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Separation of Generation and Transmission Regulatory Impact Statement

Overview

NGF welcomes SCO's analysis of the potential issues arising from co-ownership of generation and transmission but does not believe this issue is a pressing concern in the National Electricity Market (NEM).

NGF is not convinced the issue of generation and transmission co-ownership requires detailed amendment given the absence of issues arising in this area.

The RIS is a model for assessing the relative merits of alternative policy options. In this case, the NGF believes that the risk has been heavily overstated and that the correct policy response is the status quo. We believe that the policy makers should give strong credence to this submission given that we are the parties who will be impacted if this risk materialises. If the parties who are being protected from a risk see no need for additional protection, this should be a warning to policy makers that they should not proceed.

We suggest as the RIS is primarily concerned with the exercise of market power arising from co-ownership, it does not consider when co-ownership may be efficient or effective. On this basis, the RIS suffers from seeking to eliminate potential risk not managing inefficient outcomes or encouraging efficient outcomes. One of the key features of a market is that it should encourage innovation. This means that as many options as possible should be left open. This proposal is in danger of closing down some options with no good reason.

This submission addresses the following issues:

- A definition of transmission (which the RIS appears to lack)
- No evidence of a problem
- Stated issues with the existing CCA provisions
- Approach to co-ownership when a Government is the owner
- Opportunity for competitive pressure on TNSPs
- MNSP's
- Option Assessment

Transmission Definition

The RIS does not define transmission so it is assumed that the NER definition will apply which is effectively:

transmission network

A *network* within any *participating jurisdiction* operating at nominal *voltages* of 220 kV and above plus:

- (a) any part of a *network* operating at nominal *voltages* between 66 kV and 220 kV that operates in parallel to and provides support to the higher voltage *transmission network*;
- (b) any part of a *network* operating at nominal *voltages* between 66 kV and 220kV that is not referred to in paragraph (a) but is deemed by the *AER* to be part of the *transmission network*.

The significance of this definition is that it would include **all** high voltage lines including those which are essentially connection assets. So the lines running out to remote renewables, for example, may well be captured. This appears to be a very wide definition which could have many unforeseen impacts.

No Evidence of a Problem

The RIS commences at the beginning of the Executive Summary with the statement:

“Co-ownership of generation and transmission assets create significant competition concerns.”

This statement is just not true within the industry. It may be an issue for some policy makers but this view is not founded on the reality of the market place. The RIS appears unable to list one incident of where this risk has materialised in the 13 years of market operation.

NGF agrees that there are some instances where co-ownership by a competitor may give rise to specific concerns. However, a prohibition on co-ownership in its entirety is not supported given in some instances co-ownership (i.e. when constructing an asset for use in connecting generation or in diversifying an investment portfolio) should be permitted in the absence of evidence that would contravene section 50 of the *Competition and Consumer Act 2010 (CCA)*.

It is also useful to note that in the 13 years of the market this an actual incidence of this problem has not materialised even while we have had major co-ownership through state governments. The level of co-ownership is likely to be much lower in the future.

NGF has no doubt that a potentially anti-competitive arrangement would be strongly resisted by industry participants. In such a circumstance, it is entirely appropriate that industry would support Australian Competition and Consumer Commission (ACCC) action and that action should be progressed through the existing legal channels. On this basis, NGF supports Option A in the RIS.

Generator interest in transmission is likely to be driven by: (a) a localised need based on a new and substantial generation investment which creates a transmission requirement not immediately provided by a Transmission Network Service Provider (TNSP); or (b) an attempt to stabilise financial returns through access to the regulated asset base.

The first of these, a localised desire to construct and own transmission, is impeded by the existing NER and NGF supports progress of this matter, including allocation of appropriate property rights, in the Australian Energy Market Commission's Transmission Frameworks Review.

The second is only a hypothetical at this stage given the absence of co-ownership for this purpose. The current consolidation of the industry continues to be focused on competing vertically integrated players diversifying their portfolios in generation and retail and transfer of ownership of generation from the public sector to the private sector.

Should a generation business actively consider an opportunity for transmission investment it would be analysed against the same financial hurdles and expected rate of return as core business. On this basis, we consider it unlikely to be where generators are likely to direct scarce capital and are businesses in which they are unlikely to have a competitive advantage.

All of the examples cited in the RIS to justify revision potential market impacts of mergers; however, it requires of the current provisions are hypothetical. In other words, the existing provisions have not encouraged co-ownership to flourish or an abuse of market power as a consequence of co-ownership. The RIS has an abundant lack of evidence to support the desire for change notwithstanding the general theoretical validity of the concepts put forward.

Furthermore, some of the perceived risk may be overstated. The idea that a generation or retail player would rely on a strategy of owning transmission to develop their business profitability through the misuse of market power seems relatively unlikely. It ignores the range of variables that would need to be aligned in order for such a strategy to work, notwithstanding the risk of legal sanctions, the loss of return from pursuing the normal course of business, and the potential for competitor co-owners to retaliate.

Stated issues with the existing CCA provisions

We have some concern with arguments that suggest an inability to stop a merger or co-ownership should be read as inability to stop misuse of market power. We agree that economic theory has an important role to play in assessing appropriate scrutiny and should be supported by demonstrated evidence, either specifically or generally by industry support.

In this regard, it is appropriate for ACCC to vigilantly pursue plausible instances of lessening of competition suggested by economic theory; however, the court is the appropriate place to decide such outcomes. For instance, an analysis of examples like *AGL v ACCC (2003)* is likely to demonstrate that the evidential bar was set at an appropriate level and hence the findings of the court were appropriate. Something explicitly acknowledged by Justice French in his decision.

Acadia CRE in its 2006 report for the Energy Reform Implementation Group stated:

The TPA [now the CCA], as it currently applies, is effective, provided the ACCC is able to gather evidence to substantiate its *a priori* assessments of market power and the effects of mergers on competition. The provisions of section 50 allow the ACCC to address all in-principle sources of lessening of competition, across all types of horizontal and vertical electricity industry mergers. (p.ii)

NGF supports these views.

We appreciate that the current process requires a substantial critique of the economic theory based on evidence. But, we believe this is as it should be, including placing the onus of proof on the ACCC to "monitor behaviour and gather sufficient evidence of a breach" (p.16) following a merger. Clearly, if

there is no obvious breach or market power impacts, then action is not warranted and the need for a stronger limit on co-ownership is disproved. Conversely, a successful court outcome does not prove that no co-ownership should occur but that the ACCC has rightly identified a merger behaviour that requires attention.

It should be noted that in a competitive market participants should have more incentive to report and support action against an alleged misuse of market power by a competitor (who co-owned a transmission network). It should not therefore be assumed that in the absence of significant changes to existing provisions that market participants face unfettered risk if co-ownership were to proceed at some level.

Co-ownership when a Government is the owner

The RIS appears to be completely silent on the issue of Government as a co-owner. At the beginning of the NEM there was major co-ownership by state governments. This has now largely been eliminated in Victoria and South Australia. There appears to be an implicit assumption that Governments will be exempt.

One issue which should be considered is how co-ownership is measured, particularly in the case of overseas ownership and with some of the complex corporate structures which are used. This area tends to be very difficult to pin down. Given the lack of evidence of anything except a theoretical potential problem, such a debate is not at all productive for the industry or government.

Opportunity for competitive pressure on TNSPs

Under the current rules, ownership by a generation developer of some transmission is a credible threat to TNSPs. It can also be a useful way of ensuring a project is delivered on time if the generation developer is able to build the transmission and then sell the completed line to a TNSP for operation.

This issue is likely to increase as the supply side moves to use more renewable generation which is often remote. The timely development of long transmission lines may well be a critical factor in successful development.

MNSPs

NGF supports the exclusion of MNSPs, including Basslink from any proposals. In this context, MNSPs are market participants much more than network elements so the RIS approach is most appropriate. Given that MNSPs generally connect to other networks, it is hard to see that the perceived theoretical problem could even exist in relation to a MNSP.

Option Assessment

From our earlier comments, it is clear that NGF views any change as completely unnecessary. In considering options, there are two underlying policy principles which we do not think should be broken. They are:

- **The NER should not have any provisions related to ownership.** In spite of the very mixed ownership models employed, there has, to date, been no breach of this principle and we regard it as a strength of the market rules.
- **The CCA should not contain any industry specific provisions.** We believe this is a strength of this legislation and presents a more certain investment environment than capricious industry specific approaches. There are, of course, some wrinkles for some industries in this area already.

Nevertheless, while NGF supports Option A we are not opposed to strengthening of the ring-fencing provisions concerning information disclosure between related entities in the National Electricity Rules (NER). However, this does not extend to the full gamut of changes proposed in Option B particularly in relation to additional discretionary powers for the Australian Energy Regulator. The Australian Energy Regulator plays an important role in the industry but we are not supportive of this extending to decisions on potential co-ownership.

NGF does not support Option C. We believe any specific provisions in the circumstance would be heavy-handed and suggest a threshold percentage for cross-ownership would be entirely arbitrary.

As such, it is not surprising that the current instances of co-ownership raise no concerns for the MCE. Co-ownership is driven by passive objectives. This further emphasises the arbitrary nature of suggestions supporting a percentage cap on co-ownership or strengthening of provisions to circumvent section 50 of the CCA.

Hence, any change to prevent potential anti-competitive distortions would be disproportionate given the absence of evidence and the likelihood generators will only seek or wish to own transmission networks at the margins.

Hence, while market power is a concern, especially if it provides a strategic threat or is misused to damage a competitor, we see no reason not to endorse the continued use of existing CCA provisions to guard against and take action in response to issues of market power.

In response to the specific questions raised in the RIS (page 47)

What are the benefits of co-ownership, besides diversifying risk in a business' portfolio?

Within the privately owned side of the supply industry, there appears to be no appetite for co-ownership. Whilst there may be some diversifying of risks, a far more significant iss is probably the risk appetite in the two areas, These are significantly different so that the culture of a business which likes the low risks of transmission is unlikely to be attracted to a market investment and vice versa.

What are the costs of prohibiting future co-ownership of generation and transmission?

The costs are not high administratively but it may well lead to less efficient outcomes in the areas we have identified. The more important question is what benefits will flow? NGF's view is that there will be none and, depending on how the changes are implemented, it may introduce some bad policy implementations.

Do competition concerns remain if a co-owned generator is located in a different region to the transmission network/interconnector?

Given the industry have no concerns, the region is irrelevant.

Should a provision that limits co-ownership of generation and transmission connected in the NEM apply to all registered generators (being scheduled, semi scheduled and non-scheduled)?

Yes.

Conclusion

NGF appreciates that cross-ownership concerns and rules, such as those in Victoria, supported market reform during the 1990's. However, to date experience and market consolidation has not raised any concerns, outside of economic theory, that misuse of market power from co-ownership is a threat to market integrity.

As such a proposed limit, like percentage of allowable cross-ownership, is arbitrary and misdirects energy towards prohibiting potential innovation and efficient investment instead of establishing a regulatory structure that provides superior outcomes regardless of ownership.

While NGF appreciates that an absolute ban, or an effective ban, is easier and appeals to some, it is not warranted based on the evidence. Additionally, it is not necessary given section 50 of the CCA remains an appropriate safeguard against potential lessening of competition and that the CCA generally adequately equips the ACCC to pursue market participants where misuse of market power exists.

Finally, the basic concern here is that a generator will be disadvantaged as a result of another generator which is co-owned by a TNSP receiving preferential treatment. As generators, we do not believe this risk exists so we request policy makers to take no action in this regard.

Yours sincerely



Malcolm Roberts
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