



Australian Energy Market Commission

RULE DETERMINATION

National Electricity Amendment (Victorian
jurisdictional derogation, smelter agreements)
Rule 2014

Rule Proponent

Minister of Energy and Resources (Victoria)

10 April 2014

**RULE
CHANGE**

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About the AEMC

The Council of Australian Governments (COAG), through its then Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. In June 2011, COAG established the Standing Council on Energy and Resources (SCER) to replace the MCE. The AEMC has two main functions. We make and amend the national electricity, gas and energy retail rules, and we conduct independent reviews of the energy markets for the SCER.

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Summary

The Australian Energy Market Commission (AEMC or Commission) has determined to make a rule in response to a rule change request submitted by the Minister for Energy and Resources (Victoria) (rule proponent). The rule clarifies the extent and application of an existing Victorian jurisdictional derogation.

The derogation was designed to preserve certain legacy arrangements, entered into by the Victorian Government and various counterparties, prior to the commencement of the National Electricity Market (NEM). Amongst other things, it deems particular NEM participant registrations, in respect of the Point Henry smelter and the Anglesea power station, to be held by the State Electricity Commission of Victoria (SEC). The rule aims to put beyond doubt that these registrations will lapse on the expiry of the Point Henry electricity supply agreement (Point Henry ESA) on 31 July 2014, rather than the later date of 31 October 2016.

The rule proponent expressed a concern that, if the rule was not made, then SEC would retain its market registrations, and corresponding financial and regulatory obligations conferred under the derogation. This would affect Alcoa of Australia's (Alcoa) ability to complete its own registration in relation to the Point Henry smelter and the Anglesea power station, which would impact on the continuing operation of those facilities, an outcome which it believes is inconsistent with the original intention.

The rule change request was considered as a non-controversial rule, under an expedited (shortened) time frame. This is because the proposed rule would be unlikely to have a significant effect on the NEM.

The Commission has determined that it should make the rule as proposed, with some minor amendments primarily relating to the commencement date. It considers that the rule as made will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO). This is because it provides for market participant and investor certainty and confidence by improving regulatory certainty and permitting the continuation of operations of existing assets. It also provides for the incremental improvement and promotion of market efficiency through a more efficient allocation of risk.

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1 Victorian Government's rule change request

1.1 The rule change request

On 12 December 2013, the Minister for Energy and Resources (Victoria) (rule proponent) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) to clarify the extent and application of an existing Victorian jurisdictional derogation.

Amongst other things, the derogation deems particular NEM participant registrations, in respect of the Point Henry smelter and the Anglesea power station, to be held by the State Electricity Commission of Victoria (SEC). The rule aims to put beyond doubt that these registrations will lapse on the expiry of the Point Henry electricity supply agreement (Point Henry ESA) on 31 July 2014, rather than the later expiry date of the Portland electricity supply agreement (Portland ESA) on 31 October 2016.

1.2 Background

The relevant Victorian jurisdictional derogation is contained in rule 9.4 of the National Electricity Rules (NER). Its purpose is to preserve certain legacy arrangements that existed in Victoria prior to the commencement of the NEM. These arrangements were entered into by the State Electricity Commission of Victoria (SEC) and various counterparties in relation to the Point Henry and Portland smelters, and are collectively referred to in the derogation as the "Smelter Agreements".¹

The Smelter Agreements include two 30-year electricity supply agreements, setting out the terms of supply by SEC to each of the Point Henry and Portland smelters. The Point Henry ESA expires on 31 July 2014, while the Portland ESA expires on 31 October 2016. According to the rule proponent, it was originally envisaged that both agreements would commence (and therefore expire) at the same time. However, due to construction delays, the Portland ESA was executed at a later date.²

Approximately 40 per cent of the electricity requirements of the Point Henry smelter are met by Anglesea power station, which is connected directly via a transmission line to the smelter. The balance of its requirements (as well as those for the Portland smelter) is obtained from the NEM through SEC.

Clause 9.4.2(a) of the derogation deems SEC to be the registered customer and market customer with respect to the Point Henry and Portland smelters.³ Similarly, while the Anglesea power station is owned and operated by Alcoa of Australia Limited (Alcoa),

1 These are specified in schedule 3 to the *Electricity Industry (Residual Provisions) Act 1993 (Vic)*.

2 Minister for Energy and Resources (Victoria), *Victorian Smelter Agreements - National Electricity Rules Derogation*, 12 December 2013, at page 2.

3 Clause 9.4.2(a)(2) of the NER.

SEC is deemed to be the registered generator and market generator for this facility.⁴ As a consequence of these registrations, SEC also carries particular financial and regulatory obligations ascribed to these roles while these provisions remain in force.

1.3 Proponent's rationale

Clause 9.4.2(b) of the derogation provides that:

"This clause 9.4.2 ceases to have effect upon the termination of the last of the Smelter Agreements."

The rule proponent suggests that this clause implies that SEC's deemed market registrations, set out in clause 9.4.2(a), would continue to apply in relation to the Point Henry smelter and the Anglesea power station until the expiry of the Portland ESA on 31 October 2016, even though the Point Henry ESA expires on the earlier date of 31 July 2014.

As a consequence, from 2014 SEC will no longer be required to meet the contractual obligations conferred under the Point Henry ESA. It will nevertheless retain the various registrations, and the associated financial and regulatory obligations, for the Point Henry smelter and the Anglesea power station under the derogation until 2016.

While SEC remains registered in this manner, Alcoa would be unable to complete its own market registration and thereby assume the necessary responsibilities under the rules in respect of these facilities.⁵ This would further preclude Alcoa from entering into other necessary arrangements, such as a use of system agreement with the Australian Energy Market Operator (AEMO) in relation to the Anglesea power station, thereby disallowing that power station from participating in the NEM.⁶

1.4 Solution proposed in the rule change request

The rule change request proposes a number of changes to clauses 9.3.1 and 9.4.2 of the rules, to clarify that SEC's role for a particular smelter continues for only as long as the relevant contractual arrangements remain in place for that smelter.

In particular, the rule change request proposes the deletion of paragraphs (4), (6), (8) and (9) of clause 9.4.2 to remove obligations that were specific only to Anglesea power station. It would also amend the definitions of the terms "Counterparties" and "Smelter Agreements" in clause 9.3.1 such that they differentiated between facilities. References

⁴ Clause 9.4.2(a)(4) and (5) of the NER.

⁵ Section 11 of Division 1, Part 2 of the National Electricity Law (NEL) establishes general prohibitions for persons to engage in particular market activities unless that person has been registered as a participant in relation to that activity or an exemption has been granted either by AEMO under section 12, or by way of a derogation.

⁶ Minister for Energy and Resources (Victoria), Victorian Smelter Agreements - National Electricity Rules Derogation, 12 December 2013, at page 3.

in Schedule 9A3 to "Smelter Trader" would be replaced with "Alcoa of Australia Limited".

According to the rule proponent, the proposed rule change would ensure that both the Point Henry smelter and the Anglesea power station could operate in the NEM and comply with the rules like all other market generators and market customers in the NEM from the date of expiry of the Point Henry ESA.⁷

1.5 Commencement of rule making process

On 27 February 2014, the Commission published a notice under section 95 of the National Electricity Law (NEL) advising of its intention to commence the rule making process. A brief consultation paper was published together with the rule change request.

The Commission proposed to treat the request as non-controversial because it considered that the rule would be unlikely to have a significant effect on the NEM.

Under section 96 of the NEL, non-controversial rule change requests are assessed through an expedited rule change process, which is substantially shorter than the normal arrangements. It includes only one round of consultation, during which stakeholders can object to the decision to assess the rule change request on an expedited basis.

The closing date for objections to the expedited process was 13 March 2014, and none were received. Accordingly, the rule change request was considered under the expedited process under section 96 of the NEL.

Submissions on the content of the rule change request were due by 27 March 2014, and one submission was received. A copy of this submission is available on the AEMC website.⁸ A summary of the issues raised in this submission, and the Commission's response, is contained in section 3.2.

The Commission notes the announcements made during the submission period in relation to the operations of the Point Henry smelter and the Anglesea power station, but considers these matters to be outside of the scope of this rule change request.

⁷ Ibid.

⁸ www.aemc.gov.au

2 Final rule determination

2.1 Commission's determination

In accordance with section 102 of the NEL the Commission has made this final rule determination in relation to the rule proposed by the rule proponent. In accordance with section 103 of the NEL the Commission has determined to make, with some minor amendments, the rule proposed by the rule proponent.⁹

The Commission's reasons for making this final rule determination are set out in section 3.2.

The *National Electricity Amendment (Victorian jurisdictional derogation, smelter agreements) rule 2014, No 2* (rule as made) is published with this final rule determination. The rule as made commences on 1 August 2014. The rule as made is different from the rule proposed by the rule proponent. Its key features are described in section 3.3.

2.2 Commission's considerations

In assessing the rule change request the Commission considered:

- the Commission's powers under the NEL to make the rule;
- the rule change request;
- submissions received during consultation;
- matters to which the Commission must have regard in relation to the making of jurisdictional derogations;¹⁰ and
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the achievement of the NEO.

The Standing Council on Energy and Resources (SCER) has not issued a statement of policy principles which is relevant to this rule change request.¹¹

⁹ Under section 103 (3) of the NEL the rule that is made in accordance with section 103(1) need not be the same as the draft of the proposed rule to which a notice under section 95 relates or the draft of a rule contained in a draft rule determination.

¹⁰ Under sections 89 and 91(3) of the NEL the AEMC must have regard to certain matters in relation to the making of jurisdictional derogations.

¹¹ Under section 33 of the NEL the AEMC must have regard to any relevant Ministerial Council on Energy (MCE) Statement of Policy Principles in making a rule. The MCE was the ministerial body antecedent to SCER.

2.3 Commission's power to make the rule

The Commission is satisfied that the rule as made falls within the subject matter about which the Commission may make rules. The rule as made falls within the matters set out in:

- section 34(1)(a)(iii) of the NEL, as it relates to the activities of persons (including registered participants) participating in the NEM or involved in the operation of the national electricity system; and
- schedule 1 to the NEL as it relates to:
 - the registration of persons as registered participants (item 1); and
 - the exemption of persons from the requirement to be registered participants (item 2).

2.4 Rule making test

Under section 88(1) of the NEL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NEO. This is the decision making framework that the Commission must apply.

The NEO is set out in section 7 of the NEL as follows:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.”

The Commission considers that the rule as made will, or is likely to, contribute to the achievement of the NEO by promoting the efficient investment in, and operation and use of, electricity services.¹² This is because it:

- provides for market participant and investor certainty and confidence by:
 - improving regulatory certainty by clarifying the scope and effect of an existing jurisdictional derogation;
 - facilitating the continuation of operations at existing facilities under arrangements that are consistent with the established national market

¹² Under section 88(2), for the purposes of section 88(1) the AEMC may give such weight to any aspect of the NEO as it considers appropriate in all the circumstances, having regard to any relevant MCE statement of policy principles.

framework, potentially avoiding the unavailability of assets in the short term; and

- incrementally improves and promotes market efficiency through a more efficient allocation of risk. The rule as made facilitates the transfer of the financial risk associated with the operation of the Anglesea power station from a third party, SEC, to the entity who can control the risks, potentially improving its reliability.

Compatibility with AEMO's declared network functions

Under section 91(8) of the NEL the Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of the AEMO's declared network functions.

While the rule as made may affect a specific network agreement in Victoria (which is an adoptive jurisdiction), it will not impact on AEMO's declared network functions, therefore the above requirement is satisfied.

2.5 Other requirements under the NEL

Section 89 of the NEL sets out the matters that the Commission must have regard to in relation to the making of jurisdictional derogations. In particular, section 89(a) relates to the orderly transfer of jurisdictional regulation of the electricity industry to national arrangements, and section 89(b) relates to the continuation of jurisdictional regulatory arrangements where this is necessary.

Rather than making a new jurisdictional derogation, the rule as made essentially clarifies the extent of the early removal of part of an existing jurisdictional derogation, so that the national arrangements then take effect. As such, the Commission considers that the rule as made is consistent with the matters set out in section 89.

The Commission has also been advised that the Minister for Energy and Resources (Victoria) consulted with the relevant Ministers of the other participating jurisdictions, in relation to this rule change request, before lodging it with the AEMC.¹³

¹³ Under section 91(3), a Minister of a participating jurisdiction, after consulting with the Ministers of the other participating jurisdictions, may request the AEMC to make a jurisdictional derogation in respect of the jurisdiction of which he or she is a Minister.

3 Commission's assessment and decision

The Commission has assessed the rule change request and the submissions received, and analysed the issues that arise. For the reasons set out below, the Commission has determined that a rule be made, with some minor amendments.

3.1 Reasons for the Commission's decision

This rule change request seeks to clarify that the current NEM registration arrangements, and the corresponding financial and regulatory liabilities, under the derogation in relation to the Point Henry smelter and the Anglesea power station will conclude at the expiry of the Point Henry ESA on 31 July 2014.¹⁴ This will ensure that SEC's market participant registrations come to an end, thereby allowing Alcoa to seek its relevant registrations and then assume financial and regulatory liability in relation to those facilities.

In assessing the current rule change request the Commission has considered the counterfactual, or the impact of not making the rule change as requested.

Notwithstanding the continuing confidential nature of the Smelter Agreements, the Commission notes the likelihood that the derogation was drafted to reflect an original intention that both the Point Henry and the Portland ESAs would commence at the same date.¹⁵ The inference is that the derogation was never subsequently amended to reflect the later commencement of the Portland ESA, which has led to the current drafting having an unintended effect.

The Commission is mindful that the duration of the derogated arrangements should not inadvertently be extended due to unintended consequences of the drafting of the derogation. If the deemed NEM registration arrangements in respect of the Point Henry smelter and the Anglesea power station are no longer required following the expiration of the Point Henry ESA then they should be allowed to lapse along with the concurrent obligations and liabilities as intended. The Commission notes that the Minister of the participating jurisdiction has provided written confirmation to the Commission that it is no longer necessary or appropriate for the specified part of the derogation to continue.

Clarifying the derogation will also permit the timely transfer of obligations to another party, and allow the continuation of operations as that party determines. Moreover, it ensures the timely migration of these operations from the derogated arrangements to more transparent arrangements, consistent with the market framework. This also facilitates the transfer of the financial and regulatory risk associated with the continued operation of the facilities to the party best positioned to manage the risk.

¹⁴ For clarity, the rule change request is not intended to, and does not, affect the continued application of the derogation in relation to the Portland smelter.

¹⁵ See section 1.2.1 of this rule determination.

The Commission notes that developments arising since the submission of the rule change request suggest that the Point Henry smelter is unlikely to operate beyond the expiry of the Point Henry ESA.¹⁶ However, the Commission does not consider this would provide any reason not to make a decision to remove an unnecessary part of an existing derogation from the rules.

In addition, the Commission understands that the Anglesea power station may continue to operate beyond 2014 and considers that it would be inappropriate for this to be prevented by the unintended continued application of the derogation.

3.2 Commission's consideration of submissions received

The Commission received one submission on the rule change request. This submission, and the Commission's response to the issues raised, is set out below.

Major Energy Users, Inc

In its submission the Major Energy Users Inc (MEU) stated that it did not oppose the rule change request, but identified its major concern to be that consumers should benefit from any changes made to the rule.

The MEU noted that the financial losses incurred in providing electricity services under the Smelter Agreements are currently recovered through an easement land tax imposed on Victorian electricity transmission companies, and passed on to Victorian consumers. Consequently it considered that, when these arrangements finish, consumers should benefit from the reduction in these losses via a reduction in the easement land tax.

It also suggested that if the output from the Anglesea power station is used to offset the requirements of the Portland smelter in the same way as it has been used to offset the Point Henry smelter requirements, then this would further reduce the land tax. This would result in a greater benefit to consumers than if its power were to be sold directly into the NEM.

The MEU considered that the Commission should make a more preferable rule that ensures not only that SEC is released from its liabilities in relation to the Point Henry ESA, but also that the reduction in losses and ongoing risk borne by SEC are passed through to consumers via an equivalent reduction in the land tax imposed.

The Commission notes the concerns of the MEU, however the submission raises contractual and taxation issues which do not fall within the scope of the NER. As such the Commission is unable to address them in this rule determination and considers that they are matters for the Victorian Government.

¹⁶ On 17 February 2014, Alcoa announced that the Point Henry smelter "will close in August". See: Alcoa, Alcoa to Close Point Henry Aluminium Smelter and Rolling Mills in Australia, 17 February 2014.

3.3 The rule as made

The Commission agrees that the proposed rule satisfactorily rectifies the derogation to safeguard against the adverse and unintended consequences identified by the rule proponent.

The rule as made makes a number of changes to clause 9.4.2 of the existing derogation, to:

- remove those aspects that were specific to the Anglesea power station (and so no longer necessary with the expiry of the Point Henry ESA); and
- ensure that the balance of the derogation applies to each of the individual Smelter Agreements, such that the derogation falls away when a Smelter Agreement comes to an end.

The Commission has made minor drafting changes to the rule, including that Alcoa be referred to in the derogation by reference to its Australian Company Number.

It also amended the commencement date of the rule to 1 August 2014, which the Commission understands to be the first day following the expiry of the Point Henry ESA.

Abbreviations

AEMC	See Commission
AEMO	Australian Energy Market Operator
Alcoa	Alcoa of Australia's
Commission	Australian Energy Market Commission
MCE	Ministerial Council on Energy
MEU	Major Energy Users Inc
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
Point Henry ESA	Point Henry electricity supply agreement
rule proponent	Minister for Energy and Resources (Victoria)
SCER	Standing Council on Energy and Resources
SEC	State Electricity Commission of Victoria