the design and the objectives of the NEM are not compromised.

Proposed primary market objective and the assessment of rule change proposals

The NGF believes that the proposed primary market objective is internally inconsistent and may distort the market given its mixed references to the interests of consumers in price, quality and reliability on the one hand, and economically efficient investment and innovation on the other. It is probable that the adoption of the proposed market objective will lead to confusion or regulatory inconsistency, and so increase the long term regulatory risk of participants.

The NGF considers that the intended benefits of the market are much more likely to be achieved through a simple objective which focuses on economic efficiency without reference to the interests of any sector in the outcomes of the market, and recommends the following primary market objective:

"In order to justify a change to the rules, a proponent must clearly demonstrate that the proposed change will produce a net benefit in terms of the efficient operation and use of and investment in the electricity supply industry relative to the current rules."

If this objective is achieved then the interests of all groups affected by the NEM will have been promoted appropriately.

The NGF also believes that the AEMC should be required to apply criteria for good rule making practice to its decision making in pursuit of the market objective. These criteria would include:

- Clarity of purpose and meaning;
- Avoidance of possible bias;

- Regulatory accountability;
- Minimisation of the risk and adverse social consequences of error; and
- Transactional efficiency, including administrative costs for market participants.

The application of such criteria will strengthen participants' confidence in the rule-making process.

The NGF has obtained advice on these issues from Synergies (see attached paper) and refers the SCO to that advice. The NGF urges the SCO to consult further on the development of this element of the rule making process.

The making of Statements of Policy Principles

The proposed process includes a role for the MCE in making "Statements of Policy Principles". The NGF agrees that the MCE must have a sound mechanism for setting and giving effect to policy for the NEM. Nonetheless, for the mechanism to be sound it must require policy to be developed transparently and rigorously. The making of Statements of Policy Principles may meet this need, but the concept, as presented in the Consultation Paper, requires further development. The Paper states:

"The MCE may issue Statements of Policy Principles, and under the NEL, the AEMC will be required to have regard to such a Statement in carrying out its functions. Any such Statement will be required to be consistent with the Market Objectives."

These statements of policy principles are intended to have a direct influence on the development of the market rules and will have significant implications for all interested parties. The NGF, therefore, considers that such statements should be developed using a formal consultative process, as laid down in the new NEL. The MCE should also be required to explain how a draft statement is consistent with the market objectives and the effect it will have on the development of the market rules and therefore on the outcomes of the market. In addition to addressing those matters, the final statement should respond to all issues raised during the consultation period.

Conflicting roles of the AEMC

The NGF believes that the NEM needs an institution with the single task of assessing proposed rule changes against robust criteria to determine whether they should be implemented. This institution should not be empowered to build its own, or be the agent of any other group's, market development agenda. The NGF believes that the process outlined in the Consultation Paper does not achieve this goal and threatens to impose new risks on all market participants. The proposed process does this by imposing conflicting roles on the AEMC.

The paper makes the welcome statement that the AEMC not be able to initiate significant rule changes. This statement is consistent with the goal of ensuring the institution does not develop and pursue its own agenda. But the proposal that the AEMC:

- conduct reviews of market issues at either its own or the MCE's behest;

- in light of those reviews, make recommendations for rule changes which may then be initiated by other parties; and then
- assess those proposed rule changes,

is in conflict with the stated intention.

The NGF believes that a rule-making institution in the position of the AEMC cannot critically and independently assess its own rule change proposal.

Two solutions are possible. The neatest solution would be to provide that the AEMC cannot undertake reviews and or recommend or promote rule changes. All interested parties would then be required to undertake their own reviews to assess whether to pursue a rule change, thereby ensuring the impartiality of the AEMC. For example, the MCE has commissioned such a study by Charles Rivers Associates in the area of region boundaries. Further, the Advocacy Panel exists already to support those end users who may not have their own resources to fund reviews on questions of concern to them.

A second solution is to allow the AEMC to undertake reviews and make recommendations but acknowledge its conflict and therefore provide that, where a rule change has been initiated as a consequence of actions by the AEMC, parties may appeal on the merits to a body similar to the Australian Competition Tribunal.

Appeals against the merits of decisions

The NGF understands that the SCO intends to consult later in the year on the application of ‘merits’ appeals to decisions made by NEM institutions, and believes that the application of such appeals broadly to the rule-making process should be considered through that consultation.

The establishment of this new governance arrangement, where decision-making by the AEMC would not be subject to a merit based review, has been characterised by the SCO as a “status quo” position as there is no institutionalised merit review of the decision making of NECA on Code changes. The NGF believes that this assessment of the current arrangements is not strictly correct.

The current governance arrangements, where all Code changes proposed by NECA must be submitted to the ACCC for authorisation, provide a review opportunity for the decisions on Code changes of NECA and the Code Change Panel. The purpose of that review is to consider the competition effects of the change within the ACCC’s statutory requirement to apply a net benefits test. In practice, the ACCC’s open consultation procedures facilitate the airing of a wide range of matters that go to the basis of the proposed Code change. When combined with the ACCC’s powers to impose conditions on the authorisation, this provides a robust review mechanism. The removal of the formal requirement for the AEMC to seek ACCC authorisation for Code changes has a side effect of reducing the merit review options available to parties.

The NGF believes there needs to be more consideration of this question. We request that the SCO publish a paper outlining its understanding of the strengths and weaknesses of judicial review and merits appeal and the applications of these concepts to the NEM rule change and regulatory processes.

Conclusion

The NGF reiterates its concern about the extremely short period allowed so far for consultation on a matter of fundamental significance for the NEM. The NGF believes that further consultation is warranted on all the issues raised above and urges governments to emphasise quality in their policy development rather than speed. In the NGF's view, the time taken to consult represents a good investment – not just in the quality of the submissions it will then receive - but also for the longer term ownership of the outcomes. This is especially important in light of the significance of the change that is being proposed. The NGF certainly appreciates its recent one-to-one discussions with representatives of SCO on matters of substance.

The NGF looks forward to making a positive contribution to the development of the National Electricity Market.

Yours faithfully

Signed: G V Every-Burns 3/9/2004

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DEPUTY CHAIR