

Vertical Linkages in the Australian Energy
Industry:
Policy and Issues

ACCC Conference on Regulation, Industry Structure and
Market Power
Gold Coast, Queensland, 31 July 2003

Jeff Balchin
Director

Overview of Presentation

- Context – competition reforms to energy
- Strategies for regulated businesses
- Consequences of vertical relationships
- Policies to address vertical relationships
- Observations and current issues

Context – Competition Reforms to Energy

- Quid pro quo for the reduction in trade barriers that protected the traded sector
 - Objective to make the non-traded sector more efficient
- Reform framework:
 - Unbundling of functions
 - Competition where possible
 - Pro-competitive regulation of residual monopoly elements
- Expected outcomes:
 - ‘Unleashing’ competition
 - Exposing price signals
 - Making regulation easier

Context – Competition Reforms to Energy (II)

- Adverse effects of ‘vertical linkages’ recognised early
 - Benefit of experience elsewhere
- Hilmer Report (1993), Agreement to Implement Competition Reforms (1995)
- Gas Reform Agreements (1994)
- Electricity Reform Agreements (1992)

Strategies for Regulated Businesses

- Basic strategy – ‘loosen’ the price cap
- Use monopoly to create / capture rents in upstream or downstream business
 - Excluding or limiting entry / competition
 - Raising costs of competitors
 - Discounts to affiliates
- Recover the costs associated with other activities
 - Over-allocate to the regulated business
- ‘Re-package’ costs
 - ‘Independent’ supplier
- Over-allocate costs of multi-asset business
 - Different regulators / review timings

Implications of 'Strategies'

- Higher prices than otherwise
 - Fail to achieve original objectives
- May displace more efficient providers
- Continued regulation of potentially contestable elements
 - In an environment where the task has been made complex
- Regulation of monopoly components
- BUT vertical integration may provide benefits:
 - Economies of scale/scope
 - Access to a large balance sheet

Policies to Address Vertical Strategies

- 'Separation' of the monopoly activity
- 'Ring fencing' of the monopoly activity
- An 'access regime'
 - Scrutiny of terms and conditions of access
 - Regulatory accounting rules
- Scrutiny of pricing of retail incumbents

Observations and Current Issues

- 'Vertical linkages' in the Australian energy market
 - Degree of retail competition
 - Unregulated activities of distributors
- Adequacy of responses by governments and regulators:
 - Structural reforms
 - Ring fencing arrangements
 - Regulatory accounting rules
- Was the introduction of 'competition where possible' worthwhile?