

LEGISLATIVE NOTES

AMENDMENTS TO NATIONAL ELECTRICITY LAW – ACCESS AND DISTRIBUTION REGULATION

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The cooperative National Electricity Law scheme has been significantly amended to provide greater guidance, clarity and focus on access issues and to transfer regulatory responsibility for distribution network regulation to the national framework. The amendments will have implications for everyone who buys electricity as network charges typically make up over 50% of a customer's final energy bill. The amendments have been heavily consulted through the Ministerial Council on Energy's Standing Committee of Officials and include greater economic guidance, information gathering powers, performance reporting, a new merits review regime, an access disputes framework and improvements to the rule change process.

In November 2007 the South Australian Parliament passed the *National Electricity (South Australia) (National Electricity Law—Miscellaneous Amendments) Amendment Bill 2007* (the amendments) which, on commencement (expected to be 1 January 2008), will make important reforms to the National Electricity Law. The amendments will streamline the regulation of electricity distribution networks by allowing a single regulator, the Australian Energy Regulator (AER), to regulate all distribution networks in the National Electricity Market.

The National Electricity Law, Regulations and Rules apply as cooperative legislation in New South Wales, Victoria, Queensland, South Australia, Tasmania, the Australian Capital Territory and in the Commonwealth offshore area. This electricity regime regulates a wholesale market for electricity across the interconnected networks and provides for open access to, and regulation of, those networks. It also deals with the security and reliability of the electricity system.

The amendments introduce important changes to the AER's powers including a new set of revenue and pricing principles that will guide the regulator in making regulatory decisions, clarify its information gathering powers, and introduce an element of transparency by allowing the regulator to prepare and publish reports on the performance of regulated network businesses. New merits review provisions have also been introduced to allow the review of the AER's decisions by regulated businesses and users and consumers, providing the appropriate checks and balances on the regulatory decision making process.

These reforms will also streamline the National Electricity Law's rule change process by improving the Australian Energy Market Commission's (AEMC) ability to handle and manage rule change proposal submitted by stakeholders while ensuring that the rule change process is still accessible to stakeholders.

Background

In June 2006, the *Australian Energy Market Agreement* was amended and signed by all first Ministers, committing the Commonwealth, State and Territory Governments to establish a

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consistent framework for energy access which meets the criteria for an 'effective access regime' under Part IIIA of the *Trade Practices Act 1974* (TPA) and specific reforms to the distribution and retail framework.

As part of that commitment, an expert panel was appointed in December 2005 to provide advice on a national framework for energy access pricing. The Panel presented their report, the Expert Panel Report on Energy Access Pricing, to the Ministerial Council on Energy (MCE) in April 2006.¹ The MCE responded to the Expert Panel Report by announcing a set of policy decisions for its major energy market reform program. These policy decisions were publicly released in November 2006.²

In the future the AEMC and the AER's role will extend to include the regulation of gas transmission pipelines and gas distribution networks for all relevant jurisdictions. The MCE has indicated that the broad framework outlined in the amendments will be largely replicated in the new National Gas Law replacing the Gas Code and Gas Pipelines Access Law which is intended to be introduced to the South Australian Parliament in early in 2008.³ These pieces of legislation aim to ensure consistent national economic regulation of electricity and gas networks. The initial National Gas Law will also include a gas market bulletin board covering all parts of the supply chain to increase trading in gas and pipeline capacity.⁴

Also subject to separate legislation is the establishment of a national framework for the non-price regulation of electricity and gas distribution and retail, which is expected to be implemented as the next round of reforms.

Guiding Economic Principles

The amendments legislate key economic principles to guide the regime. The current national electricity market objective has been slightly amended from the existing National Electricity Law. The new national electricity objective in s 7 is:

to promote efficient investment in, and the efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity, and the safety, reliability and security of the national electricity system.

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- ¹ Available online at <<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=B0CE9FD3-F580-A65A-18912BEBFEDF64D9>> accessed 29 November 2007, released by Energy Market Reform Bulletin no 60.
- ² Online at <<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=BFCE0F8C-9E39-3759-BCA9B6735788A1E6>> accessed 30 November 2007, released by Energy Market Reform Bulletin no 71.
- ³ A second exposure draft of the National Gas Law is available at <<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=CD8D6EB1-0C73-FF1D-CC747C3E19AD27FE>> accessed 29 November 2007, released by Energy Market Reform Bulletin no 93.
- ⁴ See work of the Gas Market Leaders Group online at <<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=203FC6F9-AAFB-8679-551CB8F4946612FE>> accessed 29 November 2007.

Just as the AEMC must test changes against the objective of the law when making rules, the AER must perform its functions in a manner that will or is likely to contribute to achieving the objective of the law. The objective achieves a similar effect to the objective in s 44AA for Part IIIA of the TPA.

Determining what services are to be regulated requires an assessment of the potential for market power to be exploited by a network service provider. The amendments recognise two available forms of regulation: direct controlled network services and negotiated network services. A direct controlled network service is a service for which the price is fixed by the AER in a revenue or network pricing determination. Negotiated network services are those transmission and distribution services regulated under a negotiate/arbitrate regime. These services are not subject to upfront price control, but a binding arbitration mechanism is provided for the resolution of disputes about price and non-price aspects of access between the relevant parties. Complicated connection arrangements for large resource projects are likely to fall in this category whereas standard charges for the use of the shared distribution system are likely to be directly controlled. The AER decisions and AEMC rule-making which allocate a particular 'form of regulation' to particular distribution services for a regulatory period are guided by the market power based 'form of regulation factors' set out in s 2F of the Law.

A key feature of the amended National Electricity Law is the inclusion of six revenue and pricing principles in s. 7A that guide the development of the framework for the regulation of electricity networks. They are drawn from the pricing principles in s. 44ZZCA of Part IIIA of the TPA but have a specific energy focus. They operate underneath the national electricity objective to ensure service providers are given a reasonable opportunity to recover efficient costs, there are effective incentives to promote efficiency and service providers are given a rate of return commensurate with the regulatory and commercial risks involved. They also touch on certainty in regulatory asset values and the cost and risks of both under and over investment and under and over utilisation of a network. These principles will guide both the AER in regulating and AEMC in making rules about the regulatory framework.

Decision-making Framework

A key aspect of the regulatory framework established by the amendments is the recognition of a 'fit for purpose' decision making framework as recommended by the Expert Panel. Under this framework the detailed rules will set out the decision making framework and determine the level of discretion the AER has in dealing with the different aspects of a regulatory determination. For instance under the proposed rules the AER will be required to accept proposed forecasts of capital and operating expenditure when satisfied they meet three criteria (whether or not the AER thinks another figure would be more appropriate) but the AER will have discretion in the application of service incentive schemes in a manner which best meets the requirements of the Rules.⁵

Information Gathering Powers

There are substantial amendments to the AER's information gathering powers in new ss 28A – 28U designed to address ongoing issues of information asymmetry between regulated business and the regulator that was recognised by the Expert Panel. Information on costs incurred in supplying

⁵ See proposed rules 6.5.6, 6.5.7, 6.6.2 and 6.12.3 available from the MCE website <<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=41568C11-9DAD-4691-6349C9EC8950A826>> accessed 29 November 2007, released by Energy Market Reform Bulletin no 109.

network services is a critical input into the regulatory process and is an essential starting point for determining prices for regulated services.

The amendments create the concepts of a 'general regulatory information order' and a 'regulatory information notice', and outline the processes by which these instruments may be used by the AER. A general regulatory information order is an order made by the AER that requires classes of regulated network service provider, or classes of related provider, to provide the information specified in the order and to prepare, maintain or keep information described in the notice in a manner specified in the order. A regulatory information notice is a notice applicable to one service provider or related provider rather than a class.

Under s 28F the AER can only serve a regulatory information notice or make a general regulatory information order if it considers it reasonably necessary for the performance or exercise of its functions and has considered a number of criteria. There are additional protections for when the instruments are to be served on related providers, such as outsourced asset management arrangements or other contractors.

There are also additional clarifications and limited merits review for the disclosure of confidential information in ss 28X to 28ZB and ss 71S-71V.

Performance Reporting

Section 28V of the amendments allows the AER to publish performance reports on the financial and operational performance of network service providers. This is a key aspect of transparency for both distribution and transmission network service providers and will be of great benefit to all users and consumers. Performance reporting on regulated services is an important element of the regulatory framework as it allows the AER to consider whether the network service providers are complying with the regulatory determinations, and to promote competition by comparison for monopoly service providers. The information should also assist network users in negotiations with networks over service quality and other performance issues.

The Rule Change Process

The AEMC has been responsible for developing the National Electricity Rules since July 2005. The amendments will address workability concerns that have emerged and assist the efficient operation of the rule change process where anyone can submit a rule change for consideration. It was always intended that the AEMC, although not being able to initiate rule changes itself, would be able to solve the issues or problems raised by a rule change proposal by implementing a solution which it considers best contributes to the achievement of the national electricity objective. Section 91A makes that power clear.

Section 96A introduces a new fast track procedure that will allow the AEMC to shorten the time required to make a rule, from 26 weeks to 17 weeks, when the rule change proposal has been effectively consulted on by National Electricity Market Management Company, the AER or the Reliability Panel. Fast tracking is designed to prevent duplication of consultation processes and to ensure that rule changes are processed efficiently.

Merits Review

The amendments in a new Division 3A of Part 6 introduce a mechanism for limited merits review by the Australian Competition Tribunal of specified AER regulatory decisions under the National Electricity Law. These amendments will allow a range of affected parties, including; network service providers, materially affected users and users and consumer associations, to seek review of the primary transmission and distribution determinations made by the AER. Similar to s 39 of the Gas Pipelines Access Law, merits review will only be available on limited grounds if the original

decision contained errors of fact, if the original decision maker's discretion was incorrectly exercised, or if their decision was unreasonable, having regard to all the circumstances.⁶

An applicant for merits review will need to seek leave from the Tribunal to bring an action and, amongst other things, the matter will need to meet a materiality threshold.⁷ There will be a relatively wide scope for persons and groups to intervene in merits review proceedings, once commenced.⁸ Consistent with the current gas regime and the desire to make the original decision making process meaningful, arguments to make out a ground of review must be based upon submissions made previously to the AER. The AER is also able to raise related and consequential matters in a review to ensure that the Tribunal takes account of broader issues affecting the decision.⁹

Access Disputes

Under the new Part 10 these amendments will allow the AER to act as arbitrator between parties to an access dispute (initially only distribution disputes will be covered). They establish the AER's powers and make its access determinations binding on the parties to an access dispute. This access dispute framework is consistent with the Competition Principles Agreement and Parts IIIA and XIC of the TPA. For example, where negotiations break down regarding connection and service issues for a large development, the access dispute framework allows the AER impose a price and non-price settlement of the unresolved issues in accordance with the network's negotiating framework and negotiated distribution service criteria approved under the Rules.¹⁰

Amendments to National Electricity Rules

The amendments to the National Electricity Law are accompanied by around 230 pages of amendments to Chapter 6 of the National Electricity Rules and other consequential changes. Section 90A allows initial amendments to the rules to be made by ministerial instrument to achieve a national framework for the economic regulation of distribution. After the enactment of the initial rules, the AEMC will be able to amend the distribution rules through the rule change process. The amended Rules for all issues covered by the National Electricity Law will now be over 1000 pages long.

The amendments to the Rules implement the new policy in the National Electricity Law taking into account the work and drafting style of the AEMC in its revised Chapter 6A transmission revenue and pricing rules. This is to ensure that the MCE's objective of creating a consistent regulatory framework, to the extent appropriate, is established for transmission and distribution regulation, while at the same time recognising fundamental differences between distribution and transmission networks. The amended rules build upon the existing distribution arrangements in each State and Territory to ensure unnecessary disruption and uncertainty is not created by the changes to the national framework as required by the amended *Australian Energy Market Agreement*.

Users large and small will have extensive rights to be involved in the AER's two-stage determination process for each distribution network service provider. As part of the process, networks will need to present indicative prices over the five-year regulatory period with their revenue proposals 13 months before the period commences and maintain a pricing strategy on

⁶ See s 71C.

⁷ See ss 71E and 71F.

⁸ See ss 71J-71L.

⁹ See s 71O.

¹⁰ See in particular Part D and Part L of Chapter 6 the proposed Rules.

their website.¹¹ These should help users understand the implications of the revenue proposals and help them plan around these important input costs to their business. Large users will also retain the ability to obtain a separate disclosure of their transmission and distribution charges.¹²

Although these amendments commence on 1 January 2008, the financial impact of the new regime and access dispute framework will only take effect when a new determination is made by the AER under the new rules to replace the current jurisdictional price determinations. Accordingly, these new determinations are scheduled to take effect from 1 July 2009 in NSW and the ACT, 1 July 2010 for South Australia and Queensland, 1 January 2011 for Victoria and 1 July 2012 for Tasmania.

Further work is also being done on creating a national framework for capital contributions, distribution network planning and other aspects of large connections.¹³

Removing Barriers to Demand Side Response and Distributed Generation Options

The new rules help deliver on the Council of Australian Governments' commitment to remove barriers to the efficient uptake of renewable and distributed generation. The new rules provide the appropriate balance in considering network and non-network options in meeting investment drivers as well as ensuring there are appropriate incentives for network businesses to efficiently manage demand. Included in the new rules are provisions to ensure that customers with microgeneration capture the benefits of their energy savings in reduced network charges¹⁴ and large customers who manage their demand to make lasting reductions will also be able to have their tariff allocation reassessed.¹⁵ Treatment of embedded generators and those who export to the grid is equalised with large generators by ensuring they are not charged to export electricity to the grid.¹⁶ The new rules include a demand management incentive mechanism to help address network operator incentives for adopting efficient non-network options.¹⁷ Efficiency incentives also now consider arrangements that reduce electricity lost in distribution networks.¹⁸

Conclusion

Overall, the amendments are the outcome of two years of consultation and policy development by the MCE and are a considerable step towards achieving greater uniformity, consistency and predictability in energy infrastructure regulation.

¹¹ See proposed rule 6.8.2(c)(4) and 6.18.9.

¹² See proposed rule 6.23.

¹³ See Energy Market Reform Bulletin no 99 online at <<http://www.mce.gov.au/index.cfm?event=object.showContent&objectID=8B431891-D7EB-8152-2A5B3CB50B590C93>> accessed 30 November 2007.

¹⁴ Proposed rule 6.18.4(a)(3).

¹⁵ Proposed rule 6.18.4 and 6.7.5(c)(3)(iii).

¹⁶ Proposed rule 6.1.4.

¹⁷ Proposed rule 6.6.3.

¹⁸ Proposed rule 6.5.8(b).