Determination

Applications for authorisation

lodged by

The Independent Market Operator

in respect of

the Market Rules to govern the wholesale electricity market in Western Australia

Date: 22 December 2006

Authorisation no.: **A91004**
A91005
A91006

Public Register no.: **C2006/1234**
C2006/1236
C2006/1238

Commissioners: Samuel McNeill
Martin Smith
Willett

Summary

The ACCC has decided to grant authorisation to the Wholesale Electricity Market Rules for a period of 15 years.

The authorisation process

The Australian Competition and Consumer Commission (ACCC) can grant immunity from the application of the competition provisions of the *Trade Practices Act 1974* (the Act) if it is satisfied that the benefit from the conduct outweighs any public detriment. The ACCC conducts a public consultation process to assist it to determine whether a proposed arrangement results in a net public benefit.

The applications for authorisation

The Market Rules have been established to govern the operation of the wholesale electricity market for the South West Interconnected System (SWIS) in WA. The IMO has applied for authorisation of the entire set of Market Rules, rather than for the identified provisions that might potentially breach the Act.

The IMO is seeking authorisation to:

- make and give effect to an arrangement, a provision of which might be an exclusionary provision within section 45 of the *Trade Practices Act 1974* (the Act); and
- make and give effect to an arrangement, a provision of which may have the effect of substantially lessening competition within the meaning of section 45 of the Act; and
- engage in conduct that constitutes or may constitute the practice of exclusive dealing within the meaning of section 47 of the Act.

Background

The IMO is a body corporate which is responsible for the administration and operation of the Western Australian wholesale electricity market (WEM) in accordance with the Market Rules.

The IMO's aim is to provide and maintain an effective infrastructure for the efficient operation of the WEM in Western Australia. The IMO's responsibilities are summarised as the:

- administration of the market rules
- operation of the WEM and
- securing sufficient generation capacity to meet demand when required.

The IMO is the responsible body and applicant for authorisation for the Market Rules in this instance.

Public detriment

The ACCC is of the view that there are not likely to be any significant anti-competitive detriments arising from the proposed arrangements. Whilst aspects of the proposed

arrangements fall short of the ideal, in the ACCC's view, these are not material to the consideration of the Rules as a whole.

Public benefit

The ACCC is satisfied that the proposed Wholesale Electricity Market Rules are likely to result in the following public benefits:

- increased competition in the production and supply of electricity in the SWIS
- improved security and reliability of supply of electricity in the SWIS and
- environmental benefits from the take-up of renewable energy and DSM options.

Balance of public benefit and detriment

Overall, the ACCC considers that in all the circumstances, that the public benefits likely to arise from the proposed arrangements will outweigh possible public detriments

Length of authorisation

The ACCC generally considers it appropriate to grant authorisation for a limited period of time, so as to allow an authorisation to be reviewed in the light of any changed circumstances.

In this instance, the ACCC considers that a period of 15 years is appropriate for this authorisation.

Interim authorisation

The applicant was granted interim authorisation concurrent with the issuance of the Draft Determination on 22 September 2006. Interim authorisation will expire upon this Decision taking effect on 12 January 2007.

Contents

List of abbreviations

ABARE	Australian Bureau of Agricultural and Resource Economics
ACCC	Australian Competition and Consumer Commission
Access Code	*Electricity Networks Access Code 2004*
Act	*Trade Practices Act 1974*
DSM	demand side management
ERA	Economic Regulation Authority
IMO	Independent Market Operator
kW	kilo Watt
Market Rules	Wholesale Electricity Market Rules
MW	Mega Watt
MWh	Mega Watt hour
NCP	national competition policy
NEM	National Electricity Market
RCM	reserve capacity mechanism
STEM	short term energy market
SWIS	South West Interconnected System
Tribunal	Australian Competition Tribunal
TUAS	Top Up and Spill
WEM	wholesale electricity market

1. Introduction

Authorisation

1.1 The Australian Competition and Consumer Commission (the ACCC) is the independent Australian Government agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act is to prevent anti-competitive conduct, thereby encouraging competition and efficiency in business, resulting in a greater choice for consumers in price, quality and service.

1.2 The Act, however, allows the ACCC to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way in which parties may obtain immunity is to apply to the ACCC for what is known as an 'authorisation'.

1.3 The ACCC may 'authorise' businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment.

1.4 The ACCC conducts a public consultation process when it receives an application for authorisation. The ACCC invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.

1.5 After considering submissions, the ACCC issues a draft determination proposing to either grant the application or deny the application.

1.6 Once a draft determination is released, the applicant or any interested party may request that the ACCC hold a conference. A conference provides all parties with the opportunity to put oral submissions to the ACCC in response to the draft determination. The ACCC will also invite the applicant and interested parties to lodge written submissions commenting on the draft.

1.7 The ACCC then reconsiders the application taking into account the comments made at the conference (if one is requested) and any further submissions received and issues a final determination. Should the public benefit outweigh the public detriment, the ACCC may grant authorisation. If not, authorisation may be denied. However, in some cases it may still be possible to grant authorisation where conditions can be imposed which sufficiently increase the benefit to the public or reduce the public detriment.

The application for authorisation

1.8 On 29 June 2006, the Independent Market Operator (IMO) lodged applications for authorisation A91004, A91005 and A91006.

1.9 The IMO applied for authorisation of the Wholesale Electricity Market Rules (Market Rules).

1.10 The IMO seeks authorisation for a minimum of 15 years.

Interim authorisation

1.11 On 11 August 2006, the IMO applied for interim authorisation of the Market Rules. Interim authorisation was granted concurrent with the Draft Determination issued on 22 September 2006 by the ACCC.

Draft determination

1.12 On 22 September 2006 the ACCC issued a draft determination proposing to grant authorisation to the Rules for a period of 15 years.

Chronology

1.13 Table 1.1 provides a chronology of significant dates in the consideration of this application.

Table 1.1: Chronology of applications for authorisation A91004, A91005, A91006

DATE	ACTION
29 June 2006	Application for authorisation lodged with the ACCC.
28 July 2006	Closing date for submissions from interested parties in relation to the substantive application for authorisation.
11 August 2006	Application for interim authorisation received from applicant.
22 September 2006	The ACCC granted interim authorisation.
22 September 2006	Draft determination issued.
30 October 2006	Closing date for submissions from interested parties in relation to the draft determination.
22 December 2006	Determination issued.

2. Background to the application

The applicant

2.1 The IMO is a body corporate which is responsible for the administration and operation of the Western Australian WEM in accordance with the Market Rules.

2.2 The IMO's aim is to provide and maintain an effective infrastructure for the efficient operation of the WEM in Western Australia. The IMO's responsibilities are summarised as the:

- administration of the market rules
- operation of the WEM and
- securing sufficient generation capacity to meet demand when required.

2.3 The IMO is the responsible body and applicant for authorisation for the Market Rules in this instance.

Western Australia's electricity market

2.4 The South West Interconnected System (SWIS) is the major interconnected electricity network in WA, supplying the bulk of the south west region. It extends to Geraldton in the north, Albany in the south, and Kalgoorlie in the east. The SWIS operates in isolation to the National Electricity Market (NEM) in eastern and southern Australia.

2.5 The SWIS network supplies 840,000 retail customers and consists of approximately 6,000km of transmission lines and 64,000km of distribution lines. The SWIS comprises 4,200MW of installed generation capacity, of which 3,200MW (approx 75%) is owned by the State utility Verve. Approximately 62 percent of electricity is generated from coal, with over 37 percent from gas and less than 1 percent from renewable sources.

Reform process

2.6 In accordance with the National Competition Policy (NCP), the Government of WA has embarked on a comprehensive reform of the State's electricity sector. The NCP is a package of reforms, agreed to by all Australian governments in 1995, designed to enable and encourage competition. All reforms under the NCP involve the consideration of efficiency, social, environmental, equity and regional objectives.

2.7 Reforms required under the NCP relevant to the WA electricity industry include:

- the restructuring of public sector monopolies to:
  - separate commercial and regulatory functions
  - separate monopoly and potentially competitive elements of an industry
  - provide for competition in the competitive sectors

- the provision of third party access rights to nationally significant infrastructure services to promote competition in related markets and
- the establishment of an independent multi-industry economic regulator, such as the Economic Regulation Authority (ERA).

2.8 In August 2001, the WA Government appointed an Electricity Reform Taskforce to inquire into the WA electricity market. The recommendations of the Taskforce were endorsed by Cabinet in November 2002. The WA Government's objectives in undertaking electricity reform include to: [1]

- establish a robust and competitive electricity market that encourages investment and competition and sets the foundation for sustainable lower prices
- address Western Power's market dominance and establish new businesses with dedicated and focussed service delivery, while maintaining the viability of the new entities
- establish new regulatory frameworks that provide for independent assessment, monitoring and enforcement
- increase the opportunities for sustainable energy options
- mandate levels of safety, security and reliability of electricity supply
- provide for increased customer choice through a lowering of the contestability thresholds
- provide for increased protection for residential and small business customers and
- retain State ownership of existing electricity assets.

2.9 According to the WA Government, independent analysis conducted at the time of the inquiry suggests that the benefits of reform would be an average 8.5 per cent cut in electricity prices, an increase in gross State product of up to $300 million per year by 2010, and the creation of 2900 new jobs.[2]

2.10 The process of implementing the recommendations has been underway since 2002. Some of the significant reforms include:

- Introduction of the *Electricity Networks Access Code 2004* (the access code), which began operation on 30 November 2004. The access code has received certification for 15 years as an effective access regime under section 44M of the Act – indicating that it satisfies the principles set out in the Competition Principles Agreement under the NCP. Responsibility for regulating third party access to regulated electricity networks under the code lies with the ERA.

[1] Office of Energy WA (2005)
[2] National Competition Council, *Assessment of governments' progress in implementing the National Competition Policy and related reforms: 2003 - Volume one: Overview of the National Competition Policy and related reforms*, August 2003

- Reduction of the access threshold for contestability to 5.7 kW average load (50MWh per annum) on 1 January 2005. This increased the number of contestable customers to around 12 500 – approximately 60 per cent of Western Power's load in the south west interconnected system.

- The dominant participant in the electricity industry has been Western Power Corporation, a vertically integrated government-owned utility which in April 2006 was disaggregated into four separate state owned entities:

  - generation corporation (Verve Energy)

  - networks corporation (Western Power), responsible for both transmission and distribution

  - retail corporation (Synergy)

  - regional corporation (Horizon Power), responsible for the generation, transport and sale of electricity in all areas of WA outside the SWIS.

- Implementation of the Top Up and Spill (TUAS) market as a transitional step towards the implementation of the wholesale electricity market. This arrangement allows generators to buy additional energy from, or sell any excess energy to, Verve. Prices used under TUAS are determined by Verve, and Verve is the sole provider of balancing, reserve and standby services.

- A vesting contract has been entered into between Verve and Synergy to ensure a smooth transition to the new industry structure prior to full implementation of the wholesale electricity market. This agreement ensures that all of Western Power Corporation's obligations at the time of disaggregation are met by the newly created entities. Additionally, a displacement mechanism is included to mitigate Western Power's generation market power and encourage competition in generation.

- An independent licensing regime, administered and enforced by the ERA, commenced in January 2005. The regime includes a number of regulatory and consumer protection measures. Other consumer protection measures include the implementation of a customer service code, standard supply contracts, consumer connection policies, an energy ombudsman scheme and the imposition of retailer of last resort obligations on Synergy.

Electricity market design

2.11 Central to the reform process is the introduction of a wholesale electricity market designed to meet the specific objectives and needs of the WA environment. The arrangements for the operation of the wholesale electricity market are set out in the Wholesale Electricity Market Rules (Market Rules).

2.12 Many aspects of the Market Rules are based on the requirement to balance supply and demand for electricity in real time, and involve limitations on the production and consumption of electricity.

2.13 The IMO is the market operator and administrator of the Market Rules. The IMO is independent from the state owned entities which operate within the SWIS and has no

commercial interest in the market. Functions to be undertaken by the IMO include setting and procuring, by way of electricity capacity auctions, the level of reserve capacity to meet peak periods of demand, scheduling of electricity load dispatch from generators and administering the network control service process.

2.14 Energy trading in the wholesale market will primarily occur through bilateral contracts. The Short Term Energy Market (STEM) will support the bilateral trade process, allowing market participants to adjust their trading position under bilateral contracts on a day-ahead basis. A balancing service will be provided to account for real time variations in supply and demand, overseen by System Management (a ring-fenced entity within Western Power). A separate capacity process is also included within the market – the Reserve Capacity Mechanism (RCM).

2.15 The Market Rules commenced on 21 September 2006, the date on which the market commenced operating.

2.16 The objectives of the wholesale electricity market as set out in the *Electricity Industry Act 2004* are to:

- promote the economically efficient, safe and reliable production and supply of electricity and electricity-related services in the SWIS
- encourage competition among generators and retailers in the SWIS, including by facilitating efficient entry of new competitors
- avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions
- minimise the long-term cost of electricity supplied to customers from the SWIS and
- encourage the taking of measures to manage the amount of electricity used and when it is used.

3. The application for authorisation

Proposed arrangements

3.1 The IMO has applied for authorisation of the Market Rules, made under the *Electricity Industry Act 2004*. The Market Rules have been established to govern the operation of the wholesale electricity market in WA.

3.2 Authorisation has been applied for by the IMO, for the IMO and on behalf of the following persons:

- the Electricity Networks Corporation established under the *Electricity Corporations Act 2004*
- all those persons which are registered with the IMO under the Market Rules as a Rule Participant as at the date of the applications
- each other person who subsequently registers with the IMO under the Market Rules as a Rule Participant and
- any persons or body on which the Market Rules or the Wholesale Electricity Market Regulations confers functions, powers or responsibilities, including the Minister(s), the ERA, the Energy Review Board and members of the Market Advisory Committee.

3.3 The IMO has applied for authorisation of the entire set of Market Rules, rather than for the identified provisions that might potentially breach the Act.

3.4 The applications for authorisation comprise three separate applications under Division 1 of Part VII of the Act. These three applications will be assessed together as an integrated package.

3.5 Application for authorisation A91004 was made under sub-section 88(1) of the Act for the granting of an authorisation under that sub-section:

- to make a contract or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be, or might be, an exclusionary provision within the meaning of section 45 of the Act;
- to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of the section 45 of Act.

3.6 Application for authorisation A91005 was made under sub-section 88(1) of the Act for the granting of an authorisation under that sub-section:

- to make a contract or arrangement, or arrive at an understanding, where a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act;

- to give effect to a provision of a contract, arrangement or understanding where the provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of the Act.

3.7 Application for authorisation A91006 was made under sub-section 88(8) of the Act for the granting of an authorisation under that subsection:

- to engage in conduct that constitutes or may constitute the practice of exclusive dealing within the meaning of section 47 of the Act.

3.8 The IMO submits that authorisation of the Market Rules should remain in force until at least 1 July 2021, for the following reasons:

- the wholesale electricity market represents a new trading environment for the existing participants in the industry
- potential investors in the industry require a strong degree of commercial certainty in order to enter the market and
- market participants are likely to enter into long term contracts having regard to the Market Rules and Access Code provisions at the time of negotiation.

Overview of Market Rules

Chapter 2: Administration

3.9 Chapter 2 describes the requirements associated with the administration of the Market Rules.

3.10 The functions of the governance bodies are established under this chapter. Broadly, these bodies are:

- the IMO: the market operator and administrator of the Market Rules
- System Management: the system operator and
- the Market Advisory Committee - an industry group which advises on the operation of the Market Rules.

3.11 Processes for the determination of budgets for the governance bodies, market fees, price limits and loss factors are all established.

3.12 All persons who wish to participate in the market must register with the IMO under the relevant Rule Participant class. The registration process, along with all system and prudential requirements of participants are detailed.

Chapter 3: Power System Security and Reliability

3.13 System Management has the role of ensuring the maintenance of system security and reliability within the SWIS over the short and medium term. Chapter 3 sets out technical requirements for achieving and maintaining a secure power system.

3.14 Specific attention is directed to the provision of ancillary services, short and medium term planning including outage scheduling and the implementation of security and reliability standards and testing.

Chapter 4: The Reserve Capacity Mechanism

3.15 The reserve capacity mechanism is designed to ensure that the SWIS has adequate generation capacity and demand-side management (DSM) options at all times to meet expected peak demand, plus adequate additional capacity in the event of the largest generator failing. Market Customers are required to purchase sufficient reserve capacity from Market Generators to cover their expected contribution to system peak demand. It is anticipated that most trade will occur through bilateral contracts, with any remaining capacity allocated through a reserve capacity auction.

3.16 Chapter 4 prescribes requirements in relation to the reserve capacity mechanism for all stages of the Reserve Capacity Cycle. The IMO has responsibility for certification of capacity, issuance of capacity credits, operation of the reserve capacity auction and settlement of transactions.

Chapter 5: Network Control Service Procurement

3.17 Network control services are services provided by generation or DSM facilities instead of major network augmentation. A tender for network control services must be run by the IMO if there is the potential for generation or DSM options to provide a competitive alternative to expansion of a transmission or distribution system.

3.18 Chapter 5 outlines the tender process for procuring network control services and the obligations imposed on facilities that are successful in obtaining network control service contracts.

Chapter 6: The Energy Market

3.19 Chapter 6 governs the operation of the Energy Market.

3.20 The Energy Market describes all mechanisms for energy trading. Energy trading in the wholesale market will primarily occur through bilateral contracts. Although the contracts themselves are not regulated under the Market Rules, there are consequent obligations to provide scheduling information to the IMO arising from the making of a bilateral contract.

3.21 The STEM will support the bilateral trade process, allowing market participants to adjust their trading position under bilateral contracts on a day-ahead basis. A balancing service will be provided to account for variations between the net contract position of market participants and actual energy generation and consumption. Both these functions will be carried out by the IMO.

Chapter 7: Dispatch

3.22 Electricity is a good whose supply and transportation through the network requires continual balancing with demand to ensure the safety, security and quality of supply. Chapter 7 outlines the process by which System Management will manage the system with the aim of ensuring that:

- the SWIS is operated within the appropriate technical parameters
- supply is equal to demand in real-time and
- the ancillary services requirements are met.

3.23 The dispatch process allows System Management to adjust schedules in real-time to ensure that power system security and reliability is maintained while, to the extent possible, facilitating trade in accordance with bilateral and STEM positions.

Chapter 8: Wholesale Market Metering

3.24 Metering measures and records the flow of electrical energy. By measuring electricity flow through participants' metering points, electricity production and consumption can be determined and settlements effected. For this reason metering is essential for the efficient functioning of the wholesale market. It is also required for a network in which the suppliers of the energy consumed by any particular purchaser cannot be identified.

3.25 Chapter 8 sets out the requirements for Metering Data Agents, Meter Registry and Meter Data Submissions within the market. The Metering data Agent role for a network will be taken on by either the network operator or Western Power.

Chapter 9: Settlement

3.26 Chapter 9 details the process by which settlement of market transactions occur.

3.27 Settlement occurs separately for STEM transactions and non-STEM transactions such as reserve capacity, ancillary services and market fees. Where a Rule Participant disagrees with any aspect of a settlement statement, the IMO is required to investigate. If not satisfied with the decision of the IMO, the matter can be disputed by the Rule Participant. Court action is also possible under the Market Rules.

3.28 Remedial action available to the IMO in the event of default by a Rule Participant is set out. Options include the ability to lay claim to any credit support of the Rule Participant and full or partial suspension from the market. All other grounds for suspension of Rule Participants are also set out.

Chapter 10: Market Information

3.29 Chapter 10 prescribes requirements in relation to the retention of records and dissemination of information, including the issue of confidentiality of information.

4. Submissions received by the ACCC

Prior to the draft determination

4.1 The IMO provided a supporting submission with its application for authorisation.

4.2 One submission, from Synergy was received and it is available on the ACCC's public register and website.

Following the draft determination

4.3 On 22 September 2006 the ACCC issued a draft determination in relation to the applications for authorisation. The draft determination proposed to grant authorisation.

4.4 A conference was not requested in relation to the draft determination.

4.5 The ACCC also sought submissions from around 16 interested parties potentially affected by the Market Rules, including large and small market participants.

4.6 The ACCC received two public submissions in response to the draft determination from:

- Alinta Ltd., a company active in generation and retail of energy in the Western Australian Market.
- Landfill Gas and Power Pty. Ltd., a company specialising in the production of energy from landfill in Western Australia.

4.7 The views of the IMO and interested parties are outlined in the ACCC's evaluation of the Rules in Chapter 6 of this determination. Copies of public submissions are available from the ACCC website (**www.accc.gov.au**) by following the 'Public Registers' and 'Authorisations Public Registers' links.

5. The net public benefit test

5.1 The ACCC may only grant authorisation where the relevant test in section 90 of the Act is satisfied.

Application A91004

5.2 The IMO lodged application for authorisation A91004 under sub-section 88(1) of the Act to make and give effect to an arrangement that might be an exclusionary provision within the meaning of section 45 of the Act.

5.3 Sub-section 90(8) of the Act provides that the ACCC shall not make a determination granting an authorisation under sub-section 88(1) in respect of a provision of a proposed contract, arrangement or understanding that is or may be an exclusionary provision, unless it is satisfied in all the circumstances the proposed provision or conduct would result, or be likely to result, in such a benefit to the public that the proposed contract, arrangement, of understanding ought to be authorised.

Application A91005

5.4 The IMO lodged application for authorisation A91005 under sub-section 88(1) of the Act to make and give effect to an arrangement, a provision of which might have the effect of substantially lessening competition within the meaning of section 45 of the Act.

5.5 The public benefit test for this application is found in sub-section 90(6) of the Act. This sub-section provides that the ACCC shall not make a determination granting an authorisation under sub-section 88(1) in respect of a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied that:

- the provision of the proposed contract, arrangement or understanding would result, or be likely to result, in a benefit to the public; and
- that this benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the provision concerned were given effect to.

Application A91006

5.6 The IMO lodged application for authorisation A91006 under sub-section 88(8) of the Act for the granting of an authorisation under that subsection to engage in conduct that constitutes or may constitute the practice of exclusive dealing within the meaning of section 47 of the Act.

5.7 Sub-section 90(8) of the Act provides that the ACCC shall not make a determination granting an authorisation under sub-section 88(8) in respect of proposed conduct to which sub-section 47(6) or 47(7) applies unless it is satisfied in all circumstances that the proposed conduct would result, or be likely to result in such a benefit to the public that the proposed arrangements ought to be authorised.

Application of the tests

5.8 There is some variation in the language in the Act, particularly between the tests in sections 90(6) and 90(8).

5.9 The Australian Competition Tribunal (the Tribunal) has found that the tests are not precisely the same. The Tribunal has stated the test under section 90(6) is limited to a consideration of those detriments arising from a lessening of competition but the test under section 90(8) is not so limited.[3]

5.10 However, the Tribunal has previously stated that regarding the test under section 90(6):

> [the] fact that the only public detriment to be taken into account is lessening of competition does not mean that other detriments are not to be weighed in the balance when a judgment is being made. Something relied upon as a benefit may have a beneficial, and also a detrimental, effect on society. Such detrimental effect as it has must be considered in order to determine the extent of its beneficial effect.[4]

5.11 Consequently, when applying either test, the ACCC can take most, if not all, public detriments likely to result from the relevant conduct into account either by looking at the detriment side of the equation or when assessing the extent of the benefits.

Definition of public benefit and public detriment

5.12 Public benefit is not defined in the Act. However, the Tribunal has stated that the term should be given its widest possible meaning. In particular, it includes:

> …anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements … the achievement of the economic goals of efficiency and progress.[5]

5.13 Public detriment is also not defined in the Act but the Tribunal has given the concept a wide ambit, including:

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[3] *Australian Association of Pathology Practices Incorporated* [2004] ACompT 4; 7 April 2004. This view was supported in *VFF Chicken Meat Growers' Boycott Authorisation* [2006] AcompT9 at paragraph 67.

[4] Re Association of Consulting Engineers, Australia (1981) ATPR 40-2-2 at 42788. See also: *Media Council case* (1978) ATPR 40-058 at 17606; and *Application of Southern Cross Beverages Pty. Ltd., Cadbury Schweppes Pty Ltd and Amatil Ltd for review* (1981) ATPR 40-200 at 42,763, 42766.

[5] Re 7-Eleven Stores (1994) ATPR 41-357 at 42,677. See also Queensland Co-operative Milling Association Ltd (1976) ATPR 40-012 at 17,242.

> …any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.[6]

Future with-and-without test

5.14 The ACCC applies the 'future with-and-without test' established by the Tribunal to identify and weigh the public benefit and public detriment generated by arrangements for which authorisation has been sought.[7]

5.15 Under this test, the ACCC compares the public benefit and anti-competitive detriment generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted. This requires the ACCC to predict how the relevant markets will react if authorisation is not granted. This prediction is referred to as the 'counterfactual'.

Length of authorisation

5.16 The ACCC can grant authorisation for a limited period of time.[8]

Conditions

5.17 The Act also allows the ACCC to grant authorisation subject to conditions which the ACCC considers necessary in order to satisfy the net public benefit test.[9]

Future and other parties

5.18 Applications to make or give effect to contracts, arrangements or understandings that might substantially lessen competition or constitute exclusionary provisions may be expressed to extend to:

- persons who become party to the contract, arrangement or understanding at some time in the future[10]
- persons named in the authorisation as being a party or a proposed party to the contract, arrangement or understanding.[11]

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6 Re 7-Eleven Stores (1994) ATPR 41-357 at 42,683.
7 Australian Performing Rights Association (1999) ATPR 41-701 at 42,936. See also for example: Australian Association of Pathology Practices Incorporated (2004) ATPR 41-985 at 48,556; Re Media Council of Australia (No.2) (1987) ATPR 40-774 at 48,419.
8 Section 91(1).
9 Section 91(3).
10 Section 88(10).
11 Section 88(6).

6. ACCC evaluation

6.1 The ACCC's evaluation of the Market Rules is in accordance with the net public benefit test outlined in Chapter 5 of this determination. As required by the test, it is necessary for the ACCC to assess the likely public benefits and detriments flowing from the Market Rules.

The market

6.2 The first step in assessing the effect of the conduct for which authorisation is sought is to consider the relevant market(s) affected by that conduct.

6.3 Defining the relevant market enables an assessment of the level and materiality of any anti-competitive detriment arising from the conduct proposed for authorisation.

6.4 Section 4E of the Act provides that the term market 'includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services'. Market definition thus involves identifying the sellers and buyers who effectively constrain the price and output decisions of firms engaged in the authorised conduct.

6.5 The Tribunal has stated that:

> …a market is a field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.[12]

The time dimension of the market must be long enough to allow the demand and supply responses to the conduct to work themselves out fully. The ACCC analyses substitution possibilities over the longer term (but still in the foreseeable future).

6.6 The IMO have submitted that the relevant market pertaining to the current authorisation is:

> the supply and acquisition of electricity in the wholesale electricity market in the South West Interconnected System of Western Australia.[13]

Functional dimension

6.7 The IMO submits that the functional dimension relevant to the authorisation can be described as 'wholesale'.

6.8 Activities within the wholesale electricity market include the sale (purchase) of electricity to (by) retailers or direct customers. The wholesale market should not technically include those activities:

- upstream from the sale of electricity by generators (ie. activities related to the physical generation/production of electricity) and/or
- downstream from the purchase of electricity by retailers (ie. activities related to the on-sale of electricity to end-users).

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[12] *Queensland Co-operative Milling Association Ltd (1976),* ATPR 40-012 at 17,247
[13] IMO Submission, p.23

6.9 In order to make an assessment of whether wholesale is an appropriate functional dimension in this instance, it is necessary to examine the boundaries of accountability established under the Market Rules. Specifically, to examine the extent to which decisions regarding upstream and downstream activities are constrained by the Market Rules.

6.10 The Market Rules do not cover all generators and retailers operating in the WA market, nor all of their activities.

6.11 The *Electricity Industry Act 2004* is the over-arching legislation in WA, enacted to establish the Wholesale Market Regulations and the Market Rules. It applies to all potential participants in the electricity supply chain, regardless of location, size and customer base. Section 7 of the *Electricity Industry Act 2004* requires that a person must not generate or sell electricity except under a licence issued by the ERA.[14] The ERA may take action if a licensee contravenes a licence condition (s.32), and the Governor of WA has the power to cancel a licence if the contravention is not rectified (s.35).

6.12 It is clear that for generators and retailers in WA, the majority of activities relating to the production/on-sale of electricity are governed by the *Electricity Industry Act 2004*. The licenses include the following:

- contract requirements and price regulations with respect to small-use customers (Retail Licence)
- requirement to prepare a customer service charter (Retail Licence)
- performance standards as specified in the Electricity Industry Act 2004, or as set by the ERA (Retail and Generator Licenses) and
- maintenance of an asset management system indicating measures for the proper maintenance, expansion or reduction of the generating works (Generator Licence).

6.13 Even though generators and retailers are ultimately accountable under the *Electricity Industry Act 2004*, all of their activities remain potentially affected by the Market Rules.

6.14 Section 2.28 of the Market Rules requires market participants to register with the IMO, in accordance with Regulation 14 of the *Electricity Industry (Wholesale Electricity Market) Regulations 2004*.[15] Participants that must register include:

a) Market Generators connected to the SWIS with a rated capacity of or greater than 10MW (s.2.28.6) and

b) Market Customers who sell electricity to contestable customers in respect of facilities connected to the SWIS (s.2.28.10).

6.15 Section 2.32 of the Market Rules provides that, following an order from the Energy Review Board, the IMO may suspend or de-register a market participant judged to be in

[14] Section 7 of the *Electricity Industry Act 2004* specifies monetary penalties for any persons operating facilities without the relevant licence.

[15] Regulation 19 of the *Electricity Industry (Wholesale Electricity Market) Regulations 2004* specifies monetary penalties for parties participating in the market without registration from the IMO.

breach of the Market Rules. In practical terms, section 2.32 forces the relevant party to cease trading in the electricity market until the suspension is lifted.[16]

6.16 IMO suspension under section 2.32 of the Market Rules would leave the suspended generator / retailer restricted in its ability to carry on normal activities. For generators, the inability to trade on the wholesale market will likely have ramifications for production levels upstream. For retailers, it may affect overall risk positions.

6.17 In their submission, the IMO recognises the complexity inherent in determining the precise functional boundaries of an electricity market. They argue that:

> …it is not possible or practical to differentiate on the basis of functional levels in the wholesale electricity market given the interrelationships and reliance between Market Participants to ensure the safe and reliable operation of the wholesale electricity market.[17]

6.18 The applicant's functional dimension is accepted on this basis. All elements in the electricity supply chain must be organised and coordinated to ensure that supply instantaneously adjusts to meet demand. Hence although the Market Rules primarily concern wholesale transactions, it is inevitable that some activities technically considered outside the realm of the wholesale electricity market are affected. In this context, the term 'wholesale' should be interpreted in more general terms.

Product dimension

6.19 The IMO submits that the product market relevant to the Market Rules is a wholesale electricity market incorporating the supply and acquisition of electricity.

6.20 In making an assessment of whether this is an appropriate product market to consider, the analysis of substitution possibilities is important. The Tribunal has stated that:

> Within the bounds of a market there is substitution – substitution between one product and another, and between one source of supply and another, in response to changing prices.[18]

It is useful to have regard to the following criteria: If some (but not necessarily all or even most) end-users would switch to an alternative energy supply in the event of a small but significant rise in the price of electricity, these forms of energy should be included in the relevant product market.

6.21 While recognising that electricity does compete with other forms of energy (in particular, gas) at the fringes of the market, the ACCC has not previously recognised a fully integrated energy market.[19] In the NEM Authorisation, the ACCC found the relevant market to be an electricity market, while forecasting the following:

> In the longer term…it is possible that technological developments, as well as reforms in both the gas and electricity industries, may have an impact on the degree of inter-fuel competition.[20]

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[16] The Rules affect generators and retailers in a number of other ways, including: price setting (s.2.26), prudential requirements (s.2.37-43), and incentives for generation investment and DSM (ch 4 & 5).
[17] IMO Submission, p.24
[18] Queensland Co-operative Milling Association Ltd (1976), ATPR 40-012 at 17,247
[19] See: National Electricity Code (1997); PNG Gas Project – Final Determination (2006); East Australian Pipeline Marketing Pty Ltd – Determination (1998); VENCorp Determination (1998).
[20] National Electricity Code – Determination (1997), p. 12

6.22 A decade on, there remains no technologically or economically viable alternative for electricity in many applications (eg. lighting, whitegoods). This impedes the ability of consumers to switch from electricity to alternative energy sources in response to a price rise.

6.23 In cases where substitution is technologically possible (eg. heating and cooking), it can often take time, due to the following reasons:[21]

- for residential users, substitution may require replacement of the appliance/equipment using the energy source. This represents a sunk cost, and can significantly reduce the savings to be gained from switching.
- for industrial users, switching fuels may only be practical towards the end of the economic life of the plant, often 10-15 years. Additionally, industrial users may be locked into long-term energy supply contracts which restrict their ability to switch.

6.24 A 2003 report by the Australian Bureau of Agricultural and Resource Economics (ABARE) confirms that the ability to substitute alternative energy sources for electricity is quite limited in many industries.[22] The following points on energy elasticities are worth noting:

- In 70% of the industries studied, electricity demand is highly insensitive to the electricity price. In relative terms, gas is more price sensitive than electricity, coal and oil.
- Gas and electricity are substitute energy sources in around 70% of the industries studied (and complements in around 30% of industries). Even in the industries where substitution takes place, the extent of substitution is quite weak. For example:
  - in around 85% of the industries in which gas and electricity are substitutes, a 10% increase in the electricity price leads to only a slight increase in gas demand of between 0 and 2.5%.
  - in around 35% of the industries in which gas and electricity are substitutes, a 10% increase in the gas price leads to an increase in electricity demand of greater than 5%.

6.25 These data clearly illustrate a lack of substitution possibilities for electricity as an energy source. Additionally, following a change in relative prices, there appears to be a stronger switching effect from gas to electricity than vice versa.

6.26 On this basis, it is accepted that the product market relevant to the Market Rules is one for electricity rather than for a wider energy market.

Geographic dimension

6.27 The IMO submits that the relevant geographical market is the SWIS of WA. The boundaries of the SWIS are clearly defined as the system supplying the south west of

[21] National Electricity Code – Determination (1997), pp.10-11

[22] ABARE (2003), *Australian Energy: National and State Projections to 2019-20.* ABARE studied over 20 industries across all Australian states and territories.

the State and communities north to Kalbarri, south to Albany and east to the Goldfields.[23]

6.28 Given physical and economic impracticalities, the SWIS is not currently connected to the NEM, nor is an interconnection expected in the foreseeable future. Further, the IMO submit that:

> The geographic market is unlikely to expand in the foreseeable future given the population distributions within the SWIS and locations of major loads relative to the costs and technical constraints associated with extending the SWIS beyond its current geographical limits.[24]

6.29 The ACCC accepts the view that the geographical market relevant to the Market Rules is the SWIS of WA.[25]

Conclusion

6.30 For the purposes of assessing the competition implications of the Market Rules, the ACCC accepts the relevant market as:

> the supply and acquisition of electricity in the wholesale electricity market in the South West Interconnected System of Western Australia.

The counterfactual

6.31 The ACCC applies the 'future with-and-without test' established by the Australian Competition Tribunal (Tribunal) to identify and measure the public benefit and detriment generated by the arrangements in the future if the authorisation is granted, compared with those generated if the authorisation is not granted.[26] This involves a counterfactual of identifying the conduct likely to occur if authorisation is not granted.

Submission by the IMO

6.32 The central contention of IMO's submission is that the Market Rules are an integral part of a reform process which has – at its end – the establishment of a competitive market in electricity in the South-West of WA which would not exist in the absence of the Market Rules.

> In the absence of the Market Rules, a competitively based wholesale electricity market could not operate and the economic benefits of the structural reforms would not be realised.

6.33 The establishment of this market is the source of the net public benefit claimed by the IMO in the effect of the Market Rules (see Public Benefits).

6.34 The IMO claims that in the absence of authorisation, the implementation of the wholesale market would not go ahead in WA, thereby proposing that the effective counterfactual consists of a scenario in which either the 'Top up and spill' (TUAS) market is reinstated, or some other situation far short of a competitive wholesale market. Establishment of a wholesale market which is different in design to that laid

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[23] IMO Submission, p. 6
[24] IMO Submission, p. 25
[25] It should be noted that at times when transmission constraints bind, the geographical market(s) may be confined to intra-SWIS regions rather than comprising of the entire SWIS.
[26] See, for example, *Re Australasian Performing Rights Association* (1999) ATPR 41-701.

down in the Market Rules is not envisaged, nor is implementation of the Market Rules without authorisation.

> Without the Market Rules the existing "top up and spill" electricity market could continue to operate in the SWIS. ... While the [former] regime can be employed in the short term, it is unlikely to be sustainable for any extended period of time.[27]

Top Up and Spill arrangements

6.35 At the time the application was made the current extent of wholesale electricity trade in WA consisted of a trade balancing service made available by Verve – TUAS market.

6.36 The TUAS market was introduced on 25 June 2004 to facilitate the participation of independent power producers, including private renewable energy generators, in the SWIS. The principle of the arrangements is that producers are able to purchase electricity from Verve to meet their wholesale obligations when their output falls short of their customers' demand, and may sell any power produced in excess of their customers' demand to Verve for a nominated price.

6.37 Prior to the TUAS market's introduction, Independent Power Producers were obliged to follow – as nearly as possible exactly – their customers' demand via complex metering equipment to maintain a neutral effect on [the then Western Power's] network, or pay penalty rates for deviations from this.

6.38 Verve was required under the TUAS rules to provide published balancing prices based on 'cost neutral' principles. These rules had special provisions for intermittent renewable generators, to allow them to participate effectively in the market.

6.39 Whilst this had certain obvious benefits versus the preceding arrangements, the IMO notes a number of deficiencies:

> The key public benefit issues are that the prices used under TUAS are determined by Verve, and Verve is the sole provider of balancing, reserve and standby services. If Verve retains these obligations, there will be strong pressure for it to invest in additional generation capacity. Any such investment would only extend the period of Verve's market dominance, and lessen the prospects for meaningful competition into the future.[28]

6.40 The ACCC takes this to mean that as the obligation falls on Verve to balance the system at all times and maintain adequate levels of reserve capacity under TUAS, a significant section of the market in generation must be monopolised by Verve, even while allowing for third party access to the system.

6.41 The ACCC considers that IMO's claims in this respect are valid. The TUAS scheme did not take the form of a market in which players participate on an equal basis, and placed obligations on Verve befitting an effective monopoly entity.

Implementation of the Market Rules in the absence of authorisation

6.42 In the draft determination, the ACCC adopted the IMO's counterfactual scenario that in the absence of authorisation for the Market Rules, the wholesale electricity market would not proceed, resulting in a continuation of the TUAS market.

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[27] IMO Submission, p.28
[28] IMO Submission, p.24

6.43 The ACCC has examined the possibility, however, that the Market Rules could be implemented without authorisation under the Act by virtue of their status as subsidiary provisions established under the *Electricity Industry (Wholesale Electricity Market Rules) Regulations (WA).*

6.44 When the National Electricity Code – the equivalent founding rules for the NEM – was presented to the ACCC for authorisation in 1997, it was on the basis of the nature of the Code being an agreement between several parties in the sense of a 'contract, arrangement or understanding' under the Act.

6.45 When the basis of the NEM shifted to the National Electricity Rules, which – though identical to the National Electricity Code in most respects – were made as subsidiary legislation to the National Electricity Law, the NEM jurisdictions opted not to apply for authorisation on the basis that subsidiary legislation could not be construed as a 'contract, arrangement or understanding' under the terms of the Act, and was not therefore in need of authorisation.

6.46 It is not the ACCC's role to comment on the validity of this interpretation, and whether it extends to the Market Rules as well. At this point, it is necessary to assess whether an effective counterfactual can be construed to be that the WA Government would continue to implement the Market Rules, were the ACCC to refuse authorisation.

6.47 There are a number of conceivable scenarios where the rejection of authorisation, on any grounds, would create significant uncertainty and political risk for the market and market participants, to the extent that unwinding, cancelling or significantly delaying market development would be the result. This would in turn impair the expected public benefits associated with market implementation.

6.48 Therefore, for the purposes of this authorisation, it will be assumed that WA would not continue implementation of the Market Rules in the absence of authorisation. In the absence of any challenge made to this claim by third parties or otherwise, the ACCC accepts the position put forward by the IMO on this matter.

ACCC's assessment

6.49 In the event of authorisation, it is the ACCC's judgment that the result would be the continuation and further development of a more genuinely competitive wholesale market in electricity in the SWIS.

6.50 On the other hand, while circumstances have moved on and the STEM and other market mechanisms have begun operating since the draft determination was published, the market is in its infant stages and is expected to undergo significant change.

6.51 The ACCC has received no challenge to the counterfactual presented in the draft determination, and in view of this and the significant novelty of the market's operation, considers that refusal to authorise the Market Rules could result in a crisis of legitimacy for the market.

6.52 Without authorisation the result would be the cessation of progress in implementing the market rules and political uncertainty regarding their future. This in turn would indicate an increased likelihood of a more limited access regime and market for independent

power producers existing in the future. This forms the counterfactual scenario which is the basis for this determination.

Public detriment

6.53 As discussed in section 5, the ACCC must assess the extent to which the proposed arrangements are likely to give rise to detriment to the public constituted by any lessening of competition that flows from the arrangements.

6.54 The ACCC has identified a number of potential anti-competitive detriments that may arise following implementation of the Market Rules. This section will provide an outline of those potential anti-competitive detriments which are considered to be of particular note. It is not intended to provide an exhaustive discussion of all detriments that may arise under the Market Rules.

Barriers to entry

6.55 Barriers to entry can be any feature of a market that places an efficient prospective entrant at a significant disadvantage compared with incumbent firms. The height of barriers to entry indicates the extent by which incumbents can raise the market price above its competitive level without attracting entry.

6.56 The ACCC considers that implementation of the Market Rules may introduce some new barriers to entry into the SWIS, predominantly of a legal and regulatory nature.

Application fees

6.57 Under the Market Rules (chapter 2), market participants are required to register with the IMO in a specified class, and pay an application fee. An application fee is also payable to the IMO by a market participant applying for certification of reserve capacity (chapter 4). In each case, the level of the application fee is intended to meet the estimated average costs to the IMO of processing the relevant application.

6.58 The IMO must determine and publish the level of the application fees on 1 July of each year. For the current year to 1 June 2007, wholesale market registration fees range from $210 for an intermittent generator, up to $530 for a market customer. For the same period, the application fee for conditional certification of reserve capacity has been set at a flat rate of $550. Under the Market Rules, the level of the fees is subject to independent review by the ERA in determining the IMO's allowable revenue.

6.59 The ACCC considers that the amount of these once-off application fees is likely to be immaterial for any current or potential market participants. It is therefore not anticipated that the requirement to pay application fees will in any way influence the decision to enter the market. Additionally, similar fees are currently payable under the current TUAS arrangements, as provided for by the TUAS Market Rules made subject to regulation 5(3) of the *Electricity Industry (Wholesale Electricity Market) Regulations 2004*.

Registration requirements

6.60 The Market Rules (chapter 2) prescribe prudential requirements for market participants upon registration. This includes a requirement to procure credit support from a financial institution to cover a 'credit limit'. The credit limit, calculated by the IMO for each

individual market participant, is the maximum amount that the participant is expected to owe the IMO in any 70 day period. Credit support can be in the form of a cash security deposit with the IMO, or a bank guarantee from an accepted financial institution.

6.61 Additionally, at the time of registration, registered facilities (non-Verve) must install communications systems that enable communication with System Management regarding dispatch.

6.62 Another potential barrier to entry is the requirement for market participants to pay a security deposit for certification of a reserve capacity facility which is yet to be commissioned (chapter 4). The amount of the security deposit corresponds to approximately 90 days of payment at the maximum reserve capacity price.

6.63 The IMO submits that the registration requirements under the Market Rules are imperative to ensuring the safe, secure and reliable operation of the wholesale market. Further it is submitted that the associated public benefits outweigh any potential detriments relating to barriers to entry.

6.64 This issue has been the subject of a submission to the ACCC, and is further discussed at the end of this chapter (see section "Issues raised in response to the Draft Determination").

Market fees

6.65 Under the Market Rules (chapter 2), all registered market participants are required to pay monthly market fees to the IMO. The level of the market fee is calculated annually to ensure sufficient revenue to cover the IMO's approved budgeted costs for market operation services. The amount of the market fee payable by each participant is adjusted for trading volumes (chapter 9).

6.66 The IMO submits that:

> The fees are structured to ensure Market Participants contribute in an equitable manner to the efficient costs of running the Market.[29]

6.67 The ACCC considers it is clear that the overriding objective in determining the amount of market fees is to provide for efficient cost recovery by the IMO. Further, the amount payable by each participant is commensurate with their actual participation in the wholesale market. It is therefore unlikely that any potential entrants would find the amount of the fees excessively high so as to discourage entry.

Price controls

6.68 Price controls can result in a distortion of market-based outcomes. A market determined price is an important signal for determining the most efficient use of resources and opportunities for further investment. The Market Rules provide for price controls within the SWIS.

Price caps

[29] IMO Submission, p.41

6.69 Price caps which apply in the STEM include (chapter 6):

- the Maximum STEM price – the maximum offer price applying to facilities expected to run on non-liquid fuel. Set at $150/MWh for the year commencing 1 October 2004 and is adjusted for inflation annually.

- the Alternative Maximum STEM Price - the maximum offer price applying to facilities expected to run on liquid fuel. Additionally, this is the maximum offer price for a Market Participant submitting a tender for network control services (s.5.4.7). Set at $385/MWh for the month from 1 June 2004, and adjusted monthly to take account of movements in the Singapore Crude Oil price.

6.70 These price caps reflect the short run marginal cost of the highest cost generating works in the SWIS fuelled by natural gas or distillate respectively.

6.71 The level of these price caps are significantly lower than that currently set in the NEM of $10,000/MWh. Justification for this difference is that the implementation of a RCM removes the need for STEM prices to rise to levels which reflect opportunities for investment in additional generation capacity.

6.72 Price caps which apply in the RCM include (chapter 4) the Maximum Reserve Capacity Price – the maximum price a participant may submit in a reserve capacity auction. For the first Reserve Capacity Cycle, this was set at $150,000 per MW per year.

6.73 This price cap is based on an estimate of the fixed costs of an open cycle gas turbine. This type of generator is considered because it is relatively inexpensive to build and can be built within the period between an auction being held and the capacity being required.

6.74 Price caps may constrain efficient pricing of both reserve capacity and electricity generation. If price caps in the STEM and RCM are set too low then investment in new generation capacity, particularly peaking plant, could fall below the level required to meet system demand. Such a result would have a material impact on the overall reliability of the system.

6.75 The potential for this result should be diminished through the operation of the RCM. Capacity is scheduled approximately two years in advance of the time in which it is required to meet expected market demand, allowing for options to be explored in the event of insufficient interest in supplying capacity by market participants. Accuracy of demand forecasts released in the Statement of Opportunity Report is then the critical issue for ensuring sufficient capacity.

6.76 The IMO submits that price controls will assist in the transition to a competitive market. It states that:

> Given the newness of the Market it is considered that a public benefit is derived by ensuring an orderly market transition by providing mechanisms for price signalling, however it is considered prudent to adopt pricing limits that would limit the financial risks of Market Participants while they become familiar with the new Market trading arrangements and/or any potential market power that may deter new entry in the Market.[30]

[30] IMO Submission, p.41

6.77 The electricity market is characterised by a relatively high inelasticity to price signals in real-time for most types of consumer. Price controls should result in large price shocks being avoided, reducing the financial risk of market participants. Although market participants can limit their exposure to price shocks by entering into bilateral contracts, this is less likely to be the case for new entrants in the market. Additional certainty provided by price controls may therefore help to encourage new entry.

6.78 The basis for determining the level of the price caps should mean that they are set sufficiently high to minimise distortions of market. Additionally, the STEM and RCM price limits are required to be reviewed annually by the IMO (s.6.20 and s.4.16 respectively), with proposed changes to be submitted to the ERA for approval.

6.79 In addition to the annual review of price limits by the IMO, the ERA is required to conduct a more comprehensive review of price limits within the STEM and RCM every five years (s.2.26). These review provisions will allow for price limits to be adjusted over time to reflect market realities and minimise any distortions to competitively determined market outcomes.

6.80 The ACCC considers that given the newness of the market and the associated lack of established competition, it is prudent to adopt pricing limits which mitigate the potential for abuses of market power, avoid price shocks to the extent possible and reduce the financial risks of participants with the aim of encouraging new entry into the market.

Monthly reserve capacity price in the RCM

6.81 The monthly reserve capacity price is paid to facilities with capacity credits which are not traded bilaterally. It is determined through the reserve capacity auction, or if no auction is held, is set at 85% of the maximum reserve capacity price.

6.82 The administered price mechanism in the event of no auction occurring sets a price expectation for participants when contracting, and may therefore mute competitive pressures in the capacity market. Additionally, capacity holders may face incentives to induce a no-auction outcome where there is an expectation that the auction process will produce a price below the fallback level.

6.83 The ACCC considers that with provisions in the Market Rules for the bilateral contracting of reserve capacity credits, it is necessary for an administered default price to be in place. In the event that a bilateral agreement cannot be reached between capacity holders and market customers, the administered price will ensure a return for capacity holders and provide an avenue for market customers to meet their individual reserve requirement.

6.84 In addition, the administered price provides a return on scheduled capacity in excess of the reserve capacity requirement. A fixed price for the supply of excess capacity increases the financial risk to market customers as a result of the need to fund an uncertain quantity of excess capacity. However, the financial risk associated with investment in additional capacity is reduced, potentially encouraging further entry into the market and resulting in greater reliability of supply.

6.85 The need for an administered price could be removed through a change to the capacity credit allocation process. Allocation of all capacity credits through an auction would

remove the need to contract bilaterally and provide for a market-determined price for capacity. However, given the current concentration of market power, it is uncertain whether a market-based mechanism will produce competitive pricing outcomes.

6.86 The ACCC considers that the arrangements under the Market Rules for an administered monthly reserve capacity price are appropriate given the current lack of established competition.

Quantity controls

6.87 Quantity controls can lead to a departure from the efficient quantity of output that would be offered for sale in a competitive market. In other words, when compared to 'the efficient level of output', such controls may result in an over/under supply of the good or service.

6.88 The ACCC considers that implementation of the Market Rules may introduce some new quantity controls on energy supply in the SWIS.

Dispatch instructions

6.89 System Management has the important role of ensuring that the system will be balanced in real time (chapter 7). At times of system imbalances, System Management may issue dispatch instructions to (non-Verve) market participants, instructing them to depart from the output/consumption levels indicated in their resource plans.

6.90 The Market Rules (chapters 6 & 7) provide that the order in which facilities will be issued dispatch instructions is:

1) Verve non-liquid fuel facilities

2) Non-Verve non-liquid fuel scheduled generators / dispatchable loads

3) Verve liquid fuel facilities and finally

4) Non-Verve liquid fuel scheduled generators / dispatchable loads.

This dispatch merit order appears to discriminate against certain parties (non-Verve) and certain types of generation (non-liquid fuel).

6.91 System Management is charged with ensuring that the required level of output (real-time demand) is met by all available options. In the Draft Determination, the ACCC claimed that for balancing purposes, as Verve remains the dominant generator, it makes sense for its facilities to be dispatched first. This conclusion has been challenged in a public submission and the issue is further dealt with at the end of this section (see "Issues raised in response to the Draft Determination").

6.92 Granting dispatch priority to lower cost non-liquid fuel generators discourages generally high cost liquid fuel options from being called upon inappropriately.

Trading limits

6.93 As part of the prudential requirements, the Market Rules (chapter 2) set a trading limit for each participant, as a proportion of their credit limit. This is intended to ensure that

a market participant cannot extend its financial commitments beyond its established limits. If at any time the trading limit is exceeded, the IMO will issue a margin call for additional credit support. Additionally, if a market participant has been involved in a defined 'suspension event' (chapter 9), the IMO may draw on that participant's credit support. As the amount of credit support is reduced, the participant's trading limit is commensurately reduced.

6.94 The ACCC considers that the imposed trading limit is a prudent financial risk management measure. Whilst the requirement somewhat impinges on the freedom of participants to trade in the market, it mitigates the potential for a financial default, thereby protecting the integrity of the market.

Limits on reserve capacity

6.95 The quantity of bilateral trade of certified reserve capacity for each market participant must be approved by the IMO, so as to ensure that total bilateral trade does not exceed the total reserve capacity requirement of the system (chapter 4). By specifying a reserve capacity requirement (peak demand plus a margin), the RCM places a floor on the amount of capacity that must be available for dispatch at any given time. Additionally, obligations are placed on market customers to purchase sufficient capacity credits to fund the reserve capacity requirement.

6.96 In effect, the IMO fixes the quantity of reserve capacity required, and allows the price of capacity credits to adjust through bilateral contracting to meet this requirement. As discussed above (s.6.78), the fallback price – 85% of the maximum reserve capacity price – sets a price expectation for participants, reducing the scope for competitive adjustment in the reserve capacity market. In addition, market customers are forced to fund excess reserve capacity (if any) at the fallback price, where a competitive market could be expected to deliver a lower price.

6.97 The ACCC considers that the process for assigning capacity credits may result in an above market payment for excess reserve capacity. The ACCC understands that the objective of this arrangement is primarily to address the current level of competition in the market. It is noted that these and related issues were the subject of a number of recent rule change proposals and further refinement of these provisions is anticipated.

Price manipulation

6.98 The ACCC considers that the Market Rules may result in the potential for market participants to engage in price manipulation.

Information requirements

6.99 System management is required to conduct forecasting studies for the short and medium term (chapter 3). These studies are published by the IMO. Included in the studies is information on peak load, available generation and DSM capacity, transmission capacity and periods of expected capacity shortfall. Additionally, the IMO must publish information with respect to the operation of the market (chapter 10).

6.100 Access to this information by market participants may lead to anti-competitive conduct that would not be possible in the absence of such information.

6.101 Despite this concern, the ACCC considers that the publication of the above information is essential to the security and reliability of electricity supply in the SWIS. Efficiency of resource allocation and investment is likely to be improved as current and potential participants are better informed of opportunities in the market. Transparency in the operation of the market is also likely to increase the confidence of market participants.

Collusion

6.102 Timing of planned outages must be coordinated between network operators and other market participants under the Market Rules (chapter 3). This requirement presents an opportunity for collusion between market participants that may affect market clearing prices when outages occur.

6.103 The ACCC considers that coordination of outages for equipment and facilities is necessary in ensuring sufficient generation capacity to meet the energy needs of the SWIS. Requirements in the Market Rules for a review by System Management of outage plans submitted by market participants should minimise the opportunity for collusive activity. Network operators are required by the Access Code to have no interest in generation activities.

Market power

6.104 A stated objective of the WA electricity reforms has been to address the market dominance of the incumbents. Increased competition is expected to bring about efficiency gains in the industry, leading to lower final electricity prices.

6.105 The ACCC considers that there are some provisions in the Market Rules that appear to maintain a preference for the incumbent entities.

Ancillary services

6.106 The Market Rules (chapter 3) appear to create a preference for Verve as the provider of ancillary services. Section 3.11.8 allows System Management to acquire ancillary services from a non-Verve source where:

- Verve does not have the capacity to meet the ancillary service requirement set by the IMO or
- the ancillary services offered by the non-Verve source represent a less expensive option.

6.107 It is not specified how System Management assesses the relative cost of alternative providers of ancillary services. It is clear however that Verve is the preferred provider of ancillary services under the Market Rules. The IMO submits that:

> These provisions are considered to deliver a public benefit given that Western Power's network covers all of the SWIS and it currently provides ancillary services to System Management. Additionally the ancillary services requirements are subject to review at least once within five years of market commencement.[31]

[31] IMO Submission, p.46

6.108 The ACCC agrees that the logical provider of ancillary services in the current context is the incumbent. It is expected that the review process will allow this to change over time as competition develops.

Issues raised in response to the Draft Determination

6.109 Following the draft determination, the principal issues raised by interested parties were:

- The potential anti-competitive effects of the emergency dispatch instructions arrangements
- The potential anti-competitive effects of the administered price caps in the Reserve Capacity Mechanism and
- Levels of prudential requirements.

Public detriment – issue 1 – Balancing and dispatch arrangements

ACCC's view in the draft determination

6.110 The ACCC concluded that the balancing arrangements, whereby Verve generation assets would be automatically called on by System Management in the event that dispatch is needed, constitute a practical near-term arrangement, though falling short of a competitive outcome.

6.111 The ACCC, in its draft determination, said:

> The ACCC considers that these quantity controls are unlikely to result in a significant departure from the efficient level of output.

And

> … Verve facilities are most likely to be available in a scenario where despatch orders are given, and Verve facilities are most likely to have sufficient spinning capacity to respond adequately to events. It is also a role in line with Verve's obligations to provide network support (ancillary services) as discussed later in this chapter.

Issues arising from the draft determination

6.112 In its submission, Alinta disagrees with the ACCC's conclusion, stating:

> Alinta does not agree with ACCC's [sic] assessment in section 6.88 that Verve Energy's facilities are most likely to be available in a scenario where dispatch orders are given to balance the system in real time and that they are most likely to have sufficient spinning reserve capacity respond adequately to events. Non-Verve Energy generators should be allowed to participate in balancing the system on the same terms as applies to Verve Energy. Allowing non-Verve Energy generators to participate in balancing the system would positively influence the flexibility of the future generation mix as private generation providers would be more likely to install generation capacity suited to provide a balancing service.

ACCC's conclusion

6.113 The ACCC understands Alinta's concerns with respect of the dispatch order instructions prevailing in the SWIS at the current time. The ACCC agrees that the

current arrangements are a restriction upon competition which offsets the public benefit of competition in the generation sector.

6.114 It should be noted, however, that the quantity of energy which is likely to be dispatched via Verve generators under these arrangements, which may have been dispatched by other generators under more even-handed rules, is likely to be very small at the current time, in view of the large installed capacity of Verve.

6.115 Against the competitive benefit of more even handed balancing arrangements, the IMO contends that the current arrangements provide for a significantly simplified arrangement, reducing the complexity of ensuring smooth operation of the market in its infant stages and reducing system costs. The IMO contends that the current arrangements are viewed as temporary and that reviews of the rules are planned in 2007 which may have more competitive arrangements as an outcome.

6.116 The ACCC believes that the current arrangements fall short of the ideal for competitively neutral arrangements in the market, and that the public benefit would be best served by allowing independent power producers to provide a balancing service on an equal footing with Verve Energy. However, in view of the review mechanisms in place and the importance of these arrangements as a transitional step toward a fully competitive market, the ACCC does not propose to impose a condition of authorisation with respect to these arrangements.

Public detriment – issue 2 – Administered price caps

ACCC's view in the draft determination

6.117 In the draft determination the ACCC said:

> The ACCC agrees that price controls will assist in the orderly establishment of a competitive market. Although price caps act to restrict market outcomes, it cannot be assumed that market determined prices in the STEM and RCM will initially reflect competitive outcomes. Competition in the generation sector is expected to be limited at the commencement of the market, providing the potential for market power to be used to distort market prices.

Issues arising from the draft determination

6.118 In its written submission, Alinta says:

> Alinta agrees with [the] ACCC's assessment in section 6.77 of the draft determination that having in place price caps for the Short Term Energy Market (STEM) is prudent in the initial phase of the market to limit the potential for market power abuse.

But

> Alinta is concerned that the mechanism for setting the administered price si introducing unnecessary price uncertainty in the [Reserve Capacity] market increasing the cost of financing additional capacity. Alinta considers that [the] ACCC's suggestion in section 6.82 to look at alternatives in setting the RCM, including via auction only, should be explored in more detail.

ACCC's conclusion

6.119 Alinta's concerns with respect to the uncertainties that administered price caps introduce to markets, especially concerning the way in which these caps are adjusted by the responsible bodies, are well founded.

6.120 Ultimately, a fully competitive means of determining the price of additional capacity is desirable. Many potential mechanisms exist to achieve this - uncapped price auctions, separate reserve capacity markets, or gross pool markets all provide for this.

6.121 Of interest to the ACCC are developments in the Market Rules currently under consideration, including the proposal to alter the criteria for acceptable STEM bids to reflect generators' reasonable expectations of their short-term marginal costs.[32]

6.122 This appears to be a consequence of early experience in the STEM being of prices running at the Maximum STEM Price for extended periods of time. This may be taken to be an indication of the MSP being set too low for generators to recover efficient costs, or the exercise of market power within the STEM, or both.

6.123 Verve Energy has submitted a rule change proposal[33] requesting that the MSP and Alternative MSP be set at a higher level, so as to:

> … enable Verve Energy and other generators to accurately reflect their operating costs during times of supply scarcity

6.124 Verve Energy, in its submission on the proposal to alter the criteria of acceptable bids, notes that in between the provision of reserve capacity credits to recover capital costs, and the short run marginal costs of generation, there are other costs which may not be able to be recovered from either mechanism.[34]

6.125 Ultimately, market testing of bid prices should reflect generators' actual efficient costs to the extent that criteria for acceptable bids should not need to be a factor except in investigating exceptional circumstances and incidents of market power. The ACCC would like to see the use of the STEM as a signal for investment and in this respect the system of administered price caps requires further development.

6.126 The ACCC notes that no market participant has disagreed, *per se*, that the current price caps are a prudent provision at this stage of the market. The ACCC is of the view that the question of how to ensure fully competitive outcomes should be addressed as the market matures.

Public detriment – issue 3 – Levels of prudential requirements

ACCC's view in the draft determination

6.127 In its draft determination, the ACCC concluded:

> The registration requirements are essential to the smooth operation of the wholesale market, and are not considered excessively onerous on market participants. Importantly, in calculating a participant's credit limit, the IMO takes into account historical bilateral levels of trade. This makes the credit limit realistic and specific to the individual circumstances of the market participant. In addition, the ACCC considers that the collection of a reserve capacity security deposit is essential to ensure that the plant is available by the scheduled date. It is clear that the amount of the deposit is intended to provide some form of financial consequence to the party offering reserve capacity, rather than any reflection of IMO's legal liability if the capacity does not eventuate.

[32] Rule Change Proposal CR5, available on the Office of Energy's web site.
[33] Rule Change Proposal CR2
[34] See Verve's submission dated 1 November 2006, available on the Office of Energy's web site.

Issues arising from the draft determination

6.128 Landfill Gas and Power Pty. Ltd. made a submission to the ACCC regarding the level of prudential requirements levied upon it under the market rules subsequent to market start. In particular it was pointed out that the effective level of guarantees was double what was required for the company under the preceding TUAS requirements.

ACCC's conclusion

6.129 The ACCC notes that under the new arrangements, participants trading in the market are subject to a range of new responsibilities and roles, including trading energy directly through the STEM, and buying and supplying capacity credits through the RCM. Prudential requirements are a feature of most electricity markets, and the requirements laid down in the Market Rules are not exceptional in their nature. It is the ACCC's judgment that the requirements of the Market Rules are not anticompetitive in their intent.

ACCC conclusion on public detriments

The ACCC considers that the Market Rules contain provisions which can be construed to be public detriments as compared to the most desirable form of competitive outcomes. These detriments, however, are associated with provisions which have the effect of enabling the overarching public benefit claimed for the implementation of the Market Rules.

Public benefit

6.131 As discussed in section 5, the ACCC must assess the public benefit that is expected to flow from the authorised conduct.

6.132 The IMO has submitted that there are a number of benefits that will arise following implementation of the Market Rules. These claimed benefits are addressed in turn below.

Increased competition

6.133 The IMO submits that economic benefits will flow from increased actual and potential competition for electricity supply in the SWIS. Competition will be introduced via:

- the RCM, which provides opportunities to supply reserve capacity (including DSM options) and to trade capacity credits
- the implementation of the STEM
- provisions in the Market Rules for ancillary services and balancing and
- tenders between networks, generation and DSM for Network Control Service (augmentation) options.

ACCC's view

The Reserve Capacity Mechanism

6.134 The ACCC considers that the RCM provides a framework for increased competitive pressures in the supply of capacity to the SWIS. The Market Rules create a capacity market by enforcing two requirements on market participants:

1) retailers must acquire sufficient capacity credits to cover their demand requirements (plus a reserve margin) and

2) capacity-holders (generators and DSM options) must certify and make available their capacity to the market in order to receive revenue from the sale of capacity credits.

6.135 Creating trade through these requirements creates a market price for capacity in the SWIS – the price of capacity credits. Without authorisation of the Market Rules, the market price of capacity will not be a separately determined price – under the TUAS regime, the price of capacity is included in overall energy prices negotiated bilaterally.

6.136 The implementation of the RCM will allow generators and DSM to compete based on the bilateral price offered to retailers for capacity credits. However, as discussed above in the analysis of potential anti-competitive detriments, the extent of competition may be influenced by an administered monthly reserve capacity price.

6.137 The ACCC considers that there is potential for competition in the supply of capacity under the RCM, provided new players enter the market. In 2005, fourteen companies expressed an interest in providing new generation capacity via the RCM in 2007-08. The companies offered a total capacity of 2743 MW, well in excess of the forecast additional requirement of 400 MW[35].

6.138 If the potential for competition is realised, the ACCC accepts that public benefits will flow in the form of lower final electricity prices, and more efficient signals for generation investment. It should be noted that the Western Australian government has placed a cap on the ability of Verve to invest in new generation capacity, and this should stimulate competition in certified capacity as other suppliers step in to fulfil increasing demand.

The Short Term Energy Market

6.139 The ACCC considers that the implementation of the STEM will produce competitive pressures, particularly during periods of peak demand. At any given time, it provides a market for the supply/purchase of energy to all registered market participants (including intermittent generators).

6.140 The ability of market participants to adjust bilateral contract positions a day-ahead through the STEM will be constrained by the contract positions of other market participants. Moreover, the spot price in the STEM is competitively determined on a lowest marginal bid basis. The STEM therefore sets the framework for active competition between generators at the margin, encouraging cost-reflective bidding.

6.141 The extent to which there is any significant increase in competition via the STEM is likely to be dependent upon:

[35] IMO (2005), *A Review of the First Reserve Capacity* Cycle. It should be noted that for 1650 MW of this 'offered capacity', the approval process for the relevant facilities had not yet commenced.

- entry by new generators and retailers to the SWIS
- peak demand conditions and
- the number of, and competition between, peaking generators installed.

Ancillary services and balancing

6.142 As discussed above, the Market Rules (chapter 3) limit the acquisition of ancillary services from non-Verve sources. System Management may only acquire ancillary services from a non-Verve source where it cannot meet the requirements using Verve's registered facilities, or other services are less expensive.

6.143 The ACCC considers that placing such a requirement on System Management – to acquire ancillary services from the least expensive source – may stimulate competition in the provision of ancillary services. However there does not appear to be a mechanism in the Market Rules for System Management to determine the least expensive option.

6.144 The likely outcome of the ancillary services arrangements is that System Management will continue to acquire all or most ancillary services from Verve. This will limit the possible benefits that could arise from more competitive sourcing of ancillary services. These arrangements are to be reviewed within five years of market commencement.

6.145 The ACCC is of the view that the proposed ancillary services arrangements contribute to anti-competitive detriment by not having a defined procedure for allowing non-Verve sources to supply ancillary services. However the detriment is not sufficient to warrant imposing a condition requiring a competitive procedure be incorporated into the rules for the acquisition of ancillary services. The ACCC is of the view, however, that the public benefit would be enhanced by its inclusion. Such a procedure could take the form of a competitive tender process, or an ancillary services market. In the NEM both processes are used by NEMMCO to source ancillary services, depending in part on the level of prospective competition for the supply of different types of ancillary services. Where there are a large number of potential suppliers, NEMMCO has introduced a spot market for supply of ancillary services. NEMMCO also uses tendering processes to ensure it gets the required amount of ancillary services at the best price, where spot market arrangements are not feasible.

6.146 The balancing service allows System Management to account for real time variations in supply and demand by issuing last-minute dispatch instructions. The 'balancing price' will usually equal the STEM spot price, unless in exceptional circumstances. The ACCC considers that this represents a more competitive outcome than under the TUAS arrangement.

Network control service (augmentation) options

6.147 The Market Rules allow networks, generators and DSM to participate in a competitive tender for network augmentation. The ACCC considers that such a tender – considering all viable alternatives – sets the framework for a more competitive outcome in relation to augmentation decisions.

Incentives for demand side management

6.148 The IMO states that economic and environmental benefits will result from incentives under the Market Rules for the introduction of DSM options in relation to reserve capacity and network control services.

6.149 Options available to a provider of DSM capacity for participation in the market include:

- Offering capacity into the RCM, and making it available for dispatch by System Management
- Contracting with the IMO through a supplementary capacity auction in the event of a short-term capacity shortage
- Entering into ancillary service contracts for the use of the capacity for spinning reserve services
- Contracting with a retailer to reduce the retailers peak demand and hence the retailer's capacity requirements
- Entering into network control service contracts as a substitute for network augmentation.

ACCC's view

6.150 The Market Rules provide for consideration of DSM options on an even footing with generation options for the provision of capacity in the RCM. Likewise, both generation and network augmentation options are to be considered for the provision of network control services.

6.151 The ACCC considers that the recognition of DSM options under the Market Rules may result in a public benefit through an increase in competitive pressure within the market. Additionally, the availability of a greater range of options for meeting system requirements will allow for the more efficient use of scarce resources. It is noted, however, that the implementation of DSM options is limited by network constraints, with a sufficient level of electricity generation needed to maintain security and reliability of the system.

6.152 The ACCC accepts that the Market Rules will improve incentives for the introduction of DSM options to meet system capacity requirements. Implementation of the RCM components of the Market Rules resulted in the commitment of 131MW of DSM capacity for the 2007-08 capacity year.

6.153 The ACCC also accepts that environmental benefits will result from a substitution of DSM for electricity production.

Effective and transparent price signalling

6.154 The IMO submits that the introduction of competitive processes across the market will provide improved signalling to market participants. It states that:

> The development of market based incentives will improve the efficiency of resource allocation as more transparent price signalling will be evident to existing market participants and prospective new entrants.

6.155 The claimed benefits of these mechanisms are to:

- Improve efficiency in energy use

- Provide incentives to decrease consumption at times of peak demand and
- Potentially defer the need for new investment.

ACCC's view

6.156 The ACCC considers that the encouragement of market-based pricing will assist all current and potential market participants in their decision-making.

6.157 The separation of energy costs and capacity costs in two distinct markets will allow market participants, both current and potential new entrants, to make better-informed decisions. In addition, by allowing DSM options to compete (eg. for capacity credits and network augmentations), the Market Rules provide new signals to large end-users that DSM is economically viable.

Deferral of new capital investment or avoidance of inefficient investment

6.158 The IMO states that economic and environmental benefits will result from the adoption of competitive tendering mechanisms which allow for DSM or generation options to substitute for network augmentations.

ACCC's view

6.159 The ACCC considers that processes in place under the Market Rules for the procurement of network control services will allow for more informed investment decisions. The requirement to assess generation and DSM alternatives to a network augmentation and select the most cost effective option should lead to efficient provision of network control services.

Increased levels of intermittent generator participation

6.160 The IMO states that economic and environmental benefits will result from provisions in the Market Rules that facilitate increased levels of intermittent generator[36] participation.

6.161 In particular, the STEM is said to be essential to growth in the use of intermittent generators. The ability to put all excess output into the market and purchase additional supplies in the event of a shortfall removes the need to match generator output with customer demand and allows participation in the market by new operators without an established customer base.

6.162 Other provisions in the Market Rules which encourage the use of intermittent generation include:

- The reserve capacity obligation quantity is zero for intermittent generators. Intermittent generators which participate in the RCM are not under any obligation to provide specific levels of generation, but rather must generate to the greatest extent possible when required in real-time.

[36] Intermittent generators are generators which cannot accurately predict their output level in advance. Generators which rely on renewable energy sources such as solar, wind or landfill gas fall within this definition.

- Intermittent generators are not required to submit operating plans with output schedules. Accordingly, no financial penalties will apply for deviations from planned output.

- If registered as a non-scheduled generator, an intermittent generator may be exempt from the requirement to fund spinning reserve.

ACCC's view

6.163 The ACCC considers that increased levels of intermittent generator participation in the market may result in greater competitive pressure and the potential for improved efficiency in resource allocation. Environmental benefits may also result from the increased use of generators relying on renewable resources.

6.164 It is noted that the benefits claimed under the Market Rules in respect of the STEM are also likely to result from the operation of the TUAS regime. Participants currently have the ability to trade energy through a balancing service offered by Western Power, removing the need to match generator output with customer demand.

6.165 The ACCC considers that the ability of intermittent generators to participate in the RCM may encourage investment in this form of technology. However, priority rules for participation in the RCM may act to limit the ability of intermittent generators to procure capacity credits.

6.166 It is also noted that increased levels of intermittent generation may create added costs in balancing the network and providing appropriate infrastructure to support it. The Western Australian government has pursued higher levels of intermittent generator participation on the basis that these costs are outweighed by the public benefits. This is a legitimate view of the balance of benefits, in the ACCC's judgment.

6.167 Notwithstanding the above discussion, the ACCC considers that the net result of the Market Rules is to provide an environment conducive to the participation of intermittent generators in the wholesale electricity market, with identifiable economic and environmental benefits resulting.

Introducing a framework for new entry

6.168 The IMO submits that implementation of the Market Rules will encourage new entry into the SWIS, particularly by intermittent generators, DSM options and retailers.

6.169 The IMO claims that by removing the need to match moment by moment output with demand, the existing TUAS arrangements have already provided some initial benefits to intermittent generators. It states that:

> The move to the full wholesale electricity market will be a far more significant development and will bring greater benefits.[37]

It is submitted that a competitive wholesale market, complemented by the vertical disaggregation of Western Power and the introduction of the networks access regime, will provide greater incentives for entry by intermittent generators.

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[37] IMO Submission, p.34

6.170 There are various provisions within the Market Rules have the effect of placing DSM options on a level playing field with generation (eg. RCM) and networks (eg. Network Control Services). The IMO submits that these provisions will encourage more users to consider DSM options.

6.171 The IMO also submits that the introduction of a wholesale electricity market will make it easier for retailers to operate in the SWIS. Although it concedes that the retail market is distinct in operation from the wholesale market, it argues that:

> …the two markets are linked in the sense that retailers are 'market customers' in the wholesale electricity market and will have a commercial incentive to offer least cost options to contestable customers.[38]

The IMO claims that compared with the current TUAS arrangements, the STEM and related balancing service will better allow retailers to adjust their contract positions.

ACCC's View

6.172 In relation to the entry of intermittent generators, it is unclear how the move to a competitive wholesale market will represent a 'far more significant development' than that under the current TUAS arrangements. Intermittent generators will continue to have an assured destination for their supply (and a source of demand), albeit through a competitive market rather than through Verve. Hence the primary claimed benefit – to remove the need to match output with demand in real time – has been in essence created by the TUAS arrangements. However, as discussed in the section 'future with-and-without test', the TUAS arrangements cannot be viewed as a permanent and sustainable solution to market entry and balancing in the SWIS.

6.173 Given that most intermittent generators have very low short-run costs (ie. nil energy costs), they are likely to bid low in order to ensure dispatch whenever their output is available. However to be viable in the long-run they need to ensure recovery of usually large capital (fixed) costs. It is therefore important that the price that intermittent generators receive for their output sold in the STEM is sufficiently high so as to encourage viable entry. The ACCC agrees that it is the combination of reforms undertaken in the SWIS that is likely to encourage new entry by intermittent generators.

6.174 The ACCC agrees that the Market Rules provide encouragement to large users to consider DSM options.

6.175 The ACCC agrees that although many retail activities fall outside the realm of the wholesale market, there are important connections due to the role of the retailers as the wholesale purchaser of energy. This is discussed above under market definition (section 6.6). The ability for retailers to better adjust for and manage risk through the STEM may encourage new retailer entry. However the ACCC considers that the real driver for new entry into the retail market is likely to be further reductions in the contestability thresholds.

Economic efficiency

[38] IMO Submission, p.35

6.176 The IMO submits that the Market Rules provide public benefits related to the promotion of productive, allocative and dynamic efficiency. They state that:

> In addition to enhancing competition into the market the Market Rules provide incentives for existing businesses and new entrants to minimise costs, innovate and adopt new technologies.[39]

6.177 The IMO submits that by providing auction and tendering mechanisms that reward least cost production, the Market Rules provide for gains in productive efficiency. Further, allocative efficiency is achieved as enhanced price signalling allows market participants to observe prices that reflect the true economic cost of the good or service. Finally, the IMO argues that dynamic efficiency incentives are enhanced through provisions that allow DSM options to compete on a level playing field with generation (particularly through the RCM).

ACCC's View

6.178 As discussed above, the ACCC agrees that the establishment of a more competitive environment has the potential to encourage efficiency gains, provided that new players enter the market.

Security and reliability of supply

6.179 The IMO states that the processes involved in the RCM will ensure that sufficient generation and demand side management capacity is provided to meet the energy needs of the SWIS. Through the RCM, the IMO makes provisions for sufficient capacity to serve the annual peak load expected to occur not more than once every ten years while the largest generator is unavailable. Additionally, the Statement of Opportunities Report, which provides ten year forecasts of generation adequacy, identifies opportunities for investment in capacity.

6.180 The IMO also submits that the Market Rules provide a framework for the secure and reliable supply of electricity in the SWIS, recognising the imperative to ensure that supply equates to demand in real time.

ACCC's view

Reserve Capacity Mechanism

6.181 The ACCC considers that the introduction of the RCM will reduce the potential for shortages in generation capacity being experienced in the SWIS compared to any likely scenario where the RCM is absent. The RCM involves processes which:

- reduce the risk of investment in additional capacity through a guarantee of a return regardless of whether capacity is scheduled in the energy market
- encourage the commitment of capacity well in advance of the time in which it is needed to meet expected energy demand and
- allow for capacity shortages to be overcome through short-term contracts with capacity providers.

[39] IMO Submission, p.36

6.182 The extent to which the RCM operates to encourage the introduction of additional capacity and prevent capacity shortages in the SWIS will be dependent upon:

- the accuracy of long-term energy demand forecasts released by the IMO and
- the price offered for reserve capacity being sufficient to make additional investment commercially viable.

System operation and oversight

6.183 The ACCC considers that there is an appropriate framework established in the Market Rules for the secure and reliable supply of electricity in the SWIS. Clearly defined responsibilities are granted to specific market participants to achieve this goal:

- System Management is the main body responsible for ensuring reliability of supply over the short to medium term. It must operate the power system within its technical limits, coordinate planned outages, and procure adequate ancillary services as a last resort. In addition, it is responsible for monitoring participants' compliance with the Market Rules relating to network security and reliability.
- The IMO also has major responsibilities for ensuring reliability and security of supply, through its operation of the STEM and RCM, and as provider of incentives for DSM capacity. In addition, the IMO will coordinate investigations into major power system disturbances as reported by System Management and other relevant market participants.

6.184 Although the Market Rules provide a clear framework for maintaining a secure and reliable supply of electricity, it is noted that these functions will be undertaken in some form by market participants regardless of whether the Market Rules are introduced. Balancing and dispatch services under the TUAS regime are carried out by Western Power, with mechanisms in place for resolving industry disputes.

ACCC conclusion on public benefits

The ACCC is satisfied that the proposed Market Rules are likely to result in the following public benefits:

- increased competition in the production and supply of electricity in the SWIS
- improved security and reliability of supply of electricity in the SWIS
- environmental benefits from the take-up of renewable energy and DSM options.

Balance of public benefit and detriment

6.185 The ACCC may only grant authorisation if it is satisfied that, in all the circumstances, the market rules are likely to result in a public benefit that will outweigh any public detriment.

6.186 In the context of applying the net public benefit test at section 90(8)[40] of the Act, the Tribunal commented that:

> … something more than a negligible benefit is required before the power to grant authorisation can be exercised.[41]

6.187 The ACCC is satisfied that the proposed Wholesale Electricity Market Rules are likely to result in the following public benefits:

- increased competition in the production and supply of electricity in the SWIS
- improved security and reliability of supply of electricity in the SWIS
- environmental benefits from the take-up of renewable energy and DSM options.

6.188 The ACCC is of the view that there are likely to be limited anti-competitive detriments arising from the proposed arrangements. In particular, the ACCC noted that the Market Rules are designed to implement a potentially competitive wholesale electricity market in the SWIS where there is currently only limited competition and choice.

6.189 On balance, the ACCC is satisfied that the public benefits likely to arise from the proposed arrangements will outweigh the likely public detriments.

6.190 Accordingly, the ACCC proposes to grant authorisation to applications A91004, A91005 and A91006.

Length of authorisation

6.191 The ACCC generally considers it appropriate to grant authorisation for a limited period of time, so as to allow an authorisation to be reviewed in the light of any changed circumstances.

6.192 In this instance, the IMO seeks authorisation for 15 years.

6.193 The ACCC considers that in view of the large scale of the endeavour being undertaken in implementing the Market Rules, that a period of 15 years is appropriate for this authorisation.

6.194 Therefore, the ACCC grants authorisation to the Market Rules for a period of 15 years.

Variations to the Market Rules

6.195 The ACCC notes that any amendments to the Market Rules during the term of this authorisation would not be covered by the authorisation.

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[40] The test at 90(8) of the Act is in essence that conduct is likely to result in such a benefit to the public that it should be allowed to take place.

[41] Re Application by Michael Jools, President of the NSW Taxi Drivers Association [2006] ACompT 5 at paragraph 22.

7. Determination

The application

7.1 On 29 June 2006 the IMO lodged applications for authorisation A91004, A91005 and A91006 with the Australian Competition and Consumer Commission (the ACCC).

7.2 Application for authorisation A91004 was made under sub-section 88(1) of the Act for the granting of an authorisation under that sub-section:

- to make a contract or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be, or might be, an exclusionary provision within the meaning of section 45 of the Act;
- to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of the section 45 of Act.

7.3 Application for authorisation A91005 was made under sub-section 88(1) of the Act for the granting of an authorisation under that sub-section:

- to make a contract or arrangement, or arrive at an understanding, where a provision of which would have the purpose, or would have or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act;
- to give effect to a provision of a contract, arrangement or understanding where the provision has the purpose, or has or may have the effect, of substantially lessening competition within the meaning of section 45 of the Act.

7.4 Application for authorisation A91006 was made under sub-section 88(8) of the Act for the granting of an authorisation under that subsection:

- to engage in conduct that constitutes or may constitute the practice of exclusive dealing within the meaning of section 47 of the Act.

The net public benefit test

7.5 For the reasons outlined in Chapter 6 of this determination, the ACCC considers that in all the circumstances the arrangements for which authorisation is sought are likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the arrangements.

7.6 The ACCC is satisfied that the arrangements for which authorisation is sought are likely to result in such a benefit to the public that the arrangements should be allowed to take place.

Conduct for which the ACCC grants authorisation

7.7 Authorisation extends to market participants to engage in conduct pursuant to the Market Rules for a period of 15 years following this determination.

7.8 Further, the authorisation is in respect of the Market Rules as it stands at the time authorisation is granted. Any changes to the Market Rules during the term of the authorisation would not be covered by the authorisation.

7.9 This determination is made on 22 December 2006.

Interim authorisation

7.10 On 11 August 2006, the IMO requested interim authorisation for conduct under the Market Rules. The ACCC granted interim authorisation on 22 September 2006.

7.11 Interim authorisation will remain in place until the date the ACCC's final determination comes into effect.

Date authorisation comes into effect

7.12 This determination is made on 22 December 2006. If no application for review of the determination is made to the Australian Competition Tribunal (the Tribunal), it will come into force on 12 January 2007. If an application for review is made to the Tribunal, the determination will come into effect:

- where the application is not withdrawn – on the day on which the Tribunal makes a determination on the review, or
- where the application is withdrawn – on the day on which the application is withdrawn.