

Decision

Application for Acceptance

Access Undertaking

Murraylink Transmission Company

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Glossary

ABARE	Australian Bureau of Agricultural and Resource Economics
AC	Alternating Current
ACCC	Australian Competition and Consumer Commission
BPL	Basslink Proprietary Limited
BSA	Basslink Services Agreement
DC	Direct Current
FERC	Federal Energy Regulatory Commission
ISO	Independent System Operator
MEU	NSW Ministry of Energy and Utilities
MNSP	Market Network Service Provider
MTC	Murraylink Transmission Company
NEC	National Electricity Code
NECA	National Electricity Code Administrator
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NSP	Network Service Provider
NSW Treasury	New South Wales Treasury
RRP	Regional Reference Price
SNI	South Australia – New South Wales Interconnector
TCC	Transmission Congestion Contract
TNSP	Transmission Network Service Provider
TPA	<i>Trade Practices Act 1974</i>

Executive summary

On 6 February 2002 the Commission received an access undertaking from the Murraylink Transmission Company (MTC), a subsidiary of TransEnergie Australia. MTC is the owner of the Murraylink interconnector that will connect the Victorian and South Australian electricity regions. The Murraylink project involves the installation of a 180-km power cable that runs between Red Cliffs in Victoria and Berri in South Australia. The interconnector has a capacity of 220 MW, which will add capacity to the transfer of electricity between the Victorian and South Australian grids. Murraylink became operational in October 2002.

MTC is currently registered as a Market Network Service Provider (MNSP), and will earn revenue by arbitraging the wholesale pool price differences between South Australia and Victoria. MTC's access undertaking proposes to sell the rights to bid Murraylink into the National Electricity Market (NEM), and to earn the associated revenues. These rights will be sold in the form of both physical and financial contracts (transmission property rights).

The Commission released a draft decision on MTC's access undertaking on 31 July 2002. The draft decision noted the considerable benefits that would result from Murraylink. In particular, it was argued that by potentially adding capacity to the transfer of power between South Australia and Victoria, the interconnector has the potential to increase system reliability and promote further competition.

However, the draft decision highlighted a concern about the ability of a generator in an importing region to withhold Murraylink's physical capacity to maintain interregional price differences. The draft decision therefore imposed a recommendation requiring disclosure of the identity of parties who contract with MTC for ownership of Murraylink's transmission property rights. It was believed that this disclosure would assist in identifying any potential breach of Part IV of the Trade Practices Act.

The Commission invited interested parties to provide submissions in response to the draft decision. Submissions were received from MTC, Westpac Energy, TransGrid and the NSW Ministry of Utilities (MEU).

- ✍ MTC's submission argued that the draft decision did not adequately establish that a contract between MTC and another market participant would lead to a substantial lessening of competition. Nonetheless, MTC submitted a revised undertaking that includes the disclosure provision recommended by the Commission in the draft decision.
- ✍ Westpac Energy argued that the draft decision is an inappropriate attempt by the Commission to monitor possible market power in the electricity generation market. It also submitted that the condition might cause a precedent for other markets in terms of disclosing contract positions to the Commission.
- ✍ TransGrid and MEU both reiterated market power concerns and argued that Murraylink should be a regulated interconnector. Both argued that MTC should not be permitted to sell Murraylink's transmission rights.

The Commission has assessed the revised Murraylink access undertaking with regard to the criteria outlined in section 44ZZA of the *Trade Practices Act 1974* (TPA), and considers that MTC's undertaking satisfies the legislative criteria and represents an adequate basis for negotiating access to the Murraylink interconnector. In particular, the Commission notes that in adding to the power transfer capacity between the South Australian and Victorian regions, Murraylink has the potential to increase system reliability and promote further competition. Another benefit of Murraylink is that it can provide firm access to its services, and consequently, a firmer hedging instrument for interregional trading.

In regard to the arguments raised in submissions, the Commission firstly notes that the National Electricity Code Administrator's (NECA) code change application for the Network Pricing and MNSP code changes envisaged that MNSPs would earn revenue by selling physical and financial rights to the revenues earned by the interconnector. Therefore, MTC's application is consistent with those intentions. Secondly, the Commission believes that a requirement for MTC to effectively operate as a regulated link, without the certainty of a guaranteed revenue stream, would threaten MTC's viability as an MNSP and jeopardise its ability to recover the costs of providing the service.

Therefore, while there may be a residual market power issue associated with MTC's undertaking, it would appear to be inappropriate to impose conditions that force MTC to operate as a regulated interconnector. The code provisions create a reasonable expectation that MTC would be able to sell physical and financial transmission rights, and operate as an MNSP.

The Commission is satisfied that the revised undertaking submitted by MTC fulfils the legislative criteria outlined in section 44ZZA of the TPA, and therefore believes that MTC's revised access undertaking should be accepted.

1. Introduction

On 6 February 2002, the Murraylink Transmission Company Pty Ltd (MTC) submitted an access undertaking to the Australian Competition and Consumer Commission (Commission) under section 44ZZA of the *Trade Practices Act 1974* (TPA).

MTC is a Market Network Service Provider (MNSP) that proposes to provide access to the Murraylink transmission cables and associated assets that will connect the Victorian and South Australian electricity regions.¹ While the National Electricity Code (code) includes a specific undertaking for MNSPs (schedule 5.9), this is a recent amendment and is not included in the industry access code (NEM Access Code) that has been accepted by the Commission.²

The terms and conditions for access to market network services by the market as a whole are generally governed by the wholesale spot market rules contained in chapter 3 of the code. Schedule 5.9 establishes a pro-forma access undertaking that requires MNSPs to provide access to code participants in accordance with Chapter 3 of the code.

In September 2001 the Commission's Network Pricing and MNSPs Final Determination authorised the participation of unregulated interconnectors in the NEM.³ The authorisation of these code changes reflected the Commission's view that the involvement of MNSPs in the National Electricity Market (NEM) would deliver a net public benefit. Hence, these code changes facilitated the submission of access undertakings by MNSPs.

The Commission has accepted access undertakings from two other MNSPs in the NEM. In 1999 the Commission accepted an access undertaking submitted by TransEnergie Australia for the Directlink interconnector under schedule 5.8 of the NEM Access Code.⁴ In accepting that undertaking, the Commission required TransEnergie Australia to supply information pertaining to the bidding arrangements for Directlink in order to satisfy the requirements of Part IIIA of the TPA. On 11 September 2002, the Commission released a final decision on the access undertaking submitted to it for the proposed Basslink interconnector, which will connect Tasmania to Victoria and enable Tasmania to participate in the NEM.

¹ For the avoidance of doubt, references throughout this document to "Murraylink" denote the actual interconnector and not the MTC in its capacity as owner and operator of the interconnector.

² However, on 10 May 2002 NECA lodged an application to amend the NEM Access Code to include the MNSP undertaking in the NEM Access Code.

³ Australian Competition and Consumer Commission, Determination, *Amendments to the National Electricity Code: Network Pricing and Market Network Service Providers*, 21 September 2001.

⁴ Schedule 5.8 provides a pro-forma access undertaking for Network Service Providers (NSPs) and was already included in the NEM access code that had undergone public consultation prior to being authorised by the Commission.

MTC undertakes to make its networks available to code participants in accordance with code requirements, at prices determined pursuant to clause 3.9 of the code.⁵ Therefore, the Commission has assessed this undertaking in accordance with section 44ZZA of the TPA. In making its decision the Commission has had regard to the criteria set out in section 44ZZA(3). These criteria are:

- ✍ the legitimate business interests of the provider;
- ✍ the public interest, including the public interest in having competition in markets (whether or not in Australia);
- ✍ the interests of persons who might want access to the service;
- ✍ whether access to the service is already the subject of an access regime;
- ✍ whether the undertaking is in accordance with an access code that applies to the service; and
- ✍ any other matters that the Commission thinks are relevant.

On 31 July 2002 the Commission released a draft decision on MTC's access undertaking. In the draft decision, the Commission identified some concerns with MTC's access undertaking, many of which have been reiterated in this document. Essentially, the draft decision outlined the Commission's concerns about potential arrangements between MTC and other market participants for the bidding of Murraylink, in terms of the ability of certain bidding behaviour to inflate spot market prices beyond prices that reflect the demand and supply conditions in South Australia and Victoria.

Therefore, the draft decision recommended that MTC revise its access undertaking to include a provision for the confidential disclosure of the parties to its contracts for the sale of Murraylink's physical and financial transmission rights. On 25 September 2002 MTC submitted a revised access undertaking in accordance with the Commission's recommendation. The Commission has therefore prepared this decision outlining its analysis and views on MTC's revised access undertaking.

Section 2 of this decision sets out the statutory test that the Commission must apply when assessing an access undertaking. Section 3 contains an outline of the Commission's public consultation process for the draft and final decisions. The Commission's analysis of the revised access undertaking is set out in Section 4 and the Commission's conclusion and decision are set out in Sections 5 and 6 respectively.

⁵ Clause 3.9 of the code sets out the principles applying to the determination of spot market prices, the pricing and dispatch of ancillary services, and the general rules and processes relating to the dispatch of electricity in the spot market.

2. Legislative Framework for Assessing MTC's Undertaking

Part IIIA of the TPA establishes a legal regime to facilitate access to the services of certain facilities of national significance. It provides three alternative mechanisms for achieving access:

- ✍ undertakings;
- ✍ declaration; and
- ✍ effective regimes.

By lodging an access undertaking, MTC has opted to pursue the first of these. The advantage of this approach is that it "...provides a means by which the owner or operator of a facility can obtain certainty about access arrangements, before a third party seeks access".⁶ It can also avoid the possibility of time consuming and expensive disputes about whether a service should be declared and the terms and conditions on which access should be granted.

The Commission's role in assessing undertakings by service providers is prescribed by section 44ZZA of the TPA. Once an undertaking has been submitted the Commission must decide whether or not to accept the undertaking after conducting a public consultation process. In making its decision the Commission is required to have regard to the criteria set out in section 44ZZA(3). The criteria are:

- ✍ the legitimate business interests of the provider;
- ✍ the public interest, including the public interest in having competition in markets (whether or not in Australia);
- ✍ the interests of persons who might want access to the service;
- ✍ whether access to the service is already the subject of an access regime;
- ✍ whether the undertaking is in accordance with an access code that applies to the service; and
- ✍ any other matters that the Commission thinks are relevant.

If the Commission accepts an undertaking from MTC then the terms and conditions in the undertaking form the basis on which code participants can obtain access to MTC's network services. Once accepted, the services covered by the undertaking cannot be declared.

The Commission's publications *Access Regime - a guide to Part IIIA of the Trade Practices Act* and *Access Undertakings - a guide to Part IIIA of the Trade Practices Act*

⁶ Second Reading Speech accompanying the *Competition Policy Reform Bill 1995*, page 7.

(“Access Undertakings guide”) provide further information about Part IIIA and access undertakings. The public ations can be obtained from all Commission offices and from the Commission’s website.

3. Public consultation process

The Commission has a statutory obligation under the TPA to follow a public consultation process when assessing an access undertaking. Section 44ZZA(4) of the TPA states that the Commission must not accept an undertaking unless it has published the undertaking, invited submissions on the undertaking, and considered any submissions subsequently received.

MTC lodged its access undertaking with the Commission on 6 February 2002. Notice of the application and a request for submissions was placed on the Commission's website.⁷ TransGrid and New South Wales (NSW) Treasury provided submissions in relation to the access undertaking. These submissions have been placed on the Commission's website. Subsequently, the applicant responded to the issues raised in these submissions. This response has also been placed on the Commission's website.

Commission staff also met with the applicant and representatives of TransGrid.

The Commission released a draft decision on the original access undertaking on 31 July 2002, and invited submissions on that document. The Commission received submissions in relation to the draft decision from TransGrid, the NSW Ministry of Utilities (MEU), Westpac Energy, and MTC.

The Commission has produced this decision outlining its analysis of MTC's revised access undertaking according to the statutory assessment criteria set out in section 2.

⁷ <http://www.accc.gov.au>

4. Commission's assessment

4.1 The application

MTC is the owner of the Murraylink transmission cables and associated assets that connect the Victorian and South Australian electricity grids. The Murraylink project involves the installation of a 180 km power cable that runs between Red Cliffs in Victoria and Berri in South Australia. The interconnector will supply some 220 MW of electricity into the Victorian and South Australian grids, and became operational in October 2002. Murraylink also includes a converter station linked by direct current (DC) cables at each end of the interconnector that will convert alternating current (AC) electrical energy into DC energy, and vice versa.

Chapter 5 of the code establishes two commercial frameworks for the development of network services in the NEM, both regulated and unregulated. Regulated assets earn a regulated return in accordance with chapter 6 of the code, while unregulated assets earn revenue from trading in the wholesale electricity market. For the purposes of the code, MTC is the MNSP operating the Murraylink market network service.

MNSPs earn a revenue stream proportional to the spot price differential between two interconnected regions and the flow across the link. As an MNSP, MTC will have the right to earn spot market revenues in accordance with chapter 3 of the code. MTC will not be entitled to any regulated revenue or income pursuant to chapter 6 of the code, which applies to regulated network services.

The Commission notes, however, that on 18 October 2002, MTC lodged an application to convert Murraylink from a market network service to a regulated network service. The Commission believes that consideration of the conversion application will take approximately eight months to complete. Therefore, the Commission has decided to proceed with its consideration of this access undertaking in order to provide certainty to MTC in the period until a decision on the conversion application is finalised.

Access to Murraylink's Market Network Services.

MTC proposes to offer access seekers certain rights over the Murraylink transmission capacity, that will enable the eventual holder of that capacity to hedge basis risk between the Victorian and South Australian regions, and to directly participate in the inter-regional spot market and ancillary services market.

Proposed terms and conditions

MTC proposes to offer access to the Market Network Services provided by Murraylink through two categories of product: namely, "Financial Contracts" and a "Physical Product Contract". A potential buyer may bid for either or both types of products.

Financial Contracts

The natural position of Murraylink in the spot market enables it to simultaneously bid physical transmission capacity in both South Australia and Victoria for each 5-minute dispatch period. MTC advises that the financial contracts may include a suite of financial instruments and hedges that generators, retailers and financial intermediaries can enter into, for either one or both of the interconnected regions, to create opportunities and manage prices, volume, transmission and customer risks.

MTC submits that the Financial Contract will provide an opportunity for the prospective buyer to exchange a variable payment for a fixed payment under a Financial Contract. The underlying price will be either the Regional Reference Price (RRP) for Victoria and/or South Australia, or a calculation of the difference between the two, such as the RRP differential. The financial contracts will be settled weekly, in accordance with the National Electricity Market Management Company (NEMMCO) billing cycle.

Physical Contract Product

As an MNSP, MTC proposes to offer to the NEM all of the physical transmission capacity made available by the Murraylink interconnector. The code requires that the Murraylink transmission capacity be scheduled by NEMMCO for use by the entire market.

The Physical Contract will enable a single "Physical Buyer" to secure the rights to bid up to 100 per cent of the Murraylink transmission capacity into the NEM spot market, and receive any resulting spot market revenues from NEMMCO. MTC will be responsible for reporting the total available capacity over the Murraylink facilities and for physically operating those facilities.

The Physical Buyer will make payments to MTC based on the spot market revenues that it earns. The Draft Physical Contract directly ties the revenue received by MTC under the Physical Contract to the available spot market transmission capacity supplied by Murraylink. MTC advises that this means that MTC would receive lower payments from the Physical Buyer in the event of low transmission capacity such as the unavailability of Murraylink facilities, or constraints on the Victorian and/or South Australian AC transmission grid as notified by NEMMCO.

MTC also proposes that payments made by the Physical Buyer to MTC will be adjusted in the event that additional transmission capacity between South Australia and either Victoria or New South Wales is placed into commercial operation.

MTC submits that it will only accept Physical Contract proposals for the rights to 100 per cent of the Murraylink transmission capacity. The minimum contract period will be two years from 1 October 2002, and the maximum contract period will be 20 years.

4.2 Original submissions from interested parties

As noted previously, submissions on MTC's initial access undertaking were received from TransGrid and NSW Treasury. The arguments put forward in these submissions have been grouped under the statutory criteria.

4.2.1 The legitimate business interests of the service provider

NSW Treasury queried MNSPs' capabilities to earn a significantly higher return than the owner of a regulated interconnector, and whether MTC should be permitted to bid Murraylink as it wishes. It questions what can be considered a reasonable return on transmission assets. NSW Treasury also notes that regulated interconnectors can earn a maximum return of the regulated weighted average cost of capital on their optimised depreciated asset value, in addition to the risks of subsequent optimisation. It contends that it is therefore debatable whether an MNSP's desire to earn a significantly higher return than the owner of a regulated interconnect should be permitted to prevent access undertaking conditions that serve the public interest and the rights of access seekers.

TransGrid states that the ACCC should consider whether it is desirable, at the current stage of development of the NEM, and in particular the development of MNSPs in the NEM, for physical transmission rights to be offered for sale by an MNSP. It contends that MTC should be prohibited from negotiating bilateral contracts for the sale of physical transmission rights, because the acquirer of that capacity is not subject to any regulatory requirements under the code. Similarly, NSW Treasury submits that the Commission should impose conditions on the access undertaking that prevent MTC from selling rights to the physical capacity of Murraylink.

4.2.2 The public interest

Market impacts

NSW Treasury and TransGrid expressed a strong preference for regulated interconnection. This is based on the view that unregulated links are subject to a number of market failures that mean that, overall, regulated links are likely to generate greater public benefits than unregulated links.

NSW Treasury claims that Murraylink will be a significant interconnector in the NEM and that its operation is likely to affect the overall level of competition in at least one of the major NEM regions.

TransGrid reiterates its view that MNSPs' participation in the NEM should be limited so that the efficiency benefits of a national grid can be enhanced. It argues that if all interconnectors were unregulated, network constraints would become institutionalised and the energy market competition benefits and other efficiency benefits of the national grid would be lost. With respect to the Murraylink access undertaking, TransGrid argues that the competitive benefits of the link can be maximised by limiting the ownership of transmission rights by generators. It states that such arrangements lack transparency, and are anti-competitive as they enable the parties to influence capacity in the interconnected network to drive up regional price differences and settlement residues. TransGrid argues

that MTC should therefore be required to offer the rights to its physical capacity through an open auction process.

TransGrid also raises concern about the ownership of multiple unregulated interconnectors, where MNSPs participate in interregional settlement residue auctions, and that the access undertaking should prohibit such participation in auctions for flows into common regions (for instance, if TransEnergie developed the Heywood interconnector as a hybrid link). In this context, TransGrid argues that the access undertaking should be subject to further review if MTC or a related party acquires or develops another MNSP in the interconnected network.

Market power

TransGrid argues that market power is inherent with unregulated links. Similarly, the New South Wales Treasury submits that transmission interconnection is subject to a number of market failures, which mean that, on balance, regulated links are likely to generate greater public benefits than unregulated links.

TransGrid and NSW Treasury argue that the principal market power concerns arising from the participation of MNSPs in the NEM are network constraints, and the ability of MNSPs to withdraw capacity from the market in order to maintain price differentials between NEM regions. Both parties submit that these concerns could be addressed by requiring MNSPs to bid a zero price differential and be dispatched whenever interregional price differences exceed the cost of losses across the link. The consequence of this requirement would be that MTC would not be permitted to sell rights to the physical capacity of Murraylink. TransGrid and NSW Treasury also recommend that financial transmission rights be sold through an open auction process.

Further, both submissions argue that the analysis conducted by the Federal Energy Regulatory Commission (FERC) in its consideration of merchant transmission links in the United States is instructive for dealing with such market power issues. Indeed, TransGrid submits that the Commission should consider imposing stringent conditions on MNSPs. These are summarised in the section regarding the pricing of access rights and conditions.

Reliability impacts

TransGrid states that a requirement for MTC to bid zero at all times would essentially ensure the same system reliability benefits as a regulated link. TransGrid also argues that the MTC access undertaking must give NEMMCO the unequivocal ability to restrict ramp rates and other aspects of MTC's operation in the interests of system security. In addition, TransGrid recommends that the Commission impose conditions on MNSPs that are complementary to the obligations of Transmission Network Service Providers (TNSPs), otherwise TNSPs will be unable to achieve their network reliability accountabilities.

4.2.3 The interests of persons who might want access to the service

The nature of the access rights or transmission rights offered by MNSPs to access seekers.

TransGrid argues that the sale of electricity in a regional spot market does not constitute providing “access” to a transmission service as the draft access undertaking and schedule 5.9 of the code appear to suggest. It states that “access” as anticipated to be provided by MNSPs, refers to more than just third party “use of system” for the transmission of electricity between two connection points. It states that access rights are likely to take one of three forms:

- ✍ rights that permit third parties to participate in the economic benefits that accrue to the operator of a non-regulated interconnector;
- ✍ rights (subject to appropriate regulation) to acquire physical transmission rights that enable the access seeker to bid a portion of the capacity of the non-regulated link; or
- ✍ rights to any inter-regional settlement residues arising from the operation of the non-regulated interconnector.

Therefore, TransGrid and NSW Treasury recommend that the Commission consider conditions to require more detailed access undertakings, similar to those imposed by the FERC on the proposed Neptune merchant transmission project in the United States.

Pricing of access rights and access conditions

TransGrid argues that compliance with section 3.9 of the code does not provide sufficient guidance as to the price at which access rights will be provided by the MNSP. It proposed 14 conditions of access that it believes should be imposed upon all MNSPs’ access undertakings. The basis of TransGrid’s suggested framework is that all the capacity of an unregulated interconnector would be offered to proponents solely through a transparent auction process, and be subject to additional conditions.

Essentially these conditions would require:

- ✍ greater transparency for the terms of access rights to be offered to access seekers;
- ✍ a prohibition on the sale of physical transmission rights;
- ✍ a restriction on MTC to bidding zero price differentials;
- ✍ market monitoring by the Commission for market power abuses;
- ✍ a prohibition on MTC from participating in interregional settlement residue auctions; and
- ✍ an additional review of the undertaking in the event that MTC acquires additional unregulated transmission capacity.

Payments to TNSPs

TransGrid states that the code's safe harbour provisions contain inconsistencies and that the code does not clearly define how MNSPs must meet their obligations under clause 5.5A of the code. It argues that this impedes the TNSPs' processes of reaching agreement with MNSPs, despite the fact that clause 5.5A does not preclude such negotiation of charges. TransGrid states that the Commission should withdraw the proposed condition of the Network Pricing and MNSPs final determination, which requires the development of a universal transmission usage charge. Further, it argues that the Commission should impose a condition that requires the agreements reached between TNSPs and MNSPs to address the obligations of MNSPs under the safe harbour principles.

4.3 Submissions in response to the draft decision

Submissions in response to the Commission's draft decision on the Murraylink access undertaking were received from TransGrid, MTC, the NSW MEU, and Westpac Energy. As with submissions received in response to MTC's application for acceptance of its undertaking, the comments raised in the latest round of submissions have been grouped under the statutory criteria. The summary of these submissions below is limited to comments raised in response to the draft decision only.

4.3.1 The legitimate business interests of the service provider;

TransGrid argues that the code does not explicitly provide for the sale of physical and financial transmission rights.⁸ Further, TransGrid states that it is questionable that the Network Pricing and MNSPs code changes were intended to accommodate the sale of transmission property rights. It also argues that it would be inappropriate to allow MTC to sell transmission property rights before the completion of Jurisdictional reviews of facilitating firm access to the transmission network and reviews by NECA of generator network investment.

Similarly, MEU argues that in the first instance, MTC should not be permitted to withhold Murraylink's capacity by bidding above the price in the exporting region. As a consequence, it would not be possible for MTC to sell rights to the physical capacity of Murraylink. It argues that all financial rights to Murraylink flows should be auctioned off in an open and transparent process where no affiliate or related party of MTC would be permitted to participate.

Westpac Energy supports investments in unregulated assets, but argues that requiring MTC to provide commercial information on the basis that MTC *may* add to market power in the generation market appears to be outside the scope and intention of Part IIIA of the TPA. Conversely, TransGrid argues the draft decision runs contrary to the intentions of Part III of the TPA, and that the Network Pricing and MNSP code changes did not intend to allow one bidder to control 100% of an MNSP's physical transmission capacity.

⁸ Also referred to as transmission property rights.

Westpac Energy is concerned that the draft decision may create a disturbing precedent in other markets, whereby firms that are considered to have market power, such as certain gas field owners or generators that are considered 'gate keepers', such as Snowy Hydro and Southern Hydro, may have to continually disclose complex contract positions to the Commission.

4.3.2 The public interest, including the public interest in having competition in markets (whether or not in Australia)

Market power

Westpac Energy contends that Murraylink will increase competition in both the transmission and generation markets.

TransGrid submits that the three main generators in South Australia respectively bid a base load, a shoulder load, and a peak load, and that in times of high demand, the shoulder and peak generators have market power. It argues that the sale of Murraylink's physical transmission capacity to one of these generators would increase market power instead of alleviating it. TransGrid therefore recommends that as a condition of acceptance of the access undertaking, MTC should be prohibited from selling physical transmission rights to TXU and International Power.

TransGrid questions the intention of the code changes for one bidder to control 100% of the link's capacity, and whether this is consistent with the objectives of Part IIIA. However, MTC argues that to maximise its own revenue potential under a physical contract, it has the incentive to maximise the quantity of transmission capacity made available to the buyer. MTC explains that the buyer has an obligation to pay MTC for the actual total transmission capacity made available by MTC in addition to any extra costs of generation. MTC also states that there is no link, or tying of payments, between the parties to the control of bidding the available capacity and the actual flows across Murraylink.

Commission's recommendation for a revised undertaking

Westpac Energy argues that speculating that market power may ensue as a result of an auction of physical capacity implies:

- i. the existence of market power in the generation market prior to that auction; and
- ii. that those parties that may be disadvantaged from this market power do not themselves buy the MTC physical transmission rights.

Westpac Energy argues that this is an unlikely outcome as economic theory suggests that agents will act where the cost of the purchase is less than the benefits derived from the purchase of the bidding rights.

Similarly, MTC believes that the Commission has not adequately established the basis for imposing the disclosure condition on the MTC access undertaking. In general, MTC submits that the Commission has not demonstrated that the potential contracts would result in a substantial lessening of competition.

MTC also states that given the conditions that would be necessary for it to withhold power (the simultaneous occurrence of high demand, unavailability of competing generation, and the Heywood interconnector being constrained) – any withholding of power would only result in the exercise of trivial, not substantial, market power. Further, MTC argues that as there is no link between payments made to MTC, the parties to the control of bidding the available capacity, and the actual flows over Murraylink, it is only the subsequent bidding behaviour of the buyer that can affect competition. MTC argues that whether or not this subsequent conduct would breach the Part IV provisions should not be linked back to MTC's access undertaking.

MTC states that any anti-competitive conduct should be identified by the market monitoring activities conducted by NECA and the Commission, as well as the Commission's powers under section 155 of the TPA. MTC does not accept the Commission's desire to place conditions on its access undertakings in place of these powers.

Conversely, TransGrid argues that MTC should also undertake to provide much more detailed information about its arrangements to both NEMMCO and the Commission, to enable effective monitoring of the arrangements. TransGrid submits that the draft decision did not address market power issues arising from the participation of MNSPs in the NEM, nor did it move to regulate the availability of MNSPs' capacity and their overall ownership of interconnectors in the NEM. TransGrid recommends that while the NEM is still in its infancy, the Murraylink access undertaking should be subject to review in the event that MTC, or any affiliate of MTC, acquires or constructs additional unregulated capabilities in the NEM.

TransGrid argues that the Commission's disclosure recommendation is a necessary fundamental condition, but by itself is inadequate having regard for public interest and third party access considerations. It suggests that if the Commission does not prohibit the sale of transmission property rights, it should at least prohibit the sale of physical transmission rights. However, TransGrid states that this would still not protect the public interest to the same extent as an undertaking not to trade in transmission property rights because it opens up issues of monitoring to ensure that financial arrangements are not used to achieve the effective transfer of physical property rights.

However, TransGrid states that if the Commission facilitates the introduction of physical transmission rights into the NEM, MTC should be required to:

- ☞ deal with code participants only for the sale of transmission rights;
- ☞ disclose to NEMMCO the identity of purchasers of physical transmission rights; and
- ☞ provide NEMMCO with a copy of the contract for each sale of physical transmission rights.

TransGrid argues that the sale of physical transmission rights by MTC would allow a party that is not a registered code participant to operate Murraylink without visibility or direct regulatory obligations to other code participants, and circumvent the requirement for MNSPs to register as code participants. It states the draft decision's condition of acceptance that MTC should confidentially disclose the identity of the purchaser of the

physical product exacerbates the issue because the market will unknowingly deal with an unregistered and unidentified MNSP.

MEU asserts that the Commission authorised the MNSP regime despite recognising that the counterfactual (ie. regulated transmission) might lead to greater public benefits. It claims that the only justification for the Network Pricing and MNSPs authorisation would be for the Commission to impose Neptune-like conditions on all MNSPs from here forward, and that failure to do so delegitimises that authorisation.⁹ Therefore, MEU submits that it is inappropriate for the Commission to signal likely acceptance of MTC's undertaking without a condition that requires Murraylink to effectively operate as a regulated link.

Further, MEU argues that the key overarching policy issue arising from the access undertaking is the extent to which the regulatory regime for transmission should be the same as that for generation. It submits that degree to which regulation applies to transmission and generation should follow from the relative economic characteristics of the two. MEU argues that the fundamental differences are that transmission can be both a substitute for, as well as a complement to, generation through its function in supplying customers. It states that transmission networks derive their market power from these complementary characteristics, which are not held by generators. Hence, MEU argues that the same is true for MNSPs in the NEM. Further, MEU submits that MNSPs are still transmission operators in a market where existing transmission operators are heavily regulated under the code for their natural monopoly and market power characteristics. It argues that for MNSPs to be treated identically to generators would mean that either:

- ✗ no aspect of the market, including existing TNSPs, ought to be regulated, beyond the current Part IV TPA provisions; or
- ✗ all aspects of the market ought to be regulated in a similar manner to regulated transmission operators.

MEU states that neither alternative would be suitable.

MEU argues that if Murraylink was truly constrained from withholding capacity by the three main South Australian generators and the Heywood interconnector, then it is unclear why the Commission and MTC would object to having conditions imposed that required MTC to operate like regulated interconnectors. MEU submits that if the MNSP were required to bid zero, it would not be able to withhold capacity and customers would benefit from competition between the generators in the importing and exporting regions. It states that this competition would bring the price at the load down to the short run marginal cost of the generators (not including transmission losses).

MEU takes issue with the efficacy of the proposed condition on MTC's access undertaking. It believes that in limiting the condition to MTC's physical contracts, the potential for financial contracts to be structured so as to have the same anticompetitive effect is ignored. Further to this, MEU states that the condition does not prevent the physical buyer from re-contracting with other NEM participants, who could then bid

⁹ The Project Neptune conditions are summarised on page 25 of this document.

Murraylink in an anticompetitive manner, whilst remaining outside the scope of the Commission's disclosure condition.

Therefore, MEU argues that unless the Commission places Neptune-like conditions on the Murraylink access undertaking, then the MNSP regime that it authorised through the Network Pricing and MNSP code changes will be rendered illegitimate. The Commission believes that MEU's submission raises three major issues:

1. Should Murraylink be regulated?
2. Should Neptune-like conditions be imposed on Murraylink? and
3. Is the draft decision's recommendation for a revised undertaking appropriate?

The first issue will be discussed in the section concerning the legitimate business interests of the service provider. The remaining issues will be addressed in accordance with the public interest criterion.

4.3.3 The interests of access seekers

TransGrid submits that MTC's compliance with bidding rules in code clause 3.9 does not establish pricing principles for access seekers. It states that these principles are a separate matter and must be transparent, and that code changes would be required to accommodate them. TransGrid also submits that a "use it or lose it" condition relating to the access rights for physical capacity, should be imposed on the access undertaking to help resolve the issue of exercising market power by withholding Murraylink capacity. TransGrid states that at the very least, MTC and parties to a contract with MTC for physical transmission rights, should be required to bid available physical capacity into the market.

4.4 Commission's assessment

The Commission has analysed the undertaking, taking into account each of the statutory criteria outlined in section 44ZZA(3) of the TPA.

4.4.1 Legitimate business interests of the service provider

This criterion focuses on the commercial considerations of the service provider (in this case MTC). As stated in the Access Undertakings Guide, in assessing undertakings against this criterion the Commission will take into account the service provider's obligation to shareholders and other stakeholders.

In considering the requirements of this criterion, the Commission believes that MTC should be allowed to recover the costs of providing the service. Cost recovery allows the service provider to earn a commercial rate of return on investments commensurate with the risks associated with the investment. This outcome is consistent with those that could be expected in competitive markets.

In most access decisions, this has involved the Commission assessing the appropriate revenue stream that the infrastructure provider is entitled to receive. The access arrangements set out in this undertaking, however, are fundamentally different. The MTC's revenue stream will result from it entering into contracts with market participants for rights to Murraylink's transmission capacity.

TransGrid's submission points out that the code does not explicitly provide for the sale of physical and financial transmission rights, and questions whether the code intended for MNSPs to do so. However, the Commission notes that NECA's application for authorisation of the Network Pricing and MNSP code changes included arrangements that would provide for investments in market network services to be supported by revenue streams generated by trading electricity between the two interconnected regions. NECA's code change application envisaged that the parties to the investment would bear the risks associated with arbitraging electricity prices between the regions, and that an MNSP could manage the risk and earn revenue in the following ways:

- ✍ acting as an electricity merchant – bidding transmission capacity between the interconnected regions. The revenue earned is the energy price differential multiplied by the volume of electricity traded on the interconnector for each half-hour period; or
- ✍ underwriting the investment by selling the rights to the revenue generated by trading electricity across the interconnector. Purchasers of such rights include electricity retailers, traders and generators; or
- ✍ selling a physical trading product, that is the right to bid the capacity into the market and the rights to the revenue associated with transmitting electricity across the facility; or
- ✍ entering into contracts with NEMMCO for provision of ancillary services or reserve trader services.

These considerations fall within the broader framework for the participation of MNSPs, wherein the Network Pricing and MNSP code changes intended for MNSPs to assume all of the risks of their investments, and hence operate without regulation, and consequently not be guaranteed a return on their investment.¹⁰

Indeed, NECA's Network Pricing and MNSPs code change application stated:

The provisions to allow market network service providers to enter the market, where they meet the safe harbour provisions, adds new competitive pressures to generators at the expense and risk of the entrepreneur rather than customers.

The Commission considers that imposing conditions that prohibit MTC from selling the rights to bid Murraylink would impact on the ability of MTC to recover the costs of providing the service. Therefore, the Commission does not believe it is appropriate to prohibit MTC from selling transmission property rights.

The submissions from MEU and TransGrid argue that an alternative way to promote competition would be to require MTC, or its contracting party, to bid the link at zero at all times (preventing it from withholding the link's capacity), and earn the spot price differences. MEU contends that this arrangement would provide a better balance of the public interest and the business interests of the service provider.

If an MNSP bid capacity of the link at zero prices, the returns to the link owner are the difference in regional prices multiplied by the volume of flow across the link (minus transmission losses). However, because a merchant link can bid in positive prices, the merchant is able to constrain the link to only transport electricity when the price differential between the regions is higher than the transport bid. Therefore, an MNSP's bid can constrain the flow of electricity across the link.

However, the Commission considers that requiring MTC to price its bids at zero would threaten its viability as an MNSP. Such a requirement would mean that MTC would be effectively operating a regulated network service, but without the certainty of a regulated revenue stream, and therefore would not serve the legitimate business interests of the service provider. The Commission considers that the incentive for unregulated interconnectors to be developed in the NEM would be dampened. Any companies considering investment in market network services would observe that they would:

- (a) receive the pool price differentials when their link is dispatched amid significant competition from generators in the importing region, such as the Heywood interconnector (because they would be required to bid zero); and
- (b) not receive a regulated return on their asset; and

¹⁰ In the context of the code, an MNSP's unregulated status primarily means that it will not earn a guaranteed (regulated) revenue stream under the provisions of chapter 6 of the code. More specifically, an MNSP is unable to charge other market participants for its market network services under the chapter 6 provisions. Therefore, MNSPs are required to earn their revenue in the ways described above, and make their capacity available to NEMMCO for dispatch, in accordance with the provisions of chapter 3 of the code.

- (c) face higher risks of investment and hence greater barriers to entry as a competitor in the NEM.

The arguments submitted by MEU and TransGrid that Murraylink should be regulated imply a view that Murraylink displays similar characteristics to the TNSPs that are currently regulated in the NEM. However, Murraylink is fundamentally different. It is a stand-alone asset that connects two of the NEM regions, and will earn its revenue as an MNSP by arbitraging the interregional pool price differences.

In contrast, the existing TNSPs operate large meshed networks that underpin the provision of transmission services in the NEM. The TNSPs have natural monopoly characteristics that give rise to *per se* market power issues, and hence are subject to regulation under Part IIIA of the TPA.¹¹ Regulation subsequently allows the TNSPs to receive a guaranteed revenue stream for a specific period. Meanwhile, the code provisions create a reasonable expectation that MTC would be able to sell physical and financial transmission rights, and operate as an MNSP.

The Commission therefore believes that it would be inappropriate to require Murraylink to effectively operate as a regulated link without earning regulated revenue, as MTC would be unable to recover the costs of providing the network service. This scenario would also be inconsistent with the legitimate business interests of the service provider, and would provide perverse signals for investment in market network services.

4.4.2 The public interest

This criterion explores the extent to which an access undertaking contributes to the improved welfare of the broader community. The Commission will be guided by the objectives of the TPA, namely ‘to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection’. This objective emphasises the role of competition in promoting the welfare of Australians. Competition is a device for promoting economic efficiency. As explained in the Hilmer Report:

Competition policy is not about the pursuit of competition for its own sake. Rather it seeks to facilitate effective competition in the interests of economic efficiency...¹²

Accordingly the Commission’s assessment of the public interest criterion has focused on efficiency considerations.

The Commission believes that the analysis it undertook in the Network Pricing and MNSPs final determination is relevant to an assessment of the public interest criterion. In this determination, the Commission acknowledged that benefits would arise from the operation of MNSPs in the NEM through the potential for greater trade of electricity

¹¹ It has never been envisaged that MNSPs would provide transmission services to the same extent as the regulated networks. The functions performed by MNSPs demonstrate their lack of natural monopoly characteristics, both in the provision of transmission, and as an alternative to generation.

¹² Commonwealth of Australia, *National Competition Policy*, Report by the Independent Committee of Inquiry (Hilmer Report), 1993.

between regions. To the extent that an MNSP injects capacity into a region, the market network service is providing a source of competition for generators in the importing region. Further, where an MNSP offers financial hedges to NEM participants, inter-regional trade will be facilitated, providing a further benefit to the NEM.

However, in the final determination, the Commission also acknowledged that it was aware that in some situations the operation of a market network service might detract from the public benefits that could otherwise be expected.

The Commission recognised that the incentive placed on the proponents of a market network service might be to preserve price differentials between regions. Therefore, it was claimed that MNSPs would have an incentive to either construct a link of smaller than socially optimal capacity and/or restrict flows between the regions. As such the expected public benefits that could arise from the introduction of market network services may not be fully realised. An MNSP may bid its capacity into the NEM at high prices, though such strategies are likely to be constrained by the bid prices of competing generators and interconnectors. As such the MNSP might possess a degree of market power or may enhance the existing market power of other NEM participants and may be able to influence spot prices, especially by withdrawing capacity from the spot market.

When an MNSP has an incentive to limit the capacity of a link to preserve inter-regional price differentials, this is similar to that of a new generator who would not want to over invest in capacity leading to a substantial reduction in its regional spot price. In this context, the Commission argued that new generators avoid this risk by writing long term supply contracts to get a secure income stream and hedge against the risk of a decline in prices. Similar contracting arrangements are also open to MNSPs, who could sell the rights to inter-regional revenues to generators that want to export electricity to another region. Such a long-term contract could be similar in form to a transmission congestion contract (TCC).

The Commission also noted that the ability of the MNSP to restrict flows in order to raise prices is also analogous to generators withdrawing their capacity from the market. The success of such strategies is heavily dependent upon the nature of any financial contracts that the MNSP (or generator) may have and will diminish over time as more capacity enters the market. Further in most cases the incentive to withdraw capacity will be muted where the proponents of a market network service have sold the rights to the revenue stream, with the incentive dampened the most where long term contracts provide the bulk of the MNSP's revenue. However, in instances where an MNSP has the ability to impact spot prices the incentive to withdraw capacity may remain. The Commission noted that in some circumstances the commercial relationships between an MNSP and another market participant may be an issue.

Therefore, in the Network Pricing and MNSPs final determination, the Commission stated that where significant market network services are proposed in the NEM it may be appropriate to consider arrangements similar to the FERC's conditions on the Project Neptune interconnector, to meet market power concerns.

In the FERC order approving Project Neptune, FERC used a number of criteria to assess the proposal, including that the merchant transmission facility should:

- ✍ assume full market risk;
- ✍ create tradeable transmission rights and an open season process should be employed to initially allocate transmission rights;
- ✍ not preclude access to essential facilities by competitors;
- ✍ be subject to market monitoring for market power abuse;
- ✍ coordinate physical flows with the relevant Independent System Operators (ISOs); and
- ✍ not impair pre-existing property rights.

FERC then addressed issues of concern in the Neptune proposal, and imposed a number of requirements upon the proponents of the link, such as:

- ✍ refusal to allow bilateral negotiation for property rights prior to the initial open season allocation;
- ✍ refusal to compel payments for system benefits;
- ✍ agreeing to the proposed restriction on affiliate participation in the open season; and
- ✍ a requirement to comply with data requests from market monitoring authorities.

Market power issues

The Commission has acknowledged the potential for MNSPs to withdraw transmission capacity to increase regional prices. The Commission also recognises that where an interconnector is a DC link, the ability to withhold capacity is made easier by the link's ramp volumes, which are comparatively faster than those of competing generators. However, notwithstanding the market power issues that were identified in the draft decision, MNSPs can provide significant benefits to the NEM. For instance, in a similar way to generators, MNSPs are directly involved in the wholesale market and can offer opportunities for interregional hedges. The absence of interregional hedges reduces opportunities for market participants to manage the volatility of the spot market and therefore can be a barrier to interstate trade. The particular features of a DC link mean that the power is directly controllable, the power transfers are steady, and as a consequence, that the losses across the link are not large. This enables MTC to offer firm access to the link, and a firmer hedging instrument than the access provided by the AC networks provided by the existing TNSPs. As a result, there is less risk in interregional trading. In this regard, Murraylink's ability to provide an improved interregional hedging instrument is an important benefit in the context of adding competitors to regional markets.

Analysis of market arrangements

The Murraylink interconnector will connect the South Australian and Victorian electricity regions. The current spot market prices for the South Australian region suggest that South Australia will generally be the importing region for the purposes of

bidding Murraylink into the NEM.¹³ Given that MTC will act in a manner similar to a generator in the importing region, existing generators in South Australia represent the primary competitive constraints against the way that Murraylink is bid into the NEM.

Currently there are three major generators operating in South Australia: TXU (1280 MW); NRG Flinders (950 MW); and International Power (837 MW). AGL and Origin also have some generation capacity.

Further, NECA's 2001 Annual Report indicates that a significant level of new investment in generation is forthcoming.¹⁴ This consists of 1119-1254 MW worth of committed new investment projects in South Australia alone (including Murraylink). A further 1550-1820 MW worth of uncommitted projects are mooted for South Australia. In addition to the capacity offered by these generators, the Heywood interconnector has the capacity to transport a further 500MW from Victoria to South Australia.

It has been argued that MNSPs can enhance the market power of existing generators and entrench non-competitive market outcomes. It is therefore relevant to examine the impact on competition in South Australia and Victoria that Murraylink will have.

The fact that Murraylink is not the only link between South Australia and other NEM regions is significant in the context of determining the extent of any market power. Therefore, in most circumstances there is potential for sufficient competition in South Australia and Victoria to prevent anti-competitive outcomes resulting from an agreement between MTC and any other market participant, including generators. The issue of Murraylink's involvement with other market participants is discussed in more detail below.

Murraylink provides an opportunity for increased competition for dispatch in the importing region, and also for competition in the downstream market for electricity transmission. Murraylink can increase total supply capacity, particularly in South Australia, and therefore improve the sharing of reserve capacity in the South Australian and Victorian regions.

The presence of three major South Australian generators, all of which have significantly greater capacity than Murraylink, and the market conditions outlined above suggests that MTC faces considerable competition for dispatch by NEMMCO. In this context, withholding the link's capacity could jeopardise MTC's primary source of revenue to the advantage of competing generators and the Heywood interconnector. Where Murraylink injects capacity into the Victorian and South Australian regions, it can be considered to increase competition in one of those regions.

¹³ The analysis in the following paragraphs largely focuses on the competitive impacts of Murraylink on the South Australian region. This is because the market structure in Victoria would generally appear to be one of the most competitive in the NEM. There are several major generators competing in Victoria, in addition to interconnection with both the South Australian and Snowy regions. As such, the ability of MTC to exercise market power in the Victorian region would appear to be limited.

¹⁴ National Electricity Code Administrator, *Annual Report*, October 2001.

The Commission therefore considers that prima facie, the existence of several large generators and an alternate, larger, interconnector competing within the South Australian region is likely to substantially constrain MTC, as a stand-alone entity, from withholding Murraylink's capacity from the NEM.

Arrangements with other market participants

TransGrid submits that it is not currently appropriate for generators to be able to purchase physical transmission rights to unregulated transmission capacity. In previous determinations the Commission has acknowledged that competition concerns can arise from an arrangement between an MNSP and a generator where a dominant generator assumes a substantial amount of control over competition in a region.

MTC's access undertaking offers a range of products that provide transmission services over Murraylink. Of these products, the sale of Murraylink's physical transmission capacity would appear to raise the clearest competition concerns.

As previously mentioned, in the Network Pricing and MNSPs Final Determination the Commission noted the incentives for generators and MNSPs to withhold capacity bid into the NEM in order to preserve interregional price differences.

The incentive to withhold capacity would increase if a significant generator in an importing region purchased the rights to Murraylink's physical capacity. Under such an arrangement, a generator would have both the incentive and the power to influence spot market prices to the advantage of its generation capacity. This market power would be enhanced by either high demand in the importing region or the unavailability of either the Heywood interconnector or other generating units.

During situations where the Heywood interconnector is constrained, a generator (as physical buyer) would not have to purchase wholesale electricity from the exporting region, but could still be dispatched by NEMMCO, whilst pushing up the spot prices to be earned by dispatch of the owner's generation output. The Murraylink interconnector and the physical buyer's generating capacity would therefore receive the ensuing inflated spot market revenues without having incurred any marginal costs of having the link dispatched.

Such conduct may raise issues under the competitive conduct provisions of the TPA. Section 45 (2) (a) provides that a corporation shall not make a contract if a provision of the proposed contract would have, or would be likely to have, the effect of substantially lessening competition. Section 45 (2) (b) states that a corporation shall not give effect to a provision of a contract, if that provision has or is likely to have the effect of substantially lessening competition. A reference to a lessening of competition includes preventing or hindering competition.

The Commission considers that there could potentially be such concerns raised if a generator in an importing region purchased the physical rights to Murraylink and then bid this capacity in a way to ensure that the link did not operate. However, the Commission also recognises that similar concerns may arise in circumstances where an MNSP's physical transmission capacity is purchased by other market participants, for example by another transmission company, or a retailer.

Therefore, the Commission believes that in order to ensure that the undertaking is in the public interest, it must provide for disclosure to the Commission of the parties to any agreements concerning the sale of Murraylink's physical transmission capacity.

This is not to suggest that if a generator in an importing region purchased rights to Murraylink's physical capacity that it will be used for anti-competitive purposes. Indeed, if a generator purchased the physical rights to Murraylink, the capacity could be used as a hedging instrument. Such an arrangement could be pro-competitive. Section 46 of the TPA does not aim to prevent firms from attaining or using market power unless it is for a proscribed purpose. The draft decision stated that the Commission does not believe that any arrangement between MTC and a generator will be a per se breach of section 45, but that this aspect of the access undertaking raises concerns regarding competitive conduct. Therefore, the notion that MTC should disclose commercial information regarding its contracts to the Commission was not based on the premise that MTC *may* add to market power in the generation market, as Westpac Energy's submission suggests.

Finally, the Commission is aware of discussions concerning TransEnergie's mooted involvement with the Southernlink hybrid interconnector. However, the Commission believes that it would be inappropriate for it to impose conditions that move to regulate TransEnergie Australia's overall ownership of interconnectors in the NEM, and considers that any market power issues arising from the development of other interconnectors should be addressed when and if they arise.

As mentioned in the previous section, the submissions from TransGrid and MEU argue that the Commission should impose Neptune-like conditions on Murraylink. In particular, MEU argues that the following conditions would be relevant to Murraylink:

- ✍ MTC would not be permitted to withhold Murraylink's capacity by bidding above the price in the exporting region (accounting for losses). As a result, it would not be possible for MTC to sell rights to the physical capacity of Murraylink;
- ✍ All financial transmission rights would need to be auctioned through an open season process where no affiliates of MTC would be permitted to participate.

As described in the previous section, the Commission believes that requiring MTC to bid Murraylink at zero at all times, without having a regulated revenue stream, would directly impact on MTC's ability to recover the costs of providing the network service. It would also limit the range of products that an MNSP can offer to the market, such as hedging instruments to interregional traders. The Commission considers that such a condition would be inappropriate for Murraylink's circumstances.

With regard to open season auctions of financial transmission rights, the original code change application for introducing MNSPs into the NEM never envisaged that mandatory auctions would apply to MNSPs. MTC submitted its access undertaking with the understanding that amongst other means, MNSPs would be permitted to earn revenue in the NEM by selling physical and financial transmission rights to third parties. A decision to remove MNSPs' rights to sell financial transmission rights and then to impose open season auctions at this point would distort MTC's ability to earn a commercial return on its investment. Therefore, the Commission does not believe it is appropriate to mandate open season auctions for the sale of MTC's financial transmission rights.

Is the draft decision's recommendation for a revised undertaking appropriate?

As stated previously, the conditions suggested by TransGrid and MEU would effectively render what is intended to be an unregulated network service, a regulated investment. Under these conditions, MTC would face significant constraint from recovering the costs of providing the network service. Therefore, the Commission has focused on what it perceives to be a specific concern arising from MTC's access undertaking.

The key objectives of the Commission's condition were to:

- (a) be aware of the identity of the parties bidding Murraylink into the NEM; and as a result of this
- (b) have the ability to investigate potential trade practices breaches should they arise.

Uppermost in the Commission's considerations is the fact that MTC's access undertaking concerns an (unregulated) market network service, whose objective is to earn revenue by arbitraging inter-regional spot prices, is in accordance with the intentions of the Network Pricing and MNSPs code changes. MEU submits that the disclosure condition fails to appreciate how financial contracts can be structured to have an almost identical effect as a physical contract. However, if it appears that Murraylink has been bid anti-competitively, the disclosure condition as it currently stands gives the Commission a basis for commencing a Part IV TPA investigation, which would be likely to include details about MTC's contract cover. Financial contracts in the NEM are arranged and changed by NEM participants on a regular basis. Therefore, a condition requiring disclosure of financial contracts could involve MTC continuously bringing the details to the Commission in order to fulfil the terms of its access undertaking. The Commission considers that this arrangement would involve excessive regulatory intervention for an unregulated enterprise.

In light of the objectives for the revised access undertaking as set out above, the Commission does not consider that it is necessary for the disclosure of MTC's contract partner to be provided to NEMMCO. The Commission considers that if a trade practices issue arises from the way that Murraylink is bid into the NEM, then it will be able to draw upon the resources provided by NECA and NEMMCO to investigate potential breaches of the TPA and the code. Further, the Commission does not believe it is appropriate for the condition for MTC's revised undertaking to be extended to include disclosure to NEMMCO. The owner of MTC's physical transmission rights will have full control over the bidding of Murraylink. It is NEMMCO's role to schedule these bids in its dispatch process, without having regard to the associated financial markets. Additionally, the code's bidding and rebidding rules that apply to generators also apply to MNSPs. Therefore, it will be NECA's role to investigate apparent breaches of the code's rules. Meanwhile it will be the Commission's responsibility to address potential breaches of the TPA, should they arise.

In light of the market power concern that has been identified, the Commission considers that the condition for disclosure enhances transparency and provides the Commission with a basis for investigating potential breaches of the TPA if they were to occur. The Commission emphasises the point that it does not consider that a contract between MTC and a third party would be a *per se* breach of section 45 of the TPA. However, the

Commission believes that if the identity of MTC's contract partner remained unknown, the lack of transparency would exacerbate efforts to understand potential trade practices issues.

MTC noted that the Commission should have treated these concerns in a similar way to its decision on the Basslink access undertaking. In that decision, and in its authorisation of Tasmania's NEM entry¹⁵, the Commission raised similar concerns in relation to the Basslink Services Agreement (BSA). Under the BSA, Basslink Proprietary Limited (BPL) sold the bidding rights over Basslink to Hydro Tasmania, the dominant generator in that state. The Commission was also aware from the outset that Hydro Tasmania would control the bidding of Basslink.

Furthermore, the Tasmanian Government, in response to the Commission's competition concerns, undertook to require Hydro Tasmania to bid Basslink at zero prices on southward flows. The Commission considers that these arrangements enhance the transparency of the BSA, although the BSA is not immune from the competition provisions of the TPA. Therefore, the Commission considers that its expressed preference for disclosure of MTC's contracts, is an appropriate course of action for dealing with the concerns raised by MTC's original access undertaking, whilst not subjecting MTC to onerous conditions that effectively render Murraylink a regulated interconnect. Similarly, the agreement struck between MTC and its contract partner will not be exempt from the TPA either.

4.4.3 The interests of persons who might want access to the service

This is the counterpart to the 'legitimate business interests' criterion. It addresses the interests of access seekers. This criterion is directed towards achieving reasonable prices for access seekers. Prices should reflect efficient provision of the service and should not incorporate pricing designed to generate monopoly profits.

TransGrid argues that there is no certainty over the form of third-party access that should be provided by an MNSP in respect of an unregulated interconnector and how those access rights will be offered and priced. It states that the sale of electricity in a regional spot market does not constitute providing "access" to a transmission service as MTC's access undertaking and schedule 5.9 of the code appear to suggest.

As outlined previously, MTC undertakes to provide access to the Murraylink transmission capacity to the NEM through the bid and dispatch process overseen by NEMMCO. MTC proposes to provide this access through financial and/or physical contracts. The financial contracts will enable the purchaser to access the economic benefits that are generated by the operation of Murraylink. The physical contracts enable the purchaser to bid 100 per cent of the Murraylink Network Service into the NEM and receive the associated spot market revenues.

The Commission considers that Annexure A of the access undertaking sufficiently explains that MTC intends to offer access seekers the right to utilise the Murraylink

¹⁵ Australian Competition and Consumer Commission, Determination, Applications for Authorisation, *Tasmanian Derogations and Vesting Contract; Tasmania's NEM entry*, 14 November 2001.

transmission capacity in order to participate in, and receive the associated benefits of the interregional spot market and ancillary services market. The Commission therefore considers that the MTC undertaking will provide access to the Murraylink interconnector in a manner that is consistent with the criteria and the objectives of Part IIIA.

The Network Pricing and MNSP code changes directed that schedule 5.9 be inserted into the code specifically so that MNSPs could register as Network Service Providers (NSPs). The Commission considered that this was necessary to provide greater transparency and certainty to code participants about the obligations of NSPs. In turn, schedule 5.9 of the code requires MNSPs' access undertakings to specifically refer to the pricing provisions of chapter 3 of the code. The Commission considers that the wholesale market rules of chapter 3 are fundamental to determining the terms and conditions for access to market network services by the NEM.

It is also important to note that the price of access will be negotiated between MTC and access seekers. MTC, therefore, does not have the ability to unilaterally impose access prices on all market participants. As such, it is not in MTC's interests to set these access prices at a level whereby market participants choose not to contract with MTC. The fact that there are alternatives gives some assurance that an appropriate balance may be reached between the interests of MTC and of access seekers in relation to access prices.

The Commission also notes that the Murraylink interconnector will potentially add some 220 MW of transmission capacity into the Victorian and South Australian electricity regions. The Commission believes that the availability of this additional capacity generally promotes the interests of those seeking to transport electricity between South Australia and Victoria, such as generators, retailers and electricity traders.

TransGrid comments that it is inappropriate for the Commission to allow MTC to sell transmission property rights before the completion and Jurisdictional assessment of the reviews by NECA of facilitating firm access to the transmission network, and reviews of generator investment. However, the Commission does not believe that the Murraylink access undertaking will impede the outcomes of these reviews. As TransGrid has pointed out, the code does not explicitly provide for the sale of transmission property rights. However, the Commission notes that it is unclear whether NECA's review of firm access arrangements will be completed. The Commission considers that the sale of transmission rights is a commercial arrangement under the auspices of the code and the TPA and should not preclude the deliberations undertaken in those reviews.

MEU argues that MNSPs are required to submit access undertakings pursuant to Part IIIA of the TPA because of concerns about their market power. It is true that access undertakings constitute one part of the access regime, which is designed to facilitate access to facilities that are considered to be national monopolies, or bottleneck facilities, or facilities of national significance. The previous section discussed the Commission's views on MTC's potential arrangements with other market participants. However, while the Commission has identified some residual market power concerns, it considers that they largely do not correspond to access conditions in the same way as for regulated networks.

4.4.4 Whether there is an existing access regime

In some instances, a service provider may already be covered by a State or Commonwealth access regime. The Commission is required to consider whether access to the service is already the subject of such a regime. In this instance there is no access regime covering MTC's services.

4.4.5 Whether the undertaking is in accordance with an access code that applies to the service

The Commission is also required to consider whether the undertaking is in accordance with an access code. If the undertaking is in accordance with an access code, the Commission may accept the undertaking without following a public consultation process. However, as noted earlier, while the code includes a specific undertaking for MNSPs, this is a recent amendment and is not included in the industry access code accepted by the Commission.

5. Conclusion

MTC has submitted a revised access undertaking to the Commission in respect of third-party access to the Murraylink interconnector owned and operated by MTC. The undertaking was submitted pursuant to the provisions of Part IIIA of the TPA. The undertaking contains the terms and conditions of access to the Murraylink service.

In its draft decision, the Commission found that for the most part, MTC's undertaking represents an adequate basis for negotiating access to the Murraylink interconnector.

The Murraylink interconnector (220 MW) will potentially add to the power transfer capacity between the South Australian and Victorian regions. This has the potential to increase system reliability and promote further competition. Further, the Commission believes that the availability of this additional capacity will not only provide an alternative means of electricity transmission for access seekers, but also may ease capacity constraints on the existing Heywood interconnector.

However, the Commission considered that the original access undertaking raised some potentially significant competition concerns and hence did not satisfy the legislative criteria as set out in section 44ZZA of the TPA.

In the draft decision, the Commission stated that of the range of products offered by MTC, the sale of Murraylink's physical transmission capacity would appear to raise the clearest competition concerns. The Commission also noted that similar concerns might arise from arrangements between MNSPs and other market participants. The Commission was primarily concerned that the sale of Murraylink's physical capacity to a generator in an importing region may allow the generator to withhold the link's capacity so that pool prices in one region are higher than they would otherwise be.

While such conduct may potentially be subject to action under Part IV of the TPA, the Commission considered that under present NEM arrangements it would be difficult for it to detect any such arrangements without having a transparency mechanism in place. The draft decision therefore recommended that MTC amend its access undertaking to include a provision for the confidential disclosure to the Commission of the identity of parties to any agreement regarding the sale of Murraylink's physical capacity. The draft decision stated that if the access undertaking were revised to provide for the confidential disclosure to the Commission of the identity of parties to any agreement concerning the sale of Murraylink's physical transmission rights, then the undertaking should then be accepted.

MTC subsequently provided a revised access undertaking in accordance with the recommendation made by the Commission in the draft decision. The Commission believes that in doing so, MTC's access undertaking satisfies the concerns the Commission has raised in the draft decision, and revisited in this document. The Commission notes that MTC has confirmed its understanding that this access undertaking will cease to operate in the event that the Commission accepts MTC's application for the conversion of Murraylink to a prescribed service.

Therefore, the Commission has determined that MTC's revised access undertaking, should be accepted, having regard to the criteria set out in section 44ZZA(3) of the TPA.

6. Decision

The Commission's decision is that for the reasons set out in section 4 of this document, MTC's revised access undertaking should be accepted, having regard to the criteria set out in section 44ZZA(3) of the TPA.

7. Postscript

The Commission made the decision to accept MTC's revised access undertaking on 6 November 2002. Prior to that decision, the National Electricity Tribunal ('Tribunal'), on 31 October 2002, handed down its decision in relation to Trans Grid's proposed interconnector between South Australia and New South Wales ('SNI'). The Tribunal's decision is not addressed in the preceding reasons for the Commission's decision.

MTC had applied to the Tribunal for review of the decision made by NEMMCO on 5 December 2001 under the Code that SNI was justified. On 31 October 2002, the Tribunal (Justice Cripps and Professor Williamson in a joint decision) decided that SNI was justified. Professor McDonnell dissented.

The majority decision considers Trans Grid's submission that it would not be a proponent of the USNI option (an unbundled SNI which excludes the line from Buronga, NSW to Robertstown, SA) as MTC, as an unregulated interconnector, might so conduct itself that TransGrid's investment in USNI could become stranded. The majority decision concludes that the implementation of USNI would lead to a real risk of stranding or, at the very least, TransGrid's apprehension of the risk of stranding is real and not unreasonable. In the course of reaching this conclusion, the majority decision discusses the degree of Murraylink's market power (that is, its ability and incentive to reduce the amount of electricity it would allow to flow from Victoria to South Australia).

The Commission has reconsidered the decision that it made on 6 November 2002 in light of the Tribunal's decision. The Commission is satisfied that the Tribunal's decision does not alter the preceding reasons for the Commission's decision. The reasons for this conclusion are set out below.

In particular, the Commission's decision recognises that there are certain circumstances where MTC would have incentive to exercise market power. These include periods where there is peak demand in an importing region (for example South Australia), and the Heywood interconnector is constrained, thereby leaving Murraylink as the only available source of transporting power between Victoria and South Australia.

The final decision has taken these issues into account, and therefore, the Commission is satisfied that the decision on the MTC access undertaking is consistent with the Tribunal's findings. The Commission has accepted MTC's undertaking for the following key reasons:

- ✍ The Commission believes that Murraylink delivers considerable benefits to the NEM, including competition benefits, increased system reliability, additional power transfer capacity, and opportunities for providing firm hedging instruments to interregional traders; and
- ✍ The Commission has assessed the access undertaking in view of the fact that it concerns a market network service whose objective is to earn revenue by arbitraging interregional spot prices in accordance with the intentions of the Network Pricing and MNSPs code changes.

The Commission has concluded that it was appropriate to address the market power concerns that have been identified in this assessment through the requirement for MTC's access undertaking to include a disclosure provision for the details of MTC's physical contracts. Having taken the market power issues into consideration, the Commission believes that its treatment of the access undertaking adequately balances the public interest with the legitimate business interests of the service provider.

The code intentions for the participation of MNSPs are to develop competition and encourage prudent investment in market network services. Therefore, the Commission considers that subjecting MTC to conditions that directly impact upon its ability to recover the costs of providing the facility would not only be contrary to the code's intentions, but would also provide perverse signals for investment in market network services.