



**Australian  
Competition &  
Consumer  
Commission**

**Draft  
Determination**

**Applications for Authorisation**

**Amendments to the National Electricity Code**

**Review of Technical Standards:  
Interim Extension of Existing Derogations**

**Date: 8 May 2002**

**Authorisation Nos:**

A90821

A90822

A90823

**File Nos:**

C2002/283, 285, 287

**Commissioners**

Jones

Cousins

Bhojani

Martin

# Contents

<b>Contents.....</b>	<b>1</b>
<b>1. Introduction.....</b>	<b>2</b>
<b>2. Statutory test .....</b>	<b>3</b>
<b>3. Public consultation process .....</b>	<b>5</b>
<b>4. Commission’s assessment.....</b>	<b>6</b>
4.1 The application .....	6
4.2 Issues for the Commission.....	6
4.3 What the applicant says .....	6
4.4 Commission's considerations.....	7
<b>5. Draft Determination .....</b>	<b>9</b>

## **1. Introduction**

On 15 February 2002, the National Electricity Code Administrator (NECA) lodged applications for authorisation (Nos A90821, A90822 and A90823) to extend certain existing technical derogations to the National Electricity Code (Code). In particular, the applications are for authorisation of draft chapter 8 derogations which:

- extend the existing chapter 8 derogations of South Australian generators and import into chapter 8 those derogations of South Australian generators contained in chapter 9 which are due to expire;
- extend the existing chapter 8 derogations of NSW generators; and
- import into chapter 8 the existing derogations of Victorian generators and network service providers, upon the expiry of the corresponding chapter 9 derogations.

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

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

## **2. Statutory test**

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

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

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

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

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

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

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

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

- fostering business efficiency;
- industry rationalisation;

- promotion of industry cost savings;
- promotion of competition in industry;
- promotion of equitable dealings in the market;
- expansion of employment;
- development of import replacements;
- growth in export markets; and
- arrangements that facilitate the smooth transition to deregulation.

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

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

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

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

### **3. Public consultation process**

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

The Commission received the initial application for authorisation of extension of the existing derogations on 15 February 2002. Notification of the application and a request for submissions was advertised in *The Australian Financial Review* of 6 March 2002 and placed on the Commission's web site. Interested parties were asked to make submissions to the Commission regarding their views on the issues of public benefit and anti-competitive detriment arising from implementation of the proposed extension.

There have been no submissions received from interested parties in relation to this matter.

The Commission has produced this draft determination outlining its analysis and views on the proposed extension of derogations to the Code according to the statutory assessment criteria set out in Section 2. The Commission now invites the applicant and other interested persons to notify it within 14 days of 10 May 2002 as to whether the applicant or other interested persons wish the Commission to hold a conference in relation to this draft determination. The applicant, interested parties who receive a copy of the draft determination and any other interested parties whose presence the Commission considers appropriate are entitled to participate in the conference.

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

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

## **4. Commission's assessment**

### **4.1 The application**

NECA's application proposes extending a number of existing Chapter 8 derogations for South Australia, New South Wales and Victoria. In the cases of South Australia and Victoria, it also proposes amendments to extend the coverage of these Chapter 8 derogations.

The proposed derogations:

- extend the existing chapter 8 derogations of South Australian generators and import into chapter 8 those derogations of South Australian generators contained in chapter 9 which are due to expire;
- extend the existing chapter 8 derogations of NSW generators; and
- import into chapter 8 the existing derogations of Victorian generators and network service providers, upon the expiry of the corresponding chapter 9 derogations.

There are a variety of technical derogations in place at present. The South Australian derogations allow, for example, the specified generators to meet lower leading power factors than specified in the Code. New South Wales generators also have derogations to achieve different lagging and leading power factors. Victorian generators have, for example, derogations that deal with their ability to respond to disturbances in the system.

The derogations are proposed to cease on the earlier of the end of 31 December 2004, or 12 months after the revised technical standards resulting from NECA's current review are gazetted.

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

The proposed extension of existing derogations beyond their original expiry date of 31 December 2002 must satisfy the statutory test detailed in Section 2. The Commission is mindful that extending the duration of these derogations may have a potentially anti-competitive impact on the market. Additionally, by further delaying a wider application of the Code technical standards, extension of the derogations may diminish the public benefits that would result from a more comprehensive application of the Code.

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

NECA argues that the extension of existing derogations is required to allow a managed transition to the new arrangements proposed in its final report on the review of technical standards published on 7 December 2001. The review examines the existing technical standards of the Code and their effect on incumbent and new market entrants.

The aim of the review is to ensure a level playing field for all participants by minimising barriers to entry to the NEM, while maintaining system security and power quality in an efficient manner. NECA argues that the proposed extension will assist the review process by maintaining the status quo for participants, allowing time to finalise and implement Code changes arising out of the review. The extension of existing derogations therefore represents a pragmatic and commonsense way forward to ensure a smooth transition to the new arrangements.

NECA notes that the Reliability Panel is currently consulting on the draft changes to the Code necessary to give effect to the report's conclusions and recommendations. NECA argues that this process, on what are complex and very technical issues, and the subsequent need to establish performance standards for all existing participants will inevitably and properly take some time. It notes, however, that most of the existing chapter 8 and 9 derogations in relation to technical standards expire at the end of 2002. NECA's applications seek approval to extend those existing derogations until twelve months after revised standards are gazetted but in any case no later than 31 December 2004.

#### **4.4 Commission's considerations**

The Commission notes that the proposed Code changes potentially extend the period of the derogations to 31 December 2004 at the latest. In its original authorisation of the Code, the Commission accepted jurisdictional derogations that ended no later than 31 December 2002. It was believed that this period provided a reasonable timeframe in which to make the transition to the Code arrangements. Further, it was noted that derogations that went beyond this transition period were of concern to the Commission as "they may prolong anti-competitive arrangements or delay the benefits of an integrated NEM."

The Commission is concerned by the potential for existing derogations to be extended for up to two years. However, the Commission notes the significant recent progress that has been made reviewing technical standards in the NEM. The Commission believes that this progress is a clear indication of NECA's intent to address the issues concerning these technical standards. Although it would have been preferable if these issues had already been addressed, such that the derogations would not be needed beyond 31 December 2002, the Commission appreciates the complexity of the issues being considered by the review.

The Commission considers that there is a public benefit attached to the extension of the derogations. The need for the technical derogations originally arose as generators had difficulty meeting the Code requirements, despite the system operating at a high level of safety and reliability. The derogations had the effect of reducing the technical standards to those currently in operation. The derogations were of a transitional nature and were intended to allow an orderly transition to the provisions of the Code. At the time of authorisation, the Commission was concerned that no entry barriers were created by grand fathering existing facilities but requiring new facilities to meet Code requirements. The Commission also believed that facilities should eventually upgrade their capabilities to bring them more into line with Code requirements, but only where such upgrades were commercially justifiable.



The review of technical standards is now sufficiently advanced to justify an extension on the grounds that maintenance of the status quo for a further, defined period will allow a managed transition to new technical standards and will also promote industry cost savings.

By granting an extension, Code participants will not be required to comply for a limited time with technical standards that are currently under review and which may be subject to change. Such an extension will avert the possibility of participants having to potentially comply with three different standards over the next two years.

Therefore, the Commission believes that public benefit considerations outweigh any potential anti-competitive detriment that may result from an extension of the derogations.

## **5. Draft determination**

This draft determination is made on 8 May 2002. The Commission considers that the proposed extension of existing derogations:

- 1) is likely to result in a benefit to the public which outweighs the potential detriment from any lessening of competition that would result if the proposed conduct or arrangements were made, or engaged in; and
- 2) is likely to result in such a benefit to the public that the proposed conduct or arrangements should be allowed to take place or be arrived at, as the case may be.

For the reasons outlined in Chapter 4 of this draft determination, the Commission proposes to grant authorisation to the amendments to the Code contained in application numbers A90821, A90822 and A90823. This authorisation is subject to any pre-determination conference requested pursuant to s.90A of the TPA. Subject to the consideration of any issues raised during a possible pre-determination conference, the Commission proposes to limit the period of the authorisation to the earlier of the end of 31 December 2004, or 12 months after the revised technical standards resulting from NECA's current review are gazetted.

Regulation, Industry Structure and Market Power Conference  
Thursday 31 July & Friday 1 August 2003

DAY 1: Thursday 31 July 2003

8.30 – 9.00 – registration & coffee

9.00 – 9.30

Chairman's Welcome

9.30 – 10.30

**Keynote address – Professor David Newbery**

*Measuring and Mitigating Market Power in Utility Industries*

The keynote address for the Conference will consider the sources of market power in utility industries and the ways in which that power can be addressed. Professor Newbery will consider in particular how market structure and market power are related, and the applicability of conventional measures of market power and dominance to utility industries. Structural and behavioural means of mitigating market power will also be considered. For example, in electricity, debate has surrounded the use of structural policies, demand-side policies, market rules, transmission investment and pricing, entry policies, and long-term contracts. Professor Newbery will also consider approaches to dealing with market power in other utility industries, particularly in gas, rail and telecommunications.

10.30 – 11.00 – Morning tea

11.00 – 12.30 – Session 1 “Vertical separation in utility industries”

Over the past decade Australian Governments have introduced wide ranging structural reforms including vertical separation of integrated government owned electricity and gas utilities and rail companies. In some cases these structural reforms are being eroded, for example, through vertical integration between electricity generators and retailers. In this session Professor Wolak will discuss vertical integration considering the circumstances in which such re-integration may promote efficiency, for example risk management economies of scope etc.

**Speaker: Frank Wolak? Ingo Vogelsang?**

Discussant: DARRYL BIGGAR

Chair: ROSS JONES

12.30 – 1.45 – LUNCH

1.45 – 3.15 – Session 2 *Sources and Leveraging of Market power in Regulated Industries*

*Utilities that have control over the access of competitors to essential inputs have both the ability and the incentive to use their position to restrict or deter competition in other markets. Utility industries were traditionally vertically integrated and protected from competition. Structural reforms have, in some cases, been part of the transition to deregulation. This session considers the circumstances under which vertical integration can give rise to competition concerns (including leveraging) and illustrates this with examples drawn from, in particular, telecommunications and rail. The presentation will also consider possible remedies for the "leveraging" problem including*

different forms of separation. The principles will be illustrated with reference to the Microsoft case and the antitrust counterclaim by Napster.

Speaker: **Professor Roger Noll**

Discussant: **Tom Hird n/e/r/a**

Chair:

3:15 – 3:45 – Afternoon tea

3:45 – 5:15 – Breakout sessions

<p>Gas: "Historically, Australia's gas industry has had high degrees of vertical integration, particularly with respect to transmission, distribution and retailing of gas. With the introduction of the National Gas Pipeline Access Code in 1997, transmission and distribution pipeline companies are prohibited from engaging in business upstream or downstream. There are also ring fencing requirements and regulatory scrutiny of pipeline contracts with related parties. Nevertheless, there remains a significant degree of vertical and horizontal linkages between players within the gas industry and concerns that anticompetitive behaviour is still taking place."</p>	<p><i>Telecommunications – Dealing with Market power in emerging communications markets</i> Competition in communications markets has developed through access-based entry into traditional downstream markets and through alternative delivery platforms being adapted to provide competitive products. Speakers in this session will provide assessments of the implications of these developments in key telecommunications markets. The emphases will be on the identification and measurement of market power and on the way that the existing regulatory structure deals with that power.</p>
<p>Speaker: <b>Dr Richard O'Neill</b> Discussants: Belinda Robinson? Bill Nagle (AGA)? Chair:</p>	<p>Panel members: <b>Professor Roger Noll</b> <b>Rod Shogren</b> Franco? Chair: Ross Jones</p>

7:00 – CONFERENCE DINNER – ALLAN FELS?

DAY 2: Friday 1 August 2003

9:00 – 9:30 – arrival coffee (option of Polar Bear viewing at SeaWorld)

9:30 – 11:00 – Breakout sessions 2

<p><i>Electricity – "Beyond Parer – The Role of Transmission in the NEM"</i> The Parer Report argues that inadequate transmission links effectively 'regionalise' the National Electricity Market (NEM) leaving some states with excessive market power. Speakers in this session will discuss the scope for transmission investment to ameliorate such market power, and the circumstances in which such investment should be undertaken. Speakers will also consider how the regulatory framework covering the NEM can be designed to best capture the 'competition benefits'</p>	<p><i>Transport - "Structural Separation, Market Power and Open Access in Rail"</i> There are arguments for and against separation as a way of dealing with market power in rail infrastructure ownership and promoting competition in contestable rail services markets. The experience both overseas and in Australia provides a range of models of structural arrangements and regulation. In Australia there are examples of integration and separation. There is also diversity in regulatory approaches. Speakers will address the issue of what is the most appropriate form of structural arrangement and regulation to deal with market power in rail track</p>
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of transmission investment.	ownership and promote access.
Speaker: Rod Sims? Discussants: <b>Professor David Newbery</b> <b>Richard O’Neill</b>	Speaker: Helen Owens (PC) (invited) <b>Luke Woodward Gilbert &amp; Tobin</b> Henry Ergas
Chair: Ed Willet	Chair: John Martin

11:00 – 11:30 – MORNING TEA

11:30 – 1:00 – Session 3 *Separation: Accounting & Structural Approaches*

This session will consider the relative efficiency and effectiveness of different approaches to dealing with market power ranging from structural separation through “ring fencing” to accounting separation.

Panel Members: Ralph Lattimore  
Stephen King/Joshua Gans  
Lew Evans?

Chair:

1:00 – 2:30 – LUNCH

2:30 – 4:00 Session 4 – The Way Forward

Panel members: Roman Domanski?  
David Newberry or Frank Wolak  
**Keith Orchison**

Chair: Ross Jones?