

Mr Gary Banks  
Chairman  
Productivity Commission  
PO Box 80  
Belconnen ACT 2616

7 January 2005

Dear Gary,

**Re: ACCC comments on electricity market structures**

Ed Willett was kind enough to send me his letter to you in which he commented on my recent speech to the NSW Power Conference on 12 October, 2004 concerning the evolving market structures in the National Electricity Market (NEM). I thought I might make a few further comments in response.

I agree with the ACCC on many issues, but there were some important differences of opinion that emerged in the ACCC's letter.

I agree with the ACCC on the problems that can be associated with mergers between transmission and generation companies and I accept that Section 50 of the *Trade Practices Act* may have trouble dealing with these.

Notwithstanding the points in the last paragraph I do not have many concerns with any future link between generators and distribution. I believe the problems that the ACCC cites are unlikely, and I would be comfortable with a court taking the view that the concerns mentioned are too speculative to warrant the necessary level of concern.

I'm not sure I agree with the ACCC on how to calculate market shares. My calculations were done based on nameplate capacity because this shows the generation capacity available to respond, whether or not it was dispatched.

I have concerns with a suggestion that base load generation should be regarded as a separate market. If other players have peakers, particularly retailers, they have the ability to reduce this base load generator market power and I would have thought this was very relevant in determining the relevant market. I agree that base load generators are the ones most likely to spike prices (although peakers have been known to do it often also), however I believe that other competitors do mitigate this power.

As I said in my speech, I agree that currently the relevant market for generation is a regional market, not the NEM as a whole. Currently generators can exercise market

power within a region and generators in other regions do not have the capacity to offset this.

Where I think I have a different view from the ACCC is that I think there could be developments which can turn the NEM into one market rather than largely the five current ones. First, I think we should have more interconnection, and that the current transmission approval approach inhibits the necessary investment. Second, I think we can improve inter regional hedging by taking steps, such as the introduction of firm financial transmission rights, which would effectively allow generators in one market to curb the market power of those in another.

The ACCC suggests that I consider that independent retailers and generators should compete comfortably against the integrated “gentailers”. I do not believe there will be significant independent retailers when the market structure is settled. I do believe there will be some independent generators, however I am unsure of how large a role they will play in the market.

Further, I do not believe that “thin” hedge markets are a problem in themselves. If there were four to five vertically integrated players they would not need to hedge much and therefore the market would be thin. The key issue is the energy prices being offered to consumers and I cannot see how it matters whether that energy has been purchased through the hedge market or has been supplied directly by the generation capacity owned by the relevant retailer.

I do not think that when considering purely retail mergers it is necessary to be as concerned about regional markets. As I have said, I believe generation markets are regional. I do not think the same concerns apply that would make me necessarily conclude that the retailer market is regional.

The most important point, and the issue on which I have a slightly different perspective from the ACCC, is the role and efficacy of Section 50. While I accept that this is the ACCC’s territory, I remain unconvinced that Section 50 cannot help to stop mergers that would reduce competition when these are mergers between generators on the one hand, or mergers between vertically integrated entities. In both cases they are less complex than mergers between generators and retailers, and mergers between generators and transmission entities. In the latter two cases the courts have to deal with all the complexity of the electricity market which they seem not yet able to do.

In the case of mergers between generators, or even more so those with mergers between vertically integrated entities, these then become more “typical” transactions. Indeed, if there were six vertically integrated entities, and two of the largest were preparing to merge to take the market down to five, this does not appear to be any different to the same set of circumstances in any other market, such as, say, bricks. There is no electricity market complexity here. The vertical integration has taken out the complexity of hedging and allows us to assess this market in the same way as other markets are assessed.

My interpretation of the AGL decision is that the judge had great difficulty with the market complexity. I believe much of that complexity would have been removed were it, for example, a merger between two generation companies in Victoria.

That said, of course, I agree with the ACCC's comment that Section 50 was never designed to bring about sufficient competition when the initial horizontal separation was inadequate. Section 50 cannot help in NSW where, in my view, there is insufficient competition in the market for generation. But of course this raises the general issue as to whether the ACCC should have the power to order divestment. I have difficulty seeing why this issue is any different again to the market for bricks. Section 50 is not able to deal with the situation where you have inadequate competition in the brick market. If we are going to give the ACCC divestment powers in electricity then should we not do it for all other sectors?

In closing, I would have no problem with a NEM rule that said that there should be no link between transmission and generation, as that would seem to me to be an appropriate "electricity only" pro competition rule. I would also be willing to consider any pressure or power to increase competition in generation where the initial horizontal separation was inadequate. My only query would be why such an approach would not be taken in other sectors.

I hope the above thoughts are helpful, I would be happy to discuss them with the ACCC or the Productivity Commission further.

Rod Sims  
Director  
Port Jackson Partners Limited