



Australian  
Competition &  
Consumer  
Commission

# **Draft Determination**

## **Applications for Authorisation**

### **Amendments to the National Electricity Code**

### **Safety Net Provisions and Reserve Contracting**

**Date: 6 November 2002**

**Authorisation Nos:**

A90844  
A90845  
A90846

**Commissioners:**

Fels  
Bhojani  
McNeill

**File no:**

C2002/1327



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## Glossary

AGL	AGL Electricity Limited
code	National Electricity Code
Commission	Australian Competition and Consumer Commission
NECA	National Electricity Code Administrator
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company Ltd
TPA	Trade Practices Act 1974
Tribunal	National Electricity Tribunal
VoLL	Value of Lost Load

# 1 Introduction

On 10 September 2002, the Australian Competition and Consumer Commission (Commission) received applications for authorisation (Nos A90844, A90845 and A90845) of a derogation from the National Electricity Code (code). The applications were submitted by the National Electricity Code Administrator (NECA) on behalf of the National Electricity Market Management Company Ltd (NEMMCO).

Authorisation under Part VII of the *Trade Practices Act 1974* (TPA) provides immunity from court action for certain types of market arrangements or conduct that would otherwise be in breach of Part IV of the TPA. Authorisation may be granted where the Commission concludes that the public benefits of the arrangements or conduct would outweigh the anti-competitive detriment of such arrangements or conduct.

The Commission has prepared this draft determination outlining its analysis and views on the applications for authorisation of the proposed derogation. Chapter 2 of this draft determination sets out the statutory test that the Commission must apply when assessing an application for authorisation. Chapter 3 contains an outline of the Commission's public consultation process. The Commission's analysis of the proposed derogation is set out in chapter 4 and the Commission's draft determination is in chapter 5.

## 2 Statutory test

The applications were made under sub-sections 88(1) and 88(8) of the TPA.

Applications made under sub-section 88(1) of the TPA are for authorisation to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would or might have the effect, of substantially lessening competition within the meaning of section 45 of the TPA; and to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of section 45 of the TPA. Further sub-section 88(6) provides that an authorisation made under sub-section 88(1) has effect as if it were also an authorisation in the same terms to every other person named or referred to in the application.

Applications made under sub-section 88(8) of the TPA are for authorisation to engage in conduct that constitutes, or may constitute, the practice of exclusive dealing in accordance with the provisions of section 47 of the TPA. Further, sub-section 88(8AA) provides that where authorisation has been granted under sub-section 88(8) and this particular conduct is expressly required or permitted under a code of practice, the authorisation applies in the same terms to all other persons named or referred to as a party or proposed party to the code. Authorisations may also apply to any corporation who becomes a party in the future.

The TPA provides that the Commission shall only grant authorisation if the applicant satisfies the relevant tests in sub-sections 90(6) and 90(8) of the TPA. While sub-section 90(6) and sub-section 90(8) relate to different types of anti-competitive behaviour, the tests are essentially the same.

Sub-section 90(6) provides that the Commission shall grant authorisation only if it is satisfied in all the circumstances that:

- the provisions of the proposed contract, arrangement or conduct would result, or be likely to result, in a benefit to the public; and
- that benefit would outweigh the detriment to the public constituted by any lessening of competition that would, or would be likely to result from the proposed contract, arrangements or conduct.

Sub-section 90(8) provides that the Commission shall grant authorisation only if it is satisfied in all the circumstances that the proposed provision or conduct would result, or be likely to result, in such a benefit to the public that the proposed contract, arrangement, understanding or conduct should be allowed.

The detriment to be considered is limited to detriment caused by a lessening of competition. However, consideration of public benefits is less restricted and public benefits recognised in the past include:

- fostering business efficiency
- industry rationalisation
- promotion of industry cost savings
- promotion of competition in industry
- promotion of equitable dealings in the market
- expansion of employment
- development of import replacements
- growth in export markets
- arrangements which facilitate the smooth transition to deregulation.

In considering whether or not to grant authorisation the Commission must consider what the position is likely to be in the future if authorisation is granted and what the future is likely to be if authorisation is not granted.

If the Commission determines that the public benefits do not outweigh the detriment to the public constituted by any lessening of competition, the Commission may refuse authorisation or grant authorisation subject to conditions.

The value of authorisation for the applicant is that it provides protection from action by the Commission or any other party for potential breaches of certain restrictive trade provisions of the TPA. It should be noted, however, that authorisation only provides exemption for the particular conduct applied for and does not provide blanket exemption from all provisions of the TPA. Further, authorisation is not available for misuse of market power (section 46).

A more expansive discussion about the Commission's authorisation process and the statutory test that the Commission applies can be found in: *Guide to authorisations and notifications*, Australian Competition and Consumer Commission, November 1995.

### 3 Public consultation process

The Commission has a statutory obligation under the TPA to follow a public process when assessing an application for authorisation.

The Commission received the applications for authorisation of the proposed derogation on 10 September 2002. Notification of the applications and a request for submissions was placed in *The Australian Financial Review* on 23 September 2002 and on the Commission's web site. Interested parties were asked to make submissions to the Commission regarding their views on the issues of public benefit and anti-competitive detriment arising from implementation of the proposed changes. The Commission received a submission from AGL Electricity Limited (AGL).

The Commission has produced this draft determination outlining its analysis and views of the proposed derogation according to the statutory assessment criteria set out in chapter 2. The Commission invites the applicant and other interested persons to notify whether the applicant or other interested persons wish the Commission to hold a conference in relation to this draft determination.<sup>1</sup>

If the applicant or an interested party notifies the Commission in writing within 14 days of 6 November 2002 that it wants the Commission to hold a conference, the Commission will hold a conference in Canberra on 25 November 2005, at a time and place to be notified. The applicant, interested parties who receive a copy of the draft determination and any other interested parties whose presence the Commission considers appropriate are entitled to participate in the conference.

Following the conference, the Commission will take into account relevant issues raised at the conference, and any related submissions, and will issue a final determination. If no pre-determination conference is called then this draft determination will become the final determination.

A person dissatisfied with the final determination may apply to the Australian Competition Tribunal for its review.

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<sup>1</sup> For the purposes of the conference, an interested person is a person who has notified the Commission in writing that the person, or a specified unincorporated association of which the person is a member, claims to have an interest in the applications and the Commission is of the opinion that the interest is real and substantial.



## **4 The Commission's assessment**

### **4.1 The application**

The application for authorisation relates to a proposed derogation aimed at widening the scope of the existing reserve trader provisions to allow NEMMCO to enter into non-scheduled reserve contracts.

Non-scheduled reserve is defined in the proposed derogation as the amount of surplus or unused capacity of non-scheduled generating units or arising out of the reduction in demand (other than a scheduled load). This is intended to ensure that reserve contracts can cover both scheduled and non-scheduled entities.

The proposed derogation also amends clause 3.12.7 to allow NEMMCO to take into account any inflexibilities associated with non-scheduled reserves when deciding the appropriate time to activate reserve capacity. In addition, the proposed derogation extends 'what if' pricing to periods where NEMMCO activates inflexible non-scheduled load outside a forecast VoLL period.

Two new clauses have been proposed to minimise any distortions that non-scheduled reserve contracts may have on the market. Clause 3.9.3(c) requires NEMMCO to adopt measures to reduce the possibility that generating units or loads likely to be activated under non-scheduled reserve contracts are otherwise encumbered. Clause 3.12.6A requires NEMMCO to aim to request generating units and loads under non-scheduled reserve contracts be activated in such a way that any distortions to the market are minimised.

NECA has requested an interim authorisation of the proposed derogation to ensure that NEMMCO is able to enter non-scheduled reserve contracts for the coming summer.

### **4.2 Issues for the Commission**

The Commission supports the development of demand side management in the NEM as a means of resolving supply scarcity problems and reducing spot price volatility. The Commission is therefore interested in ensuring NEMMCO's ability to contract with demand side entities for reserve capacity does not diminish incentives for retailers and customers to develop demand side initiatives.

### **4.3 What the applicant says**

NECA states that the proposed derogation is intended to ensure:

- more reserve can be offered than is currently possible under the code
- reserve contracting is more competitive process
- any inflexibilities associated with reserve contracts can be managed through intervention.

NEMMCO states that the proposed derogation improves the effectiveness of the reserve trader provisions by allowing NEMMCO to contract with non-scheduled generation and loads. NEMMCO also states the proposed change redresses the current bias in reserve trader contracting towards the supply side of the market.

NEMMCO has indicated that it has been working closely with retailers in South Australia and Victoria in order to understand what amount of demand side response they might expect to be available for the coming summer. NEMMCO has factored these amounts into reserve forecasts and are endeavouring to encourage retailers to seek to maximise the demand side response that they are able to provide. The Commission notes NEMMCO's revision of the low reserve condition notices for early next year after retailers in South Australia and Victoria came forward with additional demand side response.

NEMMCO believes that its activities in seeking demand side contracts for reserves is likely to compel retailers to implement their own demand side management arrangements. This is on the basis that doing so would reduce the load that a particular retailer has exposed to high prices and, at the same time, not triggering what if prices.

#### **4.4 What the interested parties say**

The Commission received one submission from AGL.

AGL raised concerns that the proposed derogation has the potential to undermine the demand side initiatives of retailers. In particular AGL is concerned that:

- NEMMCO may enter into non-scheduled reserve contracts for capacity developed by retailers and subject to contracts with retailers
- NEMMCO may enter into contracts for demand side response that would have occurred due to the high price signal without the contract, thus distorting the market.

AGL argues that as the proposed changes are designed to create a new concept, address inconsistencies and clarify the operation of the code they should be implemented by a code change process rather than a derogation process. AGL considers that the proposed derogation does not meet the definition of derogation under clause 8.4.1.

#### **4.5 Commission's considerations**

The Commission considers that the proposed derogation will improve the operation of the safety net and reserve contracting provisions by:

- providing additional sources of reserve capacity ensuring NEMMCO has a greater opportunity to meet reliability standards
- increasing competition amongst reserve contract and non-scheduled reserve contract suppliers, potentially lowering the total costs incurred by NEMMCO when activating the reserve trader

- promoting demand side management as a means of alleviating supply scarcity situations.

The Commission has considered the claims of AGL that the derogation may harm the development of demand side response in the market.

NEMMCO has partially addressed AGL's concerns by stating that capacity which is or may be required or available to be provided pursuant to any other arrangement is ineligible for inclusion in NEMMCO's tender process for reserve capacity<sup>2</sup>.

The Commission considers risks that NEMMCO may contract with capacity that could otherwise be available as demand side response in the market are minimal given the historical evidence of poor demand side response by non-scheduled loads. The Commission notes by the time NEMMCO initiates the reserve trader the market has been given ample opportunity to come forward with demand side response.

The Commission also considers market distortions will be limited due to the differences between demand side contracts between customers and retailers and non-scheduled reserve contracts between customers and NEMMCO. For example, NEMMCO's non-scheduled reserve contracts are for a 'firm' amount of capacity and can be called upon by NEMMCO at any time within a defined period. Demand side contracts with retailers are longer term in nature and provide customers with more flexibility regarding when and how much demand they wish to curtail. The Commission considers that these differences will minimise any possibility that customers may withhold from entering demand side contracts with retailers to enter into a non-scheduled reserve contract with NEMMCO.

The Commission also notes that the proposed derogation only allows NEMMCO to enter into non-scheduled reserve capacity contracts until 30 June 2003. The Commission considers that if the new provisions are activated this summer useful information will be made available to both NECA and NEMMCO when they are considering to apply for more permanent inclusion of the derogation into the reserve trader arrangements. The Commission would then be able to use this additional information to assess any subsequent application to extend the proposed derogation.

The Commission has considered AGL's concern that the proposed derogation would have been more appropriately dealt with as a code change. Where a Code Participant or any other person has made a written submission to NECA to suggest a change to the code, NECA may deal with the matter as an application for a derogation<sup>3</sup>. While it may be preferable to implement a code change rather than a derogation for reasons of clarity, consistency and ease of use, the Commission accepts that NECA has valid reasons for applying for a derogation in this situation. In particular the Commission recognises the importance of having the changes in place for summer 2002-03.

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<sup>2</sup> NEMMCO, Invitation to Tender, 10 October 2002, p.20.

<sup>3</sup> National Electricity Code, clause 8.3.4(a) and (b)

The Commission is aware that several components of the Review of Directions code changes will be gazetted shortly by NECA. Given this development various clauses of the proposed derogation will be required to be deleted and amended and new clauses inserted into the proposed derogation to ensure that it is consistent with code. The Commission considers the proposed derogation would fail to deliver public benefits if it was found to be inconsistent with the code. The Commission therefore imposes a condition of authorisation that requires NECA, in consultation with Commission staff to, amend the derogation to incorporate amendments to the code arising from the Review of Directions determination issued by the Commission on 3 October 2002. Condition C1 gives effect to this requirement.

The Commission identified several issues regarding the drafting of the proposed derogation. It considers there are benefits in addressing these issues to ensure the derogation achieves its intended purpose. These issues are addressed below.

The definition of ‘non-scheduled reserve’ in the proposed derogation refers to the surplus or unused capacity arising out of the reduction in demand. The Commission considers that it may be more accurate to refer to capacity arising from an ability to reduce demand – once the reduction in demand has occurred the capacity is no longer unused. The Commission therefore imposes a condition of authorisation that requires the definition of ‘non-scheduled reserve’ to be amended to read:

(b) arising out of an ability to reduce demand (other than a scheduled load).

Condition C2 gives effect to this requirement.

The definition of reserves in the code appears to be restricted to supply side capacity. The code glossary defines reserves as ‘short term capacity reserve and medium term capacity reserve as contracted by NEMMCO under clause 3.12’. The definitions of short term capacity reserve and medium term capacity reserve both refer specifically to generating capacity.

The proposed derogation seeks to allow NEMMCO to enter into contracts for the provision of reserve with non-scheduled generation and load. However if reserves are limited to supply side capacity the derogation may not achieve its objective. The Commission therefore imposes a condition of authorisation that requires the definition of ‘reserve’ in the derogation to be amended to read:

‘reserve’ means short term capacity reserve and medium term capacity reserve and non-scheduled reserve as contracted by NEMMCO under clause 3.12.

Condition C3 gives effect to this requirement.

Clause 3.18.14 is intended to give NEMMCO more scope to utilise plant that has operational inflexibilities during times of supply scarcity. To ensure the intended objective is achieved the Commission imposes a condition of authorisation that requires clause 3.18.14 in the proposed derogation 2(b) to be amended so that it states ‘during times of projected supply scarcity’ rather than ‘during times of supply scarcity’ as this may prohibit any action under the clause until supply is actually scarce. Condition C4 gives effect to this requirement.

Clause 3.9.3 (c) is intended to reduce the possibility that NEMMCO's trading in non-scheduled reserve contracts will distort the market. The clause refers to:

'measures to be adopted in order to reduce the possibility that generating units or loads likely to be activated under non-scheduled reserve contracts are not otherwise encumbered at the time non-scheduled reserve contracts are entered into by NEMMCO.'

The Commission considers that the 'not' that precedes 'otherwise encumbered' appears to reverse the intended meaning. Therefore the Commission imposes a condition of authorisation requiring clause 3.9.3(c) of proposed derogation 2(c) to be amended to read:

...In developing this methodology, NEMMCO must consult Code Participants on measures to be adopted in order to reduce the possibility that generating units or loads likely to be activated under non-scheduled reserve contracts are otherwise encumbered at the time non-scheduled reserve contracts are entered into by NEMMCO.

Condition C5 gives effect to this requirement.

An inadvertent consequence of amendments made by the proposed derogation to clauses 3.12.1(e) and (g) of the code is that the words 'to make reserves available where required' apply to both 'reserves' and 'market network services'. These words are meant to apply to 'market network services' only. To preserve the intended meaning of the clauses a condition of authorisation has been imposed requiring that the words 'to make reserves available where required' apply only to 'reserves'. C6 gives effect to this requirement.

The proposed amendment to clause 3.12.1(h) results in 'non-scheduled reserve contract' being added to a list that presently contains scheduled generating unit, scheduled network service and scheduled load. The Commission considers that wording of the clause is improved by deleting the word 'contract' from the 'non scheduled reserve contract'. The Commission imposes this amendment through condition C7.

## 5 Determination

This determination is made on 6 November 2002. For reasons set out in chapter 4 of this draft determination, the Commission concludes that, subject to the conditions of authorisation set out below, in all circumstances, the proposed amendments to the code:

- are likely to result in a benefit to the public which outweighs the detriment from any lessening of competition that would result if the proposed conduct or arrangements were made, or engaged in
- are likely to result in such a benefit to the public that the proposed conduct or arrangements should be allowed to take place or be arrived at.

The Commission therefore grants authorisation to applications A90844, A90845 and A90846. This determination is subject to any pre-determination conference requested pursuant to s.90A of the TPA.

The Commission also grants interim authorisation, subject to the conditions below, to the proposed derogation until the date of the Commission's final determination.

The Commission's authorisation and interim authorisation is granted subject to the following conditions.

### **Conditions:**

- C1 NECA must, in consultation with Commission staff, amend the derogation to incorporate amendments to the code arising from Review of Directions determination issued by the Commission on 3 October 2002.**
- C2 The definition of 'non-scheduled reserve' in the derogation must be amended to read**
- (b) arising out of the ability to reduce demand (other than a scheduled load).
- C3 The definition of 'reserve' in the derogation must be amended to read**
- 'reserve' means short term capacity reserve and medium term capacity reserve non-scheduled reserve as contracted by NEMMCO under clause 3.12.
- C4 Clause 2(a) of the proposed derogation, which refers to clause 3.8.14 of the code, the words 'supply scarcity' must be replaced with 'projected supply scarcity'.**
- C5 Clause 2(c) of the proposed derogation, which refers to clause 3.9.3(c) of the code, must be amended to read**
- ...In developing this methodology, NEMMCO must consult Code Participants on measures to be adopted in order to reduce the possibility that generating units or loads likely to be activated under non-scheduled reserve contracts are otherwise encumbered at the time non-scheduled reserve contracts are entered into by NEMMCO.

- C6** Clause 2(d) of the proposed derogation, which refers to clauses 3.12.1(e) and (g) of the code, must be amended so that the words ‘to make reserves available where required’ apply only to sub-clauses 3.12.1(e)(2) and (g)(2).
- C7** Clause 2(d) of the proposed derogation, which refers to clause 3.12.1(h) of the code, must be amended to read:

**If NEMMCO requests a Code Participant to enter into a reserve contract in relation to a scheduled generating unit, scheduled network service, a scheduled load or non-scheduled reserve, then the Code Participant must negotiate with NEMMCO in good faith as to the terms and conditions of that contract.**







