



Australian Energy Market Commission

RULE DETERMINATION

NATIONAL ELECTRICITY AMENDMENT (PRUDENT DISCOUNTS IN AN ADOPTIVE JURISDICTION) RULE 2020

PROPONENT

The Honourable Lily D'Ambrosio MP, Minister for Energy, Environment and Climate Change (Victoria)

17 DECEMBER 2020

RULE

INQUIRIES

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ABOUT THE AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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SUMMARY

- 1 The Australian Energy Market Commission (Commission) has made a more preferable rule providing procedural clarity and consistency to the prudent discounts framework in the adoptive jurisdiction of Victoria. It has been made in response to a rule change request submitted by the Hon Lily D'Ambrosio MP, Minister for Energy, Environment and Climate Change in Victoria.
- 2 This more preferable rule will make changes to the adoptive jurisdictional framework in Victoria within the National Electricity Rules (NER) so that:
 - the declared transmission service operator's (DTSO) agreement to a prudent discount will no longer be required
 - the DTSO's role will be limited to providing relevant information to the Australian Energy Market Operator (AEMO) as the Victorian transmission network service provider
 - AEMO will need to apply to the Australian Energy Regulator for approval to recover more than 70 per cent of the value of a prudent discount from other customers.
- 3 The Commission has concluded that these changes will, or are likely to, improve the clarity and transparency of the prudent discounts framework in Victoria while improving administrative efficiency. These changes would also increase the overall consistency of this framework with the equivalent framework that applies in other jurisdictions. The changes should therefore promote confidence in, and efficiency of, the framework governing the national electricity market.
- 4 As stated in the consultation paper, the Commission considered that this rule change met the definition of a non-controversial rule, and did not receive any objections towards using an expedited rule change process.
- 5 However, the Commission received stakeholder feedback to the consultation paper that raised major concerns regarding the proposed rule. As a result, it has made a more preferable rule. The Commission considers that the more preferable rule will more effectively address the concerns of both the rule change proponent and stakeholders while also improving consistency between the two different prudent discount frameworks in the NER.
- 6 The final rule commences on 17 December 2020.

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1 THE MINISTER'S RULE CHANGE REQUEST

1.1 The rule change request

On 4 September 2020, the Hon Lily D'Ambrosio MP, Minister for Energy, Environment and Climate Change in Victoria (the Minister) submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) seeking to make clarificatory and procedural amendments to the way in which an application for a prudent discount to transmission network charges would be handled in an adoptive jurisdiction.

An adoptive jurisdiction includes one where the declared network functions of the Australian Energy Market Operator (AEMO) apply.¹ At this time, Victoria is the only such adoptive jurisdiction.

The Minister also requested that the rule change request be considered a non-controversial rule change request and, as a result, be assessed under an expedited rule change process.²

1.2 Current arrangements

Under the prudent discount arrangements in the National Electricity Rules (NER), a transmission network service provider (TNSP) may agree with a transmission customer to charge lower prices for certain services provided to that customer than the prices determined in accordance with the TNSP's pricing methodology.³ The relevant services are prescribed transmission use of system (TUOS) services and prescribed common transmission services.

The rationale for providing such prudent discounts is to prevent an inefficient by-pass of the transmission network.⁴ 'By-pass' in this context refers to:

- a technical by-pass, such as the development of a duplicate transmission line from a power station to a large load
- an economic by-pass, such as a decision to not invest in or expand a load or to shut down an existing operation.

For a transmission customer, by-passing the existing transmission network might be economic in some instances. For example, this could be the case when by-passing the transmission network would have a lower cost for the transmission customer than paying the relevant transmission network charges.

However, if the by-pass option is only cheaper because transmission charges are greater than the incremental costs caused by the transmission customer, then the outcome of the customer by-passing the transmission network will be an inefficient outcome overall.

Transmission charges levied on each customer by the TNSP will generally be greater than the incremental costs of serving that customer because the natural monopoly characteristics of electricity transmission networks mean that average costs are greater than marginal costs.

¹ An adoptive jurisdiction could also be a jurisdiction for which AEMO is authorised to exercise its additional advisory functions.

² Sections 87 and 96 of the National Electricity Law (NEL).

³ Clause 6A.26.1(b) of the NER.

⁴ AEMC, *Pricing of prescribed transmission services*, rule determination, 21 December 2006, pp. 52-54.

Transmission charges overall will need to be sufficient to recover the TNSP's average costs. It will therefore be beneficial for all customers as a whole if a customer is provided with a discount to avoid by-pass and that customer still makes some contribution to the difference between marginal and average costs.⁵

Providing a discount that would prevent an inefficient by-pass of the transmission network by a transmission customer would also lead to transmission infrastructure being used more efficiently, which should decrease costs for other transmission customers over the long term.

A TNSP has an incentive to negotiate a prudent discount to avoid inefficient by-pass of its transmission network as the Australian Energy Regulator (AER) is able to remove a TNSP's stranded assets from its regulatory asset base if it determines that the TNSP did not adequately seek to manage the risk of those assets becoming stranded. As a result, a TNSP is incentivised to negotiate lower prices with transmission customers on particular assets where this would encourage the relevant customers to continue using these transmission assets.⁶

1.2.1 Operation of the prudent discount arrangements

When a transmission customer requests that its TNSP reduce the transmission network charges it would be liable for, this triggers a requirement for that TNSP to negotiate with the requesting customer in good faith.⁷

If the TNSP agrees to provide such a discount on transmission charges to that customer, then that TNSP can automatically recover up to 70 per cent of the discounted amount from its other customers, through increasing either or both of:⁸

- the adjusted non-locational component of TUOS charges
- prescribed common transmission services charges.

The cost recovery of up to 70 per cent of the discount does not need to occur during the year when the TNSP provides a transmission customer with a discount; the TNSP could also recover the costs automatically from its other customers through the adjusted non-locational component of its TUOS charges during a subsequent financial year.⁹

Enabling the TNSP to automatically pass on up to 70 per cent of the cost of the discount to other customers while absorbing the remainder is consistent with incentive regulation practices applied to TNSPs generally. For example, the incentive framework implemented in the national electricity market (NEM) includes incentive schemes such as the capital expenditure sharing scheme, where a network service provider shares some of its overspending costs or its under-spending benefits with its customers to encourage that

5 That is, the charges to all other customers will be less when the discount is provided compared to if the discount is not provided and by-pass does occur.

6 Clause S6A.2.3(a)(3)(i) of the NER. A TNSP can only obtain a return on capital and recover costs from its standard control service customers for assets included in its regulatory asset base.

7 Clause 6A.26.1(c) of the NER.

8 Clauses 6A.26.1(d) and 6A.26.1(e) of the NER.

9 Clause 6A.26.1(g) of the NER.

network service provider to make capital expenditure decisions that are beneficial for its customers as well as for itself.¹⁰

However, a TNSP that agrees, or proposes to agree, to a prudent discount can seek to recover more than 70 per cent of the cost of the discount from its customers by applying to the AER for permission to do so.¹¹

When making a decision whether to approve the recovery of the proposed amount, the AER must take into account a number of matters, including the requirements that:¹²

- the discount is no larger than needed to prevent the applicant transmission customer from adopting the most attractive alternative action (that is, engaging in an inefficient 'by-pass' of the transmission network)
- providing the discount would not place its other transmission customers in a worse position than if the discount was not provided.

If the AER does not approve the TNSP's proposed cost recovery of the remaining portion of the prudent discount from its other customers, then the AER must provide reasons for this decision.¹³

If a TNSP enters into an agreement to provide a discount to a transmission customer and seeks to recover more than 70 per cent of the value of the discount from its other customers without receiving approval from the AER to do so, then the AER must review the discount amount when making a subsequent revenue determination for that TNSP.

If, in carrying out an ex-post cost recovery assessment, the AER determines that the recovery of any part of the discount does not comply with the two requirements noted above, then the AER can reduce that TNSP's total allowed revenue for the following regulatory control period by the amount that does not satisfy the requirements. The reduction in total allowed revenue can be up to the entire value of the discount.¹⁴

1.2.2

Operation of the prudent discount arrangements in Victoria

Victoria is an adoptive jurisdiction in terms of the parts of the NER that relate to transmission arrangements because it has declared that AEMO is authorised to exercise certain declared network functions generally associated with TNSPs.¹⁵ Other functions are exercised by the owners of the transmission assets. These parties are referred to as declared transmission

¹⁰ For more information on this scheme and the efficiency benefit sharing scheme that operates under a similar principle for operating expenditure, see AEMC, *Electricity Network Economic Regulatory Framework Review - 2017 Report*, final report, 18 July 2017, pp. 23 and 27.

¹¹ Clauses 6A.26.2(a)-(c) of the NER.

¹² Clauses 6A.26.1(f) and 6A.26.2(d) of the NER.

¹³ Clauses 6A.26.2(e) of the NER.

¹⁴ Clause 6A.26.2(k) of the NER. The AER can impose additional reductions on the TNSP's allowed revenue for interest payments.

¹⁵ These functions are described in s. 50C(1) of the NEL but do not include ownership of transmission network assets, as noted in s. 50G(2)(b) of the NEL.

system operators (DTSOs).¹⁶ Victoria is the only jurisdiction that has these arrangements in place.

As a result, and relevant to this rule change process, the prudent discount framework operates in a slightly different manner in Victoria compared to other jurisdictions. Specifically, the prudent discount related functions that are discharged by the TNSP in another NEM jurisdiction are shared between AEMO and the declared transmission system operators (DTSOs) in Victoria.

When a transmission customer in Victoria requests a reduction in its transmission network charges, this triggers a requirement for AEMO, in its role as the TNSP, to negotiate with the requesting customer in good faith.¹⁷ AEMO and the relevant DTSO have similar obligations to negotiate with each other in good faith.¹⁸ While AEMO is the only party that can grant a prudent discount in Victoria, it cannot do so without obtaining written consent to provide the discount from the DTSO.¹⁹

In regard to prudent discount cost recovery, similar requirements apply in Victoria as in other jurisdictions. However, there are two key differences to note.

One difference relates to the requirement for the AER to review a discount already agreed to by a TNSP. In this regard, the AER is unable to reduce AEMO's revenue as it can for TNSPs in other jurisdictions.²⁰ This is because AEMO is a non-profit entity and so unlike other TNSPs, it would not be able to absorb any portion of the costs associated with providing a prudent discount to a customer. In addition, the AER would not be able to reduce the relevant DTSO's allowed revenue when this situation occurs because DTSOs are not classified as TNSPs.

Another difference between the arrangements in Victoria and in other jurisdictions is that the AER is unable to take stranded assets out of the regulatory asset base of AEMO, or a DTSO, if it determines that AEMO did not adequately seek to manage the risk of the DTSO-owned transmission assets becoming stranded by seeking to negotiate with transmission customers to pay a lower price to continue using these assets.²¹

1.3 Rationale for the rule change request

In the rule change request, the Minister sought to address three key issues related to the application of the prudent discount regime in Victoria. These are:

- a lack of negotiation, and associated information, obligations on DTSOs
- no obligations to provide reasons for refusing a prudent discount application

16 The DTSOs owning, controlling or operating sections of the Victorian declared transmission system in Victoria as of 17 December 2020 include AusNet Services, TransGrid (operating as NSW Electricity Networks Operations Pty Ltd), TransGrid Services, Rowville Transmission Facility Pty Ltd, Transmission Operations (Australia) Pty Ltd and Transmission Operations (Australia) 2 Pty Ltd. The Victorian Energy Minister facilitates the creation of DTSOs through Ministerial Orders in the Victoria Government Gazette.

17 Clauses 6A.26.1(c) and S6A.4.2(k)3(1) of the NER.

18 Clause S6A.4.2(k)3(2)(ii) of the NER.

19 Clause S6A.4.2(k)3(2)(i) of the NER.

20 Clause S6A.4.2(k)(4) of the NER disapplies clause 6A.26.2(k) to AEMO in Victoria.

21 Under clause S6A.4.2(n), Schedule S6A.2 does not apply to AEMO in its entirety as it does not have a regulatory asset base, and clause S6A.2.3(a)(3)(i) does not apply to DTSOs.

- uncertainty about when AEMO can apply to the AER for full cost recovery.

These are discussed in turn below.

1.3.1

A lack of negotiation and associated information obligations on the DTSO

The Minister noted that in NEM jurisdictions other than Victoria there is a single TNSP which both assesses the request for a discount by a transmission customer and is the asset owner. As a result, it is likely to be easier for a transmission customer to source information to support negotiations in these jurisdictions than in Victoria. The Minister suggested that information that is needed by a transmission customer in order to be able to pursue its request can often be held by the asset owner. This information might, for example, include information necessary to ascertain the avoidable costs associated with the customer's facility and, therefore, whether there would be a risk of inefficient bypass.²²

In Victoria, the obligation to negotiate in good faith with a transmission customer applies to AEMO in its capacity as TNSP. There is no obligation on the relevant DTSO to negotiate in good faith directly with a transmission customer who requests a discount. The Minister considered this may impact on negotiations for a prudent discount.

In addition, the Minister suggested that, while AEMO and the DTSO are required to negotiate in good faith with each other, the obligation on the DTSO to negotiate in good faith with AEMO is not triggered in the absence of a proposal by AEMO to exercise its power to grant a discount.

Given that AEMO can only grant a discount if it has obtained the relevant DTSO's consent, the Minister suggested that there is a gap in the overall procedural rights of transmission customers in Victoria requesting a prudent discount compared to transmission customers in other jurisdictions. She noted that in other jurisdictions, transmission asset owners (that is, TNSPs) have obligations to negotiate with those customers in good faith, including to exchange such information as may be needed by the customer.

The Minister proposed to address these concerns regarding the DTSO's good faith obligations by inserting a provision into the NER to require the relevant DTSO to negotiate in good faith with a transmission customer who requests, or proposes to request, a discount.²³

In addition, to address concerns regarding the lack of an obligation on the DTSO to provide a transmission customer with relevant information, the Minister proposed that the NER be amended to oblige the DTSO to provide the transmission customer with information that is reasonably required by that customer for making a prudent discount request to AEMO.

1.3.2

A lack of obligations relating to a refusal to agree to a discount

In her rule change request, the Minister also identified that if a prudent discount application is rejected, there are no obligations on AEMO and the relevant DTSO to explain to the transmission customer why the discount was not agreed to.

²² Rule change request, p. 5.

²³ Rule change request, p. 6.

Specifically, there is no express obligation on AEMO or the DTSO to provide reasons to the transmission customer where:²⁴

- AEMO as the TNSP refuses to grant a discount to a transmission customer
- the relevant DTSO refuses to consent to AEMO providing a discount to a transmission customer.

The Minister considered that the lack of obligations on AEMO and the DTSO to explain to a transmission customer why its discount proposal was rejected:

- denies the requesting transmission customer the opportunity to respond to any adverse information or interpretation of the NER which is held or made by AEMO or the relevant DTSO (as applicable)
- makes it difficult for a transmission customer whose request is not granted to properly address the reasons for refusal in any future discount requests and/or to properly utilise any dispute resolution processes available under the NER
- contributes to a lack of transparency and accountability in the prudent discount process.

To address this issue, the Minister proposed amending the NER to state that if either AEMO or the DTSO refuse consent to providing a discount to a transmission customer, then the party choosing to reject the discount application must provide reasons to the transmission customer for this refusal.

1.3.3

Uncertainty on AEMO's ability to apply for full cost recovery on a conditional basis

The third issue identified in the rule change request is that there is a lack of clarity in the NER on whether AEMO can propose to agree to a discount on a conditional basis, pending the outcome of an application to the AER for approval to recover the entire discounted amount from other customers.²⁵

The Minister stated that she understands from the experience of Alcoa Portland Aluminium Pty Ltd (APA) in seeking a prudent discount for its Portland Smelter that:

- AEMO considers that it cannot agree to a discount, or propose to agree to a discount, without being certain that the AER will approve the recovery of the full discounted amount from other transmission customers
- the AER, in turn, is unlikely to be willing to provide a definitive view on whether it would grant approval for passing on more than 70 per cent of the discounted amount to other transmission customers without receiving a formal application from AEMO.

Since AEMO agreeing to, or proposing to agree to, a discount is a necessary prerequisite for a formal application to the AER for cost recovery approval, the Minister suggested that these procedural requirements unnecessarily hamper the ability and incentives for AEMO to seek approval for a discount in Victoria, even if it would be prudent to do so.

²⁴ Rule change request, p. 6.

²⁵ Rule change request, p. 7.

The Minister contended that this issue is exacerbated in Victoria compared to other jurisdictions because AEMO is required to assess the discount request without being the asset owner. As a result, it does not have the same economic incentives to grant a prudent discount as might be expected for a TNSP who is also the asset owner. Further, this relative disincentive for AEMO to grant a prudent discount could be exacerbated by the fact that AEMO (unlike other TNSPs) cannot absorb any of the costs of providing a prudent discount because, as a non-profit entity, it does not have the capacity to take on the risk of not being able to fully recover the revenues forgone by granting a discount.

To address this issue, the Minister proposed amending the NER to clarify the conditions on AEMO's ability to apply to the AER for prudent discount cost recovery approval.

1.4 The rule making process

On 8 October 2020, the Commission published a notice advising of its commencement of the rule making process and consultation in respect of the rule change request.²⁶ A consultation paper was also published. Submissions closed on 5 November 2020.

The Commission accepted that the rule change request was a request for a non-controversial rule as defined in s. 87 of the NEL. Accordingly, the Commission commenced an expedited rule change process under s. 96 of the NEL, subject to any written requests not to do so. The closing date for receipt of written requests was 22 October 2020.

No requests to not carry out an expedited rule change process were received. Accordingly, this rule change request has been considered under an expedited process.²⁷

The Commission received two submissions in response to its consultation paper. AEMC staff have also held meetings with key stakeholders (including AEMO, the AER, APA, AusNet Services and the Victorian Department of Environment, Land, Water and Planning (DELWP)). The issues that are not discussed in the body of this document have been summarised and responded to in Appendix A.

On 26 November 2020, the Commission extended the time for making a final rule determination for this rule change from 3 December 2020 to 17 December 2020 on the basis that the rule change request raised issues of sufficient complexity or difficulty such that it was necessary to extend the relevant time.²⁸ The Commission considered that this extension was necessary to fully assess its more preferable rule and ensure that any complexities associated with this approach were appropriately addressed.²⁹

²⁶ This notice was published under s. 95 of the NEL.

²⁷ Section 96 of the NEL.

²⁸ The extension notice made under s. 107 of the NEL is available on the Prudent discounts in an adoptive jurisdiction project page.

²⁹ While the Minister's proposed changes were largely administrative changes, concerns were raised by stakeholders regarding the outcomes of some of these proposed changes. The Commission therefore developed a more preferable rule to address the issues raised by both the rule change proponent and stakeholders.

2 FINAL RULE DETERMINATION

2.1 The Commission's final rule determination

The Commission's final rule determination is to make a more preferable final rule. The more preferable final rule adds consistency and reduces ambiguity in the Victorian prudent discount framework by simplifying the DTSO's role in the prudent discount negotiation process.

The final rule also reduces ambiguity and adds consistency to the prudent discount framework by specifying that the AER review and approve cost recovery for any prudent discount where AEMO proposes to pass more than 70 per cent of the discount value on to other consumers.

The Commission's reasons for making this final rule determination are set out in section 2.4.

This chapter outlines:

- the rule making test for changes to the NER
- the more preferable rule test
- the assessment framework for considering the rule change request
- the Commission's consideration of the more preferable final rule against the national electricity objective.

Further information on the legal requirements for making this final rule determination is set out in Appendix B.

2.2 Rule making test

2.2.1 Achieving the NEO

Under 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 national electricity objective (NEO).³⁰

The NEO is:³¹

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.

2.2.2 Making a more preferable rule

Under s. 91A of the NEL, the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule will or is likely to better contribute to the achievement of the NEO.

³⁰ Section 88 of the NEL.

³¹ Section 7 of the NEL.

The Commission has made a more preferable rule in this instance. The reasons are summarised in section 2.4.

2.3 Assessment framework

In assessing the rule change request against the NEO, the Commission has considered the following principles:

- **Improving consistency, clarity and transparency:** The provision of consistent, clear and transparent rules and processes is important, as it enables participants to understand their own and others' obligations with respect to the transactions that they undertake. This will promote confidence, and therefore efficiency, in the market.
- **Improving administrative efficiency:** Improving the effectiveness and efficiency of administrative processes can reduce costs for participants and contribute to cost savings being passed on to customers.

2.4 Outline of the rule and summary of reasons

The more preferable final rule made by the Commission is attached to and published with this final rule determination. The key features of the more preferable final rule are:

- removal of the current obligation on AEMO to obtain the written consent of the relevant DTSO before exercising the power to grant a prudent discount
- removal of the obligation on DTSOs and AEMO to negotiate in good faith when either asks the other to consider a proposal for the exercise of the prudent discounts power in a particular manner
- oblige DTSOs to provide AEMO with any information reasonably required by AEMO for the purpose of considering a prudent discount
- require AEMO to apply to the AER for approval if it agrees, or proposes to agree, to provide a prudent discount and seeks to recover more than 70 per cent of that discount's costs from other transmission customers
- transitional provisions so that any prudent discount requests made by a Victorian transmission customer to AEMO prior to the commencement of this rule would be subject to the previous prudent discount provisions.

Having regard to the issues raised in the rule change request and during consultation, the Commission is satisfied that the more preferable final rule will, or is likely to, better contribute to the achievement of the NEO for the following reasons:

- Removing the need for AEMO to obtain the consent of the DTSO before granting a prudent discount provides consistency with the framework in other jurisdictions, where a transmission customer only needs to obtain agreement to a prudent discount from its TNSP. It also provides increased clarity and transparency because in the case that a prudent discount request is rejected, the transmission customer would not face ambiguity regarding which party rejected that discount.
- Removing the need for AEMO and the DTSO to negotiate with each other in good faith if either party asks the other to consider a prudent discount proposal is consistent with

AEMO no longer needing a DTSO's consent to grant a prudent discount. This also increases clarity and consistency with other jurisdictions by making it clear that prudent discount requests should be lodged with AEMO as the TNSP.

- Imposing an obligation on the DTSO to provide AEMO with any information reasonably required by AEMO for the purpose of a prudent discount provides increased administrative efficiency and consistency with other jurisdictions by ensuring that AEMO has any information required to consider a transmission customer's prudent discount application, and can choose to provide information to the transmission customer in the same way as a TNSP in another NEM jurisdiction.
- Not obliging either the TNSP or DTSO to provide reasons for not agreeing to a prudent discount retains consistency with the prudent discounts framework in other jurisdictions.
- Requiring AEMO to apply to the AER for approval to recover more than 70 per cent of the value of a prudent discount from other customers when it agrees, or proposes to agree, to provide a discount increases consistency with other jurisdictions, where the AER must provide this approval for a TNSP. Requiring AEMO to seek approval at this stage would increase consistency and clarity of the process for transmission customers, AEMO and the AER.
- The transitional provisions provide clarity on which NER process and requirements are to apply to a prudent discount application that may be underway before the commencement of the final rule.

3 COMMISSION'S ASSESSMENT

This chapter provides an overview of the rule change request, stakeholder responses, and the Commission's assessment and conclusions, having regard to the assessment criteria discussed in Chapter 2.

Specifically:

- Section 3.1 considers negotiation and associated information obligations on the DTSO
- Section 3.2 considers obligations relating to a refusal to agree to a prudent discount
- Section 3.3 considers AEMO's ability to apply for full cost recovery on a conditional basis.

AEMO and AusNet Services provided submissions to the consultation paper for this rule change request. The issues raised by both of these stakeholders are discussed in these sections. AEMC staff also carried out discussions regarding this rule change request with the relevant stakeholders (AEMO, APA, AusNet Services and DELWP). Their comments are provided below where relevant.³²

3.1 Negotiation and associated information obligations on the DTSO

3.1.1 The proposed solutions

To address the issue that there is no obligation on the relevant DTSO to negotiate directly with a transmission customer who requests a prudent discount, the rule change request sought to insert a provision into the NER to require the relevant DTSO to negotiate in good faith with a transmission customer who requests, or proposes to request, a discount.³³

In addition, the rule change request proposed to include an additional, explicit obligation on the DTSO to provide the transmission customer with such information that is reasonably required by that customer for making a discount request to AEMO.

The Minister considered that these amendments to the NER would remove any ambiguity around the information provision obligation that would otherwise be present under an obligation for the DTSO to negotiate with transmission customers in good faith alone.

3.1.2 Stakeholder views

AEMO and AusNet Services opposed both of these proposed amendments to the NER. They suggested that these solutions would be unnecessary and inconsistent with the prudent discount framework in other jurisdictions.

AEMO argued that because it is the only party that may grant a prudent discount but also requires the written consent of the relevant DTSO, the current framework requires AEMO to not only negotiate with the transmission customer in good faith as TNSPs would in other

³² APA expressed some concerns about aspects of the Commission's more preferable rule, but otherwise none of these stakeholders indicated any significant concerns with the Commission's more preferable rule.

³³ Rule change request, p. 6.

jurisdictions, but also with the relevant DTSO.³⁴ AEMO considered that it should therefore be able to obtain information from the relevant DTSO on the transmission customer's behalf.

AusNet suggested that the DTSO's current role in the prudent discount process should continue as a party that provides input to AEMO to facilitate the primary negotiations between AEMO and the transmission customer.³⁵ AusNet agreed with AEMO that the flow of DTSO information should occur through AEMO because AEMO conducts the negotiation with the transmission customer and knows what information is held by itself and by the DTSO. AusNet stated that due to the collaborative working relationships that exist between AEMO and AusNet Services, the fact that AusNet could have information that is not possessed by AEMO would not prevent a transmission customer from obtaining access to that information.³⁶

AusNet also suggested that requiring direct negotiations to occur between the DTSO and the transmission customer would increase the administrative burden for AEMO and the DTSO. This could make the process more complex for transmission customers and undermine the cohesiveness and efficacy of the prudent discount process in Victoria.³⁷

Both AEMO and AusNet noted that in other jurisdictions the NER requires the TNSP to negotiate with the prudent discount applicant in good faith rather than requiring the TNSP to provide information to that applicant.³⁸

3.1.3

Commission's final determination: make more preferable changes

Consent from DTSOs

The Commission notes that a gap exists in the overall procedural rights of Victorian transmission customers because a DTSO's consent is required for a prudent discount to be granted to these customers, but these customers are unable to negotiate directly with the relevant DTSO.

It also considers that imposing an obligation on the DTSO to negotiate directly with a transmission customer could be equivalent to the right a transmission customer would have to negotiate with a TNSP in other jurisdictions. This is because AEMO shares some transmission network functions with DTSOs and because both AEMO and the relevant DTSO can veto a prudent discount.

However, obliging a DTSO to negotiate directly with the transmission customer would be likely to increase complexity and reduce accountability in the Victorian prudent discount framework, as both transmission customers and relevant DTSOs would be likely to need to engage with each other as well as with AEMO.³⁹

³⁴ AEMO, submission to the consultation paper, p. 2.

³⁵ AusNet Services, submission to the consultation paper, p. 4.

³⁶ *ibid*, p. 2.

³⁷ *ibid*, pp. 2-3.

³⁸ Submissions to the consultation paper: AEMO, p. 2; AusNet Services, p. 4.

³⁹ It would be possible for a prudent discount application to involve more than one relevant DTSO, which would further exacerbate this issue.

The Minister identified ambiguity regarding the triggers for the current good-faith obligations in the Victorian framework that could be increased further if the DTSO is required to negotiate directly with the transmission customer. Under the current prudent discount process in Victoria, AEMO's obligation to negotiate in good faith with a transmission customer is triggered when that transmission customer requests a prudent discount.⁴⁰ The Commission understands that AEMO would subsequently ask the DTSO to consider that request and in doing so would trigger their mutual obligations to negotiate with each other in good faith.⁴¹

However, AEMO's and the DTSO's mutual obligations to negotiate with each other in good faith could also be triggered under the current framework if the DTSO asks AEMO to consider a prudent discount request that was made to the DTSO. This could trigger AEMO's obligation to negotiate with the DTSO before its obligation to negotiate with the transmission customer, making the prudent discount process more complex. This would be even more likely under the proposed rule, which unlike the obligation currently placed on AEMO, would oblige the DTSO to negotiate in good faith with a transmission customer that is merely proposing to request a prudent discount from AEMO. As a result, the Commission does not consider that the proposed solution would best achieve the outcomes sought by the Minister.

In the Commission's view, many of the challenges that the Minister raised about the role of the DTSO stem from the fact that the relevant DTSO's consent is currently required for a prudent discount to be approved. The Commission considers that this consent should not be needed as there is no risk that a DTSO would be financially affected by AEMO making a decision to provide a prudent discount without obtaining permission from the DTSO beforehand.

As a result, the Commission's more preferable rule removes the requirement for AEMO to obtain the relevant DTSO's approval for a prudent discount. It also removes the obligation on DTSOs and AEMO to negotiate in good faith when either asks the other to consider a proposal for the exercise of the prudent discounts power in a particular manner. The Commission considers that its approach would simplify the prudent discounts process for Victorian transmission customers by only requiring these customers to seek the approval of their TNSP, (that is, AEMO) as would occur in other jurisdictions.

In discussions with AEMC staff, AusNet Services indicated support for this solution while AEMO indicated that it did not have any concerns towards the solution. DELWP acknowledged that this solution could be feasible, but stressed the importance of having regard to the positions of AEMO and the DTSOs. APA did not object to this solution, but expressed a preference for the Minister's proposed solution.

Information from DTSOs

Regarding the provision of information by the DTSO to the transmission customer, the Commission considers that AEMO is already able to obtain information from the relevant DTSO on the transmission customer's behalf. That is, the current prudent discount framework

⁴⁰ Under NER clauses 6A.26.1(c) and S6A.4.2(k)(3)(1).

⁴¹ Under NER clause S6A.4.2(k)(3)(ii).

in Victoria is consistent with other jurisdictions by enabling the transmission customer to obtain relevant information from their TNSP through a good faith negotiation obligation.

However, the Commission also notes that the mutual good faith negotiation obligation between AEMO and the DTSO does not guarantee that AEMO would be able to obtain all relevant information that either AEMO itself or a transmission customer would need from the relevant DTSO. This has the potential to hinder AEMO's prudent discount considerations. It is also inconsistent with other jurisdictions where a single TNSP alone would possess the information that AEMO and the DTSOs collectively possess in Victoria.

The Commission considers that the Minister's proposed solution of imposing an obligation on the DTSO to provide relevant information directly to a transmission customer would make this aspect of the Victorian framework even more inconsistent with the operation of the prudent discount framework in other jurisdictions. This is because under the proposed rule the DTSO would have stronger obligations to provide information to an applicant transmission customer than to provide information to AEMO.

The Commission considers that it would be more preferable to make it administratively easier for both AEMO and transmission customers to obtain the information they might require from the relevant DTSO if the NER requires the DTSO to provide AEMO with any information reasonably required by AEMO for the purpose of considering a prudent discount.

This approach would increase accountability and simplify the process by ensuring that the transmission customer would only need to seek information from AEMO rather than needing to also request information from one or more DTSOs. The rule would also maintain consistency with the framework in other jurisdictions by encouraging the TNSP to provide information to a transmission customer under its good faith negotiation obligation but not obliging it to do so. Consistency with other jurisdictions would also be supported by ensuring that AEMO can obtain the information that it needs from DTSOs to consider a prudent discount application.

AusNet Services indicated its support for this approach to AEMC staff. AEMO supported retaining the feature of Victorian transmission customers obtaining information from AEMO through AEMO's obligation to negotiate in good-faith with a transmission customer as a TNSP, and did not have any concerns towards the requirement for the DTSO to provide AEMO with any information that AEMO requires to consider a prudent discount.

However, DELWP and APA did not support retaining the feature of Victorian transmission customers obtaining information from AEMO through AEMO's obligation to negotiate in good-faith with a transmission customer as a TNSP, and thought that the Minister's original proposal would make it more likely that transmission customers would be able to obtain the information that they require for prudent discount applications.

APA supported the requirement that the DTSO provide AEMO with any information that AEMO requires to consider a prudent discount and DELWP considered that this requirement could lead to some positive impacts compared to the status quo.

3.2 Obligations when refusing a prudent discount

3.2.1 The proposed solutions

To address the issue raised around the lack of obligations on AEMO and the relevant DTSO to provide the transmission customer with reasons for the rejection of a discount proposal, the rule change request proposed to insert a provision into the NER to provide that, for any prudent discount application in an adoptive jurisdiction:⁴²

- AEMO must provide reasons for any refusal to grant a discount
- the relevant DTSO must provide reasons for any refusal to provide its consent to AEMO granting the discount.

3.2.2 Stakeholder views

AEMO and AusNet Services opposed this proposal, with both suggesting that it would create inconsistencies with the prudent discount framework in other jurisdictions.⁴³

AEMO provided additional reasons for its view:⁴⁴

- the current arrangements are carefully structured to prevent gaming and successive discount requests being made that are tailored to seek the maximum discount amount considered most likely to be agreed, based on the specific reasons provided for the refusal of the previous application.⁴⁵
- the current framework strikes the right balance as AEMO endeavours to clearly explain its position and identify the information upon which it relies as part of its commitment to negotiate in good faith without needing to provide an explanation that could prejudice future negotiations.
- the relevant TNSP is not intended to be a decision maker that provides reasons for its decisions which may be subject to administrative review.

AusNet agreed with AEMO that a negotiation conducted in good faith under the current framework should leave the applicant with an understanding of the TNSP's reasoning for declining to agree to a prudent discount. AusNet also argued that inserting a specific provision that would require reasons to be provided risks conflated public and private law concepts by imposing a public law obligation (to provide reasons) on private entities.⁴⁶

3.2.3 Commission's final determination: do not make a change

Under the more preferable rule, the relevant DTSO would be unable to reject a prudent discount, meaning the proponent's solution on addressing the circumstances when refusal is given would no longer be relevant for the DTSO.

42 Rule change request, p. 7.

43 Submissions to the consultation paper: AEMO, p. 3; AusNet Services, p. 4.

44 AEMO, submission to the consultation paper, p. 3.

45 APA has indicated to AEMC staff that it disagrees with AEMO's suggestion that providing transparency to an applicant on AEMO's reasons for refusing a discount would promote inappropriate 'gaming' of the system.

46 AusNet Services, submission to the consultation paper, p. 4.

Further, the Commission does not accept some of the reasons provided by AEMO and AusNet for why there should not be an obligation to provide reasons for rejecting a prudent discount.

The Commission notes AEMO's view that decisions made by AEMO (whether in its capacity as market operator or its capacity as TNSP exercising declared network functions) are not subject to administrative (merits) review (except for certain decisions around disclosure of confidential or protected information), particularly in the absence of a specific merits review framework in the NEL.⁴⁷

While the Commission accepts that an obligation on private entities to provide reasons for a decision may be more like a public law-type obligation, it does not consider that imposing such an obligation on AEMO (in its capacity as TNSP) would necessarily be open to administrative (merits) review (or otherwise make an administrative review application more likely).

It also notes that while the NER does not require parties to provide reasons for a decision, the NER does not prevent this from occurring either.

However, the Commission does acknowledge that in other NEM jurisdictions, there is no explicit obligation for a TNSP to provide reasons to a transmission customer for rejecting a discount proposal. On this basis of maintaining consistency between the prudent discount frameworks in Victoria and the rest of the NEM, the Commission's more preferable rule does not impose an obligation on AEMO to provide a Victorian transmission customer with reasons for rejecting a prudent discount.

The Commission considers that the more preferable solution in section 3.2.1 would be likely to increase transparency and clarity for Victorian transmission customers for this part of the prudent discounts framework. By making AEMO the only party that is able to refuse a prudent discount, it should be easier for the transmission customer to request further information from AEMO on the reasons for its decision on a good faith basis. On this basis, the Commission has decided not to amend the NER as proposed to require AEMO to provide reasons for its refusal of a prudent discount.

During discussions with AEMC staff, AEMO and AusNet Services expressed their support for the Commission's approach to this aspect of the proposal. However, DELWP raised some concerns and APA did not support the approach. Both parties thought that retaining the status quo would continue to make it difficult for a transmission customer applicant to understand and respond to AEMO's rejection of a prudent discount proposal.

3.3

3.3.1

AEMO's ability to apply for full cost recovery on a conditional basis

The proposed solution

The rule change request also sought to address the procedural challenges and associated disincentives that the Minister considered currently prevent AEMO from applying to the AER for cost recovery as a necessary prerequisite for a discount being approved in Victoria.⁴⁸

⁴⁷ Section 44ZZMAA, the *Competition and Consumer Act 2010* (Cth)

⁴⁸ Rule change request, p. 8.

The proposed rule sought to change the NER with the intention of expressly clarifying AEMO's right to apply to the AER for approval to recover more than 70 per cent of a discount from other transmission customers is triggered where AEMO 'proposes to agree' to a discount on a conditional basis. This was to be achieved by amending clause S6A.4.2(k)(4) of the NER to provide that, in an adoptive jurisdiction:⁴⁹

Clause 6A.26.2(a) applies as if the words "agreed, or proposes to agree (subject to obtaining AER approval under this clause 6A.26.2)" were substituted for the words "agreed or proposes to agree".

This amendment was intended to allow AEMO to approve a discount subject to the AER approving recovery of the proposed discounted amount from other transmission customers, breaking the impasse that the Minister considered exists under the current arrangements.

3.3.2

Stakeholder views

AEMO was the only stakeholder to comment on this aspect of the proposal in submissions, and suggested that this solution was unnecessary. AEMO argued that the 'proposes to agree' option available under the current framework is unambiguous and already includes sufficient conditionality for applications to the AER for approval of a proposed prudent discount amount on a conditional basis by AEMO in Victoria, as well as by other TNSPs in other NEM jurisdictions.⁵⁰

AEMO also disagreed with the assertion that the proposed clarification is uniquely necessary for prudent discount arrangements in Victoria. AEMO noted that as a non-profit organisation, it does not have the same economic incentive as TNSPs in other jurisdictions to grant prudent discounts or the capacity to accept the risk that the AER refuses recovery of the proposed amount. Nevertheless, AEMO did state that similar to other TNSPs, it does have an incentive to fully recover any foregone revenue as a result of agreeing to a prudent discount.⁵¹

3.3.3

Commission's final determination: make a more preferable change

AEMO has stated that it interprets the NER as already providing conditionality on its ability to seek cost-recovery approval from the AER before committing to providing a prudent discount to a transmission customer. On this basis, the Commission considers that the proposed change to provide increased clarity on AEMO's options is unnecessary. It considers that the relevant clause is already sufficiently clear.

In subsequent discussions with AEMC staff, AEMO and AusNet Services expressed support for retaining the current provisions. However, DELWP did not support this approach and APA expressed some concerns towards it. While both of these stakeholders acknowledged AEMO's submission, they considered that the proposed minor drafting clarifications should still be added to the adoptive jurisdictional provisions to put the issue beyond doubt.

⁴⁹ Rule change request, p. 10.

⁵⁰ AEMO, submission to the consultation paper, p. 3.

⁵¹ *ibid.*

However, the Commission considers that there are other ambiguities relating to AEMO's ability to apply to the AER for full cost recovery on a conditional basis that could, and should be addressed to achieve the broader aims sought by the Minister.

Similar to other jurisdictions, the current rules do not require AEMO in Victoria to obtain approval from the AER before agreeing to provide a prudent discount.⁵² However, as discussed in section 1.2.2, the AER cannot currently assess whether a discount for a Victorian transmission customer that AEMO has already accepted was a prudent discount or not. This is in contrast to the framework in other jurisdictions, where the AER must conduct an ex post review of a prudent discount if a TNSP agrees to a discount that passes more than 70 per cent of the costs to other consumers and the AER had not provided cost recovery approval beforehand.

The Commission considers that requiring AEMO to seek AER approval to recover more than 70 per cent of the costs of a prudent discount from other transmission customers would increase clarity of the process and consistency with other jurisdictions.

However, the Commission also notes that unlike in other jurisdictions, AEMO as a non-profit entity and would not be able to cover the costs of the AER rejecting cost recovery from other customers for a prudent discount that it has already committed to provide. Therefore on balance, the Commission considers that the more preferable approach is to require AEMO to seek cost recovery approval from the AER to recover more than 70 per cent of the value of a prudent discount from other customers when it agrees, or proposes to agree, to provide a prudent discount. Changing this from being optional to a requirement for AEMO improves consistency between the Victorian prudent discount regime and that in the other NEM jurisdictions.

Through the options of either agreeing or proposing to agree to a prudent discount, AEMO would be able to seek mandatory cost recovery approval from the AER before committing to provide a prudent discount to a transmission customer. The Commission considers that to minimise ambiguity in practice, AEMO would be likely to propose to agree to a prudent discount and then seek approval from the AER on this basis.

During the discussions with AEMC staff, APA, AusNet Services and DELWP all supported this solution, while AEMO did not have any concerns with it.

⁵² Further details on TNSPs seeking AER approval for cost-recovery associated with prudent discounts in other jurisdictions can be found in section 1.2.1.

ABBREVIATIONS

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
APA	Alcoa Portland Aluminium Pty Ltd
Commission	See AEMC
DELWP	Department of Environment, Land, Water and Planning, Victoria
DTSO	Declared transmission system operator
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	National electricity objective
NER	National Electricity Rules
TNSP	Transmission network service provider
TUOS charges	Transmission use of system charges

A SUMMARY OF OTHER ISSUES RAISED IN SUBMISSIONS

This appendix sets out the issues raised in the first round of consultation on this rule change request and the AEMC’s response to each issue. If an issue raised in a submission has been discussed in the main body of this document, it has not been included in this table.

Table A.1: Summary of other issues raised by stakeholders

STAKEHOLDER	ISSUE	AEMC RESPONSE
AusNet Services	Preparing a similar statement [of agreed principles] for the prudent discount mechanism is preferable to amending the NER. A statement will improve transparency by describing the process and describing AEMO’s and the DTSOs’ roles and responsibilities. This will increase AEMO’s and the DTSOs’ accountability and facilitate informed participation by prospective applicants.	This proposal may increase accountability and understanding of the current prudent discounts framework in Victoria. However, the more preferable rule should add clarity to the framework in a way that would make a statement of principles unnecessary.
AEMO [through informal discussions]	AEMO can incur considerable costs when assessing a prudent discount application. In the past, applicants have agreed to cover these costs, however, applicants are under no obligation to do so. The AEMC could consider additional amendments that ensure AEMO is able to recover its assessment costs, regardless of whether agreement is reached on a prudent discount application, given AEMO is a non-profit entity and is not able to absorb costs.	The AEMC considers this issue to be out of scope, as recovery of the costs associated with assessing a prudent discount application is a separate issue from the process issues raised in the rule change request.
APA [through informal discussions]	APA’s concern is that the AEMC may not	The more preferable rule aims to place AEMO in

STAKEHOLDER	ISSUE	AEMC RESPONSE
	adequately address the core issue that the rule change request was seeking to remedy. Some direct engagement by the DTSO with the applicant will often to be required for a prudent discount application.	a position so a prudent discount applicant would be able to obtain all of the information it requires from AEMO alone. Direct engagement between the transmission customer and the DTSO is not prevented by the NER.
APA [through informal discussions]	Any changes to the NER made by the AEMC in response to the rule change request should commence as early as is practicable.	The changes in this rule change will commence on the same date as the final determination and final rule publication date.
APA [through informal discussions]	The AEMC should consider transitional provisions which deal with situations where a prudent discount application has been submitted to AEMO prior to the commencement date, but where substantive negotiations between the applicant and AEMO have not yet commenced.	The transitional arrangements are set out in section 2.4. The AEMC considered that to avoid subjecting participants in the prudent discount process to risks of being subjected to a new unfamiliar framework without having a chance to consider it, the best approach was to implement transitional provisions so prudent discount applications submitted to AEMO prior to the commencement date would be processed under the earlier prudent discounts framework.

B LEGAL REQUIREMENTS UNDER THE NEL

This appendix sets out the relevant legal requirements under the NEL for the AEMC to make this final rule determination.

B.1 Final rule determination

In accordance with s. 102 of the NEL the Commission has made this final rule determination in relation to the rule proposed by Hon Lily D'Ambrosio MP, Minister for Energy, Environment and Climate Change, Victoria.

The Commission's reasons for making this final rule determination are set out in section 2.4.

A copy of the more preferable final rule is attached to and published with this final rule determination. Its key features are described in section 2.4.

B.2 Power to make the rule

The Commission is satisfied that the more preferable final rule falls within the subject matter about which the Commission may make rules. The more preferable final rule falls within s. 34(1)(a)(iii) of the NEL as it relates to regulating the activities of persons participating in the national electricity market or involved in the operation of the national electricity system. Further, the more preferable final rule falls within the matters set out in Schedule 1, items 16, 30E and 30F, to the NEL as it relates to the regulation of prices charged or that may be charged by owners, controllers or operators of transmission systems, the declared network functions and the application of the NER applicable to AEMO in its capacity as a provider of transmission services.

Further, Commission notes that under s. 91(7) of the NEL, a request for a rule regulating AEMO's declared network functions may only be made by AEMO, a DTSO that is party to a network agreement with AEMO or the Minister of an adoptive jurisdiction. In this case, the rule change proponent is a Minister of an adoptive jurisdiction, and therefore this requirement has been satisfied.

B.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the rule
- the rule change request
- submissions received during first round consultation
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the NEO.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.⁵³

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 AEMO's declared network functions.⁵⁴ The more preferable final rule is compatible with AEMO's declared network functions because it provides clarity regarding AEMO's roles and responsibilities within the prudent discount framework as the TNSP for the Victorian jurisdiction.

Further, under s.91(9) of the NEL, the Commission may only make a rule that affects the allocation of powers, functions and duties between AEMO and a DTSO if either AEMO consents to the making of the rule, or the rule is requested by the Minister of the relevant adoptive jurisdiction. Given the Commission is making a more preferable final rule (and therefore has not adopted the rule proposed by the relevant Minister in the rule change request) it sought AEMO's consent to the making of the more preferable final rule. AEMO provided its written consent on 4 December 2020.

B.4 Civil penalties

The Commission cannot create new civil penalty provisions. However, it may recommend to the COAG Energy Council that new or existing provisions of the NEL be classified as civil penalty provisions.

The final rule does not amend any clauses that are currently classified as civil penalty provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the final rule be classified as civil penalty provisions.

B.5 Conduct provisions

The Commission cannot create new conduct provisions. However, it may recommend to the COAG Energy Council that new or existing provisions of the NEL be classified as conduct provisions.

The final rule does not amend any rules that are currently classified as conduct provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the final rule be classified as conduct provisions.

⁵³ Under s. 33 of the NEL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated council is now called the COAG Energy Council.

⁵⁴ Section 91(8) of the NEL.