Regulatory issues

As a result of the Hilmer reform process, public utilities in many industries are either experiencing competition for the first time or are being encouraged to approximate competitive outcomes.

The Commission will play an important regulatory and administrative role in relation to public utilities. For example it will play a role in arbitrating disputes over access to facilities declared to be essential under the terms of the Trade Practices Act. It also has a role in the assessment of undertakings by owners/operators of facilities.

The following outlines the Commission's role in relation to airports, and the electricity and gas industries.

Airports

Background

In May 1994 the Commonwealth Government announced its intentions to develop an ownership-neutral regulatory regime for airports and to conduct a study into the possible sale of the 22 international, regional and general aviation airports across Australia, owned and operated by the Federal Airports Corporation (FAC), a Commonwealth statutory corporation. The regulatory regime was intended to ensure that the purchasers of airports were not able to abuse any market power arising from the monopoly characteristics of airport services.

The Government is aiming to complete phase 1 of the sales program before 30 June 1997. This involves selling separate long-term leasehold interests in Melbourne, Brisbane and Perth airports (phase 1 airports). Each of the phase 1 airports is being offered for lease separately on the basis that the successful bidder for each facility would acquire from the Commonwealth a 50-year leasehold interest (with or without an option for a 49-year renewal option) in the airport land and fixed assets. The Government expects that the remaining Federal airports will be offered for leasehold sale in one or more tranches following completion of the phase 1 sales.

Legislation enabling the leasehold sale of the FAC airports — the *Airports Act 1996* and the *Airports (Transitional) Act 1996* — was passed by the Senate, with amendments, and the House of Representatives on 12 September 1996.

The Commission's role in the regulation of privatised airports involves:

- administration of prices oversight arrangements;
- monitoring of quality of service; and
- assessment of undertakings lodged by the airports.

The Commission also has a possible role in the arbitration of airport access disputes in the event that an airport does not obtain an undertaking for the relevant services.

Prices oversight arrangements

There are several key aspects of the prices oversight arrangements. In particular the Commission will be responsible for:

- administration of the price cap for aeronautical charges, including the assessment of airport operator proposals for aeronautical charging increases outside the price cap associated with new investment proposals. (Aeronautical services include services related to aircraft movement areas, such as runways and tarmacs, and certain services related to

passenger processing areas.) The price cap is administered under the provisions of the Prices Surveillance Act. Prices will be set by Government Ministers on advice from the Commission;

- price monitoring of aeronautically related services, including services provided under domestic terminal infrastructure charges. (Aeronautically related services are those services which are not defined as aeronautical services but are related to processing passengers or handling freight and for which off-airport services are not good substitutes, such as aircraft maintenance, check-in services and baggage handling facilities);

- monitoring and evaluation of quality of service at the major airports against performance indicators. This is a requirement under the Airports Act;

- collection and publication of accounting and financial information on individual airports as a further measure to assist public scrutiny and comparison of airport performance. This role is permitted under the Airports Act; and

- review of pricing oversight arrangements as a basis for establishing the arrangements to operate after the first five years of the price cap.

The price caps will apply to core airports from the time of lease and will be announced in advance. Airports awaiting lease will remain subject to the provisions of the *Federal Airports Corporation Act 1986*, which means that the FAC aeronautical charges at these airports will remain under surveillance by the Commission. Core airports are Sydney, Melbourne, Brisbane, Perth, Adelaide, Darwin, Hobart, Launceston, Townsville, Coolangatta, Canberra and Alice Springs.

Assessment of undertakings

Section 192 of the Airports Act provides that airport services can be declared by the Minister, for the purposes of Part IIIA of the Trade Practices Act, 12 months after an airport lease has been granted unless an undertaking for the services has been accepted by the Commission.

The Commission will assess undertakings lodged by airports under normal Part IIIA provisions. If airport services are declared, the Commission may have a role in arbitrating disputes relating to access to airport services under the provisions of Part IIIA.

Quality of service monitoring

The Government has decided that service quality at major airports will be monitored by the Commission as a complement to the new prices oversight arrangements applicable to privatised airports under Part 8 of the Airports Act.

It is proposed that the monitoring program will relate to facilities provided by, or whose provisions can be influenced by, the airport operator. The monitoring program will not involve an assessment of airline performance or the service quality associated with domestic terminals owned and/or operated by airlines.

Monitoring quality of services will involve assessment of performance against a pre-determined range of quality of service indicators and public reporting of performance. The Commission is currently consulting with interested parties regarding an appropriate set of quality of service indicators.

The Australian electricity industry

Background

The reforms introduced, or being considered, in most States and Territories to facilitate competition in the electricity industry have involved the separation of integrated electricity authorities into independent bodies with responsibility for generation, transmission, distribution and retail.

The reforms have also involved the separation of regulatory and commercial functions in the electricity authorities (generation and retail

becoming part of the competitive market while transmission and distribution 'wires' will be regulated). The goal is freedom of choice of electricity supplier for all customers.

The independent electricity bodies are being corporatised in many States and Territories, and electricity distribution and generation companies have been privatised in Victoria.

In Victoria, market arrangements are in place whereby competition has been introduced between the generation bodies and a compulsory pool trading system is used for trade in wholesale electricity. Similar market arrangements have also been implemented in NSW. The arrangements in NSW and Victoria are broadly similar to the National Electricity Market proposals currently being considered by the Commission.

However, there is also recognition of the need to provide regulatory measures for those aspects of the electricity industry that cannot be subject to the discipline of competition — the transmission and distribution businesses. The monopoly characteristics of these operations means that, even with separation from generation, government regulation is required to ensure economically desirable outcomes.

National Electricity Market 1

The Commission is currently evaluating an application for authorisation for a new competitive electricity market arrangement (called NEM1) being established jointly by NSW, the ACT and Victoria to link the two State electricity markets — VicPool in Victoria and State Electricity Market in NSW. The ACT is a participant in the NSW electricity market.

The arrangement will align the two State wholesale electricity markets, incorporating a significant number of the proposed National Electricity Market (NEM) initiatives and, the applicants' submit, will enable an easier transmission into that market.

National Electricity Market

The next major development will be to establish interstate trading in electricity between the interconnected States (New South Wales, Victoria, South Australia, the Australian Capital Territory and, in due course, Queensland). The key characteristics of the proposed national market are reflected in the arrangements already in place in Victoria and New South Wales. These characteristics are:

- greater freedom for buyers of electricity (transitional arrangements are being put in place to open the market progressively to smaller buyers of electricity);
- non-discriminatory access to the inter-connected transmission and distribution networks;
- no discriminatory legislative or regulatory barriers to entry for new participants in electricity generation or retail; and
- no barriers to interstate or intrastate trade in electricity.

The arrangements for the national market will be encompassed within the National Electricty Code that has been developed by the National Grid Management Council. The NGMC was established to oversee the development of the market, including the creation of the framework rules that would govern the market's operation. The NEM code is the outcome of several years of deliberation and will form the basis of the national market's operation and provide for the regulation of the monopoly elements of the industry.

At the transmission level, the Commission has the task of determining revenue caps. It will continue to be involved in the development of competitive electricity industry arrangements through its:

- processing of the application for authorisation of the harmonised ACT, Victoria, and NSW State electricity market arrangements (NEM1);
- processing of the application for authorisation of the National Electricity Market arrangements; and
- consideration of the National Electricity Market access code and undertakings.

Post mid–1999, the Commission will take up a direct regulatory role in the determination of revenue caps for transmission services in the interconnected States and Territories. In the lead-up to that role the Commission is putting into place the systems that it anticipates will be needed to undertake the role.

Privatisations

The Commission also has a role in assessing proposed acquisitions of electricity assets under the mergers and acquisitions provisions of the Trade Practices Act.

The Australian gas industry

Structure

The Australian gas industry has been characterised by monopolies in production, transmission and distribution. The majority of Australian population centres, including Sydney, Melbourne and Adelaide, are therefore subject to monopoly power in the supply of gas.

The monopoly characteristics associated with the supply of gas in Australia are attributable to a combination of the following factors:

- high capital costs and risks associated with exploration and production;
- the absence of gas-on-gas competition and transmission pipeline interconnections;
- the lack of maturity of the Australian gas market; and
- the creation of long-term supply contracts.

Recent structural developments

New South Wales has historically been supplied by one joint venture producer monopoly. A competing joint venture from a different production basin is seeking to enter the market with the proposed construction of a new transmission pipeline. Once that pipeline interconnection is in place, inter-basin competition is expected to provide benefits to the customers in New South Wales. It may also provide benefits to Victoria and South Australia through the development of swap and back-haul arrangements.

Statutory access arrangements

Several legislative measures have recently been introduced by the Commonwealth Government to facilitate competition in markets traditionally served by natural monopoly facilities. These measures include the establishment of regimes for access to the services provided by natural monopoly facilities where access is required to enable third parties to compete in upstream and downstream markets. In particular, a generic national legislative regime to facilitate access to essential services has been inserted in the Trade Practices Act.

This regime includes provision for binding arbitration by the Commission of access disputes over services which have been declared to be essential, which includes gas transportation services. The legislation also provides for service providers to offer access undertakings to the Commission, and for State Parliaments to enact their own access regimes and seek accreditation of these regimes as effective under the Commonwealth legislative framework.

Several measures which are specific to the development and facilitation of competition in Australian gas markets have also been, or are in the process of being, undertaken. The *Moomba–Sydney Pipeline System Sale Act* 1994 applies to the transmission pipeline which links the production of gas in the onshore Cooper Basin with customers in Sydney and NSW regional centres. The Act contains provision for the resolution of disputes over access to the pipeline through binding arbitration by the Commission and provision for the approval of related-party contracts (between the pipeline operator, EAPL, and AGL affiliates).

Several State Parliaments have also enacted, or are in the process of enacting, gas industry-specific access regimes. There is a concern that the enactment of varying State access regimes in South Australia, Queensland,

New South Wales and Victoria may create inefficiencies in the regulation and provision of access to an interconnected network of gas pipelines which crosses State borders.

Inter-governmental gas reform initiatives

In order to address these problems of fragmentation and to develop an efficient national approach to gas policy and regulation, COAG agreed in February 1994 to a program of gas market reform based on guiding principles designed to achieve free and fair trade in gas by July 1996. These principles included:

- the removal of all remaining legislative and regulatory barriers to free trade in gas by July 1996;
- the implementation of complementary legislation so that a uniform national framework would apply to third party access to all gas transmission pipelines within and between jurisdictions by July 1996; and
- the introduction of legislation to ring-fence transmission and distribution activities in the private sector.

In order to achieve these objectives COAG established the Gas Reform Task Force (GRTF). With the assistance of industry and government participants, the GRTF developed a draft national uniform framework (or code of conduct) for access to transmission and distribution infrastructure. The key features of this draft framework include:

- approval by a regulator of reference tariffs and related terms and conditions proposed by facility operators;
- pricing and asset valuation principles to guide the regulator in assessing proposed access arrangements proposed by operators;
- processes for dispute resolution and arbitration of access disputes; and
- minimum requirements for ring-fencing of infrastructure businesses to separate them commercially from related businesses in competitive upstream or downstream markets.

It is intended that the code be extrinsic from but referred to in State legislation. Each State that agreed to implement the code and has enacted the provisions of the code would apply to the National Competition Council for a recommendation that the State access regime incorporating the code be declared effective.

In December 1996 the Prime Minister wrote to the State Premiers and Territory Chief Ministers seeking approval of the code. The State and Territory leaders were also asked to consider the best mechanisms for the regulatory oversight of the network. Options include a single national regulator, State-based regulators, and a mixed regime.

The need for a consistent access framework which is consistently applied and interpreted is significant for Australia as many transmission pipelines cross State borders. Variations in consistency could create uncertainty, which could be a deterrent to market entry.

In addition to developing a national access framework, the GRTF established a working group to address options for increasing upstream competition. The working group focused on the following issues:

- whether the services provided by gas processing facilities and gathering lines are 'essential services' and, if so, whether there is a need for access measures beyond the application of the generic access arrangements in the Trade Practices Act;
- whether existing acreage allocation and renewal processes restrict upstream entry and hinder upstream competition, and if so, options for reforming them; and
- whether upstream competition can be increased by removing obstacles to separate marketing by joint venture participants.

The Commission participated in the working group and assisted by obtaining legal advice on the application of the access regime to gas processing facilities.

The Commission's role in promoting gas market competition

In addition to its functions under the national access legislation, the Commission has two other roles which influence the state of gas market competition — enforcement of competition law and authorisation/adjudication.

The Commission's enforcement role includes oversight of anti-competitive mergers and acquisitions. The mergers function was used in 1992 in the gas industry to prevent the merger of Santos, a major gas producer with contractual interests supplying gas to South Australia and New South Wales, with SAGASCO, the sole distributor of gas in South Australia.

The Commission's authorisation/adjudication role is relevant to several major gas supply contracts. Several supply contracts in Australia currently have authorisation protection. The Commission completed a review of the authorisation of the AGL Cooper Basin supply arrangements in March 1996 where it revoked authorisation protection for certain anti-competitive clauses. In the Commission's view, these clauses restricted the development of inter-basin competition to supply customers in NSW. In revoking this protection, the Commission took into consideration the reforms that have been taking place in Australian gas markets to facilitate free and fair trade in gas.

When releasing the authorisation determination the Commission took the opportunity to identify actual and potential barriers to competition in gas markets. It has since sought to focus attention in various public forums on these barriers and the need for their removal.

The Commission's revocation has been appealed to the Australian Competition Tribunal by the Cooper Basin Producers. The appeal (which is a review process involving a complete re-hearing) will be heard in March 1997.