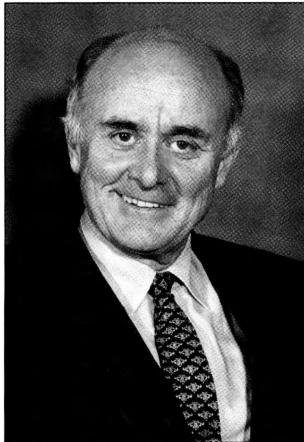


The roles and functions of the ACCC in energy regulation: current issues



This is a summary of the Chairman's presentation to PriceWaterhouse-Coopers in Western Australia on 29 March 2000. In it he discusses the current trends in the reform of energy markets which have been a major feature of micro-economic change in recent

years. He also pays particular attention to the outcomes that should be the focus of future regulatory thinking and decision-making.

The need for genuine markets

The challenge for governments is the creation of an environment that allows competition to deliver benefits to consumers. This means not only that governments adopt pro-market solutions as a first best to delivering efficiency and greater choice to customers, but that the regulatory framework is also made consistent with the development of genuine markets. Both the electricity and gas sectors are currently in transitional stages of reform, gradually moving to open competition, where the regulatory function can play a key role in facilitating the progress of reform, the provision of access and the establishment of trading regimes.

In electricity, the transition to competition in the National Electricity Market has started with a broad program of industry restructuring. It has involved vertical and horizontal separation, the creation of independent and transparent regulatory regimes and the corporatisation of government-owned businesses and the

privatisation of some of these. Structural reform, particularly the separation of monopoly and contestable elements, is vital for getting the fundamental drivers of competitive markets right in the first place. I think there are important lessons to learn from the reforms in electricity in the east that may be useful to consider here in Western Australia.

Another example of this is the gas industry. While much of the effort has gone into worthwhile mid and downstream reform, upstream reform of producer arrangements is still critical to the creation of genuine competition in this area. Indeed, it can be argued that the reduction in gas costs in Western Australia is in some part due to the Government's move to reform the upstream arrangements on the North West Shelf.

Nevertheless the benefits of reforms can easily be lost if transitional arrangements have the effect of eliminating the key elements needed to establish competitive markets.

Competition and regulation

Where the creation of competitive markets is not feasible, robust and independent regulation becomes an important factor. In the context of the energy market, regulation of the transmission and distribution infrastructure is perhaps one of the major outcomes of the reforms in the energy sector. The notion underlying regulation of key infrastructure assets is that access to certain facilities with natural monopoly characteristics, such as electricity grids or gas pipelines, is needed to encourage competition in related markets, such as electricity generation or gas production. Problems arise when owners of such infrastructure facilities may be in a position to inhibit or distort competition in upstream or downstream markets. Where they are vertically integrated into competitive upstream or downstream markets, the owners of such facilities may also have additional incentives to restrict competitor access to the facilities' services in those markets or to offer terms and conditions of access which discriminate against them.

Reforms in the National Electricity Market

Most of you will be aware of the establishment of a national electricity market (NEM) in Queensland, NSW, ACT, Victoria and South Australia. Soon Tasmania may also join this market. The establishment of the NEM followed a period of structural separation, introduction of competitive supply and creation of a market at the wholesale level. While the NEM has been operating since December 1998 and many issues are to be resolved, it can be claimed that the creation of an effective market has delivered major benefits to electricity consumers.

Western Australia is somewhat different from the NEM both in terms of the scale of the market and the extent of reforms introduced. Nevertheless, the outcome of the NEM has demonstrated that major efficiencies can be gained from introducing competition where possible, and by creating an independent and transparent framework where regulation is necessary. It may also mean that even in a small market like Western Australia, some benefits may be achieved through structural reforms. The separation of the transmission and distribution system from the competitive functions of generation and retail, and opportunities for the competitive introduction of generation should not be overlooked.



Gas reforms

As set out in the Natural Gas Pipelines Access Agreement entered into by all Australian governments in November 1997, the West Australian Government appointed an independent State-based regulator to apply the

National Gas Code in Western Australia to both transmission and distribution pipelines. The independent regulator is supported by the Office of Gas Access Regulation. This means that the Commission's role regarding natural gas in Western Australia is primarily to enforce the Trade Practices Act. This has involved investigating agreements that may have the effect of substantially lessening competition and advising parties about the competitive implications of proposed mergers and acquisitions. The Commission has also considered applications for authorisation of joint marketing, such as its determination in July of 1998 on the proposed North West Shelf Project expansion.

As in electricity, the key to having gas markets working well is to have appropriate structural separation, with competition continuing to develop in the upstream sector and barriers to entry removed to allow competition in the retail sector.

Regulated industries and the GST

In August 1998 the Commonwealth Government proposed a New Tax System (NTS) for Australia. Part VB of the Trade Practices Act prohibits price exploitation in relation to the NTS changes and confers a number of statutory responsibilities on the Commission, including a requirement that the Commission formulate guidelines about when prices for regulated supplies may constitute price exploitation. Regulatory regimes, with approval by the relevant regulator, generally do entail pass-through provisions given special circumstances — the NTS is such a circumstance. However the approved pass through needs to be consistent with the Commission's price exploitation guidelines.

Fully passing on the GST without considering the whole tax package and its implications for regulated industries would undermine the Government's objective to limit price increases to consumers and would contravene the Commission's guidelines. The Commission has been working with the jurisdictional regulators to formulate an acceptable adjustment mechanism for regulated industries that comply with the guidelines.

Ring fencing

A further area of concern is the ongoing relationship between contestable and regulated sectors, once these markets are fully competitive. The ring fencing arrangements required for electricity market participants have been an ongoing source of debate in Australia. Regulated transmission businesses have some opportunities now and will have more into the future, to develop sources of income that are outside of the regulated income of the business (for example, using the existing infrastructure to provide telecommunications services, as well as transferring power supplies).

Convergence and mergers

We are seeing a growing trend towards multi-utility companies in recent years as both the gas and electricity markets develop, particularly in NSW and Victoria. However, the Commission is conscious that although multi-product utilities may deliver real efficiencies and promote a dynamic competitive environment, it may undo the structural reforms of the markets. Energy markets are a long way from maturity, so the Commission will continue to scrutinise multi-product mergers to ensure that a significant lessening of competition, whether through increasing market power or the removal of competitive pressure, does not occur. Furthermore, the Commission has strongly supported both horizontal and vertical separation within the energy sector and therefore will look carefully at any proposal that would have the effect of recombining, either vertically or horizontally, currently separated entities. Of course each case will be judged on its merits and it is not possible to predict the outcome of hypothetical Commission decisions on hypothetical mergers of the energy industry.

Conclusion

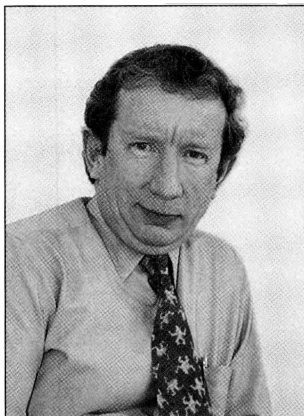
Important challenges lie ahead in adapting and refining regulatory approaches to the changes that are now underway in the energy sector. The Commission is keen to ensure that effective competition be introduced where possible, and to pursue any anti-competitive detriment. However, there are cases where this is not possible, for example, transmission and distribution networks are natural monopolies.

Therefore, effective regulation needs to be implemented to ensure that an efficient and fair outcome can be achieved. While the industry has gone some way towards achieving these efficiencies, there is still a long way to go.

Erratum: In the forum section of Journal 24 (page 43), some text from an article on the Prices Surveillance Act was inadvertently included (as the third paragraph) in the next article on Consumer policy in the European Community.

Appointment

New CEO arrives at the ACCC



Mr Brian Cassidy will start as Chief Executive Officer of the Australian Competition and Consumer Commission in July 2000.

Mr Cassidy replaces the long-standing CEO, Mr Hank Spier, who has decided to retire

from the position and take on consulting work for the ACCC as well as other organisations and government bodies.

Mr Cassidy comes to the ACCC from the Department of Prime Minister and Cabinet.

Previously he worked in Treasury where he had a long and high profile career. He has already had regular dealings with the ACCC having been instrumental in overseeing and drafting reforms of the National Competition Policy Review (the Hilmer Report) in the mid-1990s.

These changes significantly expanded the ACCC's role.

Mr Cassidy holds a Bachelor of Economics (Honours) from the University of Sydney and Master of Economics, Australian National University. He joined Treasury in 1973 and rose through several areas including banking, non-bank financial institutions, monetary policy, industries policy, fiscal policy and structural policy.

In January 1999 he transferred to Prime Minister and Cabinet to become First Assistant Secretary of the Industry and Environment Division. He was responsible for policy advice

in the areas of industry policy, environment, infrastructure, competition policy, resources, energy, transport and communications.

He was also responsible for the Commonwealth-State secretariat and issues relating to the Council of Australian Governments.

Mr Cassidy described the ACCC as 'a really interesting place these days. It has gone from being purely an enforcement agency to an important economic regulatory organisation, yet keeping a strong enforcement role'.