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NE Rule Change Process
C/- MCE Market Reform

By email: MCEMarketReform@industry.gov.au

**TXU Comments on MCE SCO Consultation Paper:
Proposed National Electricity Rule Change Process**

Thank you for providing us with the opportunity to comment on this consultation paper. We note the SCO has clearly invested a large effort into setting up this process, and that in general it appears robust. However, as the period available for industry consultation is short we have not been able to consider all potential aspects of the proposed process.

Consultation & Timeframe

Whilst we understand the MCE's motivations for rapidly progressing this consultation we do urge caution. Our understanding is that unlike previous code change procedures, these will be enacted in law, and thus the industry will struggle to adjust them at a future date should they prove inadequate. We suggest that the comments received should be published, and the SCO should consider forming an industry working group(s) to assist full consideration of these comments.

If the legislative timeframes make this impractical, we suggest instructing the AEMC to review the process within 2 years, supported by a commitment from the MCE to incorporate recommendations from that review into legislation.

Role of ACCC in rule changes with a competition aspect

We understand that the ACCC will be consulted by the AEMC for advice on rule changes that have a competition aspect. The flow chart¹ shows the ACCC having an input into the finalization of the rule change, but there is no explicit role by the ACCC in approving the rule change. Although we accept the majority of rule changes do not require ACCC review, we expect that from time to time the AEMC will be required to deal with controversial rule changes with a competition aspect. It is highly likely that there will be occasions when the ACCC and AEMC do not reach consensus. It appears from the model

¹ Figure 2

that in such cases the AEMC will retain the final decision. This circumstance seems to have the following shortcomings:

- The strength of the legal argument that behaviour in compliance with the rules, having been empowered by statutory law, is defensible against TPA litigation seems weakened where there is evidence that the ACCC has opposed a rule on competition grounds but their views were rejected.
- As the ACCC's principle objective is the promotion of competition, their expertise on such matters would be expected to be the strongest available.
- As the ACCC is the national competition regulator, to empower other bodies to make decisions potentially in conflict with it increases the risk of inconsistency in business dealings.
- As a matter of policy, it would seem appropriate to avoid the AEMC deliberating on competition matters and instead deferring to the ACCC.

The concern that by providing the ACCC a final decision on these rule changes will lead to duplication and delays no longer seems relevant now that the ACCC is permitted to have regard to previous consultations performed by the AEMC. We therefore recommend the ACCC as having final approval over rule changes with competition aspects.

Protected Provisions

TXU has no comment upon the elevation of protected provisions into the law. This appears to give them similar stability as their present status. However the creation of entirely new protected provisions, such as the new primary objective, potentially creates substantial changes to the direction of the market and should be subject to lengthy industry consultation.

TXU cautions the SCO in proposing such changes at this time. It would be preferable for the current round of work to concentrate purely upon the mechanistic issues of migrating the code into rules and avoid delving into market redesign. We recommend consideration of any changes of substance to the protected provisions be deferred to 2005.

New Objectives

Notwithstanding the view above, TXU supports the introduction of objective (b)-that operation and investment should be economically efficient. An efficiency objective has only been applied to NEMMCO previously, which gave them an objective that was not clearly consistent with those of NECA or the market. As this objective was already part of the code, we do not see its elevation to a "market" objective as a significant change.

TXU does have concerns regarding the introduction of the new primary objective "to promote the long term interests of consumers". It has been the source of much discussion within the industry, and has as many interpretations as interpreters! We note concerns raised at the Melbourne forum that this could mandate the consideration of gross wealth transfers in any net benefit test. TXU does not necessarily concur with this interpretation,

but if such an interpretation were taken by the AEMC it would lead to inefficient, unstable and unpredictable decision making.

We believe the MCE is in fact aiming to create:

- as *efficient* a market as possible and therefore increase net societal welfare; and
- as *competitive* a market as possible and therefore transfer the benefits of this efficiency, over time, to the customers.²

In TXU's view, this mechanism is adequately addressed by objective (a) "the market should be competitive"; and (b) "the operation and investment should be economically efficient".

It is clearly preferable to avoid presenting objectives that have uncertain and contentious interpretations. Given the presence of the other objectives, there seems no value in inserting this new objective.

Net Benefits Test

Whilst the principle of requiring an analytical demonstration of net benefits is intuitively attractive, in TXU's experience estimating the highly uncertain and intangible benefits of a rule change is a fraught process, open to distortion through selective assumptions. In our view, the market's greatest protection in this regard is through a high level of expertise and independence of the individuals making the decision. If the AEMC has achieved this, a qualitative analysis of the benefits is likely to be superior to any econometric modeling.

The consultation paper at present does not prescribe an analytical process, leaving the calculation approach to the discretion of the AEMC. TXU supports this position.

Consultation Protocols with conflicted parties

As the MCE appoints the AEMC commissioners and CEO, and jurisdictions have the power to propose their own rule changes, there is a danger that representatives of the jurisdictions will be in a position to unduly influence the AEMC to the detriment of other stakeholders, especially where those stakeholders compete with jurisdictionally owned participants.

To avoid this reality and perception, we suggest the AEMC rule change process should also include a protocol for transparent dealings with parties representing or affiliated with MCE constituent jurisdictions. We suggest that in considering a rule change, the AEMC would be only able to receive public submissions and correspondence from them, and that any discussions on rule changes between the AEMC and jurisdictional representatives be publicly minuted.

² Implicit in this benefit transfer is the understanding that the creator of the efficiency will be allowed to capture rents from their own innovation for a period prior to it being competed away by market forces.

The framework of such protocols would be aimed at achieving the MCE stated objective of discouraging jurisdictions from involvement in matters of detail in the rules, instead remaining focused upon high-level and transparent matters of public policy.

Refusing a rule change

Whilst we understand the AEMC's need to reject some rule changes, TXU would prefer that the process retain a mechanism such as exists in the current code, that when six registered participants indicate support that the AEMC takes the rule change forward.

Time limit for rejecting a rule change

There have been experiences in the current regime where a rule change has been proposed and neither carried forward or rejected. The AEMC should be subject to a time limit, say, 4 weeks, to reject or progress a rule change.

For further discussion on these matters, please contact Ben Skinner, Regulatory Manager Wholesale Markets, on (03) 8628 1280.

Yours Sincerely

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