RECENT DEVELOPMENTS

COMMONWEALTH

ENERGY MARKET REVIEW*

Background

In 2002, the Council of Australian Governments (COAG) commissioned a four-member panel chaired by the Hon. Warwick Parer to develop a medium to longer-term strategy for Australia's energy markets. This review generated considerable interest, receiving more than 250 submissions from governments, regulators, industry participants, industry consultants and the public.

The result of the review is a 290 page report entitled "Towards a Truly National and Efficient Energy Market", which was released on 20 December last year.

The thrust of the report is that, while the reform of Australia's energy markets has resulted in substantial benefits, there remain significant deficiencies which must be addressed.

The Panel has accordingly made a number of far-reaching recommendations for reform. It estimates that, if these recommendations are fully implemented by 2005, Australia's real GDP would be increased by around $8.3 billion in five-year net present value terms to 2010. In addition, it forecasts that they will reduce real retail electricity prices by between 12.1% and 14.4%, real wholesale electricity prices by between 8.8% and 11.4% and real gas prices in the eastern States by 9%.

These are significant potential rewards. However, a number of the Panel's proposals are controversial, and have generated vigorous debate between governments, industry participants and energy consumers.

The Panel's principal recommendations are described below.

Single regulator

Panel's proposal

The large number of energy market regulators has long been an area ripe for reform: the multiplicity of jurisdictional-specific regulators and regulatory instruments imposes significant costs on energy industry participants who trade in more than one State or Territory or who trade in

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both electricity and gas. However, concerns relating to jurisdictional sovereignty and the accommodation of regional differences make this a politically sensitive matter.

The Panel has nonetheless tackled this issue head-on. It proposes the establishment of an independent national regulator (the National Energy Regulator or NER) that will take over:

- the regulation of the electricity and gas transmission and distribution access regimes that are currently administered by the ACCC and various jurisdictional regulators;
- the electricity and gas licensing functions that are currently performed by jurisdictional regulators;
- the National Electricity Market Reliability Panel's role in setting technical standards for power system security;
- the role of the NECA (National Electricity Code Administrator Limited) in monitoring compliance with, and enforcing, the National Electricity Code; and
- the role of the NCC (National Competition Council) and the Commonwealth in deciding on pipeline coverage under the National Gas Access Code.

In addition, the National Electricity Tribunal would be abolished, with decisions of the NER being open to appeal on their merits to the Australian Competition Tribunal.

Accompanying this regulatory rationalisation is a proposed streamlining of the process for changing the National Electricity Code (NEC) and the National Gas Access Code (NGAC). Under the proposed new process, changes to these codes would be developed and sponsored by two new statutory end-user and industry committees, the National Electricity Code Change Committee and the Gas Advisory and Code Change Committee. The NER would then be responsible for simply approving or rejecting any proposed change following a merits review (but with no further consultation); it would have no power to initiate code changes or to amend code changes submitted to it.

One issue that is left unresolved by this approach is the role of the ACCC in authorising changes to the NEC. The NEC has been authorised by the ACCC and so any changes to it are also subject to ACCC authorisation. Typically this has involved the ACCC in undertaking its own assessment of, and consultation in relation to, proposed Code changes despite NECA having undertaken a similar process in developing the changes. If the ACCC is to retain its role in authorising Code changes (including its power to require the Code changes to be modified), this potentially perpetuates the duplication that is inherent in the existing structure.

Commonwealth's proposal

The Commonwealth Minister for Industry, Tourism and Resources (the Hon. Ian Macfarlane) has released his own proposal for a new regulatory regime. Under this proposal, three new bodies would be created:

- the Australian Energy Commission (AEC), a separate legal entity within the ACCC, which would act as the national energy market regulator and the decisions of which could be appealed to the Australian Competition Tribunal;
- the Australian National Energy Corporation (ANEC), which would be responsible for market development, system planning, market monitoring and changes to the NEC and

the NGAC, and the decisions of which could be appealed to the National Energy Tribunal (currently the National Electricity Tribunal); and
- the Australian Energy Market Management Company (AEMMCO), which would be responsible for electricity and gas market operations.

The perceived benefit in this approach is that there is a clear separation between market regulation (AEC), market development (ANEC) and market operation (AEMMCO), all of which would be undertaken in the context of a policy framework established by the Ministerial Council on Energy. The distinction between "policy" and "market development" is one that will, in practice, require some degree of refinement. Moreover, the role of the ACCC in the authorisation of NEC changes (see above) will need to be clarified if it is not to blur this distinction.

Alternative approach

The proposal to establish a single national regulator has already provoked a strong response from the States. Accordingly, it may be short-sighted to close off other options. For example, if licensing conditions are rendered consistent between jurisdictions (with due regard for any necessary jurisdictional deviations), there is no reason why the resulting licensing system could not be administered and enforced by separate jurisdictional regulators, as this would not entail the exercise of much discretion. The main task in this regard will be to achieve a high degree of uniformity between licence conditions – this is likely to involve considerable debate between the jurisdictions as well as with industry participants, not least because it will raise issues of the policy behind various licence conditions and because it will entail changes to existing licence conditions (which may have cost implications for industry participants). Similarly, distribution pricing could remain with the jurisdictional regulators, with the necessary uniformity being introduced through a legislatively enshrined common set of pricing principles and a mechanism for appeal to a single body (such as the NER) if a party is dissatisfied with the price review. This would enable any appropriate jurisdictional differences to be addressed by the jurisdictional regulators, with uniformity in approach being assured by a common appellate body.

Policy formulation

The Panel recommends that the Ministerial Council on Energy should be solely responsible for electricity and gas market policy oversight. It further recommends that such policy should only be established through legislation (eg. changes to the National Electricity Law or the National Gas Access Law) and not through participation in the code change process. The Macfarlane proposal imposes a gloss on this and would enable the Council to initiate or prevent code changes relating to protected (or "core") code provisions.

Price signals

The Panel considers that the energy-only design of the National Electricity Market (NEM) is well-placed to provide a strong set of investment signals but that this potential is impeded by market distortions. Accordingly, it recommends:

- the abolition of the NSW Electricity Tariff Equalisation Fund and Queensland's Benchmark Pricing Agreement as soon as possible; and

- the introduction of full retail contestability in all markets, and the removal of retail price caps, as soon as practicable but in any event within the next three years.

In order to minimise the distortionary impact of price caps pending their removal, the Panel suggests that the jurisdictions should set any price caps "based on the bilaterally negotiated contract rates secured by each affected retailer and the other costs reasonably associated with retailing electricity". It also suggests that price caps should be set by time of day and season. The purpose of this approach is to avoid retailers being exposed to unmanageable risks. However, this presumably means that end-users would correspondingly be exposed to such risks and, to this extent, to at least some of the volatility of the spot market. Moreover, this approach will entail considerable complexity because retailers' bilateral contract positions are likely to vary over time and to differ from each other.

Demand-side management

An important element of demand-side management is the provision of time-of-use meters so as to enable retailers to develop, and electricity consumers to take advantage of, innovative products that encourage load reduction at peak time. Accordingly, the Panel recommends that all contestable customers be provided with interval meters within 5-10 years.

In order to provide further impetus to demand-side involvement in the NEM, the Panel also recommends the introduction of a revised demand-reduction bidding system which would enable users (including retailers and aggregators) to bid price and volume into the market to reduce load. These demand-reduction bids would be paid on an "as bid" basis (rather than at the system marginal price) so as to enable bidders to reap the financial benefits associated with demand-reduction. A failure to reduce demand in accordance with a bid would result in the bidder paying the associated costs (eg. the costs of acquiring the required ancillary services).

Electricity transmission regulation

The Panel recognises that an integrated electricity transmission network is essential to inter-regional trade and the reduction of regional generator market power. It has therefore made four key recommendations that are directed at achieving a properly functioning and cohesive interconnected transmission system.

The first recommendation is the development of firm financial transmission rights (FTRs), which are to be auctioned by NEMMCO. These FTRs would be funded by inter-regional settlement residues and the proceeds arising from the FTR auctions, with any funding deficiency being met by a separate market levy.

The second recommendation is the introduction of incentives and penalties to encourage regulated transmission network service providers to improve their network performance. The incentives would be structured so as to encourage the minimisation of outages during peak periods. Conversely, penalties would be payable where a significant price separation between regions occurs and the interconnecting transmission line is operating below a target capacity level.

The third recommendation is that the cost-reflectivity of transmission pricing arrangements be increased, eg by eliminating loss-averaging and postage-stamp pricing and requiring generators to

pay transmission use of system charges. Consistently with this, the Panel recommends an increase in the number of NEM regions, followed by the introduction of full nodal pricing in 7 to 10 years. To the extent governments consider it desirable to ameliorate any resulting price differentials between consumers, this should be done through the payment of transparent direct subsidies.

The fourth recommendation is the introduction of a more nationally focused and coordinated approach to transmission network planning. Under the proposed new planning regime:

- NEMMCO would continue to provide information in relation to the potential for transmission augmentation opportunities; and
- if the market fails to react to any such augmentation opportunity, NEMMCO would conduct a competitive tender process for the augmentation as a regulated investment - in the case of non-reliability related investments, the "trigger" for this process would be the traded price of firm FTRs sustainably exceeding the unit cost derived from the net present value of the new transmission augmentation.

Natural gas

The Panel's view is that, despite encouraging developments, "[s]ome significant barriers to a truly competitive natural gas market remain". This is largely the result of a high level of upstream ownership concentration across the basins that supply the eastern gas markets. This is a vexed issue because upstream competition is vital for gas consumers to benefit from downstream reforms, but the Panel has not been able to make any substantial recommendations in this regard. Instead, its principal suggestion is that joint venturers must (for informational purposes only) notify the ACCC of all future joint marketing arrangements, and that the ACCC must assess the feasibility of separate marketing when considering any authorisation.

In addition, the Panel recommends that acreage management regimes should include, as award criteria, the "promotion of competition" where there is a reasonable prospect of a commercial gas discovery.

The Panel has, however, made a number of more substantive recommendations in relation to the regulation of natural gas pipelines – in particular, that:

- the NER be able to make a binding pre-investment determination that a proposed pipeline is not covered by the NGAC;
- transmission pipeline owners be given an option not to have price regulation imposed on a proposed new pipeline for the first 15 years of its operation (following which it would be assessed for coverage based on whether the pipeline owner exercises market power) – this option is only to be exercisable if there is a sufficient vertical separation of ownership of the pipeline from upstream or downstream market participants, tariffs for access to the pipeline are published and the pipeline's capacity is fully tradeable;
- prospective pipeline owners be able to enter into an agreement with the NER to "lock in" for extended periods key regulatory parameters such as the WACC and depreciation schedules; and
- a code of conduct be introduced for non-covered pipelines – this code of conduct would, for example, address the ringfencing of pipeline operations, the publication of pipeline tariffs and the offering of tradeable capacity.

Greenhouse gas emissions

The Panel recommends that the existing range of diverse greenhouse gas measures (including the Commonwealth's Mandatory Renewable Energy Target) be replaced with an economy-wide national emissions trading system that is not specific to any particular technology or fuel type and that focuses on carbon reduction (rather than the use of renewable energy sources). In this way, the Panel seeks to ensure the adoption of greenhouse gas abatement measures that are the most efficient and least costly. Energy-intensive users in the traded goods sector would be exempted from this scheme (subject to meeting world best practice in energy use) until Australia's main competitors have joined a greenhouse gas scheme.

The proposed emissions trading scheme would be designed so as to achieve the same level of emission reductions as the greenhouse gas abatement measures that it replaces. Moreover, given that a number of renewable energy projects have been established on the basis of financial incentives provided under these existing measures, the Panel recommends the grandfathering of the effective subsidies that these investments currently receive.

Conclusion

The COAG Energy Market Review Panel has made a valuable contribution to the debate about the reforms that are required to Australia's energy markets. Further contributions to this debate can be expected with the Commonwealth's formal response to the report in March and its consideration by the COAG Energy Ministers in April.

NEW SOUTH WALES

WORKERS COMPENSATION ACT – INTERACTION WITH MOTOR ACCIDENTS COMPENSATION ACT[*]

***Pender v Power Coal Pty Ltd* [2002] NSWSC 925, 26 September 2002, NSW Supreme Court, Wood CJ at CL**

Facts

The Plaintiff filed a Statement of Claim claiming damages under the NSW Workers Compensation Act for injuries sustained while working in the Angus Place Colliery of the Defendant. The Plaintiff asserted that he was injured when workers were attempting to unwind a 50mm reinforced water hose which had been wound around a 750kg metal drum by means of a forklift. The operator of the forklift reversed the vehicle pulling the drum along the ground without lifting it free of the ground. The drum then fell off the forklift and rolled onto the Plaintiff causing injuries to him.

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