Explaining the ACCC's Business

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1. INTRODUCTION

We are all acutely aware that the electricity and gas industries have been undergoing major structural and regulatory reforms during much of the 1990s. The immediate objective has been to increase the extent and effectiveness of competition in Australia's energy markets with the ultimate objective of improving efficiency, resource allocation and market growth within the sector and of delivering lower prices and more efficient energy services to industry and household energy users.

While there has been considerable progress to date in both sectors, neither the electricity nor the gas reforms can be regarded as being "in the bag" today. Much remains to be done before the energy reforms are effectively implemented. Today I would like to give an overview of the ACCC's role in relation to energy sector reform and also outline the ACCC's approach to its assessment of the National Electricity Market (NEM) Code of Conduct and lessons we have learnt to date.

2. ACCC ROLE IN THE NATIONAL ELECTRICITY MARKET

The access regulation and the wholesale market trading arrangements are set out in a very detailed Code of Conduct which will have the backing of state/territory laws. The code was submitted to the ACCC for formal authorisation under Part VII of the Trade Practices Act (TPA) and for approval of the industry code and related access undertakings under Part IIIA of the TPA (the latter to avoid the risk of declaration the services of transmission and distribution facilities under Part IIIA of the TPA). As I have just mentioned, there are two elements to the Commission's assessment role in relation to the NEM Code of Conduct.

One is examining the NEM in terms of the potential for it to contravene Part IV (anti-competitive conduct provisions) of the Act. This assessment role is set out in the authorisation provisions of the Act (Part VII). Basically the Commission's task is to evaluate any anti competitive detriment and weigh that against the public benefits that arise from the proposed market arrangements. Provided there is a 'surplus' of public benefits (as against the anti competitive negatives of the conduct) the Commission may authorise the arrangements. The value of authorisation is that it removes the uncertainty that may arise from possible legal action under the Act in respect of that conduct (note however, that the authorisation applies to anti-competitive arrangements and not misuse of market power).

On 5 March 1997, the Commission granted a conditional interim authorisation for the NEM1 Stage 1 market arrangements. The Commission's Energy Team is currently

analysing submissions and compiling a list of issues to be used as a basis for public consultation. The other element is the access code that has been submitted for acceptance. The NEM arrangements also provide mechanisms for accessing the distribution and transmission wires businesses. This will obviously be very important to the operation of the market as it will introduce an element of competition both up stream and down stream of the wires businesses. The access code has been submitted under Part IIIA of the Act.

In simple terms what this means is that if the wires' businesses provide an undertaking that sets out the terms of access to the wires, and this is subsequently accepted by the Commission, it removes the threat that their businesses may be declared under Part IIIA. Declaration provides a legal right to negotiate access which, if unsuccessful, can be referred to the Commission for resolution.

Part IIIA has its own provisions for determining whether the Commission should accept an access code and or access undertakings. The criteria cover such things as the interests of the owners of the facilities covered in the application, the users of the facilities, public policy issues and some other matters, one of which is enhancing competition. The Commission is currently evaluating the NEM access code in respect of these criteria and I would expect a preliminary decision in the next month or so. The Commission is currently working to the following timetable in relation to the NEM Code:

30 June 97: NEMNET to be established.

1 July 97: Registration of participants, metering agents etc to identify parties for consultation.

14 July 97: Reliability Panel to meet.

End July 97: Submission of NEM1 Stage 2 (ACCC to assess before October 1997).

Aug/early Sept 97: NEM - Access under Part IIIA TPA and Authorisation for conduct under s.45/47 TPA. Draft determinations for both.

29 Sept 97: Regions to define and publicise for NEM3.

6 Oct 97: NEM1 Stage 2 commences; commencement of Queensland market.

2 Nov 97: New arrangement for ancillary services.

29 March 98: Commencement of NEM.

Mid 98: NECA to complete review into transmission pricing.

The ACCC will have to authorise changes to the Code and approve any changes to access undertakings submitted to it from time to time. The Commission will also act on any anti-competitive conduct which might occur in the electricity market that may contravene Part IV of the TPA, including proposed mergers or acquisitions which may contravene S.50.

3. ACCC ROLE IN GAS INDUSTRY REFORMS

Initially, the ACCC's gas regulatory functions will be for transmission pipelines, and possibly Victoria's distribution network. In future years the ACCC may be given the role of regulating other States' distribution networks.

Thus the ACCC will have the following responsibilities:

- Assessing access arrangements for transmission pipelines, including:
  - - assessing the scope of the services being offered;
  - - determining reference tariffs;
  - - assessing the capacity trading and queuing arrangements in the primary and secondary markets;
  - - assessing minimum ring-fencing requirements;
  - - establishing minimum information requirements;
  - - gathering and checking all such information;
  - - consulting with interested parties;
  - - publishing a draft determination; and
  - - making a final determination;
- · Assessing revisions to access arrangements;
- · Ongoing monitoring and enforcement roles for:
  - - adequacy of and compliance with ring fencing arrangements;
  - - achievement of rate of return targets, cost and demand projections and effectiveness of incentive mechanisms;
  - - potential breaches of the Code's hindering access prohibition; and
  - - changes in market circumstances;
- · Resolving disputes over access to spare or developable capacity including:
  - - determining if there is a dispute;
  - - arbitrating between the parties; and
  - - making determinations on access to capacity;
- · Approving affiliate contracts, which includes:
  - - public consultation;
  - - issuing a draft determination;
  - - considering submissions; and
  - - making a final determination;
- · Approval of competitive tendering processes proposed by jurisdictions.

In addition, the ACCC would of course monitor anti-competitive conduct which might contravene Part IV of the Trade Practices Act 1974. The relevant state regulator will regulate distribution pricing in the participating jurisdictions.

4. MOOMBA-SYDNEY PIPELINE

In the shorter term, the ACCC will perform the following regulatory functions for the Moomba-Sydney Pipeline, until the Moomba-Sydney Pipeline System Sale Act is replaced with the National Gas Code:

- · Dispute resolution;
- · Approving related party contracts;
- · Monitoring haulage charges;

- · Ongoing monitoring and enforcement roles for:
  - - compliance with ring fencing requirements;
  - - potential breaches of the Act's hindering access prohibition; and
  - - other provisions of the Act.

5. NATIONAL GAS CODE

Under the National Gas Code which is nearing finalisation, if initial coverage is for NSW, Victoria and the ACT, the only pipelines which would be covered are the two transmission systems, the Moomba Sydney Pipeline System and the Gas Transportation Company System. The ACCC may be given the role of Regulator under the National Gas Code but this issue has not yet been decided.

The Gas Reform Implementation Group (GRIG) is aiming to finalise the Code by the end of June, after which it will be publicly released for discussion again. It is proposed that the National Competition Council will be involved in the public hearings, to facilitate its consideration of the Code and related legislation and Inter-Governmental Agreement (which are currently be drafted) as an effective access regime.

Government intention is to have all necessary legislation in place by November 1997, enabling the Code to become operational by the end of the year. Within 90 days of the National Gas Code being implemented, both the EAPL and GTC would be obliged to offer access arrangements to the Regulator for their respective systems. In deciding whether to approve or not approve an access arrangement, the Regulator must have regard to the following criteria:

- · Service provider's legitimate business interests and investment in the pipeline;
- · the cost of providing access, bit not losses from increased competition;
- · economic value of additional investment;
- · interests of all users;
- · firm and binding contractual obligations of the Service provider or other persons already using the pipeline;
- · operational and technical requirements necessary for safe and reliable operation of the pipeline;
- · economically efficient operation of the pipeline;
- · public benefit from having competitive markets.

The Regulator must either approve the proposed access arrangement or not approve it. If not approving it, the Regulator must either identify areas needing change, or if the Service Provider has already been given a second chance to fix it up, the Regulator can develop and approve its own access arrangement. The Regulator must also keep a public register of all access arrangements.

At any time after an access arrangement has been approved, the Service provider can apply for a review of the access arrangement and propose revisions of it. The Regulator must then consider such proposed revisions, following an identical public consultation process to the initial approval process.

The Regulator has a significant ongoing monitoring and enforcement role. Areas requiring monitoring include compliance with the ring fencing arrangements and assessments as to whether they are appropriate given any changes in the market circumstance, potential breaches of the hindering access prohibition, whether target rates of return have been achieved, whether proposed costs are incurred, whether proposed demand projections are accurate and the effectiveness of incentive mechanisms.

The Regulator must approve any related-party contracts. This involves a process of public consultation, including a draft determination, consideration of submissions and a final determination.

The Regulator also has a significant ongoing role in dispute resolution. Dispute resolution is limited to disputes over access to spare or developable capacity, where negotiations have broken down. The Regulator determines if there is a dispute or not. The Regulator can arbitrate and make determinations in relation to access to capacity and the Code sets out detailed principles the Arbitrator is to take into account in making any arbitration determination and also restrictions upon determinations. The Code does however provide the Regulator with the right to appoint an agent to act as arbitrator.

6. VICTORIAN GAS REFORM PROPOSALS

In the period prior to the introduction of the National Gas Access Code, Victoria intends to implement a transitional access regime consisting of the Gas Industry Act and the Victorian Gas Access Code.

Under the proposed framework, the ACCC would be the regulator for transmission pipelines and the ORG would be the distribution regulator. The regime will be submitted to the NCC for certification as effective. All three of these approval processes are to be pursued simultaneously. It is proposed to conduct a trial of the arrangements from 1 July 1997 through to 1 November 1997.

The Victorian Code is based on the National Code and although the key differences are transitional they are significant. The Victorian Government will make a Tariff Order, setting a five year price path for both the transmission and distribution services, rather than leaving the Service Providers (SPs) to propose reference tariffs for regulatory approval.

Over the next ten weeks, the Commission will be raising any concerns it has in relation to the Victorian reforms while the proposal is being finalised. There are many regulatory bodies, not just the ACCC, responsible for the reform of various industries. To coordinate the approach taken in relation to these reforms, the ACCC and various State regulatory bodies have formed the Regulators' Forum. This Forum will allow the various jurisdictional regulators and the ACCC to discuss common issues and approaches to regulation.

7. LEARNING FROM EXPERIENCE TO DATE

It will never be the case where a regulator will have as much information as an industry participant. Facility operators have much more information about their businesses, their costs, capacity to make efficiency improvements and their future market prospects. Further, facility operators typically stand to benefit from presenting partial or misleading information to the regulator. This is the "information asymmetry" problem. This has the potential to bias regulatory outcomes in favour of facility operators and increases the likelihood that tariffs will be set above the efficient costs of new entry.

There are a number of options for redressing this information asymmetry problem, including:

- · statutory requirements that facility operators maintain records for regulatory purposes of specified costs and other data and provide information to the regulator in a timely manner and in prescribed formats;
- · maintenance by regulators of detailed benchmarking data on the cost, productivity and tariff performance of Australian and overseas energy facility operators; and
- · the use of incentive options to encourage facility operators to reveal their costs and efficiency improvement potential.

The Commission strongly encourages and indeed relies on industry feedback for the process of reform. However, the ACCC believes it is also vital to pursue all relevant information and not allow a regulated enterprise to dictate the level of information provided to or the approach to analysis taken by the Commission.

Transparency in the regulatory process is essential as is the need to keep all stakeholders abreast of what is going on to avoid unexpected shocks at any stage. For this reason, the ACCC believes it is important to adopt a timetable, as it has done with the NEM Code authorisation application, which allows thorough work by the Commission and adequate comment by stakeholders at each stage of the process.

Finally, it is also important that regulators be allocated sufficient resources as there is a danger of poor assessment if limited resources are allocated to a task.

6. THE ENERGY SECTOR COMPETITION REFORMS: POTENTIAL GAINS AND REMAINING RISKS

As we are all aware, the broad approach being taken by the energy reforms is to promote effective competition in those sectors of the electricity and gas industries where competition is feasible (ie in production/generation, marketing, wholesale and retail supply) and to underpin that competition with efficient regulation of the natural monopoly sectors of the two industries (ie transmission and distribution).

In practice, the substantial economy-wide economic benefits predicted by the IC will be achieved only if the reforms also eliminate most of the existing barriers to entry and competition in the energy sector and result in major pro-competitive changes to the commercial and market conduct of energy market participants. If the reforms are to be fully effective, over the next few years we would expect to see dynamic and highly competitive energy industries characterised by:

- · the free entry of new electricity and gas retailers and marketers promoting more competitive and innovative trading and contracting in energy and transportation in competition with established market participants;
- · existing energy producers and distributor/retailers being forced to compete more aggressively (including by entering each other's traditional markets) to protect their existing markets and to obtain a share of market growth;
- · third party access arrangements giving large industrial energy users commercially viable options for separate direct purchases of energy and transportation as alternatives to the purchase of bundled services from incumbent distributors;
- · entry of new gas producers and electricity generators in response to improved access to exploration acreage, or in response to the cost advantages and flexibility of new generating technologies and the commercial opportunities offered by a growing, competitive market;
- · new energy infrastructure developments such as interstate pipeline and transmission wire interconnections promoting gas basin-on-basin competition and strengthening interstate competition among electricity generators; and
- · gas and electricity businesses taking ownership and trading positions in the markets for both energy sources, to take better advantage of the competitive marketplace by providing convenient, lower cost, integrated energy products and services to customers.

The point to emphasise, however, is that this dynamic and highly competitive future market activity (and the IC's estimated GDP growth that should result from it) can be achieved in practice only if the following necessary reform preconditions are established during the implementation phase:

- · the discipline of effective competition in markets for energy trading and contracting which produces competitive market prices (ie prices which do not include premiums above efficient supply costs due to the exercise of market power); and
- · implementation of "efficient" regulatory arrangements for the natural monopoly energy transportation facilities which establish the cost-based tariffs (with no monopoly rents) that would be expected from a competitive market.

The corollary is that the anticipated economic benefits from the energy reforms, both within the sector and for the economy as a whole, will be reduced substantially if competition and/or regulation of the natural monopoly facilities proves to be ineffective in removing monopoly rents from energy prices and transportation tariffs.

As noted above, there are a number of remaining obstacles to the effective implementation of the market reforms that will have to be overcome to satisfy these reform preconditions, including:

- · the potentially distorting influence of uncompetitive market structures in the gas and electricity industries, including the existence of monopoly or oligopoly at the production/generation stages, vertical integration at the distribution and retail stages and the presence of barriers to entry to those sectors of the market; and

- · the potential for inefficiency in the regulation of the natural monopoly facilities (due to shortcomings in the regulatory rules or in the regulators' implementation of them or both) resulting in a failure to eliminate monopoly rents from the pricing of these essential infrastructure services.

The first of these issues is largely a matter for governments to address in the context of their electricity market restructuring decisions and their reviews of regulations and policies that restrict entry into the upstream generator/production sector of the energy markets. However, regulators can also make an important contribution in this area. The second issue is largely one for regulators to resolve in their implementation of the access regulations set out in the two codes. Governments also have a role to play, however, particularly in the context of the privatisation of energy businesses and the regulatory arrangements that accompany that process.

7. CONCLUSION

During the coming months, many decisions will be made in relation to the energy sector reforms, a great deal of work must be done, many problems will arise and many questions will be asked. The ACCC wants to be and will do its best to be a part of the answer.