Submission to the Productivity Commission review of the National Access Regime

CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

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1 INTRODUCTION AND BACKGROUND

Introduction

This submission details the response of the Chamber of Commerce & Industry of Western Australia (CCIWA) to the Productivity Commission's inquiry into the national access regime. It examines the issues arising from current access arrangements and draws on experiences with arrangements existing in Western Australia's electricity, gas and rail sectors.

CCIWA is strongly supportive of competition policy in general and has in the past called on governments at both Commonwealth and State levels to implement National Competition Policy more vigorously and comprehensively.

CCIWA is also in broad support of the intention of National Competition Policy to ensure that businesses get fair and reasonable access to essential infrastructure services, whether the public or the private sector owns the infrastructure concerned.

However, CCIWA has a number of reservations about the current or possible future application of competition policy principles in relation to access, which we would like to draw to the attention of the Productivity Commission in this submission.

History and Overview of Regulation and Deregulation in Western Australia

Since the early to mid 1990s, and in part stemming from the 1995 Competition Principles Agreement, the Government of WA has implemented reforms designed to provide third party access to essential infrastructure. The aim has been to increase competition and to lower prices for consumers, with access being only part of a broader reform process. The pace of these reforms in the gas and rail sectors has outstripped those in the electricity sector.

Table 1 shows timelines of major reforms/developments in these three industries that relate to access to third party infrastructure.

Electricity

Partial competition reform has been undertaken in the WA electricity sector. The State Government's overarching agenda has been that Western Australia is best served by preserving the incumbent vertically integrated utility (Western Power) while encouraging the involvement of private sector generation around it by lowering access levels. The National Electricity Code does not apply in WA.

The State Government's approach to competition-based reforms in the electricity sector has not delivered the hoped-for gains. Research commissioned jointly by CCIWA and the Chamber of Minerals and Energy of WA and published in 1999[1] found that WA's performance compares unfavourably with that realised in the Eastern States Electricity Market and in the WA gas sector.

For example it found that, *"Western Australian prices started relatively high and have become higher than the Eastern States over the past four years. Western Australia has lost and will continue to lose industrial projects to other States and overseas because of its relatively high electricity prices."* (pages 1-2) and that *"Western Australia has made limited*

[1] 'Microeconomic Reform in Western Australia: Electricity', ACIL Consulting, October 1999

progress towards achieving competition in electricity supply. In comparison, it has made substantial progress in reforming the gas industry."

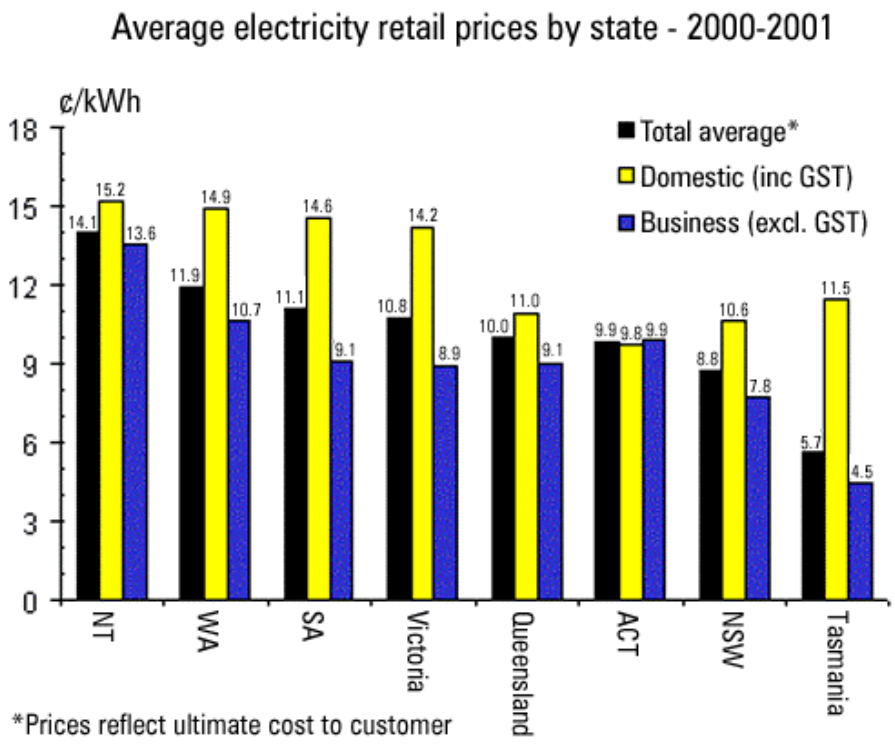
Western Power does not accept this analysis. It argues that WA's system reliability is close to the best in Australia, that tariffs for franchise customers are similar to those in the eastern states, and that prices for large customers are on a par with South Australia, which, Western Power argues, is the most similar Australian market to WA.

Determining appropriate benchmarks for comparing utilities' performance in diverse markets has become virtually a discipline in itself. The most recent data from ESAA's website, giving data for 2000-01, suggest that WA's average electricity charges for domestic and business users are high by Australian standards (second only to the Northern Territory), but not much higher than in South Australia (Figure 1). Western Power contests the validity of this comparison, arguing that average costs fail to take sufficient account of different pricing structures and demand conditions (such as industrial bases and climatic conditions).

CCIWA believes that the evidence in the WA electricity sector suggests that establishing access to an integrated utilities network may be a necessary, but is by no means a sufficient condition to develop robust competition. For competition policy reform to be effective it is also necessary that:

- the different markets (generation, transmission, distribution and retail) within the electricity industry be effectively segregated, and where feasible opened to competition (preferably through divestiture rather than ring fencing),
- an independent electricity access regulator is appointed, and
- a market mechanism such as a pool system is developed which allows electricity and standby power to be traded.

Figure 1



Source: Data from ESAA "Electricity Prices in Australia 2000-2001", graphic copied from website http://www.esaa.com.au/head/portal/informationservices/prices/electricityprices2000-2001/

Box 1: Deregulation Time Line

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The current access regimes covering Western Power's transmission and distribution networks have not been declared by the National Competition Commission (NCC). As part of the ongoing Triennial Review of pricing for access to Western Power's electricity transmission and distribution system, CCIWA recommended that, if certain information was not released, it would be wise to submit the finalised regulatory pricing principles and associated methodology to the NCC for ratification. The unavailable information pertained to advice received by Western Power on the calculation of the weighted average cost of capital for the transmission and distribution network, Western Power's proposals on asset depreciation, and Western Power's operations and maintenance costs. This proposal was rejected by the OoE.

Gas

As Box 1 shows, there has been significant reform in the WA gas sector. These reforms, which are in line with and to some degree stem from the CoAG initiates of the 1990s, have delivered a competitive gas market. Reform in this area has resulted in a number of competing suppliers, a privately owned and separate transmission entity, a privately owned and ring fenced distribution/retailing entity (ring fenced as per the National Third Party Access Code for Natural Gas Pipeline Systems (Code)) and access conditions regulated by the independent Office of Gas Access Regulation (OffGAR) in accordance with the Code.

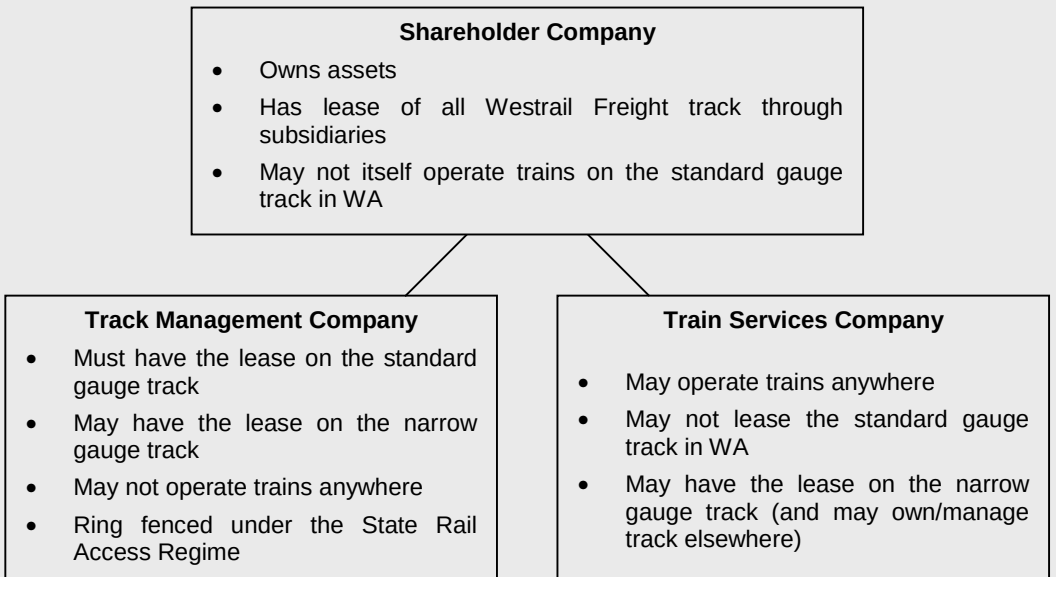
Customers have generally embraced the increased level of competition that has arisen from the granting of access to gas pipelines. The lowering of the access threshold, in accordance with a strict access threshold reduction timeline, has delivered substantial price drops to contestable customers in this sector. Price reductions are expected to be delivered to smaller business customers as the threshold for contestability is lowered further (currently 100 TJ/year), reaching zero on 1 July 2002.

Rail

CCIWA has supported the establishment of third party access to the WA rail freight network. It recognised the desirability of selling the track and freight rail businesses, in line with WA government policy. Under continued Government ownership Westrail's Freight business would almost certainly have performed poorly in the increasingly competitive environment that will result from national deregulation. Westrail requires the funding opportunities and flexibility that private ownership confers.

However, CCIWA had some initial concerns about the track network and the above-rail freight transport business being sold as a single unit. Ownership of the track and operation of services could potentially inhibit competition and provide incentives for the track owner to impede access by potential competitors. However, the strong ring fencing requirements and planned appointment of an independent access regulator (originally planned to come under

Box 2: Possible Westrail Ownership Structure



the auspices of Department of Transport, the latter recommendation flowing from a National Competition Council certification process), CCIWA and industry generally are satisfied that the benefits of constrained vertical integration justify this approach. Low volume regional railroads are most efficient if vertically integrated, and sale on a disaggregated basis might not have attracted a high calibre of bidders.

The ownership structure proposed by government for a privatised Westrail prior to sale is depicted in box 2.

Under the government's model, the standard gauge track had to be leased by a dedicated track management company that does not run trains. The narrow gauge track (the regional services network) would be leased by a dedicated track management company or a company that also runs trains.

The ring fencing model will ensure transparency regarding management and the financial operations of the above and below ground rail assets, without the full costs of separation. CCIWA understands that the ownership structure being put in place by the new owner of Westrail, Australian Railroad Group, incorporates greater structural separation than was required by the WA Government.

Significantly, under the ring fencing provisions the standard gauge track is separated from the narrow gauge track. This should improve the prospect of competition in the intra-state rail freight market. The Australian Rail Track Corporation was offered the opportunity to bid for the standard gauge track as part of a consortium but was not successful.

The legislation enacting the independent access regulator is provided for under the Government Railways (Access) Amendment Bill 2000, which has passed through both houses and is awaiting assent.

2 Issues and Principles in Access Regulation

Access Regulation is a 'Third Best' Solution

In a competitive market with many players and no artificial or natural barriers to entry, the issue of access to essential infrastructure would not arise. If a business refused to sell infrastructure services to another business then the potential purchaser could either buy those services from other providers or invest in their own infrastructure.

Even in a naturally monopolistic[2] market, the key market failure likely to arise in the delivery of infrastructure services lies in the incentive and capacity of the monopolist to charge higher prices than a business facing competition. But it would make no sense to refuse to sell any services at all to a potential customer or group of customers, as long as they are prepared to pay the monopolist's price.

To refuse to sell infrastructure services even if to do so would increase profits in one segment of the market is only logical for an infrastructure owner if selling the service lowers profit in another segment of the market, and that in turn is likely only if the business seeking access is an actual or potential competitor. And for a 'natural' monopolist owning infrastructure, this can only happen if the infrastructure owner is operating not only in a part of the market which is a natural monopoly, but also in markets which are, or have the potential to be, competitive.

In short, a vertically integrated monopolist with operations in potentially competitive markets is most likely to have a reason to deny access.

In such a market, the 'first best' solution for a regulator would usually be to separate out the various stages of vertical integration and, if possible, to introduce horizontal competition as well within each segment of the market, so that no effective monopoly power remains.

Where part of a market is a 'natural monopoly', at least one of the stages of production is likely to remain in the hands of a single owner.

For example, a railway operation might be broken up into a track owner and several transport service providers owning rolling stock. The track network itself might remain a single entity as a 'natural' monopoly, but many current and prospective firms could operate transport services on the tracks. If so, that monopolist track owner will probably be subject to all the processes of competition policy regulation, including price regulation, in order to reduce the inefficiencies which monopolistic markets typically create. But such a monopolist will no longer have any reason to deny access to the infrastructure for any transport service provider.

The 'second best' solution is therefore to separate the monopoly from the potentially competitive segments of a vertically integrated business. This still raises the prospect of higher pricing, lower servicing and inefficiency inherent in monopolistic markets. But it at least ensures that the monopolist has no incentive to deny access to potential competitors upstream or downstream in the production process.

In any market which requires an access regime, there must by definition be either a vertically integrated monopolist with the opportunity to exclude a potential customer because that

[2] A natural monopoly is a market where a single business can meet the whole market demand more cheaply than two or more businesses, typically because start-up costs are very high and/or the delivery of services requires the operation of large-scale physical capital which it is inefficient to duplicate (such as sewerage pipes).

customer is also a potential competitor, or some other unusual factor/s at work which might provide an incentive for the infrastructure owner to deny access.

Getting the market structure right has taken on added importance in the context of the recent tendency of governments to privatise business enterprises which have, or had, monopolistic characteristics. Although a privately owned vertically integrated monopoly is inherently no more likely to exploit its market position than a government monopoly, it is more difficult and costly to correct inefficient market structures once a business is privatised. This issue was dealt with at length in the Hilmer Report, which addressed the need for structural reform of government monopolies, and the separation of natural monopoly and potentially competitive elements, and the particular importance of structural reform prior to privatisation[3].

Western Australian Issues

WA's experience in the electricity market points to both the difficulties which can arise in implementing competition policy, and the problems which can be created if it is not implemented wholeheartedly.

CCIWA maintains that a major impediment to competition in the WA electricity sector is the continued vertical integration of Western Power. This is at odds with the principle inherent in the Competition Principles Agreement that the natural monopoly elements of a government monopoly should be separated from the competitive elements, and that vertically integrated monopolies should be split.

In WA, Independent Power Producers (IPPs) must negotiate access prices and conditions, including standby options, with their major competitor in generation (Western Power). Furthermore, the process for drafting and approving access regulations is overseen by the Electricity Access Steering Committee, which is composed only of representatives from the Office of Energy (OoE) and Western Power.

The Government and Western Power maintain that ring-fencing of Western Power's transmission and distribution operations fosters competition, while maintaining a vertically integrated operation delivers efficiencies through economies of scale and scope.

A study of scale and scope economies in power generation and its application to WA has been commissioned by and produced for Western Power. It found that the loss of scale and scope economies if Western Power was broken up into competing units would add to aggregate costs. Although not formally released as a public document, it has been distributed for comment to CCIWA and others. We have forwarded preliminary comments on its finding and analysis to Western Power, but we have yet to discuss its findings in detail with either Western Power or CCIWA's main members with interests in this area.

Meanwhile, in December 2000 the WA Government announced that its reforms of the WA electricity market would allow Western Power to remain an integrated utility operating in generation, transmission and distribution, while lowering but not eliminating the threshold for competition. A copy of the Minister's press release is attached as the first press release reproduced in Appendix 3.

Many businesses are sceptical about whether ring-fencing can ever be truly effective, an important consideration when Western Power needs not only to deal fairly with potential competitors in fact, but also needs to be seen to be doing so.

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[3] 'National Competition Policy', Report by the Independent Committee of Inquiry, August 1993, AGPS, pp 216-226

Box 3 contains comments sent to CCIWA by Mr Ky Cao, managing director of Perth Energy Pty (an independent power retailer and competitor), during our consultation with members in the preparation of this submission, concerning the relative market power of Western Power and its potential competitors.

Western Power's response to these comments was equally forceful: *"I appreciate that, as a competing energy retailer, he will have a firm position on this matter, as well as a vested interest. It must be accepted however, that his position is not universally held by all members of CCI, and that some parties, including Western Power obviously, have fundamentally different views"*

CCIWA acknowledges that neither Western Power's view nor Perth Energy's represents the unanimous opinion of our membership.

However, both sets of comments serve to illustrate the difficulty which vertically integrated monopolists have in persuading potential competitors of their good intentions.

CCIWA welcomed some of the government's recent policy changes, but was disappointed that it did not move further down the path of deregulation (see second press release in Appendix 3).

CCIWA maintains that many of the impediments to competition in the WA electricity sector would be overcome if Western Power were disaggregated. Structural segregation has the effect of removing both the ability and the incentive to restrict competition.

At a minimum, the transmission and distribution sections of Western Power should be spilt off and corporatised. The new company would have its own management and own board. Ideally, Western Power should be split into 3 or 4 corporate divisions - generation, transmission, distribution and retail with the distribution and retail division effectively ring fenced. It may be open to debate whether distribution should be grouped with retail or with transmission, or be a totally separate entity, but during consultations in the preparation of this report one member argued strongly that combining distribution and retail "*… would be a frightening option with the 'monopoly' retailer having control over access to the*

Box 3: Comments on WPC

"WPC (Western Power Corporation) is holding tight to base load generation monopoly and leaves the less viable mid-merit and peaking capacity job to IPP. This is shown in WPC re-powering Kwinana for base load, not bidding for the first procurement round of 240+120MW mid-merit plant, then coming back in for the base load capacity in the second procurement round.

"Leaving the procurement job in WPC's hand, chaired by an independent person, is giving WPC carte blanche to prevent IPP capacity being installed for the purpose of supplying the contestable market directly. In this arrangement, IPPs are there only to service WPC. They are expected to install, at their cost, least cost mid-merit capacity for WPC to supply the market. If an IPP shows any signs of planning for a larger plant than what is required to supply the 360MW total WPC needs, it may not be chosen. What would guarantee the market that an invisible 360MW cap will not be placed on the bidders? Would an independent chair be able to see through the overwhelming technical details that the WPC procurement team could dump on him / her in picking a winning bid?

"The policy steps again put the cart in front of the horse. Dealing with generation while leaving network access untouched is strange. In terms of accessibility to contestable customers, there is no change. Can IPPs trust WPC network businesses to fight for their interest while answering daily to the integrated WPC executive and board? The Minister said integration is needed to help WPC commit to large capital expenditure to develop the network in order to develop the state. But network revenue is guaranteed by regulations. Separating network out of WPC will not affect state development from a network augmentation viewpoint. It has nothing to do with integration or WPC's other (competitive) businesses.

"WPC said we had to deal with generation now and the market structure later because we don't have time to do the other way around. This is saying the industry / consumers should pay for the lack of foresight and action by Government and WPC over the last 5 years.

"The end result for contestable users is, don't count on getting cheaper electricity. WPC will get cheaper power from IPPs through public procurement but will sell this power into a largely captive market, half franchise and the other half protected by a network access regime designed and implemented by WPC itself."

"We would also like to add that in our view, half-hearted reform can sometimes be more damaging than no reform at all. Corporatisation of WPC releases the utility from the constraints

distribution network." It was also argued that the currently combined transmission and distribution activities of Western Power are much more profitable than the rest of the organisation, making access costs higher than necessary and raising the possibility of cross-subsidisation.

Within generation, it may be appropriate for further horizontal segregation to encourage generator-on-generator competition.

This would be consistent with the market structure in the WA gas industry.

The application of stronger ring fencing requirements to Western Power is a second-best option. Regulatory alternatives may curtail the ability of a vertically integrated utility to interfere with competition, but they do not address the incentive issue.

> …of a public sector organisation, but failure to introduce effective competition leaves WPC with unparalleled market power. eg., WPC is no longer subject to FOI legislation (as it is now corporatised), yet it is allowed to design and implement open access as it pleases like it was a public policy body. "Commercial confidentiality" is used to protect it from public scrutiny usually reserved for a public sector body, while lack of competition protects it from market discipline.
>
> WPC has the best of both worlds.
>
> **- comments from Mr Ky Cao, Managing Director, Perth Energy Pty, during CCIWA membership consultations on energy market deregulation.**

At a minimum, adoption of the legal separation ring fencing requirements of the National Gas Code (regulated entities to be contained within a separate legal entity, as recognised in the Corporations Law) would be preferable to the current ring fencing requirements provided for under the Electricity Corporations Act 1994 which are perceived by industry as being ineffective.

It would no doubt have been preferable for ownership separation to have been required at the time Western Power was established in 1994. In the event that the WA Government decides in future to privatise Western Power (an outcome Western Power's Managing Director publicly supports) then a satisfactory resolution of these issues will take on much greater urgency, not least because sovereign risk associated with shifting regulatory goalposts is emerging as one of the key concerns of businesses which have bought privatises entities (see below).

However, even a bungled privatisation can be rectified at a cost. Recent experience in New Zealand has shown that policies for ownership separation can be introduced, and implemented, even at a late stage in the reform process. But this is a second-to-worst solution, being a superior outcome to leaving monopoly power in a vertically integrated monopoly, but inferior to sorting out the corporate structure and competitive environment before privatisation.

In contrast, the access issue in WA's rail privatisation was more finely poised. While concerns about the potential for a track owner which also operated freight services are in principle identical to those in other markets such as electricity, a well-established and growing competition existed in rail (indeed, the imminent introduction of full-blown above-rail competition was the most important reason for privatising Westrail).

Further, analysis of the regional, narrow-gauge segment of Westrail's operations presented a plausible argument for efficiencies from co-ordination which could be lost if track ownership and service delivery were separated. And the internal ring fencing and separation within the rail operations appear, at least on paper, particularly rigorous. For these reasons, CCIWA came to accept that its concerns about the privatisation of Westrail as an entity which both owned the rail network and provided freight services had been addressed. Of course, we will not see how well the new regime works in practice until the legislation receives assent and the privatised arrangements start to operate.

The respective functions of the Access Seeker, the Owner, the Regulator and the Arbitrator, together with the access information requirements, level of public consultation and enforcement have been developed for the new WA rail regime and are available from the WA Department of Transport.

How to Regulate

The Issues Paper which accompanies this Productivity Commission Inquiry asks, "*Should access regulation be in the form of a national regime, industry-specific arrangements, or a combination of both?"*

There is a third possibility which is in fact the default regulatory arrangement in many states (not, unfortunately, in Western Australia) and which combines the benefits of each approach, though with other associated difficulties. A single regulator could cover a range of industry sectors but be located and operating within a State, not national, jurisdiction.

Western Australia at present operates separate regulatory structures for its gas, electricity, rail, and other transport operations. In some cases the regulated agency has formal involvement in the development and operations of the regulations which govern it. CCIWA has a strong preference of a generic cross-industry regulator, for a number of reasons:

- It is administratively efficient, and avoids duplicating expertise and experience across agencies. Many issues arising in the conduct of regulation and price surveillance are common to different industries and circumstances. A generic regulator would acquire depth of knowledge and experience unlikely to be found in a plethora of small agencies.
- It reduces the risk of 'capture' of the regulatory agency and its officers by the businesses it is supposed to regulate. It is in the interests of business to devote significant resources to influencing the opinions of those public servants whose decisions could influence or determine their regulatory environment. It is in the interests of regulators that they minimize conflict and ensure the longevity of the regulatory regime they administer.
- It allows consistency and intellectual rigour in the application of policy across industries and activities. For example, some of the competition policy reviews undertaken by WA government agencies when reviewing the regulations they themselves police can most kindly be interpreted as lacking a clear understanding of what National Competition Policy requires. The review of the Potato Marketing Act which concluded that WA consumers benefit from reduced choice and higher prices was especially noteworthy.

In WA there are also concerns about the political as well as the administrative allocation of responsibility for regulation. CCIWA maintains that the regulatory and commercial functions associated with an industry should fall under separate ministerial portfolios. A minister with responsibility for the commercial operations of a government business enterprise is responsible for ensuring that the government's assets are managed responsibly and generate an acceptable rate of return. An industry regulator has very different objectives, which may relate to environmental management, price oversight, service quality and/or consumer protection but which will certainly conflict with the business' commercial objectives.

These issues would equally be addressed by a national or state based regulatory regime. A national regime would have two additional advantages. Firstly, it would be further removed from the possibility of capture and political interference, especially in the case of privatised formerly state-owned enterprises where business operators, public servants and politicians have become used to close working relationships over the years.

Secondly, it would allow for consistency and transferability of practices between jurisdictions, with businesses having reasonable confidence that activities which are

permissible in one state are permissible in all states.

Despite these benefits, CCIWA's preference is for a generic, state-based regulator.

Although CCIWA is generally highly supportive of the principles and objectives of National Competition Policy, it has long held the reservation that the emphasis on consistency and uniformity of National Competition Policy (and particularly the Hilmer Report) has the potential to inhibit competition[4]. Long before National Competition Policy was formalised, States were implementing reforms and restructuring along the lines which National Competition Policy advocated and for similar reasons.

Uniform regulation has the potential to inhibit competition. For example, under the old centralised wage system businesses had little incentive and few opportunities to achieve competitive advantages through innovative human resource management strategies. Businesses are more willing to tolerate onerous or costly regulation if their competitors carry an identical burden. More generally, the concept of *competitive federalism* suggests that inter-state rivalry in regulatory, taxation and spending regimes is a source of efficiency, innovation and improvement in the same way that rivalry between businesses creates these effects.

The principle of *subsidiarity* suggests that the costs and benefits of government action and regulation should, as near as possible, fall within the same community. Nationwide regulation is appropriate either where activities in one sub-national (State or local) jurisdiction have clear and significant costs or benefits in another jurisdiction, or where there is unanimous agreement that uniform regulation is necessary.

This is not merely a concern of abstract political theory; it has considerable relevance for the operation of government policy in practice. It is much easier to gain political capital by 'robbing Peter to pay Paul' when Peter and Paul are not neighbours. While aloofness from the rough and tumble of local politics might make for a better, more dispassionate regulator it can make for worse, less outcome-focussed political decision-making. And in the final analysis it is politicians, not regulators, who decide on the most controversial regulatory decisions.

This may provide the explanation for recent Commonwealth decisions like the maintenance of high vehicle tariffs, or proposals such as the use of Commonwealth funds to finance dubious projects such as the very fast train and the Alice Springs to Darwin railway (in the latter case, despite the fact that the South Australian and Northern Territory governments are seeking to apply a local content requirement which would deny businesses from other states the right to tender for more than 30 per cent of contracts).

Western Australian Issues

The experience in WA's electricity sector has highlighted the necessity of an independent access regulator with the powers to enforce access under fair and reasonable terms. Under the current system in WA the OoE employs 'light handed' regulatory methods to establish access conditions and prices for access to Western Power' network. Western Power is heavily involved in developing the process and there are concerns that the OoE us unable to access

key information and therefore is at a considerable disadvantage relative to Western Power.

The recent Triennial Review of prices in Western Power's transmission and distribution networks has highlighted the problems associated with the current regime. In particular,

[4] see "Economic Reform and the Hilmer Report: A Discussion Paper". Chamber of Commerce and Industry of WA, May 1994.

important information on the Weighted Average Cost of Capital and the Regulated Asset Base have not yet been released for public scrutiny, despite the fact that the review has been in progress for 10-11 months now. Not only does the absence of such information hinder the ability of industry to make quality submissions, it also does not engender confidence amongst industry that the process will be conducted comprehensively and fairly.

When this information is released, probably in early 2001, industry will almost certainly have the opportunity to comment only on the OoE's consultant's review of Western Power's reports.

Other specific concerns with relate to access to Western Power's network, and necessitate the need for an independent regulator include:

- The unavailability of sufficient service/quality standards;
- The time taken to negotiate access;
- The lack of consumer education on contestability levels and potential IPPs;
- Technical and operation hurdles that confront IPPs and customers when obtaining access (obtaining access is not an easy process);
- Reluctance by Government to lower access levels to zero while Western Power retains responsibility for paying for Community Service Obligations; and
- Undercutting of price of renewable energy supplied by IPPs by Western Power with electricity generated by conventional methods.

As mentioned above, CCIWA's preferred model for independent electricity regulation is an economy-wide model similar in nature to the Office of Regulator General in Victoria or the Independent Pricing and Regulatory Tribunal of New South Wales. This could be established by extending the remit of OffGAR. The second-best option is for OffGAR to take over the responsibilities for regulating the electricity sector and become an energy regulator. The WA government has foreshadowed the establishment of an energy regulator, and has indicated recently that it will be in place by 1 July 2001. However, there is now an urgent need to develop an effective electricity code. The current access regime instituted by the OoE and Western Power is not robust, as evidenced by the current ineffective Triennial Review.

In summary, the WA electricity case provides evidence that there is a need when dealing with vertically integrated monopolies in the electricity sector for Part IIIa to consider the exercise of monopoly power when dealing with access seekers and not just focus on access issues. However, additional regulation should be considered a second best option and avoided when other measures such as vertically disaggregation may be more effective and less intrusive on an ongoing basis.

Inefficient Regulation and the Meaning of 'Essential'

In some respects competition policy started out down the wrong track, by focussing on the type of asset rather than the type of market as the prime determinant of whether access to an asset should be regulated. The inference appears to be that some types of assets are so important they should be treated differently than others. The attempt to focus on access to 'essential' infrastructure is flawed because it assumes that the extent to which a market merits regulation is determined by the importance of the market, rather than the potential for regulation to correct for market failure.

A related concern is that, if a piece of infrastructure is deemed 'essential', it appears to be taken for granted that regulation is both desirable and appropriate. The term 'essential' seems to lend credence to the idea that the market is so important that regulation should be allowed whatever the cost.

In either event the normal rules of judging regulatory efficiency – that the benefits of regulation can been clearly seen to exceed the costs imposed – seem to fall by the wayside.

Finally, while regulators might pay appropriate attention to the efficiency of the organisations they regulate, they also need appropriate incentives to ensure that they are themselves operated efficiently.

Western Australian Issues

In WA the net of regulation has been cast widely and without proper regard for the appropriateness of regulation. In the gas, sector, in particular, there is concern that it is economically inefficient to regulate some pipelines because of their small size and throughput.

An example is the Tubridgi Pipeline, which is a small pipeline with a capital value of about $16 million. The costs of regulating this pipeline are relatively high and the benefits are negligible, as the supply of gas along this pipeline is dedicated to the Dampier to Bunbury Natural Gas Pipeline and it is highly unlikely that there will be demand in the foreseeable future for alternative off-takes.

A concern that traverses customers and infrastructure owners is the time taken for OffGAR to undertake the regulatory process. For instance, Epic Energy (the owners of the DBNGP) commenced work on their Access Arrangement for this pipeline in June 1999. This was lodged in December 1999. OffGAR has yet to make a draft decision and will still need to hold one more period for public submissions before a final decision is made. Based on the time taken to complete recent access arrangements it is reasonable to expect that the Access Arrangement will not be in place until mid to late next year, 2-2.5 years after Epic commenced work on it.

CCIWA recognises that OffGAR is coming to grips with its role. Nevertheless there is a need to hasten the process.

CCIWA has an ongoing concern regarding the adoption of prescriptive licensing regimes covering gas safety standards and technical matters under the Energy Coordination Amendment Bill 1997. CCIWA recognises that there is a need to protect minimum standards in areas such as safety but we are strongly opposed to a regulatory regime (whether in the form of licences or other regulations) which has the intent or effect of creating a barrier to entry. There have been recent examples cited in both the gas and electricity generation area.

CCIWA's position is that in the gas industry when regulating issues such as safety standards and technical matters, it may be better to regulate these through other matters such as accreditation or certification schemes, negative licensing (no prior licence is required before entering a market but excluded if a serious breach) and self regulation. Therefore, CCIWA believes that there is a need to conduct a complete review of the gas industry legislation to bring about some rationalisation. Currently it is an extraordinary complex set of overlapping Acts, which impedes access.

As reform progresses in the electricity sector it is important to avoid the imposition of a similar safety and technical regime in this sector. A number of concerns have already been raised by industry with respect to access to the electricity transmission network being impeded by technical issues.

CCIWA believes that as far as possible the access regimes and regulatory models applied to access seekers and providers in the gas and electricity industries should be consistent. The importance of developing consistent regimes across these industries will increase, as it is likely that 'multi' utilities with infrastructure interests in both sectors will emerge in WA.

New Versus Established

The risk entailed in purchasing (say) an established privatised asset is less than that in investing in a new asset. The market size and demand are known, prices are transparent, the technology and efficiency of the production processes are proven, and the purchasers can be (reasonably) sure that the final cost of obtaining the asset is the price they agreed to pay.

Unless rates of return reflect these different degrees of risk – or, a much less desirable outcome, the asset owner is able to shift some of the risk – then a rate of return which might seem adequate or even generous for the purchaser of a privatised asset might not be enough to induce additional investment in the industry.

Major infrastructure projects tend by their nature to be relatively risky. Major risks include:

- market risk arising from uncertainties about future demand and competitive conditions;
- network risk if the commercial viability of a project can be affected (either positively or negatively) by the behaviour of operators of other parts of an infrastructure network (such as roads, rail or telephony systems);
- construction risk, arising from physical conditions;
- technological risk associated with untried technology; and
- sovereign risk associated with changes in government policy.

In addition to all of these risks, the magnitude of the losses relative to costs when major infrastructure projects fail tends to be greater than for other assets.

Typically (not always), such major projects are designed to do only one thing and cannot do anything else. With a limited or zero range of alternative uses there is a limited or zero range of prospective purchasers for the assets of a failed investment – the risk of 'stranding' is much greater.

In Western Australia this problem has been illustrated by BHP's deliberations over whether or not to close its recently constructed direct reduced iron (DRI) plant. The plant has been losing money, but closing it down could cost more than keeping it running. In contrast, someone who builds, say, an office block in a city centre knows that they will almost certainly find someone to buy it in future, even if it sells at a loss.

Some infrastructure purchasers have used these arguments to rationalise a case for higher returns on the assets they have bought. However, the fact that rates of return on existing assets are not high enough to induce new investment does not in itself justify a higher rate of return on that investment.

In particular, a regulatory process which permitted abnormally high returns on existing assets in order to finance otherwise non-viable investment in new infrastructure reintroduces some of the key flaws which competition policy is designed to address – using monopoly power in one part of the market to cross-subsidise other parts, excluding competition in the name of expansion, etc.

Ideally, the solution is to develop a regulatory framework in which the rate of return permitted in each part of the market and for each type of investment accommodates a reasonable reflection of the different degrees of risk associated with that investment, including the risk of ending up with a stranded asset.

Western Australian Issues

These issues have taken on greater importance as more and more businesses become both the

owners of relatively safe privatised assets and the potential providers of riskier new ones, especially as those providers deal with the same regulatory body and framework for both investments.

Infrastructure owners among CCIWA's membership have raised concerns with the access tariffs and conditions set by OffGAR and the regulatory process being conducted. Their paramount concern is that the outcomes favour the customer at the expense of owners and are thus contrary to the Code, which requires a balance between the two parties.

Pipelines owners contend that the rates of return are too low and uncertain, and discourage new pipeline investment. There is a belief that OffGAR should take a more holistic long-term approach and give more weight to issues relating to pipeline investment. CCIWA is aware that this concern is a nationwide concern and is held by owners of regulated infrastructure in other states and in other sectors, notably electricity, airports and gas.

Access Alone is not the Issue

This paper has covered many areas beyond those which can be described as strictly relating to an access regime. This is inevitable – as the Issues Paper points out, access is one dimension of the regulatory and competition policy framework and is inextricably linked with the other parts. In real markets, issues of access, pricing, technical regulation and standards etc are so closely interlinked as to become inseparable.

They also tie in to other, necessary, related reforms. For example, CCIWA believes that effective access in the WA electricity sector requires the establishment of some form of market mechanism to enable electricity trading. This need will heighten if Western Power is structurally segregated into different divisions. Such a system should enable electricity retailers to purchase power from a suite of competing generators. The price of electricity and standby power would be set in accordance with market mechanisms. The nature of the market mechanism (i.e. gross pool or net pool) needs to be investigated further.

The importance of seeing regulated markets in context and of viewing regulation as an integrated whole reinforces the point made earlier, that CCIWA's preferred position is for a generic gross industry regulator which is state based.

Too narrow a focus on one dimension of one sector could prevent effective pro-competitive regulation which is cognisant of all the factors affecting competitive conditions. But a national regulator would be unlikely and probably unable to implement the kind of initiatives necessary to create a pooling mechanism in the WA electricity market.

The formal prescriptive processes of declaration are a last resort, applied only when other voluntary or compulsory regulatory processes and procedures have failed. For this reason it has actually been applied only rarely.

This is appropriate. An access declaration is unlikely to succeed in a market where the other parts of the competition policy processes are failing to operate to promote competition and efficiency. Nor does the fact that it is seldom invoked make the existence of the access provisions unnecessary – the very threat of a final declaration provides a strong incentive for parties to reach voluntary, if reluctant, agreement before the last resort is reached.

Access regulation has, potentially, the capacity to induce a facility provider to generate more efficient use of essential infrastructure and lower costs to consumers in relation to existing services, improve quality, encourage innovation and offer new technologies in services as a result of competitive pressures. CCIWA supports the retention of the current provisions, but with the provisos and refinements identified in this submission.

3 APPENDIX 1: LIST OF ACRONYMS

ACCC	Australian Competition and Consumer Commission
CCIWA	Chamber of Commerce and Industry of WA
CoAG	Council of Australian Governments
DBNGP	Dampier-Bunbury Natural Gas Pipeline
ESAA	Electricity Supply Association of Australia
IPP	independent power producer
KW	Kilowatts
MW	Megawatts
NCC	National Competition Council
NWIS	North West Interconnected System
OffGAR	Office of Gas Access Regulation
OoE	Office of Energy
SWIS	South West Interconnected System
Tj	Terajoules
WA	Western Australia
WPC	Western Power Corporation

4 APPENDIX 2: TERMS OF REFERENCE

Assistant Treasurer Rod Kemp has instructed the Productivity Commission to conduct an inquiry into the national access regime.

Its terms of reference are to report on current arrangements established by Clause 6 of the *Competition Principles Agreement* and Part IIIA of the *Trade Practices Act 1974* taking into account of:

- legislation or regulation that restricts competition or that may be costly to business should be retained only if the benefits to the community as a whole outweigh the costs; and if the objectives of the legislation or regulation can be achieved only by restricting competition or by imposing costs on business;
- where relevant, the effects of Clause 6 and Part IIIA on the environment, welfare and equity, occupational health and safety, economic and regional development, consumer interests, the competitiveness of business (including small business), investment and efficient resource allocation;
- the need to promote consistency between regulatory regimes and efficient regulatory administration through improved coordination to eliminate unnecessary duplication; and
- mechanisms that may improve Clause 6 and/or Part IIIA processes for achieving third party access to essential infrastructure, or that may engender greater certainty, transparency and accountability in the decision making process in Clause 6 and Part IIIA.

The Commission has been asked in particular to focus on those parts of the legislation that restrict competition, or that impose costs or confer benefits on business.

5 APPENDIX 3: PRESS RELEASES ON ELECTRICITY DEREGULATION

Statement by Minister Colin Barnett

Below is the text of a Media Statement issued by the WA Government on 8 December 2000 by the he Hon. Colin Barnett M.Ec, MLA, Minister for Resources Development; Energy; Education; Leader of the House in the Legislative Assembly, on the government's energy policy.

Government to spend $2 billion to expand WA's electricity infrastructure

8/12/00

Energy Minister Colin Barnett today unveiled a $2 billion package of major energy measures to see Western Australia through this decade.

He said the package included new power generation, deregulation of the electricity sector, expansion of the power line system and broad structural change to industry itself.

Mr Barnett said under this package $1 billion would be spent in investing in new power stations.

A further $1 billion would be spent upgrading transmission and distribution power lines - particularly into regional areas.

The power generation package would be in three stages - Kwinana B, mid merit and base load.

The strategy called for the additional power to be provided in three stages to allow opportunities for both gas and coal.

"Latest forecasts that power demand will grow three per cent to four per cent annually until the end of the decade, make it imperative that an additional power plant was operating," Mr Barnett said.

"New power generations capacity of about a further 1,000 megawatts will be needed over this decade.

"In a further deregulation of the State's electricity market, private generators will bid to supply that power to Western Power in a new open competitive tendering process.

"This will ensure WA has the most competitively priced, most efficient and most up to date technology available.

"There is no doubt that reliable and quality supplies of electricity are essential as the WA economy continues to grow.

"The private sector will have the opportunity to provide those electricity supplies.

"Preparing the process for that to happen has been an enormous challenge.

"The result, which has drawn on international experience, is rigorous but fair. Mr Barnett said Western Power would also replace two ageing 120MW gas/oil fired generating units at Kwinana Power Station with new, high efficiency gas plant by the end of 2003.

This meant coal burning at Kwinana would be phased out by 2003 and replaced with gas - a significant plus for Perth's air quality.

"The two stages of public procurement allowing the private sector to build new plants would be merit - or daytime power - and base load," Mr Barnett said.

"Bids for the first stage of the public power procurement process will be called by middle of next year and contracts awarded by mid-2002 so that the additional plant will begin delivering electricity for the 2004-05 summer.

"Major international and national companies keen to enter the WA electricity market are likely to compete.

"The public power procurement process requires all new additional power plant to be put to the market and will be overseen by an independent chairman and independent auditors who will report to the Minister for Energy.

"Western Power will negotiate suitable power purchase agreements with the successful bidder.

"The outcome we seek should yield lower electricity prices for Western Australians although it should be noted that there has been just one increase (3.75 per cent in 1997) in residential tariffs and no increases for the business sector since 1991-1992."

- Mr Barnett said the plan would provide:
- timely additional generation plant;
- new privately owned plant;
- competition between Western Power and private generators;
- continuation of the appropriate balance between fuels;
- an appropriate range of base load, mid merit and peaking generation plant; and -
- environmental benefits.

Mr Barnett also outlined initiatives which would continue the reform process of WA's electricity sector to foster effective competition and lower electricity prices.

He said phased third party access to Wester Power's distribution networks began in July 1997 with access available for transporting electricity to single customers with an annual average load of at least 10 megawatts at a single premise.

At the beginning of January 1998 access levels were reduced to an annual average load of at least five megawatts.

This was further reduced to a megawatt at the beginning of this year when about 120 of Western Power's biggest electricity customers - representing 30 per cent of Western Power sales - were in the contestable market.

"To encourage a more competitive market through independent power producers and private retail participation, the Government is now accelerating the rate of access to Western Power distribution systems," Mr Barnett said.

"From July next year, customers with an annual consumption of 0.23 megawatts at a single site will be able to negotiate with the supplier of their choice.

"The access levels on Western Power's South West Interconnected System and North West

Interconnected System distribution networks will be reduced at the beginning of January 2003 to 0.034 megawatts.

"This would mean about 450 big customers - small industrial plants, hospitals, large hotels and shopping centres - open to competition with the first stage. This represents about 40 per cent of Western Power's sales.

"The second stage involves about 2,500 medium customers - smaller-sized businesses, schools, smaller hotels and supermarkets - open to competition representing about 50 per cent of Western Power's sales."

Mr Barnett said Western Power would spend more than $1 billion in the next five years on its transmission and distribution networks including major upgrades and reinforcement of the transmission and distribution networks.

He said nearly $480 million would be spent over five years on transmission to improve the capacity, reliability and quality of electricity delivered to country areas north and south of Perth.

The Government would establish an independent Energy Access Regulator for both gas and electricity and would enhance ring-fencing arrangements.

A customer education program would be implemented and an investigation of an electricity code for Western Australia, market arrangements and regulatory arrangements which would apply to new electricity market participants undertaken.

Statement by CCIWA Chief Executive Lyndon Rowe

Below is the text of a Media Statement issued by CCIWA in response to the above announcement.

Electricity plan: More focus needed

CCIWA welcomes the tabling by the Minister for Energy today of the Government's intentions for the WA electricity sector in the coming decade.

Uncertainty and speculation have been mounting within industry about the Government's plans. Mr Barnett's announcements have helped clarify the direction the current government proposes to take.

Cabinet's confirmation that the threshold for contestability by private powers providers will be lowered to 34 kW by July 2003 is particularly welcome. It will bring the number of customers who are free to access the provider of their choice to around 2,500.

The decision to expand the role of the Office of Gas Access Regulation to also encompass electricity access is another positive development.

Clearly, the Government places a high priority on ensuring Western Australia continues to be provided with a robust and reliable electricity supply.

However, CCIWA remains concerned at the lack of focus in the government's statements and actions on means to bring the price of electricity down. This is the most urgent issue of all - Western Australia has fallen too far behind the tariffs available in other states where there has been more concerted deregulation than has been allowed in the WA electricity sector.

The program announced today by Mr Barnett will not produce the competitive market structure that industry requires and has argued long and hard for.

His rhetoric implies an increasing involvement of the private sector in the generation and retail supply of electricity. But the detail of the program points to ongoing impediments and continuing dominance by the state utility, Western Power Corporation.
While there has been a stronger commitment to the ring-fencing of Western Power's distribution arm, this is no substitute for the proper structural separation of Western Power generation and transmission into independent agencies operating alongside private sector competitors in a truly deregulated electricity market.

CCIWA will maintain its position on these issues and its lobbying of the case to government in the interests of getting the cost of electricity in WA down to a level that is competitive with the rest of Australia.

6 NATIONAL COMPETITION POLICY AGREEMENT

The clauses of Part 6 of the Competition Principles Agreement relating to access issues are given below.

6. Access to Services Provided by Means of Significant Infrastructure Facilities

6.1. Subject to subclause (2), the Commonwealth will put forward legislation to establish a regime for third party access to services provided by means of significant infrastructure facilities where:

a) it would not be economically feasible to duplicate the facility;

b) access to the service is necessary in order to permit effective competition in a downstream or upstream market;

c) the facility is of national significance having regard to the size of the facility, its importance to constitutional trade or commerce or its importance to the national economy; and

d) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

6.2. The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:

a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or

b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

6.3. For a State or Territory access regime to conform to the principles set out in this clause, it should:

a) apply to services provided by means of significant infrastructure facilities where:

i) it would not be economically feasible to duplicate the facility;

ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and

b) incorporate the principles referred to in subclause (4).

6.4. A State or Territory access regime should incorporate the following principles:

a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

c) Any right to negotiate access should provide for an enforcement process.

d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.

g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

h) The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

i) In deciding on the terms and conditions for access, the dispute resolution body should take into account:

   i) the owner's legitimate business interests and investment in the facility;

   ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

   iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

   iv) the interests of all persons holding contracts for use of the facility;

   v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

   vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

   vii) the economically efficient operation of the facility; and

   viii) the benefit to the public from having competitive markets.

j) The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:

   i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

   ii) the owner's legitimate business interests in the facility being protected; and

   iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

p) Where more than one State or Territory regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other cooperative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.