



**Australian
Competition &
Consumer
Commission**

Draft Determination

**Application by
Retail Energy Market Company Ltd**

**for authorisation of
The Retail Market Rules**

2 June 2004

Authorisation Nos:

A40090
A40091
A40092

File No:

C2004/287-01

Commissioners

Samuel
Sylvan
Willett
McNeill
Martin

Table of contents

ABBREVIATIONS	3
SUMMARY	4
1. INTRODUCTION.....	6
2. THE APPLICATIONS.....	6
2.1 THE PROPOSED CONDUCT	6
2.2 PARTIES TO THE APPLICATIONS	7
3. PUBLIC CONSULTATION PROCESS.....	8
4. BACKGROUND.....	9
4.1 THE GAS MARKET IN SOUTH AUSTRALIA AND WESTERN AUSTRALIA	9
4.2 REMCO'S ROLE AND FUNCTIONS	9
4.3 THE RETAIL MARKET RULES.....	10
4.4 SWING SERVICE PROVISIONS OF THE RMR	11
5. STATUTORY TEST.....	12
5.1 STATUTORY TEST FOR SUBSTANTIAL LESSENING OF COMPETITION AND EXCLUSIVE DEALING.....	12
5.2 STATUTORY TEST FOR EXCLUSIONARY PROVISIONS AND THIRD LINE FORCING.....	12
5.3 APPLICATION OF STATUTORY TESTS	12
6. COMPETITION ISSUES.....	13
6.1 MARKET DEFINITION.....	13
6.1.1 PRODUCT MARKET.....	13
6.1.2 GEOGRAPHIC MARKET.....	14
6.1.3 FUNCTIONAL MARKET	15
6.2 COUNTERFACTUAL	15
7. ASSESSMENT OF PUBLIC BENEFITS AND DETRIMENTS	16
7.1 PUBLIC BENEFITS	16
7.2 DETRIMENTS	17
8. PERIOD OF AUTHORISATION	17
9. DRAFT DETERMINATION.....	19

Abbreviations

ATPR	Australian Trade Practice Reporter
ACCC	Australian Competition and Consumer Commission
CoAG	Council of Australian Governments
Code	National Third Party Access Code for Natural Gas Pipeline Systems
CLR	Common Law Reports
ERA	Economic Regulation Authority
ESCOSA	Essential Services Commission of South Australia
FRC	Full retail competition or full retail contestability
GJ	Gigajoule, equal to one thousand million joules
LNG	Liquefied Natural Gas
MSO	Market and System Operations
PJ	Petajoule, equal to one million GJ
Re QCMA	Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd
REMC _o	Retail Energy Market Company Ltd
RMR	Retail Market Rules
SSNIP	Small but significant non-transitory increase in price
SSPUD	Swing Service Provision Umbrella Deed
SSPOLRUD	Swing Service Provider of Last Resort Umbrella Deed
TJ	Terajoule, equal to one thousand GJ
TPA	Trade Practices Act (1974)
Tribunal	Australian Competition Tribunal
VENCorp	Victorian Energy Networks Corporation

Summary

On 20 February 2004, the Retail Energy Market Company (REMCo) applied to the ACCC for authorisation under Part VII of the *Trade Practices Act 1974* of only Chapter 5 (Allocation, Reconciliation and Swing) and Chapter 6 (Disputes) of its Retail Market Rules (RMR) and associated ancillary Deeds. Authorisation was sought for a 10 year period commencing 31 May 2004.

REMCo also sought interim authorisation. This was granted by the Commission on 19 May 2004.

REMCo has been established by industry participants as the retail market administrator for the South Australian and Western Australian gas retail markets. It is a non-profit making company, governed by an Independent Board of Directors, and funded by industry participants on a cost recovery basis.

The Retail Market Rules

The RMR are the rules under which the retail gas market systems are to be operated in South Australia and Western Australia.

The RMR are specifically designed to facilitate the implementation of full retail competition (FRC) by providing efficient arrangements for customer transfers between retailers, and meeting the respective jurisdiction's competition policy obligations to implement FRC.

The RMR do not create a wholesale spot market for gas unlike the Victorian arrangements. Instead gas retailers in South Australia and Western Australia have contractual arrangements for the purchase, transmission and distribution of gas. The wholesale gas price and terms and conditions of supply are governed by those agreements and not the RMR.

Access issues are not dealt with by the RMR but are addressed in contracts and by the National Third Party Access Code for Natural Gas Pipeline Systems.

Draft Determination

For the reasons outlined in this draft determination, the ACCC believes Chapters 5 and 6 of the RMR and the affiliated contracts are likely to result in:

- a benefit to the public which outweighs the detriment from any lessening of competition that is likely to result from the operation of these parts of the RMR
- such a benefit to the public that these parts of the RMR should be allowed.

The application and supporting submission sought authorisation with respect to any contract, arrangement or understanding constituted by or under Chapters 5 and 6 of the RMR, the Swing Service Provision Umbrella Deed (SSPUD) and the Swing Service Provider of Last Resort Umbrella Deed (SSPOLRUD). The ACCC has no concerns with respect to granting authorisation for any contract, arrangement or understanding that may be constituted by these provisions.

However, the ACCC does have concerns about the potential scope of an authorisation for any contract, arrangement or understanding constituted under them. An authorisation expressed in such terms might inadvertently protect agreements not specifically required in order to comply with the rules. Accordingly, the proposed authorisation under s88(1) is expressed so

as to apply to any contract, arrangement or understanding constituted by or *required* under Chapters 5 and 6 of the RMR, the SSPUD and the SSPOLRUD.

As a result, the ACCC proposes to grant authorisation in the following terms:

- authorisation is proposed to be granted in respect of applications A40090 and A40091 with respect to any contract, arrangement or understanding between REMCo and Participants (as defined in the application) that is constituted by or required under Chapters 5 and 6 of the RMR (version 4.5), the SSPUD and the SSPOLRUD; and
- authorisation is proposed to be granted in respect of application A40092 with respect to Chapters 5 and 6 of the RMR (version 4.5), the SSPUD and the SSPOLRUD.

The authorisation would remain in force until 31 May 2009, unless revoked before that date.

The proposed authorisation is expressed to apply to or in relation to another person who:

- (a) in the case of an authorisation to make or arrive at a contract, arrangement or understanding - becomes a party to the proposed contract, arrangement or understanding at a time after it is made or arrived at; and
- (b) in the case of an authorisation to give effect to a provision of a contract, arrangement or understanding – becomes a party to the proposed contract, arrangement or understanding at a time after the proposed authorisation would be granted (see section 88(10)).

This proposed authorisation applies in respect of other contracts or proposed contracts that are or will be in similar terms to the contracts or proposed contracts that are the subject of the applications (see section 88(13)).

1. Introduction

On 20 February 2004, REMCo applied to the Australian Competition and Consumer Commission (ACCC) for authorisation under Part VII of the *Trade Practices Act 1974* (TPA) of portions of its Retail Market Rules (RMR). Authorisation was sought for a 10 year period commencing 31 May 2004.

REMCo also sought interim authorisation. This was granted by the Commission on 19 May 2004.

This *Draft Determination* outlines the ACCC's current analysis and views on the applications for authorisation of the RMR.

2. The applications

REMCo seeks authorisation only for Chapters 5 (Allocation, Reconciliation and Swing) and Chapter 6 (Disputes) of the RMR and the associated ancillary contracts, being the SSPUD and SSPOLRUD.

The ACCC received three separate applications from REMCo for authorisation under:

- section 88(1) of the TPA for an authorisation to make and give effect to any contract, arrangement or understanding, constituted by or under the RMR, where a provision of the proposed contract, arrangement or understanding would or might be an exclusionary provision within the meaning of sections 45 and 4D of the TPA¹
- section 88(1) of the TPA for an authorisation to make and give effect to any contract, arrangement or understanding constituted by or under the RMR, where a provision of the proposed contract, arrangement or understanding would or might have the effect of substantially lessening competition within the meaning of section 45 of the TPA (including any deemed lessening of competition through price fixing arrangements within the meaning of section 45A of the TPA)²
- section 88(8) of the TPA for an authorisation to make and give effect to the RMR to the extent that making the RMR or giving effect to a provision of the RMR, involves engaging in conduct that would or might constitute the practice of exclusive dealing within the meaning of section 47 of the TPA.³

2.1 The Proposed Conduct

Under Chapter 5 of the RMR, REMCo propose to operate a bid stack to establish a user price for swing service, where the user has not dealt with its imbalance through commercial negotiation.

¹ A40090, Form A: Exclusionary provisions, REMCo, 20 February 2004.

² A40091, Form B: Agreements affecting competition, REMCo, 20 February 2004.

³ A40092, Form C: Exclusionary dealings, REMCo, 20 February 2004.

The operation of the bid stack and the entering into the SSPUD and SSPOLRUD may constitute REMCo and RMR participants entering into contracts, arrangements or understandings that have the purpose or likely effect of substantially lessening competition in a market, or of fixing, maintaining or controlling the price of swing service provision in contravention of sections 45 and 45A of the TPA.

The processes under the SSPUD and SSPOLRUD may also involve RMR participants in exclusive dealing to the extent that swing service providers offer services on condition that users acquire services from REMCo.

While the bid stack is designed to produce a competitive market price for the swing service, REMCo acknowledges that the price information supplied to subscribers and provisions allowing withdrawal and variation of bid books lodged could inadvertently involve REMCo and RMR participants in conduct that may contravene the TPA.

Chapter 5 of the RMR also allows REMCo to require a member to make a 'swing service causation compensation payment' where that person materially contributed to the causation of swing service. This is a deterrent to gaming the swing service payments and a way of clawing back any gains from such activity. Enforcing any such judgement in accordance with the RMR may involve REMCo and REMCo members in exclusionary conduct in contravention of section 45 of the TPA.

Chapter 6 requires the creation of an independent compliance panel, which can make determinations including the imposition of financial penalties on RMR participants or REMCo and to order an RMR participant or REMCo to take action or cease action, to ensure compliance with the rules. Such activities may involve REMCo and RMR participants in exclusionary conduct in contravention of section 45, or exclusive dealing in contravention of section 47 of the TPA.

2.2 Parties to the applications

The applications for authorisation are made by REMCo, and not on behalf of any other corporation or other person.

However, any contract, arrangement, or understanding constituted by or under the RMR will be between the applicant and a RMR participant, or between RMR participants, and any exclusive dealing conduct constituted by giving effect to the RMR may be engaged in by RMR participants as well as by REMCo.

As such, the applicant has submitted that the authorisation should extend to existing and future RMR participants. This objective is provided for under the following provisions of the TPA:

- section 88(6), which provides that an authorisation granted to a person to make or give effect to a contract, arrangement or understanding has effect as if it were also an authorisation to every other person named or referred to in the application for authorisation
- section 88(10), which provides that an authorisation granted to make or give effect to a contract, arrangement or understanding may apply to another person who becomes a party to the contract, arrangement or understanding subsequently

- section 88(13), which provides that an application for authorisation in relation to a particular contract or proposed contract can be expressed to be also an application for other contracts that are similar in terms to the first-mentioned contract, and if so, the Commission may grant a single authorisation or separate authorisations.

REMCo has listed current participants in its applications (reproduced in Appendix A) and therefore under section 88(6) any authorisation granted may apply to those participants. Under section 88(10) any authorisation may also apply to future participants.

In accordance with section 88(13), REMCo has requested that any authorisation is expressed as a single authorisation and that it includes contracts between REMCo and participants and between participants that are constituted by giving effect to the RMR.

3. Public consultation process

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

Notice of REMCo's applications for authorisation was sent to interested parties on 9 March 2004, seeking submissions by 5 April 2004. Advertisements were posted in the *Australian Financial Review*, the *South Australian Advertiser* and the *West Australian* on 12 March 2004.

No submissions have been received in respect of the REMCo applications for authorisation. The ACCC notes that REMCo has consulted extensively prior to applying for authorisation and that the majority of interested parties have actively participated in the development of the RMR.

The ACCC has produced this *Draft Determination* outlining its analysis and views on the RMR authorisation applications, according to the statutory assessment criteria outlined in section 5 of this document. The ACCC now invites the applicant and other interested persons to notify it within 14 days of release, whether they wish the ACCC to hold a conference in relation to this *Draft Determination*.⁴

If any person notifies the ACCC in writing within the time period that they wish the ACCC to hold a conference, the ACCC will appoint a date, time and place for the conference and give notice to all interested parties. The applicant and interested persons who receive a copy of the *Draft Determination* and any other interested person whose presence the ACCC considers appropriate, are entitled to participate in the conference.

⁴ For the purposes of the pre-decision conference, an interested person is a person who has notified the ACCC in writing that the person, or a specified unincorporated association of which the person is a member, claims to have an interest in the application and the ACCC is of the opinion that the interest is real and substantial.

4. Background

4.1 The Gas Market in South Australia and Western Australia

In South Australia, there are two main pipelines, the Moomba-Adelaide pipeline (which also diverts into Whyalla and Port Pirrie) and the SEAGas pipeline from Port Campbell, Victoria to Adelaide. There are 14 separate sub-networks in South Australia which rely on supply of gas from these pipelines.

In Western Australia, there are two main relevant pipelines, the Dampier to Bunbury Natural Gas Pipeline and the Parmelia Pipeline. There are 16 separate sub-networks in Western Australia which rely on supply of gas from these pipelines.

Both the South Australian and Western Australian gas markets are ‘contract carriage’ regimes, unlike the Victorian gas market which is a ‘market carriage system’. Gas retailers in each of South Australia and Western Australia must therefore have contractual arrangements in place for purchase, transmission and distribution of gas.

4.2 REMCo’s Role and Functions

REMCo has been established by industry participants as the retail market administrator for the South Australian and Western Australian gas retail markets. It is a non-profit making company, governed by an Independent Board of Directors, and funded by industry participants on a cost recovery basis.

Its purpose is to develop and operate cost efficient and effective retail market arrangements to facilitate full retail competition (FRC) in these markets.

In South Australia and Western Australia, network operators and users participating in the gas retail markets may become REMCo members.

REMCo is licensed by the Essential Services Commission of South Australia (ESCOSA) and will be subject to ESCOSA’s review and oversight for its South Australian operations. In Western Australia, REMCo will initially be subject to the review and oversight of the Western Australian Minister for Energy. However, this function will be transferred to the Economic Regulation Authority (ERA) one year after the commencement of the FRC provisions.⁵

The functions of REMCo as retail market administrator are:

- to support meter registration
- to effect customer transfers
- to undertake the balancing and the apportionment and reconciliation of gas supply between retailers.

In South Australia and Western Australia, state legislation requires REMCo, as the retail market administrator, to publish retail market rules to govern the conduct and operations of

⁵ Regulation of the retail market operator arises because it forms part of an approved retail market system. However, there are no express licensing provisions for the retail market administrator under the Energy Legislation Amendment Act 2003.

the market. In both States, retailers and distributors are required to comply with these retail market rules via their license.

4.3 The Retail Market Rules

The RMR are the rules under which the retail gas market systems are to be operated in South Australia and Western Australia.

The RMR are specifically designed to facilitate the implementation of FRC by providing efficient arrangements for customer transfers between retailers, and meet the respective jurisdictions competition policy obligations to implement FRC.

In particular the RMR allow the extension of FRC to small commercial (less than 10TJ per annum) and all domestic customers in both South Australia and Western Australia. This includes providing for:

- allocation and management of delivery point identifiers
- metering of delivery points
- transfer of delivery points between retailers
- administration of the RMR, including establishing dispute resolution, rule change and REMCo cost recovery processes.

In addition, the implementation of FRC requires market systems to bridge the gap between the daily settlement of the wholesale market and the basic meters used by small commercial and domestic retail customers, which generally only have quarterly manual reads. This requires forecasting of load for each basic meter for each day by reference to historical usage and initial settlement on the basis of these load forecasts. It also requires ongoing reconciliation upon actual metering data being received.

The RMR therefore embodies rules to assist with:

- balancing, allocation and reconciliation of wholesale gas
- Swing Service provision.

The RMR does not create a wholesale spot market for gas unlike the Victorian arrangements. Instead gas retailers in South Australia and Western Australia have contractual arrangements for purchase, transmission and distribution of gas. The wholesale gas price and terms and conditions of supply are governed by those agreements and not the RMR.

Access issues are not dealt with by the RMR and are addressed by contracts and the National Third Party Access Code for Natural Gas Pipeline Systems (the Code).

The RMR will be given legal effect in South Australia by the Gas Act 1997 (SA) and associated licensing obligations,⁶ and in Western Australia by the Energy Coordination Act 1994 (WA)⁷.

⁶ Gas Act, section 26(1)(a) for distribution licensees, section 26A(2)(a) for retail licensees and section 26B(1)(a) for REMCo.

⁷ Section 11ZOC requires gas distributors and retailers to be bound by agreement to relevant provisions of an 'approved retail market scheme'. In addition, gas transmission operators and persons prescribed under regulations must comply with relevant provisions of the retail market rules of an approved retail market scheme. Section 11ZOK empowers the Minister for Energy to declare when an approved retail market scheme comes into force.

The RMR must initially be approved by the relevant Ministers in each of South Australia and Western Australia. The RMR contains a rule change process which requires any subsequent amendments to be approved by the Essential Services Commission of South Australia (ESCOSA)⁸ and the Western Australian Minister of Energy.⁹ This means amendments can be made to Chapters 5 and 6 of the RMR that would not be covered by this authorisation. However REMCo can, if it believes it is necessary, seek to vary the authorisation to include such changes once they have been developed.

The rule change process is prescribed in the RMR and allows any person or organisation to propose changes to the RMR.¹⁰ Final approval of a rule change is subject to regulatory approval by ESCOSA in South Australia or either a Government Minister or the ERA in Western Australia.

As foreshadowed in its application, REMCo have notified the ACCC of minor changes to the RMR as a result of the South Australian Government's approval process. The ACCC believes none of these changes have a material impact on the intent or operation of the RMR. The ACCC has considered version 4.5 of the RMR when making this Draft Determination.

4.4 Swing Service Provisions of the RMR

The need for Swing Service arises when there are two or more pipelines connecting to a gas sub-network, as occurs in both South Australia and Western Australia. The gas supplied by each pipeline is mixed in the sub-network and supplied to retail customers. In order to protect the operational integrity of the pipelines and the sub-networks to which they are connected, it is necessary to maintain pressure in each pipeline while seeking to match physical supply and demand with the underlying contractual arrangements.

REMCo will allocate users a 'Swing Service' for any day on which pipeline injections differ from the users' deemed withdrawals from a particular pipeline.

Payment is made for the Swing Service, not the gas which is temporarily loaned or parked in the pipelines. It is expected that the price payable by users for the Swing Service will be considerably less than the cost of the physical gas.

The Swing Service does not involve a physical supply of gas, rather it relates to the provision of capacity for a particular pipeline. Payment for physical gas remains the subject of separate contractual arrangements between users, producers and shippers and is not regulated by the RMR.

⁸ It is a requirement of REMCo's Gas Retail Market Administration Licence that subsequent amendments to the RMR's be submitted for approval to ESCOSA (Gas Act s. 26B(1)(d)).

⁹ The Western Australian Minister of Energy must approve the RMRs and any amendments to the RMRs in the course of approving a gas retail market system for a gas distribution system. The Minister's responsibility for approving the RMRs and any amendments to the RMRs will be transferred to the Energy Regulation Authority (ERA) one year after the contestable retail gas market provisions to be inserted into the Energy Coordination Act 1994 by the Energy Legislation Amendment Act 2003 come into operation. This will occur on the proclamation of the contestable retail gas market provisions.

¹⁰ Part 9.2 RMR.

Thus the Swing Service regime intends to:

- create incentives for retailers to be accurate in their forecasting
- help protect gas pipeline system integrity
- allow pipeline operators/shippers to ascribe a value to the provision of a swing service and to provide a mechanism to determine a fair market value for the provision of the swing service.

5. Statutory test

This section outlines the criteria set out in the TPA that the ACCC must comply with when assessing application for authorisation.

5.1 Statutory Test for Substantial Lessening of Competition and Exclusive Dealing

Sub-section 90(6) provides that the Commission must not grant an authorisation under sub-section 88(1) or 88(8) in respect of a proposed contract, arrangement or understanding or proposed conduct which:

- would or might have the effect of substantially lessening competition; or
- would constitute exclusive dealing (other than conduct to which sub-section 47(6) or 47 (7) applies),

unless it is satisfied in all the circumstances that:

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

5.2 Statutory Test for Exclusionary Provisions and Third Line Forcing

Sub-section 90(8) provides that the Commission must not grant an authorisation under sub-section 88(1) or (8) in respect of:

- a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision; or
- proposed conduct which amounts to third line forcing under sub-section 47(6) or (7),

unless the Commission is satisfied in all circumstances that the proposed provision or the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed contract, arrangement or understanding or proposed conduct should be allowed.

5.3 Application of Statutory Tests

The assessment of whether or not the Commission may grant an authorisation involves:

- identification of the relevant markets

- comparison of the likely shape of the future both with and without the relevant conduct for which authorisation is being sought¹¹
- an examination of the public benefits arising from the arrangements or conduct in question
- an examination of any detriment constituted by any lessening of competition
- an assessment of the public benefits against any detriments.

6. Competition Issues

6.1 Market Definition

An important step in assessing any application for authorisation is to define the market in which the proposed conduct will take place. The ACCC is then able to assess the likely benefit and detriment of the proposed conduct within the market defined.

Markets are generally defined in product, geographic and functional space.

In general terms, markets must always be defined with a view to the purpose of doing so.¹² The purpose in this instance is to assess the public benefit and anti-competitive detriment likely to flow from the RMR. A market can be defined as an area over which a hypothetical monopolist (or monopsonist) could exercise a significant degree of market power. It is clear from section 4E of the *Trade Practices Act* that all actual or potential substitutes for the good or service in question should be included in the market.

This concept of substitutability was discussed by the Tribunal in *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976) ATPR 40-012 (*Re QCMA*):

A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them... Within the bounds of a market there is substitution – substitution between one product and another, and between one source of supply and another, in response to changing prices...

It is the possibilities of such substitution which set the limits upon a firm's ability to 'give less and charge more'. Accordingly, in determining the outer boundaries of the market we ask a quite simple but fundamental question: if the firm were to 'give less and charge more' would there be, to put the matter colloquially, much of a reaction?¹³

This formulation was referred to with approval by the High Court in *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989).¹⁴

6.1.1 Product market

The product market is made up of those goods or services that could be substituted in demand or supply, by buyers or sellers, in response to a small but significant and non-transitory increase in price (SSNIP).

¹¹ Re Tooth & Co Ltd and Tooheys Ltd (1979) ATPR 40-113 at 18, 186-187.

¹² Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited & Anor (1989) ATPR 40-925 at 50,008; Australian Meat Holdings Pty Ltd v Trade Practices Commission (1989) ATPR 40-932 at 50,104.

¹³ ATPR 40-012 at 18,196 to 18,197.

¹⁴ 167 CLR 177.

The starting point for determining the product market is the activities to which the RMR relate. Namely, the interaction of REMCo and RMR participants in South Australia and Western Australia's retail gas markets.

For natural gas, the relevant question is whether a gas market exists, or whether gas is part of a wider energy market that includes electricity.

This may be determined by applying the *Re QDMA* test. The examination of actual and potential substitutes should extend to substitutes in supply as well as in demand.

Applying this approach, the ACCC should consider both the ability of end users of gas to use fuels other than natural gas, and the ability of suppliers of other products similar to gas, to enter the gas market.

The latter possibility seems remote. The infrastructure required to extract and process natural gas (two activities that are generally performed by the same entity) is highly specialised, and requires substantial capital investment. The infrastructure used, say, to generate electricity could not be switched to producing gas instead.

The question of whether end users of gas can substitute gas for electricity warrants consideration.

The correct means of evaluating this view is the SSNIP test. The extent to which gas users are likely to switch to electricity in the event of a price rise depends on both the magnitude of the price rise and the capital costs of switching. Householders may take the view that the costs of switching outweigh the impact of short term price rises. The issue of substitutability is more likely to arise when appliances for space heating, water heating and cooking are replaced.

The Tribunal has considered this issue on several occasions. In *Duke Eastern Gas Pipeline*, the Tribunal concluded that:

It was agreed that the product of concern is mainly gas as there is little competition between energy sources at this time.¹⁵

The ACCC believes this continues to be the correct view. Thus, the ACCC agree with REMCo that the relevant product market is natural gas.¹⁶

6.1.2 Geographic market

The geographic market is the physical area in which sellers distribute the product and in which purchasers can practicably look for supply of substitutable goods or services.

The question of geographic market definition turns on two issues:

- delineation of the relevant area over which sellers of gas supply or could supply
- delineation of the relevant area to which buyers of gas can effectively turn.

¹⁵ Duke Eastern Gas Pipeline at 21.

¹⁶ The Commission has reached this conclusion in considering previous gas authorisations and the Tribunal also adopted it in the Duke Eastern Gas Pipeline matter.

The ACCC agree with REMCo's submission that the relevant geographic markets are South Australia (and the town of Mildura in Victoria) and Western Australia, since the RMR only applies to retail gas sales made in those jurisdictions.

6.1.3 Functional market

The functional dimension of a market is the parts of a supply chain relevant to consideration of the competition issues. In order to identify the relevant functional dimension of the market, it is relevant to consider both the economics of vertical integration and whether substitution possibilities at a functional level (in either the product or the locations at which the product is supplied) constrain the players at another functional level from imposing a SSNIP or from otherwise exercising market power.¹⁷

The ACCC agree with REMCo's submission that the functional market is the retail sale of gas. REMCo argue that the RMR only have limited impact on the wholesale or upstream gas markets – facilitating multi-shipper allocation through metering data collection.

6.2 Counterfactual

In the course of applying section 90 of the TPA the ACCC is required to apply a 'future with and without test'. As the Tribunal stated in *Re Media Council of Australia & Ors*¹⁸ (in the context of a review of a Determination by the ACCC to revoke an earlier Determination):

...in the course of determining relevant public benefit and detriment the Tribunal must compare the position which would or would be likely to exist in the future, on the one hand if the authorisation were to continue, and on the other hand if it were absent.

This 'future with and without test' is to be applied in the context of the relevant market(s) identified by the ACCC. The ACCC must determine and assess what the state of the relevant markets would be (at the relevant time in the future) both with and without the proposed conduct.

The ACCC considers that the purpose of the with and without test is limited to assisting it to determine the net benefits from the proposed conduct, should it be authorised and carried out (*Re John Dee* (1989)).¹⁹ It is a tool used to assist the ACCC to establish whether the proposed conduct results in the alleged net benefits.

It follows that it is not necessary to establish that the proposed conduct is the only possible way of achieving the alleged benefits (see *In re Tooth: In re Tooheys* (1979)).²⁰ It is sufficient if it is established that the relevant conduct leads – as a matter of cause and effect – to the occurrence of those benefits, even if other modalities of conduct could also hypothetically lead to the achievement of the same results. The question is whether, in the absence of the proposed conduct, the claimed benefits and detriments would occur, and if so to what extent.

¹⁷ Rhonda Smith and Neville Norman (1996) Functional Market Definition, *Competition and Consumer Law Journal*; Rhonda Smith and Jill Walker (1998) Part IIIA, Efficiency and Functional Markets, *Competition and Consumer Law Journal* Vol. 5 No. 3 April 1998 pp. 183-208.

¹⁸ (1996) ATPR 41-497 at 42,241.

¹⁹ ATPR 40-938 at 50,206.

²⁰ ATPR 40-113 at 18-187.

If the Commission were not to authorise the RMR it would prevent the implementation of gas full retail contestability (FRC) in South Australia and Western Australia.

In South Australia, while the Gas Act has provided a legal framework for FRC since 1 July 2001, due to the absence of mass market systems only 150 large customers have practically had the option of switching retailers.

In Western Australia, the Energy Legislation Amendment Act 2003 was assented to on 8 October 2003 and the FRC provisions will come into operation when they are proclaimed. However, under the transitional provisions of the Energy Legislation Amendment Act 2003, a proposed retail market system for a distribution system may be submitted to the Western Australia Minister for Energy for approval, so that a retail market system is ready to be implemented as soon as the FRC provisions commence.

REMCo stated that the inclusion of swing service in the RMR was a requirement of pipeline operators in each of South Australia and Western Australia and that without the swing service provisions the RMR are unlikely to be approved by either jurisdiction.

As a result, the ACCC agree with REMCo's proposal²¹ that the relevant counterfactual is the South Australian and Western Australian retail gas markets without FRC.

7. Assessment of public benefits and detriments

7.1 Public Benefits

The swing service provisions in Chapter 5 and compliance panel provisions in Chapter 6 are integral components of the RMR. Therefore the public benefits of the RMR as a whole must be considered when considering the public benefits of the swing service and compliance panel provisions of the RMR.

REMCo submit the expected public benefits include:

- implementation of FRC, including the creation of an open and competitive environment for the retailing of gas in each of South Australia and Western Australia
- fulfilment of South Australia and Western Australia's competition obligations under CoAG to implement gas market FRC
- the promotion of economic efficiency and passing through the benefits of reform and competition to consumers
- a significant reduction of barriers to entry into South Australian and Western Australian retail gas markets
- general benefits to the South Australian and Western Australian economies by improved and more competitive gas retail services.

In addition, the swing service provisions of the RMR provide the following additional public benefits:

²¹ REMCo application 17 February 2004 p. 16.

- A formal mechanism for recovering the cost of providing the swing service. Previously, there has not been any mechanism to recover the costs of providing the swing service, or indeed a recognition that the service was being provided. This will result in a more efficient upstream gas market.
- A means of allocating the cost of providing swing service to the parties responsible for the need for services. This would create an incentive for users to improve the accuracy of their forecasting of gas retail requirements, leading to improved operational efficiency of the pipelines and gas sub-networks.
- Support to system integrity and increased efficiency in the provision of gas carriage services and, as a consequence, ultimately improve the services provided to users and customers.

Similarly, the creation of a compliance panel and alternative dispute resolution processes in the RMR provide the following public benefits:

- An independent fast track dispute resolution mechanism which is low cost and industry – funded. This would deal with alleged breaches of the RMR, the interpretation of the RMR and any other matters in relation to the RMR.
- A mechanism for the enforcement of the RMR, which is necessary for the RMR to be effective and produce the benefits of implementation of full retail competition in South Australia and Western Australia.

The ACCC agree with REMCo’s conclusion that there would be significant net public benefits from Chapters 5 and 6 of the RMR.

7.2 Detriments

Potential public detriments include the additional costs due to:

- REMCo charges
- Swing Service charges
- dispute resolution charges passed on to participants.

The ACCC considers that considerable effort has been made to minimise the costs of operating the RMR. Having one organisation administer the RMR in both Western Australia and South Australia delivers significant savings. In addition, REMCo’s charges must be approved by independent regulators in each jurisdiction.

The ACCC agrees with REMCo that these regulated costs would be minor relative to the overall retail gas markets. At most, they should only constitute an incremental increase in the retail cost of gas and would be more than offset by efficiency gains from the introduction of competition into the retail gas markets.

8. Period of Authorisation

The applicant has sought authorisation for a period of ten years, from 31 May 2004 to 31 May 2014.

REMCo contends that a ten year period of authorisation is appropriate given that:

- it would provide certainty for REMCo and its members, and for the evolving retail gas markets in South Australia and Western Australia, recognising that uncertainty affects price and investment
- processes are established by the RMR to effectively manage rule changes to address changing industry and market requirements
- ongoing regulatory oversight and review will apply to REMCo and the RMR by the regulatory bodies in South Australia and Western Australia, recognising that further unnecessary regulation increases costs and reduces certainty
- it would be consistent with other authorisations regarding comparable market rules in electricity and gas (for example, the NEC and VENCORP MSO Rules).²²

REMCo states it is not uncommon for the Commission to grant authorisations for lengthy periods in appropriate cases, as illustrated by the Commission's determinations in respect of the North West Shelf Project (7 years) and Mereenie Producers (effectively 10 years) authorisation applications.²³

The ACCC considers that authorisation for 10 years may be too long initially, given that the RMR are new and untested in the market.

The ACCC's experience in Victoria was that a number of changes were made to VENCORP's Market and System Operations (MSO) Rules in the first five years of operation. The ACCC notes that Chapter 5 of the RMR requires REMCo to review its operation after 6 months, 18 months and 3 years.

Initially, authorisation was granted for the MSO Rules for a five year period. At the end of that five year period, VENCORP sought reauthorisation for a 10 year period, which the ACCC granted. This reflected the greater understanding of the market impact of the MSO Rules at that time, but also the timing of a major review of the MSO Rules that made authorisation for a five year period inappropriate.

For these reasons, the ACCC considers that initially the appropriate period for authorisation of the RMR is five years. The ACCC would consider a longer period of authorisation for any subsequent application for reauthorisation.

²² REMCo submission 17 February 2004 pp 9-10.

²³ National Electricity Code Determinations – 2001, North West Shelf Project Determination – 29 July 1998 and Mereenie Producers – Gasgo Sales Agreement Determination – 7 April 1999.

9. Draft Determination

For the reasons outlined in this document, the ACCC believes Chapters 5 and 6 of the RMR and the affiliated contracts are likely to result in:

- a benefit to the public which outweighs the detriment from any lessening of competition that is likely to result from the operation of these parts of the RMR
- such a benefit to the public that these parts of the RMR should be allowed.

The application and supporting submission sought authorisation with respect to any contract, arrangement or understanding constituted by or under Chapters 5 and 6 of the RMR, the SSPUD and the SSPOLRUD.²⁴ The ACCC has no concerns with respect to granting authorisation for any contract, arrangement or understanding that may be constituted by these provisions.

However, the ACCC does have concerns about the potential scope of an authorisation for any contract, arrangement or understanding constituted under them. An authorisation expressed in such terms might inadvertently protect agreements not specifically required in order to comply with the rules. Accordingly, the proposed authorisation under s88(1) is expressed so as to apply to any contract, arrangement or understanding constituted by or *required* under Chapters 5 and 6 of the RMR, the SSPUD and the SSPOLRUD.

As a result, the ACCC proposes to grant authorisation in the following terms:

- authorisation is proposed to be granted in respect of applications A40090 and A40091 with respect to any contract, arrangement or understanding between REMCo and Participants (as defined in the application) that is constituted by or required under Chapters 5 and 6 of the RMR (version 4.5), the SSPUD and the SSPOLRUD
- authorisation is proposed to be granted in respect of application A40092 with respect to Chapters 5 and 6 of the RMR (version 4.5), the SSPUD and the SSPOLRUD.

The authorisation would remain in force until 31 May 2009, unless revoked before that date.

The proposed authorisation is expressed to apply to or in relation to another person who:

- (a) in the case of an authorisation to make or arrive at a contract, arrangement or understanding - becomes a party to the proposed contract, arrangement or understanding at a time after it is made or arrived at
- (b) in the case of an authorisation to give effect to a provision of a contract, arrangement or understanding – becomes a party the proposed contract, arrangement or understanding at a time after the proposed authorisation would be granted (see section 88(10)).

This proposed authorisation applies in respect of other contracts or proposed contracts that are or will be in similar terms to the contracts or proposed contracts that are the subject of the applications (see section 88(13)).

²⁴ The conduct for which authorisation is sought under s 88(1) is described in different ways throughout the application and submission. In some parts of the application there are references to authorisation of any contract, arrangement or understanding constituted “under” Chapters 5 and 6 of the RMR, the SSPUD and the SSPOLRUD, while in other parts of the application and throughout the submission there are references to authorisation of any contract, arrangement or understanding constituted “by or under” these provisions. Despite this, it is clear that the substance of this application relates to any contract, arrangement or understanding constituted by or under Chapters 5 and 6 of the RMR, the SSPUD and the SSPOLRUD.

Appendix 1

List of RMR Participants in South Australia and Western Australia

South Australia

Retailers	Origin Energy Retail Ltd	AGL South Australia Pty Ltd	TXU Pty Ltd	Energy Australia Pty Ltd#
Network Operators	Envestra Ltd			
Shippers	Origin Energy Retail Ltd	AGL Wholesale Gas Ltd	TXU Electricity Limited	TerraGas Trader Pty Ltd
Pipeline Operators	Epic Energy South Australia Pty Ltd	SEAGas Partnership		

Western Australia

Retailers	Alinta Sales Pty Ltd	CMS Gas Transmission of Australia	Origin Energy Retail Ltd	AGL South Australia Pty Ltd	Western Power Corporation
Network Operators	AlintaGas Networks Pty Ltd				
Shippers	Alinta Sales Pty Ltd	CMS Gas Transmission of Australia	Western Power Corporation	Origin Energy Retail Ltd	AGL Gas Trading Pty Ltd
Pipeline Operators	Epic Energy (WA) Transmissions Pty Ltd	CMS Gas Transmission of Australia			

#Intending Retailer

Details of Participants

Market	Company name	Address
South Australia	Origin Energy Retail Ltd ABN 22 078 868 425	Level 39, AMP Centre 50 Bridge Street Sydney NSW 2000
South Australia	Envestra Ltd ACN 078 551 685	Level 10, 81 Flinders St, Adelaide 5000
South Australia	Epic Energy South Australia Ltd	Level 7, GHD House 239 Adelaide Toe, Perth WA 6000
South Australia	AGL South Australia Pty Ltd ABN 49 091 105 092	226 Greenhill Rd, Eastwood 5063
South Australia	AGL Wholesale Gas Ltd CAN 072 948 504	AGL Centre Cnr Pacific Highway and Walker Street North Sydney NSW 2060
South Australia	SEAgas Partnership ABN 81 366 072 976	Level 4, 70 Hindmarsh Square, Adelaide 5001
South Australia	TXU Electricity Limited ABN 91 064 651 118	Level 33, 385 Elizabeth Street Melbourne Vic, 3000
South Australia	Energy Australia Pty Ltd ABN 24 070 374 293	570 George Street, Sydney NSW 2000
South Australia	TerraGas Trader Pty Ltd ABN 13 094 384 291	168 Greenhill Rd, Parkside 5063
Western Australia	Alinta Sales Pty Ltd ABN 92 089 531 984	The Quadrant, 1 William St Perth 6000
Western Australia	AlintaGas Networks Pty Ltd ABN 90 089 531 975	The Quadrant, 1 William St Perth 6000
Western Australia	Epic Energy (WA) Transmissions Pty Ltd ABN 69 081 609 190 (company currently under external administration)	Level 7, 239 Adelaide Tce Perth 6000
Western Australia	CMS Gas Transmission of Australia ARBN 078 902 397	8 Marchesi St, Kewdale 6105
Western Australia	Origin Energy Retail Ltd ABN 22 078 868 425	Level 39, AMP Centre 50 Bridge Street, Sydney NSW 2000
Western Australia	Western Power Corporation ABN 38 362 983 875	363 Wellington St, Perth WA 6000
Western Australia	AGL South Australia Pty Ltd ABN 49 091 105 092	226 Greenhill Rd, Eastwood SA 5063
Western Australia	AGL Gas Trading Pty Ltd CAN 068 827 038	AGL Centre, Cnr Pacific Highway and Walker Street, North Sydney NSW 2060