

A new NEM regulatory framework

Glossary

ACCC means the Australian Competition and Consumer Commission.

AER means the Australian Energy Regulator, being the new energy industry regulator having responsibility for market regulation as proposed in the MCE Report.

AEMC means the Australian Energy Market Commission, being the new regulator with responsibility for rule making and market development as proposed in the MCE Report.

COAG means the Council of Australian Governments.

Code means the National Electricity Code.

Code Change Process means a process and procedure by which changes to the Code are identified, evaluated and made and regulatory issues (if any) under Division 1 of Part VII of the *Trade Practices Act* are addressed.

Code Participants means participants who have registered with NEMMCO under Chapter 2 of the Code.

Market Framework means:

- (a) the combination of principles and structures that together would comprise a series of arrangements between Market Participants and the AEMC and the framework within which the NEM would operate;
- (b) the framework within which the code and subsidiary instruments would operate; and
- (c) the framework that would be authorised under Division 1 of Part VII of the *Trade Practices Act*.

for the purposes of the Proposed Code Change Process.

Market Participants means participants who have registered with NEMMCO under Chapter 2 of the Code and who are subject to the market rules in Chapter 3.

Market Principles means, for illustrative purposes in this report, those provisions of the Code that might be considered to contravene Part IV of the *Trade Practices Act* and that would require the protection of an authorisation under Division 1 of Part VII of the *Trade Practices Act*.

Market Procedures means, for illustrative purposes in this report, those provisions of the Code that are mechanical or procedural in nature and that, viewed and assessed in isolation, would not contravene Part IV of the *Trade Practices Act*.

MCE means the Ministerial Council on Energy comprising the Ministers from the Commonwealth, State and Territory Governments having responsibility for energy.

MCE Report means the Ministerial Council on Energy Report to the Council of the Australian Governments “Reform of Energy Markets”, 11 December 2003.

NECA means the National Electricity Code Administrator.

NEM means the national electricity market.

NEMMCO means the National Electricity Market Management Company Limited.

PASA means projected assessment of system adequacy being the medium term and short term processes described in clause 3.7 of the Code.

Proposed Code Change Process is the Code Change Process described in Section 7 of this report.

1 Executive Summary

The object of this report

- 1.1 The object of this report is to propose a Code Change Process for further consideration, evaluation and discussion by interested parties (generally referred to in this report as the “**Proposed Code Change Process**”).
- 1.2 The Proposed Code Change Process as described in this report is supported by a practical example of the Market Framework, relating to parts of Chapter 3 of the Code, as set out in Annexure B.
- 1.3 The Proposed Code Change Process is not presented in this report in isolation. It is presented in the following context:
 - (a) Section 2 sets out relevant issues, circumstances and perspectives relating to the history of the authorisation of the Code.
 - (b) Section 3 identifies technical issues (including statutory issues) relating to the authorisation process under Division 1 of Part VII of the *Trade Practices Act*.
 - (c) Section 4 identifies issues that have arisen, or have been perceived, in relation to the role and powers of the ACCC in evaluating, and making a determination upon, an application for authorisation of each proposed Code Change.
 - (d) Section 5 addresses the difficulties involved in dividing (or attempting to divide) the Code into Market Principles (being provisions of the Code that would be authorised) and Market Procedures (being provisions of the Code that would not be authorised).

Annexure A is to be read together with this section. Annexure A describes certain aspects or features of the Code that may contravene a provision or provisions of Part IV of the *Trade Practices Act*. However, the purpose of Annexure A is to demonstrate the risk of attempting to isolate particular provisions of the Code and to classify them as requiring authorisation to the exclusion of the other provisions of the Code. These risks are highlighted in section 5.

Basically, the conclusion is that an approach of this kind applied to the Code Change Process would generate considerable uncertainty and risk.

- (e) Section 6 sets out particular observations upon the proposals for the Code Change Process summarised in the MCE Report.

Basically, the concern is that this proposal, in practice, may not effect any material change to the current Code Change Process.

- (f) Section 7 sets out the Proposed Code Change Process and an explanation of it (in the context of the Code and Division 1 of Part VII of the *Trade Practices Act*).

- (g) Section 8 (together with Annexure B) provides a practical example of the application of the Proposed Code Change Process, being a potential form of Market Framework in relation to parts of chapter 3 of the Code (in particular, spot price determination and the prudential regime).

- 1.4 The purpose of giving consideration to the history of the authorisation of the Code, issues and concerns that have arisen in relation to the current Code Change Process and other potential alternatives for a revised Code Change Process, is to enable the Proposed Code Change Process to be assessed and discussed on a comparative basis.

Obviously, the Proposed Code Change Process is presented and discussed in a summary form. Of course, the precise description of the Market Framework and the requirement that the Market Framework be prepared as a series of arrangements and conduct capable of authorisation under Division 1 of Part VII of the *Trade Practices Act*, are critical issues. However, we believe that the Market Framework can be prepared as an effective “umbrella” instrument that is capable of authorisation.

The object of a modification to the existing Code Change Process

- 1.5 The underlying object of a modification to the existing Code Change Process is to facilitate a proper, efficient and efficacious operation of the NEM without unnecessary formality and process in connection with Code amendments. This involves a mechanism and procedure by which proposed amendments to the Code can be formulated, made and given effect to under the protection of an authorisation under Division 1 of Part VII of the *Trade Practices Act* in a more efficient, expeditious and cost-effective manner than is the case at present.

- 1.6 Implicit in achieving this object, is the management and correction of the following issues and concerns:

- (a) On each occasion that an amendment to the Code is proposed, an application for authorisation of the Code as a whole (and as amended) must be made and the statutory processes and assessments required by Division 1 of Part VII must be undertaken.

But for section 91A of the *Trade Practices Act* (Minor Variations of Authorisation), there is no power granted to the ACCC and under Division 1 of Part VII to vary an authorisation.

However, the provisions of section 91A have not simplified the procedure and have not been effective in practice.

- (b) In assessing an application for authorisation of the Code together with proposed amendments, the ACCC has introduced or promoted elements or provisions that have been viewed by market participants as amounting to the ACCC creating or designing the ACCC’s preferred arrangements for the NEM and the Code.

Technically, the ACCC's statutory duty should not allow it to design for others business arrangements that can be authorised, or to insist on optimum arrangements before granting authorisation.

- (c) Many of the amendments to the Code:
 - (i) would not appear to have any potentially anti-competitive purpose or effect (or deemed purpose or effect); and
 - (ii) would have no impact upon the net public benefit of the Code as a whole.

Such amendments should be capable of prompt introduction and implementation without any prejudice to the existing authorisation.

The risks of attempting to divide the Code into Market Provisions and Market Procedures

- 1.7 In our view, it is possible to identify the principal aspects or features of the Code that may give rise to competition issues under sections 45 and 47 of the Trade Practices Act. We have undertaken this exercise for chapter 3 of the Code and this is set out in Annexure A.
- 1.8 However, a number of legal and practical issues will impact on the efficacy, relevance and feasibility of this classification in relation to the authorisation process under Division 1 of Part VII as follows:
 - (a) In our view it is not practicable and would not achieve the object of the Proposed Code Change Process to classify the existing provisions of the Code into, say, "red" and "blue" provisions with the former being authorised and the latter not. The existing Code provisions are complex and interrelated. They are not susceptible to an easy or effective division into those which require authorisation and those which do not.
 - (b) The authorisation process involves a broad assessment of "public benefit" and "public detriment" in the context of the NEM and will be public in procedure and nature. The authorisation process may not be necessarily any less complex than the authorisation process is now in relation to amendments to the Code. This is because the assessment of "public benefit" and "public detriment" undertaken by the ACCC will involve all provisions of the Code and surrounding conduct and a broad assessment of net public benefit in the context of the NEM generally.
 - (c) In the absence of the whole of the Code (as amended) being authorised, there will always be the risk that the unauthorised provisions of the Code, and any conduct engaged in respect of those unauthorised provisions, would continue to be at risk of contravening Part IV of the *Trade Practices Act*. In particular:
 - (i) the ACCC has stated (for example, in relation to the authorisation of the Victorian Gas Market System Operation Rules) that it will not make, and that it has no power to make, a determination or assessment as to which provisions of a

code or a set of rules are at risk under Part IV of the *Trade Practices Act* and should be authorised; and

- (ii) no assessment or determination by any other person in connection with any separation of Market Principles from Market Procedures could fetter or restrict:
 - the statutory powers and duties of the ACCC under the *Trade Practices Act* (save for an express amendment to the *Trade Practices Act* to that effect); or
 - the rights of any “private litigant” to commence proceedings under Part IV of the *Trade Practices Act*.

- (d) At the practical and operational level, it may not be realistic or feasible to separate the provisions of the Code from time to time into Market Principles and Market Procedures that are “mutually exclusive” in relation to potential issues under Part IV of the *Trade Practices Act*.

Further, any such classification may change over time by reason of the interrelationship between provisions, changes of laws, the evolving and developing nature of the NEM and market definition over time and other events, occurrences and circumstances that are beyond the control of Market Participants.

- (e) As an authorisation cannot be granted retrospectively, any conduct engaged in under or pursuant to a provision of the Code any time prior to the grant of an authorisation in relation to that provision (and any conduct engaged in under it):
 - (i) will continue to be subject to Part IV of the *Trade Practices Act*; and
 - (ii) will not restrict or fetter the exercise by the ACCC of its powers under the *Trade Practices Act*, whether or not the ACCC had expressed any opinion as to whether a provision of the Code was likely or may contravene a provision of Part IV of the *Trade Practices Act*.

Even if a provision (or a proposed provision) of the Code were classified as one that may contravene a provision of Part IV of the *Trade Practices Act*, it could not be made or given effect to until it is authorised. The *Trade Practices Act* does not provide any protection, save only for the grant of an interim authorisation, pending the ACCC’s final determination.

- (f) It is almost inevitable that the AEMC, acting on behalf of all Market Participants, would take a conservative approach in relation to any assessment of whether a provision of the Code or a proposed change to the Code, would or may be likely to contravene a provision of Part IV of the *Trade Practices Act*.

The MCE Report proposal

- 1.9 As a general observation, a concern with the proposal in relation to the Code Change Process as set out in the MCE Report is that it runs the substantial risk, in practice, of amounting to a process similar to that which has developed in relation to previous Code changes, including a mandatory authorisation process for every Code change, “dual” assessment (in relation to differing tests) as between the AEMC and the ACCC, the proposed statutory discretion to be given to the ACCC not having any material effect upon the “dual” assessment, significant time, effort and expense for every Code change, unnecessarily broad consultation processes for most Code changes, significant delay for a Code change to take effect and the continuing impediment of the ACCC having no power to grant an authorisation retrospectively.

The object of the Proposed Code Change Process

- 1.10 The object of the Proposed Code Change Process is to achieve a Market Framework for the NEM within which the Code can operate as an evolving and developing instrument, by reference to the following principles:
- (a) Acceptance of the ACCC retaining responsibility for administering the prohibitions on anti-competitive conduct contained in the *Trade Practices Act*, including “for competition-related Code change authorisations under Part VII”.
 - (b) Working within the existing legislative framework and principles established, applied and accepted under the *Trade Practices Act*. A proposal for significant legislative change will introduce complexity and uncertainty of outcome.
 - (c) There would be no intention to change or modify the test set out in Division 1 of Part VII of the *Trade Practices Act* or the statutory powers, duties and functions of the ACCC under that Division.
 - (d) To the extent that there may be any legislative change or modification, it would be consistent with established principles and public policy under the *Trade Practices Act*. This would include:
 - the recognition that an authorisation can be only revoked (to the extent relevant in the present context) if there has been a material change of circumstances;
 - the application of existing provisions of the *Trade Practices Act* that could apply by way of analogy (for example, the notification procedure in relation to the practice of exclusive dealing under Division 2 of Part VII of the *Trade Practices Act*); and
 - the potential application of the interim authorisation provisions contained in section 91(2) of the *Trade Practices Act*.

The Proposed Code Change Process

- 1.11 The Code Change Process that we consider warrants further analysis is for the concept of the authorised market arrangements to be broader and more flexible than the actual provisions of the Code itself.

In effect, the authorised market arrangements would be a defined framework within which the NEM operates while contemplating and allowing for procedural flexibility within that framework. It is that defined framework that would be authorised under Division 1 of Part VII of the *Trade Practices Act*.

The Code (as amended from time to time) would represent a manifestation of that authorised framework, but would not be the only precise method by which the framework could be implemented and operated.

- 1.12 The authorised market arrangements would be a framework or form of “umbrella” under which various methods of operating within that framework could be introduced or an existing method (such as the Code) could be varied, without any authorisation being required.

- 1.13 The primary objects of the Proposed Code Change Process would be as follows:

- (a) To identify and describe the arrangements and market framework that would be sufficiently certain to be authorised and to identify the Code as *one* manifestation of the market procedures under which that market framework can be implemented.
- (b) As a result, rather than:
 - (i) applying the authorisation process (and the exercise by the ACCC of its statutory powers and functions under that process) to particular provisions of the Code that may have the potential to contravene Part IV of the *Trade Practices Act*; or
 - (ii) proposing amendments (or substantive amendments) to the statutory processes and tests under Division 1 of Part VII of the *Trade Practices Act* (or the ACCC’s powers and functions in respect of those functions and tests),

the authorisation process would be eliminated altogether in relation to most proposed amendments to the Code.

This would be achieved by reason of the fact that the market arrangements and market framework would comprise the subject matter of the authorisation and for so long as any amendment to the Code falls within that authorised market framework, the authorisation would not be affected at all.

- 1.14 The identification and description of market arrangements and a market framework as the authorised instrument is consistent with the certain degree of flexibility and generality that is inherent in Part IV of the *Trade Practices*

Act and the subject matter that is capable of authorisation under Division 1 of Part VII.

By way of practical example, the current clause 3.18 of the Code (Settlement Residue Auctions) adopts a similar approach. The Code provisions set out the principles identifying settlement residue auctions at a high level, (including the anti-competitive features of the auction process), but provide for NEMMCO to develop and amend the particular actual auction rules. Neither the development nor the amendment of the auction rules requires any authorisation; it is the auction framework as described in clause 3.18 that is authorised.

- 1.15 Of course, there may be a proposed amendment to the Code that is sufficiently material as to raise the question of whether it falls outside the parameters of the authorised market arrangements and framework.

It may be that this element of risk could be removed if a procedure similar in concept to that applied in relation to the notification of exclusive dealing under Division 2 of Part VII of the *Trade Practices Act* is introduced. In this context, the “notification” concept could be applied so as to:

- (a) give the AEMC the power to “certify” that the proposed amendment to the Code falls within the authorised market framework; and
- (b) provide that any certification by the AEMC has effect unless and until the ACCC withdraws it (after following a prescribed procedure) on the ground that the ACCC considers that:
 - the certified amendment expands or modifies or is inconsistent with the market framework as authorised; or
 - the net public benefit attaching to the market framework as authorised has been, or is likely to be, materially diminished (ie, the certified amendment amounts to a material change of circumstances); and
- (c) if the ACCC withdraws the certification and an application for authorisation of the market framework as amended by the proposed amendment is to be made, the ACCC would be required to grant an interim authorisation under section 91(2) of the *Trade Practices Act* until it gives due consideration to the application and makes a determination in respect of it.

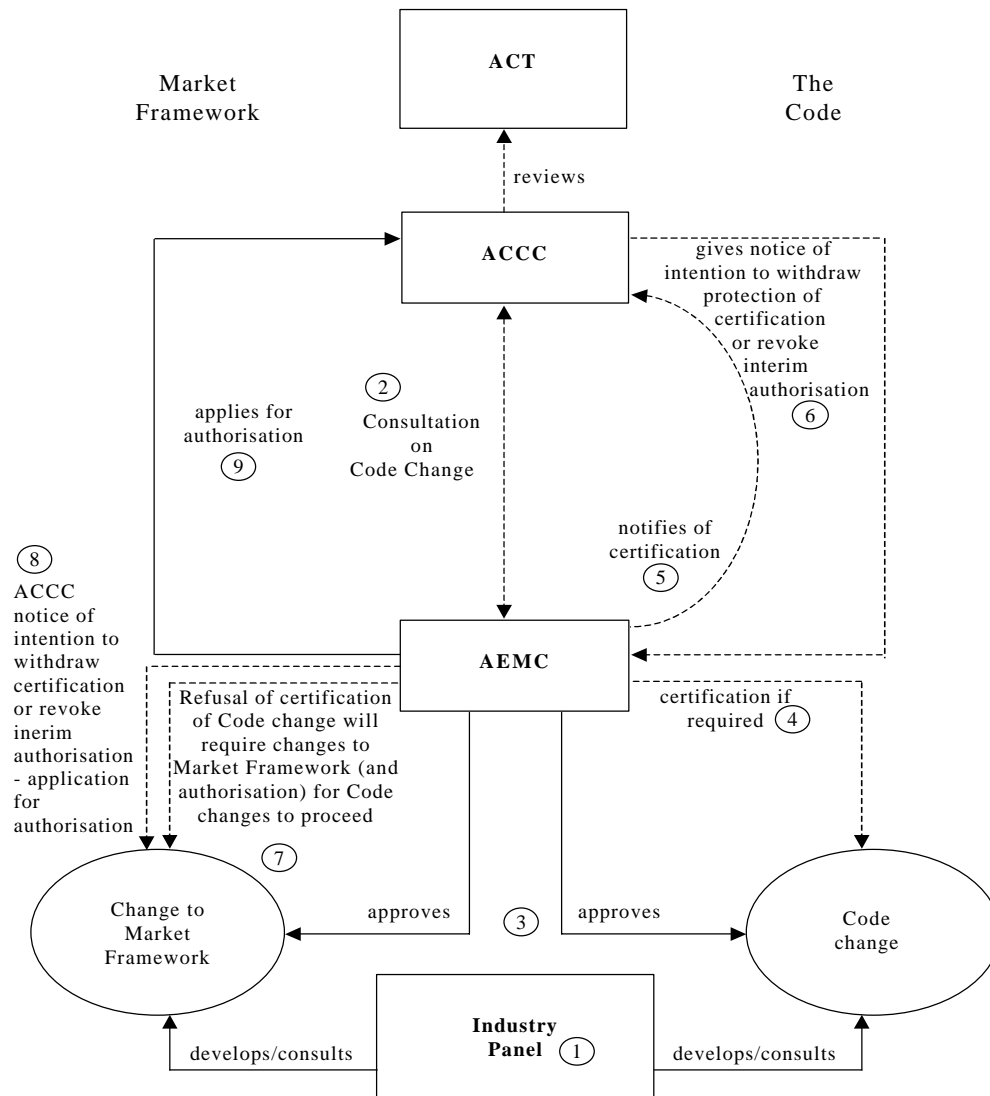
- 1.16 As a potential alternative to the “notification” concept, in the context of the Proposed Code Change Process, the “interim authorisation” procedure as provided for in section 91(2) of the *Trade Practices Act* could be applied so as to:

- (a) give the AEMC the power to “certify” that the proposed amendment to the Code falls within the authorised market framework; and
- (b) provide that if the AEMC gives that certification in circumstances that raise the question of whether the Code change, or conduct that would be engaged in under it, may fall outside the parameters of the authorised market framework, the ACCC would be required to grant

an interim authorisation for the market framework as amended by the change certified by the AEMC, until the ACCC gives due consideration to it and makes a determination upon any application for authorisation in respect of it that may follow.

1.17 The Proposed Code Change Process is described in the following diagram:

Overview of the Proposed Code Change Process



- ① Industry Panel develops and consults on changes to the Market Framework and the Code.
- ② The AEMC considers each proposed change to the Code and consults with the ACCC.
- ③ If the proposed Code change falls within the Market Framework, AEMC approves changes pursuant to defined change process which would deal with market rather than competition (or public benefit) issues, taking into account the market objectives. The ACCC is not involved, no process under Division 1 of Part VII of the *Trade Practices Act* is triggered and no “public benefit” test in the context of the *Trade Practice Act* applies.
- ④ If there is a concern that a change to the Code may not be consistent with, or may extend beyond, the Market Framework, AEMC has the power to certify that change as being within the Market Framework. Certification would relate only to consistency with the Market Framework and would not involve any public benefit test.
- ⑤ AEMC notifies ACCC of any certification. Arrangements and conduct consistent with certified Code changes are protected by the existing authorisation (or by an interim authorisation the ACCC would be required to grant). This would require amendments to the *Trade Practices Act*.
- ⑥ ACCC may give notice of intention to withdraw certification of Code change (or revoke interim authorisation). ACCC would need to establish that the Code as amended by the certified change:
 - expands or modifies or is inconsistent with the Market Framework as authorised; or
 - amounts to a material change of circumstances (ie, has, or is likely to have, an impact on public benefit and public detriment).
- ⑦ If AEMC refuses certification of Code changes:
 - the proposed Code changes will need to be modified to be consistent with existing Market Framework; or
 - the Market Framework as amended to reflect the proposed Code changes, would be the subject of an application for authorisation.
- ⑧ If ACCC gives notice of intention to withdraw certification by AEMC of a Code change or to revoke interim authorisation:
 - the proposed Code changes will need to be modified to be consistent with existing Market Framework; or
 - the Market Framework as amended:
 - to reflect the proposed Code changes; and
 - to reflect and address the material change of circumstances identified by ACCC, would be the subject of an application for authorisation.
- ⑨ The Market Framework as amended by the proposed changes is authorised by the ACCC on application by the AEMC (on behalf of all Market Participants), applying the net public benefit test.

Practical example of the Proposed Code Change Process

- 1.18 We have prepared an example of the Market Framework dealing with certain aspects of Chapter 3 of the Code (spot price determination and the prudential requirements) that could form part of the authorised arrangements under the proposed Code Change Process. This example is set out in Annexure B.
- 1.19 This exercise has demonstrated that a division of the existing Code between Market Principles and Market Procedures is not practicable or workable. The outcome of this exercise is more consistent with the Proposed Code Change Process - the Market Framework is identified, but there is flexibility as to how it is actually implemented. In our view, these principles (although an example only) could form part of the Market Framework for the NEM that would be authorised.
- 1.20 This exercise raised a number of practical issues which we discuss in section 8 of this report. In particular, determining the level at which the market arrangements and framework are described is likely to be the subject of discussion, particularly as the relevant competition concerns involve questions of degree. For example, the principal competition concern with the prudential requirements is that they could form a barrier to entry to the market and therefore substantially lessen competition. It would not be a case of simply authorising the existence of prudential requirements - it is likely that the ACCC will need the requirements to be described with some measure of particularity in order to obtain authorisation.

However, in our view, there is no reason or basis under Division 1 of Part VII of the *Trade Practices Act* for the market arrangements and framework to be fixed or inflexible.

Access Code

- 1.21 Further thought needs to be given to the role of the NEM Access Code in the context of the Proposed Code Change Process. Our initial assessment is that the NEM Access Code approved under Part IIIA could also comprise general rather than specific rules for access to the electricity networks in the NEM.

Approval of the NEM Access Code under Part IIIA and authorisation of the Code under Part VII are separate issues and involve different tests.

Accordingly, a material question is whether the Market Framework as authorised and the NEM Access Code are capable of being one document or should be separate (and different) documents, with future amendments to each proceeding on an independent basis in accordance with different procedures and tests.

2 History of Authorisation of the Code

The Authorisation of the Code as a whole

- 2.1 The Code is authorised under Division 1 of Part VII of the *Trade Practices Act* as a whole until 31 December 2010 in respect of the following:
- (a) Any provision or provisions of the Code that would be or might be an exclusionary provision within the meaning of section 45 of the *Trade Practices Act*.
 - (b) Any provision or provisions of the Code which would have the purpose, or would have, or might have, the effect, of substantially lessening competition within the meaning of section 45 of the *Trade Practices Act* (including fixing, controlling or maintaining prices within the meaning of section 45A).
 - (c) Any conduct engaged in and any practice required under a provision or provisions of the Code (including giving effect to any provision of the Code) being a practice that would or may constitute the practice of exclusive dealing.
- 2.2 Participants in the NEM are required to register with NEMMCO and, upon registration, bind themselves to comply with and perform any duties and obligations imposed by the Code (clause 2.8.2 of the Code; 9(1)(c) of NEL). As a practical matter, this involves Code Participants subjecting themselves to the enforcement regime in the NEL.
- Although registration does not give rise to the Code provisions forming an enforceable contract between Code Participants (unless they enter into a contract to that effect), the consequences of registration can constitute an arrangement or understanding for the purposes of section 45 and can compel Code Participants to engage in particular conduct that may constitute the practice of exclusive dealing for the purposes of section 47.
- In addition, as a requirement of registration, Code Participants enter into agreements with NEMMCO in which they contractually bind themselves to comply with the Code.
- 2.3 The ACCC, among others, identified a number of provisions of the Code or, conduct required or permitted under the Code, which may have been in contravention of section 45 or section 47, but for authorisation of the Code.
- For example, chapter 2 of the Code requires generators, customers, network service providers and traders to register with NEMMCO and requires exclusive trading in certain cases. The registration requirements are detailed and prescriptive, eg the requirements to meet technical standards and prudential obligations. Arguably, these requirements:
- may constitute exclusionary provisions in contravention of section 45 as competing participants agree not to trade with unregistered persons;
 - may constitute exclusive dealing provisions in contravention of section 47 as each participant trades on the condition that they will

not supply electricity to, or acquire electricity from, unregistered persons; or

- may be an exclusionary provision or may have the effect, or likely effect, of substantially lessening competition in the relevant market because the prescriptive nature of the requirements may constitute a barrier to entry and prevent, restrict, limit or hinder:
 - other persons engaging in competitive conduct; or
 - the supply of goods or services to, or the acquisition of goods or services from, particular persons or a class of persons.

The History of the Authorisation of the Code

2.4 The Code was authorised as a whole (as distinct from only separate and discrete provisions of the Code) for the following principal reasons:

- (a) The nature of the “public benefit test”, the application of the “future with-and-without test” and the identification of the appropriate counterfactual in order to apply that test, demonstrate that the assessment cannot be made in respect of isolated provisions, particularly to the extent that they are an inseverable part of the whole framework or market structure. The ultimate question is whether the whole of the inseverable framework or structure is likely to deliver a “net public benefit” (in the context of the relevant market considered as a whole) by way of comparison with the “future without” or counterfactual scenario.

Questions of economic efficiency cannot be realistically assessed as against one particular provision or a selected combination of particular provisions. It is the market structure and the market rules that permit that structure to be operative that deliver, as an inseverable whole, the public benefit. Although a particular provision may be, at least potentially, an exclusionary provision or price fixing, any perceived detriment that such a provision in isolation may be considered to have, must be weighed against that broad public benefit. Given the nature of that comparison, and the inseverable nature of the various provisions and conduct, such a provision may well have a positive benefit; namely, being part of an overall structure that has created and facilitates the operation of the NEM.

- (b) There is also the “micro” issue that unless the Code as a whole was not authorised, there may be provisions, or conduct engaged in or pursuant to provisions, that would not be authorised, but which may have some connection with conduct or a practice that may be or perhaps at some later time may be, a contravention of a provision of Part IV of the *Trade Practices Act*.

If a particular and specific provision only is authorised, other conduct engaged in connection with the particular provision that is authorised, may not be protected.

Further, in relation to conduct that has the effect of substantially lessening competition, the assessment of whether that conduct is likely to have such an effect is a continuing process and the outcome of any assessment may vary over time depending upon market conditions and circumstances prevailing from time to time, developing and evolving markets and definitions for markets, changes in laws and other factors beyond the control of the parties.

- (c) The ACCC was also of the view that the whole of the Code should be authorised. In the submission to the ACCC relating to the applications for authorisation of the Code (13 November 1996), it was noted as follows:

“In its Issues Paper dated March 1996, the Australian Competition and Consumer Commission (“ACCC”) commented that in view of the complexity and integrated nature of the Code, a case could be made for authorisation of the whole Code rather than for authorisation of those provisions in it which may fall within sections 45, 45A or 47 of the Act. Since that time the ACCC has indicated that it would prefer the Code to be submitted for authorisation as a whole.”

Issues that arose in relation to authorisation of the Code

- 2.5 It is instructive to discuss briefly several issues that arose in connection with the applications for authorisation of the Code and the statutory constraints imposed by Division 1 of Part VII of the *Trade Practices Act* (as in force at that time).

The concept of an industry code

- 2.6 The Code comprises a set of rules with which all Code Participants must comply. Accordingly, it is essential that:
- (a) each person named or referred to in the application for authorisation as a party to the arrangement comprising the Code, is protected by the authorisation; and
- (b) each person, even if not known or identified at the time of the application, who subsequently becomes a Code Participant, is entitled to the protection of the authorisation.
- 2.7 Although section 88(6) provides that an authorisation to make or give effect to a contract, arrangement or understanding has effect as if it were also an authorisation in the same terms to every other person named or referred to in the application as a party to that contract, arrangement or understanding (or proposed party), that sub-section only applies to an application for authorisation (to the extent relevant in the present context) in relation to section 45. It does not apply to engaging in conduct that constitutes or may constitute the practice of exclusive dealing for the purposes of section 47.
- 2.8 In addition, although sections 88(13), (14) and (15) did permit the ACCC to grant a single authorisation in respect of several contracts, arrangements or understandings that were, or would be, in similar terms, there was a question of whether those sub-sections would apply to an industry code of practice the parties to which would change over time (by reason of Code Participants

entering or leaving the market). The applications for authorisation of the Code were made on the basis that they extended to each other proposed contract, arrangement or understanding for the purposes of sections 88(13), (14) and (15) that would be made between a person who registers with NEMMCO under the Code as a Code Participant and each existing Code Participant at that time.

2.9 By reason of these issues (or potential issues), the *Trade Practices Act* was amended as follows:

- (a) Section 88(8AA) was introduced to ensure that in respect of conduct that constitutes or may constitute the practice of exclusive dealing for the purposes of section 47, the authorisation protects every other person named or referred to in the application for authorisation as a party or proposed party to the contract, arrangement, understanding or industry code of practice.
- (b) Sections 88(13), (14) and (15) were amended so that the word “contract” includes an arrangement, understanding and industry code of practice.

Minor variations

2.10 It was appreciated that the Code would be varied or modified over time, perhaps on a regular basis, in order to meet the requirements of the evolving and developing NEM. Further, it was appreciated that Division 1 of Part VII of the *Trade Practices Act* did not contemplate or provide for the variation of an authorisation.

This question was seen as being particularly relevant to procedural amendments that should not be the subject of a complicated, lengthy and public statutory process (such as the process involved in an application for authorisation).

The result was the introduction of section 91A (Minor Variations of Authorisations) and certain other provisions of the *Trade Practices Act* so far as they relate to that section. Section 91A is discussed further in section 6.

3 The nature of the authorisation process under Division 1 of Part VII of the *Trade Practices Act*

The nature of the test - Public Benefit

- 3.1 The basic test that is applied in relation to the subject matter of application for authorisation is whether, in all the circumstances, the proposed contract, arrangement or understanding or the proposed provision or conduct would result, or be likely to result, in such a benefit to the public that the benefit would outweigh the detriment to the public.¹ Although the actual description of the tests set out in section 90(6) and (8) of the *Trade Practices Act* differs, the tests postulated in those subsections, in substance are the same.²
- 3.2 It is for the parties seeking authorisation to satisfy the ACCC (and on any review, the Australian Competition Tribunal) that benefit to the public is likely and that there will be sufficient public benefit to outweigh any likely anti-competitive and other public detriment.
- 3.3 In weighing relevant public benefits and public detriments, the ACCC must compare the position which would or would be likely to exist in the future, on the one hand if authorisation were to be granted and on the other hand if it were absent. This is known as the “future with-and-without test” and has been applied consistently in Tribunal decisions.

“Public Benefit” and “Public Detriment” are broad concepts

- 3.4 The concept of “public benefit” is very broad, including “anything of value of the community generally, any contribution to the aims pursued by society including as one of its principal elements (in the context of Trade Practices legislation) the achievement of the economic goals of efficiency and progress”.³

Similarly, the concept of “public detriment” is broad, including “any impairment to the community generally, any harm or damage to the aims pursued by society including as one of its principal elements the achievement of the goal of economic efficiency”.

Inseverable Nature of the Analysis - Provisions cannot be assessed in isolation

- 3.5 The assessment of public benefit and public detriment requires a broad exploration of relevant (or potentially relevant) issues. “Public Benefit” and “Public Detriment” cannot be assessed by reference to a particular provision or particular conduct considered in isolation. As was observed in *Re Concrete Carters Association (Victoria)*⁴, the assessment “can only be made in the overall context of the function performed by the applicants, of the industry in which they operate, and of the market or markets which would be affected by such conduct”.

¹ See sections 90(6) and (8) of the *Trade Practices Act*.

² *Re 7-Eleven Stores Pty Ltd* (1994) 16 ATPR 42,644 at 42,654.

³ *Re Queensland Co-operative Milling Association* (1976) 25 FLR 169.

⁴ (1977) 31 FLR 193 at 202

- 3.6 In applying the “future with-and-without test”, particularly in relation to Codes or other forms of business rules, the Tribunal has recognised the breadth and inseverable nature of the analysis to be undertaken in order to determine whether there is the necessary “net public benefit”. For example, the Tribunal has observed as follows:⁵

“The Tribunal does not contemplate conducting this review by a detailed examination of, and a determination of a balance of benefit and detriment for, individual rules. Such a process would be unwieldy and erroneous. The Code and their component rules exist as a corpus and derive force and effect accordingly.”

- 3.7 In *Re AGL Cooper Basin Natural Gas Supply Arrangements*⁶, the Tribunal made the following observation:

“...although the Tribunal accepts that certain provisions of the letter of agreement are anti-competitive in their effect, we have concluded that in some instances these provisions were so essential in their effect to the original conclusion and implementation of the Letter of Agreement, as to be intrinsic also to the achievement of the benefit that arises from its existence and implementation. This consideration warns against assessment of particular clauses in isolation from each other. It is important that benefit or detriment is determined by considering the Letter of Agreement as a whole. It is the sum of its parts, some of which in their effect are anti-competitive; but others have positive benefit.” (emphasis added).

- 3.8 In *Re Australasian Performing Right Association Ltd*⁷, the Tribunal applied a test of necessity in respect of provisions of articles and rules. For example, a clear public benefit is the existence of the NEM and the underlying basis upon which it operates and is administered. Components of conduct that are essential to the operation of the NEM should be authorised. Only if a particular feature is not essential would it then be appropriate to consider whether that feature, standing alone, has a net public benefit.

The different tests between Part IV and Part VII

- 3.9 The issues for determination by a Court in the event of a contravention, or an alleged contravention, of a provision of Part IV of the *Trade Practices Act* are different from those for determination when an authorisation is sought. Further, the mere act of making an application for authorisation does not carry with it any presumption as to the arrangements in question contravening a provision of Part IV of the *Trade Practices Act*.

Accordingly, the question of whether the relevant contract, arrangement, understanding, provision or conduct is or involves an exclusionary provision, price fixing or an arrangement or conduct that has the purpose or effect of substantially lessening competition, is not relevant to the test set out in Division 1 of Part VII of the *Trade Practices Act*.

⁵ *Re Media Council of Australia (No. 2)* (1987) ATPR ¶40-774 at 48,443

⁶ (1997) ATPR ¶41-594 at 44,220

⁷ (1999) 151 FLR 1 at 75-76

3.10 Similarly, questions of public interest or public benefit are not relevant for the purposes of determining whether a provision of Part IV has been contravened. For example, in the context of section 47, it has been observed as follows:⁸

“Except perhaps in relation to a question of whether or not an injunction ought to be granted, it is not relevant to an application for relief under sec. 47 that the purpose or effect of a respondent’s conduct may be to enhance competition in some other market or markets or even overall, or that the respondent’s conduct may be in the public interest.”

3.11 The stark differences between the tests set out in the various provisions of Part IV and the “net public benefit” test set out in Division 1 of Part VII indicate that the identification of a particular provision, clause or paragraph of a contract or arrangement may be sufficient to found a contravention of the relevant provision of Part IV, but would not be at all determinative (if relevant) in the context of an application for authorisation.

“Net Public Benefit” assessment different from analysis of likely effect on competition

3.12 As a result of the fact that the test to be applied in relation to an application for authorisation is underpinned by an assessment of public benefit, that assessment is very much broader than an analysis of any likely effect of any particular provision upon competition in a relevant market. For example:

- (a) The assessment of efficiency and progress must be from a perspective of society as a whole and that efficiency itself encompasses allocative efficiency, production efficiency and dynamic efficiency.
- (b) The very existence of the authorisation procedure under Division 1 of Part VII of the *Trade Practices Act* demonstrates that there are circumstances in which conduct (or a combination of conduct) that may be associated with a potential lessening of competition will have value to society, the Tribunal having observed:⁹

“we cannot rely upon the functioning of competitive markets to deliver everything ‘of value to the community generally’.”

- (c) Anti-competitive conduct can be a “public detriment” for the purposes of the test to be applied in respect of an application for authorisation, but anti-competitiveness does not necessarily equate to detriment; it may be, in fact, a positive benefit, as recognised in *Re Media Council of Australia (No. 2)*¹⁰:

“It is erroneous to equate anti-competitiveness with detriment. Anti-competitive behaviour may in certain circumstances be a positive benefit.”

⁸ *Outboard Marine Australia Pty Ltd v Hecar Investments (No. 6) Pty Ltd* (1982) ATPR ¶40-327 at 43, 986

⁹ *Re 7-Eleven Stores Pty Ltd* (1994) ATPR ¶41-357 at 42,677

¹⁰ (1987) ATPR ¶40-774 at 48,419.

Authorisation cannot be granted retrospectively

- 3.13 An authorisation cannot be granted retrospectively. Section 88(12) of the *Trade Practices Act* provides that the ACCC does not have power to grant an authorisation to make a contractual arrangement if it has been made before the ACCC makes a determination in respect of the application for authorisation.

Similarly, the ACCC does not have power to authorise other conduct (such as giving effect to a contractual arrangement) that was engaged in before the ACCC makes a determination in respect of the application for authorisation.

- 3.14 However, there is no restraint upon the power of the ACCC to authorise prospectively giving effect to a provision of a contract or arrangement. It has been held that the operation of section 88(12) is confined to the subject matter of section 88(1)(a) (the paragraph relating to making a contract or arrangement) on the following grounds:¹¹

“The legislature was concerned that, if the Commission’s power to grant authorisation could be exercised with respect to the making of an agreement or arrangement or the arriving at an understanding so as to have it retroactive effect, it would render nugatory the consequences of previous or existing breaches of provisions of Part IV of the Act which may have occurred after the making of the relevant agreement or arrangements or the arriving at the relevant understanding. Section (12) does not therefore prevent authorisation being given to a corporation’s future conduct which takes place pursuant to a contract or arrangement or understanding the making of which may itself be outside the jurisdiction of the Commission to authorise.”

¹¹ Re *Queensland Stock and Station Agents Association* (1989) 95 FLR 250 at 271.

4 The role and powers of the ACCC in relation to an application for authorisation

The ACCC makes no assessment under Part IV or whether an application is necessary

- 4.1 A significant issue in relation to an application for authorisation, and the assessment process undertaken by the ACCC (or the Tribunal on review) in connection with such an application, is that the ACCC must consider the subject matter of the application before it and to assess whether that subject matter has the necessary “net public benefit”.

In assessing whether the subject matter of an application for authorisation has the necessary “net public benefit”, it is not for the ACCC to determine whether the subject matter of the application is, or is likely to, contravene any provision of Part IV of the *Trade Practices Act*.

- 4.2 It is not for the ACCC to determine whether the application is necessary or appropriate. The power to grant an authorisation exists where making or giving effect to a provision of the contract, arrangement, or understanding “might be” of a prescribed kind. It is irrelevant that the application for authorisation may be unnecessary. If an applicant believes on what appears to it to be good grounds, that its conduct (if not authorised) may contravene a provision of Part IV of the *Trade Practices Act* and an application for authorisation is made, the duty of the ACCC is to decide the application on the public benefit grounds set out in Division 1 of Part VII of the *Trade Practices Act*. Those grounds do not include the question of whether the application may appear to be unnecessary.¹²

The ACCC has no power to design arrangements

- 4.3 It is not for the ACCC to manufacture or design the subject matter of an application for authorisation. The ACCC must assess the application as made “and the subject matter as described” and make a determination as to whether that subject matter has the necessary “net public benefit”. Although the ACCC has the power under section 91(3) of the *Trade Practices Act* to determine to grant an authorisation subject to conditions, any condition must be one that the ACCC considers is necessary to give the subject matter of the application the necessary “net public benefit”.
- 4.4 In particular, it is not a function of the ACCC in its assessment of an application for authorisation to create or design an arrangement that the ACCC may consider preferable. In fact, the Tribunal has recognised that the ACCC is constrained by its statutory duty in this regard:¹³

“The Commission is, however, constrained by its statutory duty, which arguably implies (just as the Tribunal’s statutory duty implies in these and other proceedings) that the Commission’s role is not to design for others business arrangements that can be authorised, nor to insist on optimum arrangements before granting authorisation, but rather to assess formally whether some proposed conduct that might breach the provisions of the Act yields a net public benefit, and therefore can be authorised.”

¹² Re *Australasian Performing Right Association Ltd* (1999) 151 FLR 1 at 8-9.

¹³ Re *7-Eleven Stores Pty Ltd* (1998) ATPR ¶41-666 at 41,481

- 4.5 Similarly, although a counterfactual must be identified for the purposes of the “future with-and-without test”, that counterfactual must be the pragmatic and likely alternative if the arrangement is not authorised. This has been recognised as follows:¹⁴

“The counterfactual is not necessarily the arrangement which might be preferred by the Commission or by others with an interest in the industry. The Commission does not have the mandate, nor the expertise, to be the market designer. The counterfactual is simply the Commission’s pragmatic and commercial assessment of what is likely to occur in the absence of the proposed arrangement.”

Market Power and Authorisation

- 4.6 Conduct that involves the misuse of market power for the purposes of section 46 of the *Trade Practices Act* cannot be authorised under Division 1 of Part VII of the *Trade Practices Act*. The only limited form of protection that can be obtained is provided under section 46(6) which states that section 46 does not prevent a corporation from engaging in conduct that does not constitute a contravention of section 45 or section 47 by reason that an authorisation is in force. Accordingly, if an arrangement or conduct is authorised under section 45 or section 47, a corporation giving effect to that arrangement or engaging in that conduct cannot be a misusing market power for the purposes of section 46.
- 4.7 However, for section 46(6) to apply, the conduct engaged in must correspond to the conduct authorised under section 45 or section 47 (as the case may be). Given the material differences in the tests as set out in the relevant provisions of Part IV of the *Trade Practices Act*, it would be unusual (if not rare) that conduct which satisfies the test set out in section 46(1) would correspond to, or be encompassed entirely within, conduct that may be authorised for the purposes of section 45 or section 47.
- 4.8 In particular, it must not be assumed that because the Code as a whole is authorised for the purposes of sections 45 and 47 of the *Trade Practices Act*, conduct engaged in by a market participant which has a substantial degree of power would be protected under the authorisation of the Code by reason of section 46(6). Any such conduct (for example, gaming, collusion or other strategic behaviour) would not be authorised by reason of section 46(6). Any such behaviour, if established, may well contravene section 46.
- 4.9 This was recognised in the submission made in relation to the applications for authorisation of the Code as follows:¹⁵

“In the market design, the trading rules for the spot market and central dispatch process cannot eliminate or even significantly reduce any market power of a Market Generator. Any Market Generator large enough to profit by withdrawing capacity at the last minute may also, and with less visibility, withhold or overprice capacity in the contracts market.

...

¹⁴ *Rugby Union Players’ Association Inc. vs Commerce Commission (No. 2)* [1997] 3 NZLR 301 at 308

¹⁵ Submissions in relation to the application to the ACCC for authorisation of the National Electricity Code under Division 1 of Part VII of the *Trade Practices Act*, 13 November 1996 at page 112.

The proposed market design, as embodied in the Code, provides a neutral and flexible trading framework. It is submitted that the market design in terms of the spot market and central dispatch process cannot solve market power problems. The best protection is to provide a market design that is based on readily auditable processes for bidding and for merit order dispatch. In addition, the arrangements for the publication of information, including bidding information after the event, to participants and to the public, needs to be comprehensive. The net effect of this will be an enhanced capacity for potentially concerned parties to monitor a supply of behaviour to identify quickly any activity that may be regarded as an excessive or inappropriate influence on spot prices, or collusive behaviour, and to raise the alarm. The processes are transparent and auditable - thereby enabling ready investigation of complaints by the ACCC as the regulator of general market conduct.”

These observations continue to be relevant. Behaviour that amounts to a misuse of market power for the purposes of section 46 of the *Trade Practices Act* is a contravention of the *Trade Practices Act* and is not, and cannot be, authorised under Division 1 of Part VII of the *Trade Practices Act*. The object of the market design in this regard is to facilitate exposure of conduct that is demonstrative (or, at least, indicative) of a sustained ability to act in a manner inconsistent with an environment of workable competition and to assess whether that ability is being used for a proscribed purpose under section 46(1). Accordingly, under clause 3.13.7 of the Code, NECA is under an obligation to monitor variations in prices and to prepare quarterly reports for the ACCC and the public, identifying and reviewing any significant price variations over the relevant period.

- 4.10 The question of whether a contract or arrangement that is the subject of an application for authorisation is also likely to give rise to the potential for a misuse of market power, would be a relevant consideration for the ACCC to take into account as part of the broad concept of “public detriment”. However, as discussed above, conduct that may amount to a misuse of market power cannot be the subject of an application for authorisation. The application must be in relation to conduct that may contravene section 45 or section 47 of the *Trade Practices Act*.

Accordingly, although the question of a potential misuse of market power is relevant as a “public detriment”, it is not, and cannot be, the reason for or primary subject matter of an application for authorisation.

- 4.11 An interesting example was the application for authorisation to amend the Code in relation to the changes to bidding and rebidding rules.¹⁶

It is submitted that as the Code had been authorised as a whole with its original rebidding provisions (and in that form being determined to have had a net public benefit), any suggestion of a misuse of market power should have been addressed by either or both of the following:

- (a) The ACCC relying upon section 46 of the *Trade Practices Act*.
- (b) The ACCC asserting that:

¹⁶ Final determination: Application for Authorisation - Amendments to the National Electricity Code Changes to Bidding and Rebidding Rules, 4 December 2002

- (i) the nature of the market had changed in relation to rebidding practices, that such a change amounted to a material change in circumstances for the purposes of section 91C of the *Trade Practices Act*; and
- (ii) that the authorisation of the Code should be revoked and substituted with a new authorisation for the one revoked, incorporating provisions necessary to address the increased public detriment associated with that material change of circumstances.

Limited power to vary an Authorisation - Section 91A of the Trade Practices Act

- 4.12 As part of the concept of authorising the Code as a whole it was recognised that variations would be essential from time to time and that many of these variations would not have any material effect upon the “net public benefit” attaching to the authorisation of the Code as a whole.
- 4.13 Prior to the introduction of section 91A (Minor Variations of Authorisations), there was no capacity in Division 1 of Part VII to vary an authorisation. Accordingly, if a contract or arrangement were authorised, an amendment or variation to that contract or arrangement would require the existing authorisation to be revoked and a new authorisation to be granted for that contract or arrangement as amended or varied.

The original intention of the proposal to introduce a power for the ACCC to vary an existing authorisation was to simplify the procedure and to avoid unnecessary processes in circumstances where the variation was not likely to alter, or alter to any material extent, the net public benefit attaching to the Code as a whole.

- 4.14 However, the procedure required by section 91A of the *Trade Practices Act* still requires the ACCC to determine whether the variation is a “minor variation” and a consultation process with any persons who appear to the ACCC to be interested. It also provides that the ACCC must not make a determination varying an authorisation if a variation would result, or would be likely to result, in a reduction in the extent to which the benefit to the public of the authorisation outweighs any detriment to the public caused by the authorisation.

In other words, even if the ACCC is satisfied that the variation sought in an application is a “minor variation” (which is defined in section 87D(1) as a “single variation that does not involve a material change in the effect of the authorisation”), the ACCC must still pursue a consultation process with any persons who appear to the ACCC to be interested. This statutory procedure appears to have been of little benefit, primarily because of the statutory procedure described in section 91A and the conservative approach that has been adopted in describing a “minor variation”.

- 4.15 Other difficulties with section 91A include the following:
- (a) The ACCC must invite submissions from any person who appears to the Commission to be interested. This is potentially a broad class of

persons and is no narrower than the class of persons from whom the ACCC must seek submissions if it intends to revoke an authorisation. The expression “any persons who appear to the Commission to be interested” is not defined, but, as with the test of “sufficient interest” in section 101 (Applications for Review), the test is not an unduly high one.¹⁷

- (b) Although the ACCC must not make a determination to vary an authorisation unless it is satisfied, in all circumstances, the variation would not result, or would be likely not to result, in a reduction in the benefit to the public that arose from the original authorisation, this appears to be potentially inconsistent with the definition of “minor variation”. That definition refers to a single variation “that does not involve a *material* change in the effect of the authorisation”. It appears clear that there could be some reduction in the benefit to the public without that involving a material change in the effect of the authorisation. However, in that case, it is likely that the ACCC could not determine to vary the authorisation.

- 4.16 The potential of any proposal to broaden and to simplify the operation and procedure relating to “minor variations” in section 91A is that regardless of the process, any administrative body (whether the ACCC or another regulator) will be likely to follow a public process (even if limited in its nature and scope). Further, there will be always questions and issues as to what is a “minor variation”.

Revocation of an authorisation by reason of a material change of circumstances

- 4.17 An authorisation can be revoked by the ACCC in accordance with the procedures set out in section 91B (Revocation of an Authorisation) or 91C (Revocation of an Authorisation and Substitution of a Replacement), if there has been a material change of circumstances since the authorisation was granted.

A “material change of circumstances” has been described as follows:¹⁸

“Material change of circumstances refers to circumstances that have an impact or likely impact upon public benefit and/or detriment.”

¹⁷ See, for example, *Re Telstra Corporation Ltd* 160 FLR 120 at 124-125.

¹⁸ *Re AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR ¶41-594 at 44,212.

- 4.18 It is likely that the reference to a “material change of circumstances” is a reference to circumstances in connection with a market that may change over time, rather than an amendment or variation to an authorised contract or arrangement. In other words, the authorisation applies to the contract or arrangement as authorised and does not include amendments or variations regardless of whether or not they are likely to have any effect upon the net public benefit. Giving effect to such a contract or arrangement as amended or varied, would not be consistent with the technical terms of the authorisation and may not be protected.
- 4.19 Accordingly, it is not likely that an amendment to the Code could be made and the authorisation protected, by asserting that the amendment does not involve a material change of circumstances.

Does the ACCC have power to make assessments upon a division between Market Principles and Market Procedures?

- 4.20 Any variation or amendment of a contract, arrangement or industry code of practice that is authorised under Division 1 of Part VII of the *Trade Practices Act* must involve the ACCC. Further, any question of whether a provision of the contract, arrangement or industry code of practice is likely from time to time to contravene a provision of Part IV of the *Trade Practices Act* cannot be answered or settled absolutely and conclusively unless and until that contract, arrangement or industry code of practice is authorised.
- 4.21 For example, in the process of the authorisation of the Market and System Operations Rules for the gas market in Victoria, it had been proposed that the Rules would include a provision to the effect that if a rule change were proposed, it would be referred to the ACCC who would decide whether it would or would be likely to amount to a material change of circumstances or result in a contravention of the *Trade Practices Act* for which no authorisation had been granted. If the ACCC were to decide that any of these circumstances applied, then an application for authorisation of the Rules as amended had to be made.

The ACCC rejected provisions of this kind, stating that such a provision could not bind the ACCC. The ACCC observed:¹⁹

“The provisions in clauses 8.6 to 8.8 which require the Commission to make a decision as to whether or not a rule change requires authorisation, or an amendment to an authorisation or approval of an access arrangement cannot bind the Commission. Unless an authorisation is in place, any action taken by parties that relies on a Commission decision, made pursuant to Chapter 8 of the MSOR, that there is no breach of the *Trade Practices Act*, may nevertheless be open to prosecution. This is because the power to decide whether a provision of the MSOR which is not protected by authorisation breaches the *Trade Practices Act* is vested in courts of competent jurisdiction and not in the Commission.

The Commission does not have the power to grant authorisations retrospectively and therefore draws the applicant’s attention to the fact that were it to approve a rule change being made with retrospective effect it would be acting outside its powers. Parties are only able to engage in conduct that may breach section 45 and/or section 47 from the date of authorisation. Parties may be open to

¹⁹ Draft Determination - Applications for Authorisation - Market and System Operations Rules, 28 May 1998 at page 115.

prosecution for conduct to which the retrospective provisions apply if that conduct occurs prior to the date of authorisation.”

Accordingly, there is no “half-way house” where the ACCC is involved. The ACCC is an administrative body²⁰, will follow a public process and cannot fetter its statutory powers.

- 4.22 If it is proposed that the ACCC would make assessments of the kind that had been proposed in the draft MSOR in an endeavour to avoid the authorisation process for certain proposed changes to the Code, that proposal will be rejected by the ACCC.
- 4.23 This means that if the Code were to be divided between, or separated into, Market Principles (that would be authorised) and Market Procedures (that would not be authorised), the following consequences would ensue:
- (a) The ACCC would not undertake the function, and in any event, could not undertake the function effectively, of determining which provisions of the Code are at risk under Part IV of the *Trade Practices Act* and should be authorised under Division 1 of Part VII of the *Trade Practices Act*.
 - (b) No assessment or determination by any other person in connection with any separation of Market Principles from Market Procedures could fetter or restrict:
 - (i) the statutory powers and duties of the ACCC under the *Trade Practices Act* (save for an express amendment to the *Trade Practices Act* to that effect); or
 - (ii) the rights of any “private litigant” to commence proceedings under Part IV of the *Trade Practices Act* and seeking a remedy under Part VI of the *Trade Practices Act*.
 - (c) In the absence of the whole of the Code (as amended from time to time) being authorised under Division 1 of Part VII of the *Trade Practices Act*, there will be the risk that unauthorised provisions of the Code (being the Market Procedures), and any conduct engaged in with respect to Market Procedures, would continue to be subject and exposed to the relevant provisions of Part IV of the *Trade Practices Act*, bearing in mind the inability of any later authorisation to have retrospective effect.

²⁰ See, for example, *Australian Petroleum v Australian Competition and Consumer Commission* (1997) ATPR ¶41-555.

5 The difficulties with a separation or division of the Code into Market Principles and Market Procedures

Elements to be satisfied for separation of Market Principles and Market Procedures

- 5.1 A separation of particular provisions of the Code between the Market Principles and the Market Procedures requires each of the following elements to be satisfied:
- (a) It must be feasible for Market Principles to be separate and distinct from the Market Procedures so that the appropriate protection provided by an authorisation under Part VII of the *Trade Practices Act* can be achieved by the authorisation of the Market Principles alone.
 - (b) As a point collateral to paragraph (a), it must be feasible for the Market Principles not to have any element of conduct that might be a contravention of a provision of Part IV of the *Trade Practices Act* at any time.
 - (c) The question of how and by whom the Market Principles are to be identified is critical.
 - (d) Once a Market Procedure is identified, it is critical that a Market Procedure (whether present or future) is not at risk of contravening a provision of Part IV of the *Trade Practices Act*.
- 5.2 In addition to the need to separate Market Principles from Market Procedures in the Code as presently in force (in order to identify and distinguish between provisions of the Code that require authorisation and those that do not), that separation and classification would also need to be implemented in respect of all future proposed amendments to the Code. Each amendment will need to be identified as a Market Principle or a Market Procedure.

The distinction between the identification of aspects or features of the Code which may contravene Part IV and the authorisation process

- 5.3 The purpose of Annexure A is to identify aspects or features of the Code that may contravene a provision or provisions of Part IV of the *Trade Practices Act*. Annexure A is not, and it is submitted could not be prepared as being, an exhaustive list of provisions of the Code of that kind.

In fact, an ability to identify some provisions of that kind, in the context of Market Participants requiring protection generally from Part IV of the *Trade Practices Act*, demonstrates the inadequacy of such a process, two particular concerns being:

- (a) the fact that it would be dangerous to assume that liability, or potential liability, under Part IV would be limited necessarily to particular isolated provisions of the Code; and

- (b) the fact that the “net public benefit” test under Division 1 of Part VII requires a consideration and evaluation of all provisions of the Code and all relevant “public benefits” and “public detriments”.

These issues are discussed further in the following paragraphs.

5.4 As summarised in Annexure A, aspects or features of the Code that may contravene a provision or provisions of Part IV of the *Trade Practices Act* are identified. In identifying those principal aspects or features, it is not necessary to make a determination upon whether those aspects or features will contravene Part IV; it is sufficient for the purposes of Division 1 of Part VII to identify the aspects or features that may or might contravene a provision of Part IV.

5.5 However, the identification of those principal aspects or features does not mean that the authorisation process under Division 1 of Part VII is limited to those aspects or features alone.

In fact, the evaluation undertaken by the ACCC (and upon review, by the Tribunal) will involve all inseverable and interrelated provisions of the Code (and surrounding conduct) and a broad assessment of “public benefit” and “public detriment” in the context of the NEM.

In making that assessment of “public benefits” and “public detriments” as against the likely counterfactual, all provisions of the Code (whether classified as a Market Principle or Market Procedure) will be drawn into the analysis.

5.6 Any test that involves an evaluation or assessment of “public benefit” or “public detriment” will be public in procedure and nature. This is further emphasised by the administrative nature of the statutory functions undertaken by the ACCC. For example, in the case of an application to withdraw or vary an access code under section 44ZZAA(6) of the Trade Practices Act, the ACCC applies “public interest” criteria, notwithstanding the fact that section 44ZZAA does not set out a statutory test or consultation procedure to apply to an application to withdraw or vary an access code under section 44ZZAA(6).

5.7 The ultimate point is that even if a Market Principle (being an actual provision of the Code that may contravene a provision of Part IV) is identified and separated from a Market Procedure, it does not follow that the authorisation process for that Market Principle will be necessarily any less complex than the authorisation processes that occur now in relation to amendments to the Code.

Classification between Market Principles and Market Procedures and inability to authorise retrospectively

5.8 In relation to a proposed amendment to the Code and the classification of that proposed amendment as a Market Principle or a Market Procedure, the following observations can be noted:

- (a) If that amendment is classified as a Market Principle, it could not be made or given effect to until it is authorised. The *Trade Practices Act* does not provide any protection, save only for the grant of an interim authorisation, pending the ACCC’s final determination.

- (b) If the amendment is classified as a Market Procedure, making or giving effect to that Market Procedure cannot be authorised retrospectively at some later time if that Market Procedure has been misclassified or otherwise forms part of a Market Principle. Conduct engaged in pursuant to such a Market Procedure before authorisation will be subject to the provisions of Part IV of the *Trade Practices Act*.

Concerns with a separation between Market Principles and Market Procedures

- 5.9 Any proposal to identify and separate Market Principles and Market Procedures in the Code and to classify future proposed amendments as either a Market Principle or a Market Procedure, carries with it the following concerns and risks:
- (a) At the practical and operation level, it may not be realistic or feasible to separate the provision of the Code from time to time into Market Principles and Market Procedures that are “mutually exclusive” in relation to potential issues under Part IV of the *Trade Practices Act*.
 - (b) As markets evolve and develop over time, and as the provisions of the Code have an inseverable interrelationship with the operation of the NEM, even if a provision were to be classified as a Market Principle or a Market Procedure at a particular time, that classification may change over time and by reason of the interrelationship between provisions, conduct engaged in under a Market Procedure may still be conduct engaged in with respect to, or by reason of (directly or indirectly), a Market Principle.
 - (c) Any classification of the provisions of the Code from time to time between Market Principles and Market Procedures:
 - (i) will not be binding on the ACCC;
 - (ii) will not restrict the rights of any “private litigant” under the *Trade Practices Act*; and
 - (iii) will mean that Market Procedures remain subject to the provisions of Part IV of the *Trade Practices Act*.
 - (d) As an authorisation cannot be granted retrospectively, any conduct engaged in prior to the grant of an authorisation:
 - (i) will continue to be subject to Part IV of the *Trade Practices Act*; and
 - (ii) will not prejudice, restrict or fetter at any future time the exercise by the ACCC of its powers under the *Trade Practices Act* in respect of any conduct relating to a Market Procedure, whether or not the ACCC were to express any opinion as to whether a provision was a Market Provision or a Market Procedure (which the ACCC would not do in any event).

Practical difficulties in applying a limited authorisation process to particular aspects or features of the Code that may contravene Part IV

- 5.10 The practical difficulties in applying a limited authorisation process to particular and isolated provisions of the Code is demonstrated by the following procedures that would be involved in undertaking such a process:
- (a) The first step is to identify the aspects or features of the Code that are likely to, or may, contravene section 45 (including the *per se* contraventions of price fixing and exclusionary provisions) or section 47 of the *Trade Practices Act*.
 - (b) Assuming that those aspects or features of the Code can be identified for that purpose, it is necessary to assess whether an aspect or feature:
 - (i) is, is likely to be or may be, a *per se* contravention, on the one hand; or
 - (ii) a provision or conduct that would only contravene Part IV of the *Trade Practices Act* if it had the purpose, effect or likely effect, of substantially lessening competition in the relevant market, on the other hand.
 - (c) As an applicant can make an application for authorisation, (and as the ACCC must assess and make a determination upon that application), whether or not it was necessary to make that application, it follows that:
 - (i) the question of whether or not the provision or conduct is likely to contravene Part IV need not be undertaken; and
 - (ii) it is not necessary as part of an application for authorisation to justify the grounds of the application under Part IV or to undertake any assessment of the risk or likelihood of Part IV being contravened.
 - (d) The question of whether an application for authorisation is to be made ultimately is one of risk assessment. Clearly, the proper and prudent course is for any provision or conduct that may or might contravene Part IV to be protected by the authorisation. This would include and extend to interrelated or interconnected provisions and conduct.
 - (e) Given the technical elements, limbs and requirements of the provisions of Part IV that involve a *per se* contravention, together with the various judicial opinions expressed in relation to those technicalities (or their application), there can be differences of opinion as to whether a provision or conduct would be, or would be likely to be, a *per se* contravention. The considerable risk of making an inappropriate or incorrect assessment is clear.
 - (f) In order to determine whether competition in a relevant market is likely to be substantially lessened, all provisions of the relevant contract, arrangement, understanding or industry code of practice are aggregated as are the provisions of any other contract, arrangement,

understanding or code of practice involving the corporation or corporations.

- (g) Clearly, aggregation requirements of this kind, coupled with evolving and developing markets and conditions (including changes to market rules), make any assessment difficult.
- (h) The question of whether a provision or conduct is likely to have a particular effect (ie the effect of substantially lessening competition) is a continuing analysis. A provision of the *Trade Practices Act* that is expressed to render a provision of a contract or arrangement unenforceable if the provision of that contract or arrangement has or is likely to have a particular effect, will continue to apply at all times notwithstanding that:
 - (i) at an earlier time the provision of that contract or arrangement did not have that effect or is not regarded as likely to have that effect; or
 - (ii) the provision of that contract or arrangement will not or may not have that effect in the future²¹.

5.11 Accordingly, if any provision or conduct (or combination of provisions or conduct) may or might contravene Part IV at any time during which effect is to be given to the contract, arrangement, conduct or industry code of practice, authorisation is prudent.

5.12 The result is that if the AEMC is to make assessments of this kind in order to distinguish between a Market Principle and a Market Procedure of the Code, as the assessment will involve a determination of whether or not to authorise a provision or conduct, significant risks will arise, potentially to all Code Participants.

The assumption must be that a very conservative approach will be taken and that, notwithstanding any proposed change to the classification of the provisions of the Code as between Market Principles and Market Procedures, the result will lead almost inevitably to many (if not all) of the provisions of the Code (including proposed amendments) being classified as a Market Principle in order to avoid the risks of a possible potential contravention of a provision of Part IV at some time.

²¹ Section 4(3) of the *Trade Practices Act*.

6 Comment on the Ministerial Council on Energy Proposals for the Code Change Process

6.1 In the MCE Report, the MCE set out its proposal for the Code Change Process as follows²²:

- (a) The AEMC is bound to consider all the relevant proposals for Code 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.
- (b) 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 Code change.
- (c) The AEMC will be required, in making Code changes, to assess and report on the competition and access impacts of those changes and to assist the ACCC in considering whether to authorise Code changes.
- (d) 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.
- (e) In considering applications for authorisation or approval of Code changes, the *Trade Practices Act* 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 seek specifically from the AEMC, AER or any other party.

6.2 It is not the purpose, or within the scope of, this report to comment generally upon the proposal for the Code Change Process summarised in the MCE Report.

However, it is material, in the context of this report, to make the following particular observations:

- (a) As the Code is authorised as a whole, every change to the Code requires an application for authorisation for the whole of the Code as amended by the proposed Code change. The above proposal does not suggest any amendment to that underlying structure of the authorised instrument and appears to infer that the ACCC may have some discretion in this regard. That will not be the case; for every Code change, the ACCC would be required to consider an application for authorisation.

²² Ministerial Council on Energy, report to the Council of Australian Governments: “Reform of Energy Markets”, 11 December 2003.

Accordingly, the issues that have arisen, and have been of concern to market participants, by reason of that mandatory application of Division 1 of Part VII of the *Trade Practices Act*, would not change.

- (b) If the AEMC is to consider, and consult upon, each developed proposal for Code change, it would appear unnecessary, and likely to introduce unintended delays and complexities, for the consultation process to be undertaken by the AEMC to be as broad as the above proposal indicates. In effect, the practical outcome may be that the process and procedure undertaken by the AEMC for *each* proposed Code change, would be no different from the process and procedure that is now undertaken by the ACCC.

Further, as has been demonstrated in relation to most Code changes that have been made, the relevant issues and considerations relating to the Code change are likely to be limited to market issues and considerations, without any need for broad ranging consultation with the public.

Again, this is likely to lead to the AEMC undertaking a broad and conservative administrative function, similar to that undertaken now by the ACCC in respect of each Code change.

- (c) In particular, it is very likely that most proposed Code changes will not involve competition or access issues and it would appear that issues (or potential issues of this kind) could be dealt with:
- as an early consultation by the AEMC with the ACCC; and
 - without crystallising any formal involvement or participation of the ACCC (such as that crystallised when an application for authorisation is made) or the application of any inappropriate or unwarranted test.
- (d) The proposal that the AEMC would apply a “net benefit test” raises the concern that the AEMC will apply, in effect, the same test as is applied by the ACCC in relation to an application for authorisation. This would appear to be inappropriate and unnecessary for reasons including the following:
- Given the nature, scope, extent and operation of most proposed Code changes, the test to be applied by the AEMC should be one directed predominantly to the efficient operation of the market.
 - A “net benefit test” infers a process of weighing benefits against detriments.

It would be inappropriate for a “net benefit test” to encompass a quasi “net public benefit” test as applied for the purposes of an application for authorisation under Division 1 of Part VII of the *Trade Practices Act*. The “public benefits” and “public detriments” inherent in that test may well be inappropriate and irrelevant. They relate to a test prescribed in relation to arrangements and conduct that otherwise

may contravene a provision of Part IV of the *Trade Practices Act*. For example, in the case of an application for authorisation, although the concept of “public detriment” is very broad, it has been emphasised that, in the context of the *Trade Practices Act*, “the most important of potential detriments will normally be the anti-competitive effects or negative effects on competition”²³.

Further, the application of such a test may lead to unnecessary cost and delay in connection with a proposed Code change the benefit of which may be directed to the more efficient operation of the NEM.

- (e) An amendment to the *Trade Practices Act* that gives to the ACCC a discretion not to seek submissions or undertake consultation, will not remove the “dual” assessment process that occurs now. If every Code change is to continue as a mandatory authorisation process, it is inevitable that in relation to many proposed Code changes, the ACCC, as an administrative body, will act conservatively in ensuring that procedural fairness is observed by it. Even though the ACCC may have a discretion not to seek submissions or undertake consultation, it could only exercise that discretion if it is satisfied that its administrative obligations of procedural fairness (in the context of the test to be applied under Division 1 of Part VII of the *Trade Practices Act*) have been satisfied.

- 6.3 As a general observation, a concern with the proposal in relation to the Code Change Process as set out in the MCE Report is that it runs the substantial risk, in practice, of amounting to a process similar to that which has developed in relation to previous Code changes, including a mandatory authorisation process for every Code change, “dual” assessment (in relation to differing tests) as between the AEMC and the ACCC, significant time, effort and expense for every Code change, unnecessarily broad consultation processes for most Code changes, significant delay for a Code change to take effect and the continuing impediment of the ACCC having no power to grant an authorisation retrospectively.

²³ *Re Queensland Independent Wholesalers Limited* (1995) ATPR ¶ 41-438 at 40,927

7 The Proposed Code Change Process

Concerns relating to Code change processes

- 7.1 Although the Code must be a “living instrument” that develops and evolves over time, the processes involved in amending the Code (in particular, the authorisation process), are too complex and have introduced influences that should not impact upon the Code change processes.
- 7.2 Relevant concerns include the following:
- (a) The formal statutory process that is involved on each occasion that an amendment to the Code is proposed. On each such occasion, an application for authorisation of the Code as a whole (and as amended) must be made.
 - (b) The authorisation process involves considerable time, effort, costs, delays and uncertainties.
 - (c) The authorisation process has facilitated issues relating to market design and structure, addressing perceived market power and remedies and penalties for transgressions of the Code, none of which should be taken into account, or should be given the prominence that they have been given, in the context of an application for authorisation and the statutory provisions that govern such an application.
 - (d) Many of the amendments to the Code would have no impact upon the net public benefit of the Code as a whole and should be capable of prompt introduction and implementation without any prejudice to the existing authorisation.
 - (e) The minor variations provisions set out in section 91A of the *Trade Practices Act* involve a formal process and the question of what is a “minor variation” will always be difficult (and, in any event, will be determined by the ACCC (subject to rights of review to the Tribunal)).

The Proposed Code Change Process

- 7.3 The Code Change Process that we consider warrants further analysis is for the concept of the authorised market arrangements (being the Market Framework) to be broader and more flexible than the actual provisions of the Code itself.
- 7.4 The Proposed Code Change Process involves the elevation of the authorised instrument, or series of arrangements and conduct, from the Code to a broader series of principles within a defined framework (described in this report as the Market Framework).

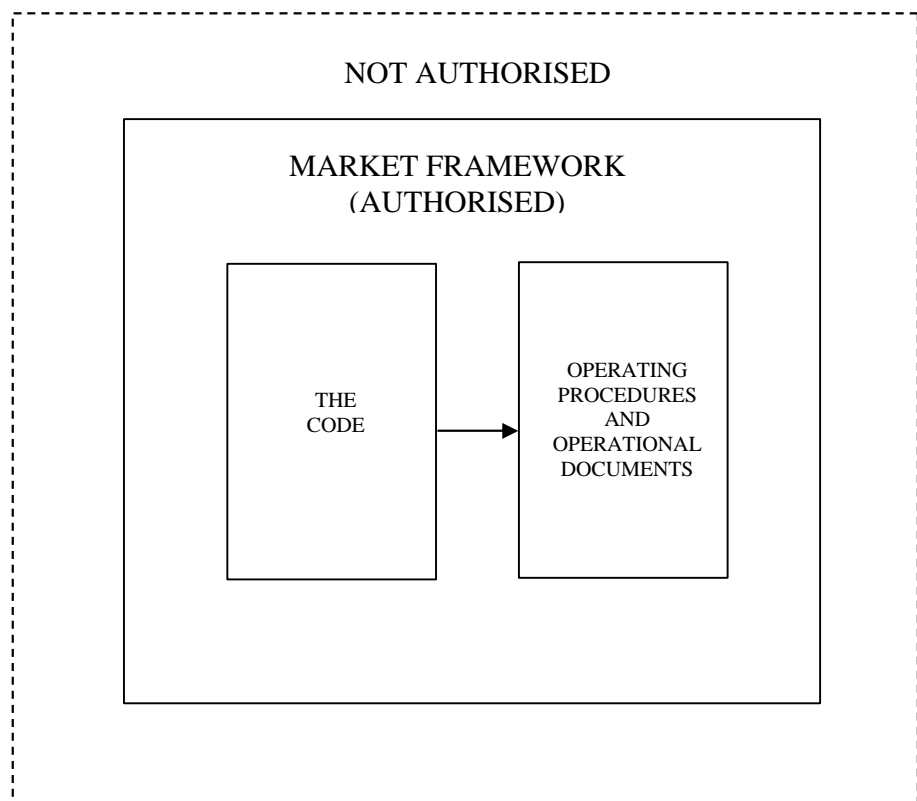
The Market Framework, although comprising a series of principles and structures under which the NEM will operate, will be a series of arrangements and conduct capable of authorisation under Division 1 of Part VII of the *Trade Practices Act*.

The Code and operational procedures and operational documents contemplated by, or used under or in connection with, the Code would fall within the Market Framework.

- 7.5 The underlying purpose of creating a Market Framework as the authorised instrument under Division 1 of Part VII of the Trade Practices Act, is to permit the required flexibility and latitude in proposing and making Code changes without crystallising (or necessarily crystallising) the authorisation process each time a Code change is proposed. It is anticipated that many Changes would be effected pursuant to proper and efficient market related criteria (without undue delay or suspension pending a determination by the ACCC in respect of an authorisation application), under the continuing protection of the authorised Market Framework. It would be only if a Proposed Code Change extends beyond, or is likely to or may extend beyond, the parameters of the Market Framework that an application for a new authorisation of the Market Framework as amended by such a significant Code Change, would need to be made.

In simple terms, the Proposed Code Change Process is depicted in figure 1.

Figure 1



- 7.6 This would not mean that the Market Framework would be too vague or uncertain to be capable of meaningful description, but it does mean that it would be set at a broader and higher level and description than the specific provisions of the Code.

In effect, the Market Framework would be a framework within which the NEM operates while contemplating and allowing for procedural flexibility within that framework. It is the Market Framework that would be authorised under Division 1 of Part VII of the *Trade Practices Act*.

The Code itself would represent a manifestation of that authorised Market Framework, but would not be the only precise method by which the Market Framework can be implemented and operated.

- 7.7 This would mean that the Market Framework as authorised would be a form of “umbrella” under which various methods of operating within that Market Framework can be introduced or an existing method (such as the Code) can be varied, without any authorisation being required.

If the Code is not the subject matter of the authorisation, but a broader Market Framework is, many (if not most), amendments to the Code would not challenge the accepted (and authorised) parameters of the Market Framework.

Further, it would avoid any requirement for legislative change (in particular, any amendment to the *Trade Practices Act*), other than in relation to the procedure proposed for significant amendments to the Code.

- 7.8 More specifically, a primary object of the Proposed Code Change Process would be to eliminate the need to assess whether a particular provision, or amendment to a provision, of the Code may be likely to contravene Part IV of the *Trade Practices Act*. For so long as it is the Code itself that embodies the subject matter of the authorisation (or, for that matter, any combination of provisions of the Code), that assessment and the attendant risks, will arise. In each such case, it would be necessary to undertake the authorisation process for the reason that it is the Code itself (as amended from time to time) that is authorised.

If, and for so long as, the authorisation process is involved, the issues, difficulties, concerns and complexities discussed in sections 3 and 4 will continue to apply.

- 7.9 In support of this proposal, the following observations can be made:

- (a) A certain degree of flexibility and generality is inherent in Part IV and the subject matter that is capable of authorisation under Division 1 of Part VII. For example, an understanding, or an attempt to arrive at an understanding, of a proscribed kind, will contravene Part IV. Similarly, section 88(1) provides for arrangements or understandings that may fall within section 45 to be authorised.

An “arrangement” or an “understanding” is a broad concept (ie, a meeting of minds) and does not require any formality to give rise to a contravention.

- (b) The concept of a “price fixing arrangement” in contravention of sections 45A and 45 is also very broad. An understanding between competitors that is likely to have the effect of “fixing, controlling or maintaining” prices of goods or services supplied or acquired, is a *per se* contravention.

Further, there is judicial uncertainty as to what is meant by the expression “controlling price”. One judge of the Federal Court has expressed the view that “putting to one side de minimis cases, the degree of control, although relevant to penalty, is not relevant to the issue of contravention”²⁴. Another judge of Federal Court has more recently disagreed with that proposition and has expressed the view that “it is more consistent with the other authorities... to regard the word ‘control’ in section 45A as indicating a degree of control towards the higher end of the scale”²⁵.

Accordingly, the subject matter of an authorisation should encompass a flexible concept of an arrangement, understanding or conduct the essence of which may contravene Part IV, but the particulars or terms of which (or the method of implementation of which) has flexibility, if not a degree of uncertainty.

- (c) Sections 88(1)(a) and (b) empower the ACCC to grant an authorisation to make a contract or arrangement, or arrive at an understanding and to give effect to a provision of a contract, arrangement or understanding. Similarly, section 88(8) empowers the Commission to grant an authorisation to engage in conduct. Although it is in respect of those kinds of activity that an authorisation may be granted, it is clear that a Market Framework broader than the Code itself is capable of being the subject matter of an application for authorisation, provided the authorisation is to do something contemplated by those subsections²⁶.
- (d) The original authorisation of the Code itself, taking into account some of the general and uncertain provisions contained in it at that time, represents an example of a permitted flexibility in the subject matter of an authorisation.
- (e) A recent example of an authorisation that was determined by the Tribunal to be sufficiently certain, while retaining flexibility, is found in *Application by National Foods Ltd.*²⁷ The Tribunal made a determination by consent which authorised the following general arrangement (subject to certain conditions and requirements):

- “(a) Groups of dairy farmers are authorised to form collective bargaining groups through which they may collectively negotiate terms of supply, including

²⁴ *Australian Competition and Consumer Commission v CC (NSW) Pty. Ltd.* (1999) 92FCR 375 at 415 [178] per Lindgren J.

²⁵ *Australian Competition and Consumer Commission v The Australian Medical Association Western Australian Branch Inc.* (2003) ATPR ¶ 41-945 at 47, 261 [195] per Carr J.

²⁶ *Jones v Australian Competition and Consumer Commission* (2003) 200 ALR 234 at 249 [65].

²⁷ (2002) ATPR ¶41-885

pricing, with a dairy processing company that each member of the group wishes to supply;

- (b) the Australian Dairy Farmers' Federation...is authorised to hold general non-specific, discussions with supermarkets, on an individual and voluntary basis, regarding the impact of tender processes on dairy farmers.”

Clearly, the subject matter of that authorisation contemplates a variety of arrangements, outcomes and procedures that would fall within the terms of the authorisation. Those procedures could change or vary at any time and the authorisation would not be prejudiced. Basically, the underlying concern was that the proposed arrangements could give rise to an exclusionary provision or price fixing arrangement of a general nature (depending upon the outcome of each negotiation process). That subject matter was considered sufficiently certain for the purposes of authorisation.

- 7.10 The discussion in chapter 8 (in particular) and the example Market Framework in relation to chapter 3 set out in Annexure B, take into account this Proposed Code Change Process.

Obviously, the example Market Framework in relation to chapter 3 of the Code set out in Annexure B relates only to a potential (and yet to be further assessed) framework within which the spot market could operate. The totality of the Market Framework that would be authorised would comprise the combination of arrangements under which the NEM would operate and the Code as a whole would fall (as a form of sub-set).

For present purposes, Annexure B is a potential example of how the Proposed Code Change Process could be developed. Annexure B could be part of the Market Framework that is authorised and chapter 3 of the Code would be a particular manifestation of the operation of the spot market under that Market Framework. So long as amendments to chapter 3 continue to fall within that Market Framework, no authorisation for those amendments would be necessary.

Examples of “high level” authorisation in the existing Code

- 7.11 There are already a number of examples in the Code itself where the ACCC has authorised conduct at a “high level”, allowing procedures to be put in place later which set out the detailed arrangements.
- 7.12 At the time the Code was initially authorised, these included the following fairly minor examples:
- (a) **dispatch algorithm:** clause 3.8.1(d)²⁸, which contemplates that NEMMCO will establish a dispatch algorithm to be used by NEMMCO for the purposes of central dispatch and pricing. The dispatch algorithm must be consistent with the principles for central

²⁸ Originally clause 3.8.1(c). It has since been renumbered.

dispatch (particularly those set out in clause 3.8.1(a) and (b)) and pricing (particularly those set out in clause 3.9); and

- (b) **power system operating procedures:** clause 4.10.1, which contemplates that NEMMCO will compile power system operating procedures that Code Participants must observe.

- 7.13 The concept was used in a more significant case in the provisions inserted into the Code in 1999 (clause 3.18) dealing with settlement residue auctions. Mallesons prepared the relevant provisions for NEMMCO and the authorisation application.
- 7.14 Clause 3.18 of the Code contemplates that NEMMCO would develop auction rules governing the conduct of settlement residue auctions. In developing 3.18, we analysed the auction process and identified the features of the auction which were likely to raise competition issues. We then specifically dealt with these “anti-competitive” features in the proposed code clause (which was authorised as part of the Code), leaving other more procedural issues to be dealt with in auction rules.
- 7.15 These “anti-competitive” features included:
- (a) the ability to exclude certain persons from particular auctions (particularly TNSPs, the South Australian generators and Snowy Hydro Trading);
 - (b) the establishment of reserve prices (up until 1 January 2002); and
 - (c) the common clearing price.

NEMMCO was then free to develop (and amend) rules setting out the auction procedures, subject to oversight by a settlement residue committee.

The ACCC authorised the Code changes, including NEMMCO’s discretionary power in relation to auction rules, with conditions designed to increase NEMMCO’s accountability.

- 7.16 In some aspects, the NGF’s proposal is very similar to the process accepted by the ACCC in relation to settlement residue auctions:
- (a) the principles are set out in a document which is authorised (in the case of settlement residue auctions, clause 3.18 of the Code); and
 - (b) the detailed arrangements are contained in rules or procedures which are developed by the market operator and “signed off” on by another body (in the case of settlement residue auctions, the settlement residue committee).

Significant Amendments to the Code

- 7.17 Of course, there may be a proposed amendment to the Code that is sufficiently material as to raise the question of whether it, or conduct that

would be engaged in under it, may fall outside the parameters of the authorised Market Framework.

In such an unusual case, there is the potential for the following risks and issues to arise:

- (a) The inherent risk in making any assessment as to whether such a proposed material and significant amendment may fall outside the terms of the authorised Market Framework.
- (b) The fact that the ACCC will not make that assessment and, in any event, cannot be bound by any such assessment.
- (c) The fact that an authorisation cannot be granted retrospectively.

The application of a “notification” concept

- 7.18 It may be that in the case of a material and significant amendment to the Code, the element of risk could be removed if a procedure similar in concept to that applied in relation to notification of exclusive dealing under Division 2 of Part VII of the *Trade Practices Act* will be introduced. Basically, the notification procedure (other than in the case of third line forcing) provides for a corporation to give notice of the proposed conduct (by setting out particulars of that conduct) to the ACCC. Where a corporation has given such a notice to the ACCC, the engaging by the corporation in the conduct referred to in the notice will not contravene section 47 unless the ACCC has given notice (and followed the prescribed procedures) stating that the protection of the notification is to cease.
- 7.19 In the context of the Proposed Code Change Process, the “notification” concept could be applied so as to:
- (a) give the AEMC the power to “certify” the proposed amendment to the Code as falling within the authorised Market Framework; and
 - (b) provide that any certification by the AEMC has affect unless and until the ACCC withdraws it (after following a prescribed procedure) on the ground that the net public benefit attaching to the Market Framework as authorised has been, or is likely to be materially diminished.

- 7.20 Such a procedure would mean that by the AEMC certifying the proposed amendment, effect could be given to that amendment with the statutory protection of the existing authorisation afforded by the certification process. Any subsequent decision by the ACCC to withdraw the protection of that certification would only have prospective effect (as it does in relation to the notification procedure under Division 2 of Part VII of the *Trade Practices Act*).
- 7.21 The effect of any proposed withdrawal by the ACCC of the protection of the certification, would mean that the Market Framework (as modified by the significant amendment to the Code) would only then require a new and separate authorisation.
- 7.22 If the ACCC decides to withdraw the certification given by the AEMC and an application for a new and separate authorisation of the revised Market Framework is then made to the ACCC, the ACCC would grant an interim authorisation under section 91(2) of the *Trade Practices Act* for that revised Market Framework to enable the ACCC to give due consideration to that application.

The potential use of the interim authorisation as an alternative

- 7.23 Section 91(2) of the *Trade Practices Act* provides in part as follows:
- “If the Commission considers it is appropriate to do so:
- (a) for the purpose of enabling due consideration to be given to:
- (i) an application for an authorization; or
- (ii) an application for a minor variation of an authorization; or
- (iii) an application for the revocation of an authorization and the substitution of a new one; or
- ...
- (c) for any other reason;
- the Commission may at any time:
- (d) in the case of an application for an authorization - grant an authorization that is expressed to be an interim authorization; and
- (e) in the case an application for a minor variation of an authorization - grant an authorization that is expressed to be an interim authorization dealing only with the matter the subject of the application for a variation; and
- (f) in the case of an application for the revocation of an authorization and the substitution of another - suspend the operation of the authorization sought to be revoked and grant an authorization that is expressed to be an interim authorization in substitution for the authorization suspended.”
- 7.24 The fact that certain activities, practices or conduct may commence pursuant to the grant of an interim authorisation would have no effect upon any assessment the ACCC may make of a certification given by the AEMC in relation to a Code change. Indeed, section 91(2) provides an express

recognition of the need for arrangements, practices and conduct to be protected by means of interim authorisation “for the purpose of enabling due consideration to be given to” applications made under Division 1 of Part VII of the Trade Practices Act. There would appear to be no reason why a similar procedure could not apply in relation to a Code change certified by AEMC and which may have the potential to extend beyond the authorised Market Framework.

- 7.25 The fact that the particular conduct as certified by the AEMC would have been engaged in while the ACCC gives “due consideration” to it, it does not affect the power of the ACCC to revoke the interim authorisation under section 91(2AB) of the Trade Practices Act²⁹.

It is also relevant to note the following observation of the Trade Practices Tribunal³⁰:

“The Commission may grant interim authorization for certain conduct pending its examination of the matter and finally refuse authorization, but continue the interim authorization until a specific period so that the applicant may apply to the Tribunal for a review of the determination refusing authorization.

...

There is no necessary inconsistency between a determination of the Commission not to grant authorization and the grant by it, even at the same time, of interim authorization. The Commission itself has power to do this and in the past has frequently exercised it, so that the unsuccessful applicant may apply for review to the Tribunal and not be prejudiced in the meantime.”

- 7.26 Significantly, section 91(2A) provides that sections 90(4) to (9) inclusive, do not apply in relation to an authorisation that is expressed to be an interim authorisation. This straightforward mechanism for granting an interim authorisation was recognised and applied by the Trade Practices Tribunal in *Re International Air Transport Association* as follows³¹:

“First, the fact that an application is for interim authorization pending the final hearing of the application for authorization points strongly to the conclusion that the Tribunal is not dealing finally with any issues in the matter.

Second, generally it would be inappropriate to examine too closely or precisely questions of law which arise in the matter... or to sift through extensive material to determine questions of fact in issue between the parties and which may be finely balanced. It would be unfair to the parties...to come to conclusions on difficult questions involved at an early stage of the process of review. ...

Third, like the Commission, the Tribunal is not bound, upon the hearing of an application for interim authorization, by the prohibitions imposed by s 90(6), (7), (8) and (9) of the Act (s 91(2A)) though the two bodies are generally otherwise bound by them. This does not mean that questions of benefit or detriment to the public or competition are irrelevant on the hearing of an application for interim authorization. Indeed, they are fundamental to the Tribunal’s task and of great importance. It simply means that the prohibitions which would otherwise apply are rendered inapplicable by the Act itself.”

²⁹ See, for example, *Re McIlwraith McEachern Ltd.* (1991) 104 FLR 295.

³⁰ *Re International Air Transport Association* (1985) 58 ALR 721 at 725-726.

³¹ (1985) 58 ALR 721 at 728, referring to, and adopting, the approach applied in *Re Queensland Timber Board* (1975) 24 FLR 205.

- 7.27 Accordingly, as a potential alternative to the “notification” concept, in the context of the Proposed Code Change Process, the “interim authorisation” concept could be applied so as to:
- (a) give the AEMC the power to “certify” that the proposed amendment to the Code falls within the authorised Market Framework; and
 - (b) provide that if the AEMC gives that certification in circumstances that raise the question of whether the Code change or conduct that would be engaged in under it, may fall outside the parameters of the authorised Market Framework, the ACCC will be required to grant an interim authorisation for the Market Framework as amended by the change certified by the AEMC, until the ACCC gives due consideration to it and makes a determination upon any application for authorisation in respect of it that may follow.
- 7.28 The interim authorisation procedure was used, and applied by the ACCC, on several occasions in relation to the authorisation, commencement and operation of NEM1.

8 A practical example of the application of the Proposed Code Change Process

Overview

8.1 In Annexure B, we have taken parts of chapter 3 as an example of how the division between the Market Framework and provisions of the Code could operate.

The parts of chapter 3 which we focus on are:

- (a) spot price determination; and
- (b) the prudential regime.

8.2 Both these parts raised competition issues for the ACCC when the Code was originally authorised. We have selected these parts because of the contrast they provide:

- (a) The Code already specifies “principles” for spot price determination while it does not for the prudential requirements.
- (b) In the case of spot price determination, the competition issue is relatively clear (ie price fixing) while the competition issue relating to the prudential requirements is not so clear cut (eg barriers to entry)

8.3 As a practical test of the example Market Framework in Annexure B, we have then briefly considered certain Code changes in relation to spot price determination and the prudential regime since market start to determine the extent to which those Code changes would or should require authorisation of changes under the example Market Framework.

Approach and warning

8.4 We have based the example on clauses and concepts already existing in the Code. We have not analysed the appropriateness of those concepts or principles.

The approach we have taken is to draft the principles as broadly as possible while still attempting to ensure that the relevant contract, arrangement, understanding or conduct which raises competition concerns is authorised.

8.5 The Market Framework in Annexure B represents a limited example. Clearly, any articulation of principles for the purposes of giving effect to the Proposed Code Change Process will require, among other things, a more detailed consideration of each of the following:

- (a) The competition issues concerned and whether the principle encompasses the relevant concerns.
- (b) The underlying purpose of those provisions in the context of the NEM and whether they have been articulated properly.
- (c) The interaction with other parts of the Code.

We have not defined terms used in the example Market Framework at this stage. We believe that Code definitions should not be used in the Market Framework for the reasons explained below.

General observations

8.6 Before discussing the specific issues raised by the example Market Framework, we make the following general observations on the exercise:

- (a) While we have drafted the Market Framework broadly, we have used examples as a way of demonstrating how the principle may be applied in the procedures. For example, in the principle relating to the AEMC determining procedures for market suspension, we have given specific examples of the types of events that may give rise to a suspension such as power system failure and declarations of jurisdiction.
- (b) There is a risk that the Market Framework could come to be interpreted or applied strictly. We therefore think it would be advisable to include in the final Market Framework document a section stating that they are to be interpreted broadly. This would be along the lines of similar provisions in the various Interpretation of Legislation Acts³².
- (c) We do not believe that the Code Change Process is best achieved by separating the Code into, say “red” and “blue” provisions with the former being the Market Principles authorised under Part VII and the latter being merely the Market Procedures.

As shown by the prudential requirements, it is necessary to draw out the aspects or features of those requirements which raise competition concerns and it is not always possible to point to a particular clause or provisions as containing the “principle” or encompassing all the issues requiring authorisation.

Even where the Code contains principles (such as those for spot price determination), the principles should be articulated at a higher level to allow proper flexibility for Code changes that do not crystallise the authorisation process.

- (d) The use of Code definitions in the Market Framework may cause difficulties where the term is defined by reference to procedures and may blur the distinction between the authorised Market Framework and Code provisions within that Market Framework. For example, the Market Framework for spot price determination refers to central dispatch. *Central dispatch* is defined in the Code by reference to clause 3.8. Clause 3.8 contains 27 sub-clauses, much of which should probably be in procedures that may be modified from time to time.
- (e) The procedures and processes to apply under the Market Framework would include the detailed Code provisions. However, the procedures could comprise much more. For example, when

³² See for example, section 35 of the *Interpretation of Legislation Act 1984* (Vic).

NEMMCO issues a direction, spot price determination is the subject of the procedures in the Code. Those procedures contemplate NEMMCO publishing a methodology to determine spot prices in those circumstances (clause 3.9.3). There is no reason why that detailed methodology of NEMMCO could not itself be a procedure.

Spot price determination

8.7 The concerns under section 45 and 47 of the *Trade Practices Act* that were raised in relation to spot price determination are noted in Annexure A. A number of these relate to the requirement to trade in the spot market and the conditions which must be met before a person may do so. The major competition issue with spot price determination is the potential for it to constitute a price fixing arrangement for the purposes of sections 45 and 45A and we will concentrate on this aspect.

8.8 The principles for spot price determination could be considered to be a price fixing in that competitors agree to a particular pricing mechanism (primarily the auction process inherent in central dispatch) and principles being used to determine the spot price. In addition, there are a number of occasions in the Code, when this “auction price” can be modified or limited (for example, market floor prices, VoLL, when directions occur, administered price periods and market suspension).

Accordingly, the potential price fixing arrangement could relate to both the spot market to the extent it gives a common clearing price and to the circumstances in which NEMMCO will modify or depart from that clearing price.

8.9 For the purposes of this exercise, we have limited the example Market Framework to that directly relevant to the spot price determination under chapter 3. However, other parts of the Code may also impact on spot price determination and these may also be part of a price fixing arrangement or understanding (and therefore represented in the final Market Framework).

8.10 The example Market Framework dealing with spot price determination are based on the principles in clause 3.9.1, but we have substantially modified them to make them less prescriptive (and therefore allow more flexibility in the relevant procedures) and to remove the reliance on other provisions of the Code.

In the next sections, we will look at the role of VoLL and the market floor price in spot price determination.

Background to VoLL and the market floor price

8.11 In its original determination authorising the Code, the ACCC questioned the need for a price cap and market floor price in the NEM. In a competitive market, a price cap and floor should not be necessary and may distort price signals. The ACCC, noting the experience in New Zealand, considered that VoLL may not be required as the NEM matures.

8.12 However, the ACCC accepted that there could be good reasons for having a price cap provided the need for, and the level of cap, was kept under constant

review. In respect of the zero price floor (as it then was), the ACCC authorised it on the condition that it was interim measure only. On the basis of its conditions, the ACCC found the public benefits of the price cap and floor outweighed the public detriments.

- 8.13 In 1999, the ACCC received applications for authorisation of changes to the Code by:
- (a) changing VoLL from \$5,000 to \$20,000;
 - (b) removing the zero price floor and having a market floor price of minus \$1,000; and
 - (c) including the administered price cap provisions which are now in clause 3.14.

These changes were based on a work done by the Reliability Panel and the Code Change Panel. The proposed Code changes sought to separate the economic price signalling and risk capping roles of VoLL. The increase in VoLL was to provide a less fettered price signal to the market, primarily in relation to the need for more capacity. The administered price cap provisions were designed to minimise the risks to the market of the increase in VoLL.

The ACCC's conditions to authorising the changes included changing VoLL to \$10,000. The major public detriments identified by the ACCC included the additional risks to the market by raising VoLL, concerns over how generator market power may manifest itself with a higher VoLL and the likelihood of higher prices across the NEM.

Example Market Principles relating to VoLL and the market floor price

- 8.14 The example Market Framework is designed to authorise the existence of the price cap and floor. The example Market Framework does not necessarily require authorisation of changes to either VoLL or the market floor price. This is quite deliberate but likely to be controversial.

What the Market Framework seeks to do is authorise the existence of a market with a price cap and floor as it is the existence of those price restraints, *not the level of those restraints*, which will constitute a breach of section 45. Putting it another way, whether VoLL is \$1 or \$1M - it may still constitute a price fixing arrangement which needs authorisation.

- 8.15 However, there is a practical issue involved. For the price restraints to be authorised, the public benefits must outweigh the public detriments. The ACCC may regard it as impossible to assess the public benefits and public detriments of price restraints without considering the level of those price restraints and all other related or relevant issues, conditions and circumstances to be taken into account as part of the analysis under Part VII of the *Trade Practices Act*. To deal with this issue, it may be possible to include in the principles a framework for changes in the price restraints (for example, movements to be within a certain range or movements in only one direction).
- 8.16 In many ways the VoLL debate is a good example of the ACCC's approach to authorisation of the Code. The issue comes back to the change over time in the way the ACCC sees its role in relation to Code authorisations. In its original authorisation of the Code, the ACCC was more focussed on the necessity of the price restraints in the NEM. In fact, it noted that the level of VoLL was essentially arbitrary and the ACCC was not in a position to recommend the appropriate level. However, the ACCC's concerns in its 2000 VoLL determination were not so much about the existence of the price cap but its level, and the impact of that level given its concerns about the structure of the market. However, as the ACCC acknowledged in its original authorisation of the Code, market structure is not an issue addressed in the Code but was a matter for the individual jurisdictions to determine.
- 8.17 Other points to note about the example Market Framework are:
- (a) The Reliability Panel is required to review the need for, and level of, the price cap and floor annually. This ensures that the authorisation for the price caps and floor is not "carte blanche" for the length of the period of authorisation.
 - (b) The market must have at least two years notice before changes to the price cap and floor take effect. This addresses the ACCC's concern at the time of authorising the new VoLL that market participants have sufficient time to adjust their arrangements in light of the proposed changes.
 - (c) The administered price cap mechanism is contemplated in the principles.

Prudential regime

- 8.18 At the time of the authorisation of the original Code, it was considered that the prudential requirements could constitute:
- (a) exclusionary provisions, in that competitors agree not to buy electricity from, or sell electricity to, Market Participants unless they satisfy the prudential requirements;
 - (b) exclusive dealing provisions, as each Market Participant trades on condition that they will not sell electricity to, or acquire electricity from, any person who does not satisfy such requirements; or
 - (c) provisions substantially lessening competition, in that they may create barriers to entry.

8.19 In authorising the original Code, the ACCC's was concerned that the prudential requirements were excessive. Its particular concerns related to what constituted an acceptable credit rating, the time in which a change to the acceptable credit rating could take effect (10 days) and the time for the provision of further credit support (24 hours).

The ACCC was also concerned about the great deal of discretion given to NEMMCO to alter prudential requirements and noted the potential for these provisions to be exercised in an anti-competitive manner.

The level of the acceptable credit rating is capable of raising a competition issue as it could constitute a significant barrier to entry (and potentially an exclusionary provision), but the other two specific concerns mentioned above are more in the nature of procedural issues.

8.20 We make the following comments about the example Market Framework relating to the prudential regime:

- (a) We consider most of the current prudential regime to be procedural. Given some of the potential competition concerns are a question of degree (for example the question of what constitutes an unacceptable barrier to entry which substantially lessens competition), it is difficult to judge the extent to which the principles need to be prescriptive as to the form which the prudential requirements will take and the manner in which they will be exercised.
- (b) The example Market Framework contemplates a number of the current mechanisms in the Code. Arguably, the principles could be set at an even higher level although the ACCC is likely to take a fairly conservative view, given that it delved into the specifics of the procedural operation of the prudential regime when authorising it.
- (c) Market Framework 3(h) deals with the ACCC's general concern about the discretion given to NEMMCO to alter the prudential requirements on short notice. It seems to us this concern can be dealt with by imposing an appropriate principle about consultation and the time at which changes take effect, rather than requiring the ACCC to undertake a detailed consideration of the procedures.

Changes to the prudential regime

8.21 There have been two major changes to the prudential regime:

- (a) changes authorised in 1999 to widen the market for credit support arrangements within the NEM from banks to include building societies and credit unions prudentially supervised in Australia as well as central borrowing authorities of governments; and
- (b) the introduction of the security deposit mechanism.

In our view, neither of these Code change packages should require authorisation. The first change lowered barriers to entry and should not raise competition concerns. Similarly, the second change was designed to provide further flexibility for participants in relation to how they meet the prudential requirements.

An interesting issue is whether a tightening of the acceptable credit criteria should require authorisation.

- 8.22 Under the example Market Framework, neither the actual changes or a tightening of the acceptable credit criteria should require a change to the Market Framework. In respect of the acceptable credit criteria, we have dealt with the ACCC's concerns by suggesting that the AEMC is specifically required to consider the impact of the acceptable credit criteria as a barrier to entry in the market when setting those criteria.

9 NEM access code

Introduction

- 9.1 The Code contains an industry access code in respect of electricity networks, generally described as the NEM Access Code.

Non-discriminatory access to electricity networks was a key aspect of the reforms to the electricity supply industry. Open access to this infrastructure was considered critical to establishing competition in the upstream generation market and the downstream retail market.

The NEM Access Regime sits under the umbrella regime for access to services provided in Part IIIA of the *Trade Practices Act*. Under section 44ZZAA of the *Trade Practices Act*, prescribed industry bodies (such as NECA) may give a written code to the ACCC setting out rules for access to a service. The ACCC may accept the access code if it thinks it appropriate to do so having regard to a number of criteria specified in the *Trade Practices Act*.

- 9.2 NECA's original application for acceptance of the Code as an access code under Part IIIA stated that the NEM access code consisted of chapters 4 to 9 and relevant parts of the remaining chapters as well as identified "applicable regulatory instruments" of the participating jurisdictions.

Despite the scope of this application, the ACCC stated that it accepted all the chapters of the Code, other than chapter 3, as an industry access code until 31 December 2010³³. This statement has been confirmed in the ACCC's draft decision relating to NECA's application to vary the NEM Access Code dated 16 July 2003.

The nature of the NEM Access Code and the authorisation process

- 9.3 An access code and an access undertaking are not the same and one does not stand in place of the other; in effect, they complement each other. If an access code is accepted by the ACCC, it means that when a participant under that access code proposes to give an access undertaking to the ACCC, the ACCC can accept that undertaking without complying with section 44ZZAA(4) if the ACCC is satisfied that the undertaking is in accordance with that access code.

The effect of these provisions is that as the NEM Access Code has been accepted by the ACCC, an access undertaking that is in accordance with the NEM Access Code (being the form of access undertakings in Schedules 5.8 and 5.9 of the NEC) enjoys a "short circuit" route to acceptance by the ACCC (and, by extension prevents a third party from making an application to have the services declared under Part IIIA of the *Trade Practices Act*).

- 9.4 The authorisation of the Code under Part VII of the *Trade Practices Act* is separate, distinct and independent from the acceptance of the NEM Access

³³ However, clause 1.12 of the Code suggests only chapters 4-9 comprise the industry access code.

Code by the ACCC and the access undertakings in the form of Schedules 5.8 and 5.9, under Part IIIA.

The acceptance by the ACCC of the Access Code and the access undertakings given by Market Participants pursuant to the Access Code, confer no protection at all against Part IV.

- 9.5 An important aspect of access codes accepted by the ACCC is that they do require variation from time to time. Section 44ZZAA(6) provides that the industry body (in this case, NECA) may vary the NEM Access Code at any time, but only with the consent of the ACCC. Section 44ZZAA does not stipulate what statutory test the ACCC is to apply, nor what public consultation procedures the ACCC is to follow, in connection with an application to vary an accepted access code.
- 9.6 The ACCC has formed the view that it must follow administrative law principles and that, as a result, when deciding whether or not to accept a variation to an access code, the ACCC must follow a public process, by publishing the proposed variations and inviting submissions, and to have regard to the matters prescribed in a case where the ACCC is requested to accept a code in the first instance.

The place of the NEM Access Code in the Proposed Code Change Process

- 9.7 It may be possible to isolate the essential features of the Code which provide access to network services for approval as an industry access code.

As the NEM Access Code must set out rules for access to a service as required by section 44ZZAA(1), it should follow that the whole of the Code would not be eligible to be the set of rules that comprises the NEM Access Code unless the whole of the Code sets out “rules for access to a service”.

In particular, the definition of “code” under section 44ZZAA means “a set of rules (which may be in general or detailed terms)”. This suggests that the rules which are approved as an access code do not necessarily need to include all the specific procedures relating to access.

- 9.8 The authorisation of the Code and the approval of the NEM Access Code are separate processes and subject to different tests. The fact that a provision or provisions of the Code may be amended, does not mean necessarily that a corresponding amendment must be made to the NEM Access Code (unless that amendment relates to a “rule for access to a service”).
- 9.9 The draft decision by the ACCC in relation to the proposed variation to the NEM Access Code³⁴, highlights the difficult issues arising as between the authorisation processes for the Code and variation of the NEM Access Code. In particular, the ACCC has not agreed to include chapter 3 of the Code into the NEM Access Code noting that it will continue to consult on future MNSP Access Undertakings.

³⁴ ACCC draft decision - *Application to Vary an Access Code - Variation to the National Electricity Market Access Code*, 16 July 2003

The ACCC rejected the submission that provisions of chapter 3 relating to rules for access to a service have already been accepted by the ACCC. The ACCC *draft* decision does not refer to the statement in the ACCC decision to accept the NEM Access Code (16 September 1998) that the NEM Access Code is “principally comprised of Chapters 4 to 9 of the NEC but it also encompasses the relevant part of the remaining parts of the NEC Chapters as well as the applicable regulatory instruments of the participating jurisdictions”.

In making its draft decision, the ACCC considered that it was sufficient for it to rely upon its authorisation analysis in respect of the various amendments to the Code which had been authorised and which are the subject of the application to vary the NEM Access Code.

However, this approach has been criticised on the basis that a variation to the NEM Access Code “should be evaluated by reference to the Access Code change criteria”.³⁵

³⁵ Submission by TransGrid to the ACCC in relation to the draft decision.

Annexure A - Identifying aspects or features of the Code for the purposes of sections 45 and 47 of the *Trade Practices Act*

- 1 We believe it is possible to identify the principal aspects or features of the Code that may contravene section 45 or section 47 and, in fact, we did this exercise in preparing the original submission for authorisation of the original Code in 1996.

As we are using parts of the current chapter 3 of the Code in our practical example (as set out in Annexure B), we consider below some of the restrictive trade practices concerns which could *arguably* arise with chapter 3. We do not necessarily agree that the following aspects or features of the Code actually give rise to these concerns.

- 2 The principal relevant aspects or features of the Code that may contravene section 45 or section 47 are summarised as follows:

- (a) **Prudential requirements**

The prudential requirements imposed on Market Participants as a condition to participation in the spot market may contravene sections 45 and 47 as they could:

- constitute exclusionary provisions as competing participants agree not to trade with other Market Participants unless they satisfy the prudential requirements;
- constitute exclusive dealing provisions as each participant trades on the conditions that they will not supply or acquire electricity from any person who does not satisfy the requirements; or
- have the effect of substantially lessening competition because the requirements constitute a barrier to entry to the market.

- (b) **Network losses**

To the extent that network losses calculated under the Code and used in the settlements process create cross-subsidies between participants (eg averaging of losses across a region), such provisions could be price fixing arrangements or could substantially lessen competition in a region.

- (c) **PASA and other information disclosure**

The collection and publication of PASA data could substantially lessen competition in the NEM by giving participants information which could enable them to manipulate the market or tacitly collude and therefore substantially lessen competition.

(d) **Compulsory spot market and spot price determination**

The NEM requires all electricity generated and used to be transacted through the spot market at the centrally determined spot price. This spot price is constrained by a price floor and price cap (VoLL).

These requirements could be considered to be:

- exclusionary provisions, as competing participants agree not to trade with other persons except through the spot market;
- exclusive dealing, as Market Participants agree to trade on condition that they will not supply electricity to, or acquire electricity from, unregistered persons;
- price fixing, in that Market Participants agree to a particular pricing mechanism being used to determine the spot price and limits on that price;
- provisions having the purpose or effect of substantially lessening competition, to the extent that a requirement to trade through the spot market, or to trade at particular prices creates a barrier to or lessens competition in the electricity market;

(e) **Settlement residues**

We considered settlement residues in more detail in section 7.

(f) **Ancillary services**

NEMMCO is responsible for the purchasing of non-market ancillary services by way of a tender process. Under the Code, potential ancillary service providers must be Code Participants and must meet a number of criteria, including technical standards. These requirements might be considered:

- an exclusionary provision, in that competitors agree not to acquire non-market ancillary services from persons unless they comply with NEMMCO's requirements and are successful in NEMMCO's tender;
- exclusive dealing, as participants trade on the condition that one or both of them will not acquire non-market ancillary services from persons unless they comply with NEMMCO's requirements and are successful in NEMMCO's tender;
- third line forcing, in that NEMMCO is supplying services to Code Participants on condition that they obtain non-market ancillary services from Code Participants who have been successful in the tender; or
- to substantially lessen competition in that the requirements may reduce the potential pool of non-market ancillary service providers and the possibility that the tendering process may

give rise to the exercise of market power if only certain generators can supply non-market ancillary services in certain areas or monopsony power by NEMMCO as it is the only acquirer of these services.

Similar issues may arise to the extent that generators required to provide certain “base” ancillary services as part of their connection agreements.

The ancillary services provisions have changed substantially since market start. In particular, the new FCAS arrangements of the market will raise substantially the same competition issues as the energy aspects of the market.

(g) **Reserve trader**

NEMMCO’s reliability safety net provisions could be an anti-competitive arrangement in that the provisions allowing NEMMCO’s intervention could substantially lessen competition in the generation market.

(h) **Market intervention and suspension**

NEMMCO’s powers to intervene in the market to either invoke an administered price cap or suspend the market could be regarded as a price fixing arrangement. The provisions relating to pricing during mandatory restrictions could give rise to similar issues although the intent of those provisions is to preserve the pricing signals.

3 At the time of the original authorisation of the Code, the ACCC also raised a number of competition concerns which were not referable to specific Code provisions.

- (i) The ACCC raised a concern that the complexity of the Code itself could constitute a barrier to entry and to innovation and competition and therefore substantially lessen competition.
- (j) Another concern was the market functions of NEMMCO and whether the concentration of these responsibilities in NEMMCO could have adverse effects on competition. This concern may be heightened in the context of some of the further market reform which has been proposed by the COAG Energy Markets Review, eg if NEMMCO is responsible for financial firm transmission rights as well as system security in so far as it relates to regulated interconnectors.
- (k) In relation to the spot market, the ACCC was concerned about opportunities of gaming by market participants under the proposed market structure.

Annexure B - Market Framework for selected parts of the Chapter 3 of the Code

1 Market procedures

- (a) The [industry panel] will determine, and may vary from time to time, market procedures to govern the operation of the market relating to wholesale trading of electricity and the provision of ancillary services. These market procedures will include provisions, conforming with this Market Framework where relevant, relating to:
- (1) prudential requirements to be met for participation in the market;
 - (2) the operation of the spot market;
 - (3) bidding and dispatch;
 - (4) spot price determination;
 - (5) the determination of ancillary services prices;
 - (6) NEMMCO functions;
 - (7) market information requirements and obligations;
 - (8) the conditions and procedures for market suspension; and
 - (9) settlements.
- (b) Market procedures, and variations to market procedures, referred to in paragraph (a) will not take effect until they have been approved by the AEMC.
- (c) The purpose of the market procedures is to create a regulatory environment which promotes an efficient, competitive and reliable market for the wholesale sale and purchase of electricity and ancillary services.

[For simplicity, we have not dealt with ancillary services on the following principles.]

- (d) In:
- (1) developing and changing the market procedures, the industry panel; and
 - (2) in approving market procedures or changes to them, the AEMC,

must take into account the following principles:

- (3) minimisation of NEMMCO decision-making to allow market participants the greatest amount of commercial freedom to decide how they will operate in the market;
- (4) maximum level of market transparency in the interests of achieving a very high degree of market efficiency;
- (5) avoidance of any special treatment in respect of different technologies used by market participants;
- (6) consistency between central dispatch and pricing, to the extent practicable; and
- (7) equal access to the market for existing and prospective market participants.

2 Spot market

NEMMCO will establish, operate and administer a spot market in accordance with the market procedures as a mechanism for:

- (a) balancing electricity supply and demand;
- (b) acquiring market ancillary services; and
- (c) setting a clearing price for electricity and market ancillary services prices at each regional reference node.

3 Prudential requirements

- (a) The market procedures may include eligibility criteria for persons participating in the spot market designed to ensure that the market participants are solvent and their obligations under the Code are capable of being enforced.

[It is anticipated that the Market Procedures in respect of this principle will primarily constitute- clause 3.3.1 of the Code]

- (b) The market procedures may include acceptable credit criteria for market participants. The industry panel in developing, and the AEMC in approving, what constitutes acceptable credit criteria (or changes to them), must take into account:

- (1) the need to encourage market entry and have the widest range of possible credit support providers; and
- (2) the need to protect the integrity of, and confidence in, the market by reducing the risks of participants defaulting.

[Market Procedures - clauses 3.3.2(a) -(e); 3.3.3; 3.3.4]

- (c) If a market participant does not meet the acceptable credit criteria, then that market participant will ensure that NEMMCO holds the benefit of credit support (from a person who does meet the acceptable credit criteria and is not itself a market participant) or other security in respect of that market participant in a form required by NEMMCO.
- (d) The amount which can be drawn under the credit support provided by a market participant must not, at any time, be less than a maximum credit limit determined for that market participant by NEMMCO. NEMMCO will determine maximum credit limits on the principle that it should cover the “reasonable worst case” exposure of NEMMCO - an exposure which, while not being impossible, is likely to happen only occasionally.

[Market Procedures - clauses 3.3.6; 3.3.7(b); 3.3.8; 3.3.8A; schedule 3.3]

- (e) The market procedures will include methodologies for monitoring the credit risk posed by market participants to NEMMCO. For example, market participants may be set trading limits calculated by reference to the market participant’s maximum trading limit or credit support which NEMMCO holds in relation to it. NEMMCO will monitor its exposure to market participants’ in accordance with those methodologies on a regular basis.

[Market Procedures - clauses 3.3.9; 3.3.10; 3.3.15; 3.3.15; 3.3.17]

- (f) The market procedures may include triggers or thresholds in relation to a methodology developed by the industry panel and approved by the AEMC. In developing and approving these procedures or changes to them, the Industry Panel and AEMC must balance:
 - (1) the credit risk posed by the market participant in respect of whom a trigger or threshold has been met; and
 - (2) giving the market participant an opportunity to take steps to rectify those credit risk issues before the payment default procedures apply.

- (g) If those triggers or thresholds are met, NEMMCO may take steps, in accordance with procedures in the market procedures, to reduce the credit risk posed by that market participant. These steps may include requiring the market participant to provide additional credit support, pay a security deposit or pay outstanding liabilities.

[Market Procedures - clauses 3.3.11; 3.3.13; 3.3.13A; 3.3.18]

- (h) NEMMCO may draw on the credit support of that market participant in accordance with the payment default procedures.

[Market Procedures - clauses 3.3.7(a)]

- (i) To the extent practicable, the AEMC will, in approving procedures relating to the prudential requirements, ensure that:
 - (1) changes to those requirements may only be made after consultation with market participants; and
 - (2) market participants are given time to adjust to any changes.

4 Regions

- (a) For the purpose of conducting the spot market, the market is to be divided into regions from time to time as recommended by NEMMCO and approved by the AEMC.
- (b) A region is an area served by a particular part of the transmission network containing one or major load or generation centres or both. The principles to be taken into account in determining regional boundaries, in order of priority, are:
 - (1) The boundary of a region will be closed and will enclose at least one significant load centre or generation centre or both.
 - (2) Where practicable significant generation centres and load centres separated by network constraints should be located in separate regions where those network constraints are likely to influence the optimal dispatch of generation and scheduled load.
 - (3) The region boundaries should be located so that transfer limits between regions can be clearly defined, and transfer flows across regions easily measured, at the region boundary.
 - (4) The number of regions created should be minimised,but recognising that it may not be possible to satisfy all principles.

[Note the impact of loss factors on regional boundaries may also need to be included in the principles.]

- (c) NEMMCO should review the regional boundaries from time to time and, if a region no longer complies with the principles in paragraph (b), take steps to alter the regional boundaries in accordance with procedures determined by the AEMC.
- (d) Each region must have a single regional reference node, the location of which will be determined by NEMMCO in accordance with procedures developed by the industry panel and approved by the AEMC.

- (e) NEMMCO will assign each connection point on the transmission network to a single region.
- (f) A change in regional boundaries must not take effect for at least one year after that change has been approved by the AEMC.

[Market Procedures: clauses 3.5.1(b)(1); 3.5.1(c)-(f); 3.5.3]

5 Spot price determination

- (a) The following principles will apply to the determination of prices in the spot market:
 - (1) spot prices will provide market participants with signals as to the value of providing, or cost of consuming, electricity at a particular location at a particular time;
 - (2) NEMMCO will determine a separate spot price for each regional reference node;
 - (3) a spot price will apply for an interval determined by the AEMC and may be set by reference to averages within that interval;
 - (4) in general, spot prices will be determined by reference to the central dispatch process. The AEMC may approve procedures, based on the principle in (1), for determining spot prices during those intervals where NEMMCO is unable to determine spot price by reference to the central dispatch process;
 - (5) where load is shed as a result of insufficient generation being available to supply demand in a region, NEMMCO will the set spot prices for that region for the affected intervals at VoLL;
 - (6) spot prices will determine dispatch such that a generating unit or load whose bid is at or below the local spot price at the transmission connection point for the relevant plant will normally be dispatched;
 - (7) a participant's bid for plant in the central dispatch process will not be considered in determining spot prices (but may be considered for the purposes of dispatch) if:
 - (A) that plant is operating in accordance with a direction from NEMMCO;
 - (B) that plant is not conforming with dispatch instructions from NEMMCO;
 - (C) that plant is constrained-on by NEMMCO due to a network constraint; or

- (D) other circumstances as approved by the AEMC apply;
- (8) network losses, network constraints, the availability of scheduled network services and network dispatch offers may be taken into account in the determination of dispatch and may consequently affect spot prices;
- (9) when the spot price is determined, it is to apply to both sales and purchases of electricity at a particular location and time;
- (b) To the extent that the Reliability Panel has determined that a market floor price and VoLL will apply in the market, spot prices must not:
 - (1) be less than the market floor price; or
 - (2) exceed VoLL.
- (c) A single regional reference price which is the spot price at the regional reference node will provide a reference from which the spot prices are determined within each region.
- (d) The local spot price at each transmission network connection point is the spot price at the regional reference node for the region to which the connection point is assigned multiplied by the intra-regional loss factor applicable to that connection point.

[Market Procedures: clauses 3.9.2; 3.9.7]

6 Market Floor Price and VoLL

- (a) The Reliability Panel will review annually the need for a market floor price and VoLL in the market and, if necessary, the level of the market floor price and VoLL.
- (b) If the Reliability Panel considers that a market floor price is necessary, the Reliability Panel will set the market floor price at a level which the panel considers will:
 - (1) allow the market to clear in most circumstances;
 - (2) not create substantial risks which threaten the overall stability and integrity of the market; and
 - (3) take into account any other matters required by the AEMC or which the Reliability Panel considers relevant.
- (c) If the Reliability Panel considers that VoLL is necessary, the Reliability Panel will set VoLL at a level which the panel considers will:
 - (1) allow the standard for reliability established by the Reliability Panel as part of power system security and reliability standards to be satisfied without use of NEMMCO's powers of direction;

- (2) in conjunction with other aspects or features of the market, not create risks which threaten the overall integrity of the market; and
- (3) take into account:
 - (A) the impact on spot prices, investment in the market and the reliability of the power system; and
 - (B) any other matters required by the AEMC or which the Reliability Panel considers relevant.
- (b) The Reliability Panel must give market participants at least two years notice before a change in the market floor price or VoLL takes effect.

[Market Procedures: clauses 3.9.4; 3.9.5]

- (c) Where a spot price in a region is set at the market floor price or at VoLL, then spot prices at all other regions directly or indirectly connected to the affected region by a regulated interconnector will be determined by NEMMCO according to procedures developed by the industry panel approved and by the AEMC. To the extent practicable, these procedures should minimise the distortion of price signals.

[Market Procedures: clauses 3.9.5; 3.9.6A]

7 Spot price determination in cases of directions, intervention and market suspension

- (a) If NEMMCO:
 - (1) gives a direction; or
 - (2) dispatches plant under a reserve contract entered into by NEMMCO under the reliability safety net provisions,

then NEMMCO will determine the spot price for the affected intervals in accordance with procedures developed by the industry panel and approved by the AEMC. To the extent reasonably practicable, the procedures will be based on the principle that the spot prices for the affected intervals should be the spot prices that would have otherwise applied but for the direction or the dispatch of that plant under a reserve contract.

[Market Procedures: clause 3.9.3]

- (b) The market procedures may set out circumstances in which NEMMCO may intervene in the normal operation of the market which may involve adjusting spot prices which would otherwise apply without intervention.

- (c) To the extent reasonably practicable, the industry panel in developing, and the AEMC in approving, the circumstances, and procedures to be followed by NEMMCO in those circumstances, will take into account the following principles:
- (1) the circumstances giving rise to price intervention must be of sufficient magnitude that the integrity of the market, or confidence in the market or its participants, could be affected without intervention or the ability to intervene;
 - (2) the period of intervention, and the modification to spot prices, should be the minimum necessary in the circumstances;
 - (3) the procedures for price intervention should be designed with the aim of having the least impact possible on the normal operation of the spot market; and
 - (4) the price intervention should minimise the distortion to the normal price signals from the spot market.

[Market Procedures: clauses 3.12A; 3.14.1 - 3.14.3]

- (d) The market procedures may include circumstances in which NEMMCO may suspend the spot market in a region. For example, these circumstances may include a collapse of the power system, a declaration of emergency by a participating jurisdiction or a market systems failure.
- (e) The spot market must not be suspended retrospectively.
- (f) The market procedures may set out procedures to be followed by NEMMCO to determine spot prices in a region where the spot market has been suspended. To the extent reasonably practicable, the procedures will be based on the principle that the spot prices for the affected region should reflect as closely as possible the spot prices that would have otherwise applied but for the suspension of the market. For example, the spot prices could be based on those of an unaffected adjacent region or NEMMCO's pre-dispatch schedule.

[Market Procedures: clause 3.14.1 - 3.14.3; 3.14.4-3.14.5]

- (g) Price intervention or suspension of the spot market must not occur solely because:
- (1) spot prices have reached VoLL or the market floor price;
 - (2) NEMMCO has issued a direction; or
 - (3) NEMMCO has dispatched plant under a reserve contract.

[We have not included principles relating to compensation.]

A new NEM regulatory framework

Dated

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