



ICRC

independent competition and regulatory commission

Final report

**Review of contestable electricity
infrastructure works**

April 2004

The Independent Competition and Regulatory Commission (the commission) was established by the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act) to determine prices for regulated industries, advise government about industry matters, advise on access to infrastructure and determine access disputes. The commission also has responsibilities under the Act for determining competitive neutrality complaints and providing advice about other government-regulated activities.

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Foreword

The Independent Competition and Regulatory Commission (the commission) has undertaken this review at the direction of the Treasurer, who has issued a reference requiring the commission to investigate and provide advice on the net public benefit of removing restrictions on the contestability of work on selected areas of the electricity infrastructure in the Australian Capital Territory (ACT).

Currently, the ACT's electricity distributor, ActewAGL Distribution (ActewAGL), is the sole supplier of services associated with the development and expansion of the electricity distribution infrastructure within the ACT. This inquiry considers whether there are overall economic and public welfare benefits from making contestable certain services currently provided solely by ActewAGL. The services under consideration can be broadly defined as those that are provided by ActewAGL to third parties and for which third parties must pay capital contributions.

Elsewhere in Australia, parties other than the network operator can provide these types of services, giving customers a choice of service providers. In the ACT, however, the development of a contestable market is restricted by legislation. Whether the market for these services should remain restricted is the question on which this review seeks to provide advice. Specifically, the review seeks to shed light on the costs and benefits of retaining these restrictions on competition. The existence of a contestable market for these services would avoid the possible need for more regulatory oversight of the services. However, a number of legal, economic, social and technical reasons have been advanced for not opening this part of the market to competition. The commission's role is to advise government on what action, if any, it needs to take to ensure that the ACT's economy achieves the highest possible economic efficiency for the community as a whole.

The commission has undertaken a detailed assessment of this issue and has drawn heavily upon submissions received in response to the draft report released in December 2003 and experiences in other Australian jurisdictions.

Ultimately, the commission is required to make recommendations to the government. Any decision on whether to remove or retain the current

restriction on customer-funded infrastructure works remains with the government.

The commission has concluded that there will be net benefits to the ACT's economy from removing the restriction on competition. This conclusion follows detailed consideration of a range of social, economic, safety, technical and administrative issues that potentially arise from a change to the current arrangements. In line with the requirements of the Competition Principles Agreement and the national competition reform program, the commission has not found that the net benefits of retaining the restriction on competition exceed the costs to the territory of its retention. Accordingly, the commission has recommended that the restriction on competition be removed under a phased program beginning in mid-2005.

Finally, the commission would like to acknowledge the assistance and input of those who made submissions to the inquiry, and the valuable input of the commission secretariat in the preparation of this report.

The final conclusions and recommendations to the government remain those of the commission itself.

Paul Baxter
Senior Commissioner
28 April 2004

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Executive Summary

Conclusions

The Treasurer's terms of reference require the commission to advise on whether there is a net public benefit to the community in making electricity infrastructure works contestable in the ACT. In making its assessment the commission has considered the degree of competition in the current arrangements, the potential for contestability, and the costs and benefits of contestability.

In preparing advice on this matter, the commission has been guided by the provisions of the National Competition Policy and, in particular, clauses 1 and 5 of the Competition Principles Agreement (CPA). Clause 5(1) of the CPA requires governments to ensure that legislation does not restrict competition unless there is a net benefit to the community as a whole, or unless the objectives of the legislation can only be achieved by restricting competition.

The commission has given considerable attention to the definition of contestable customer-funded infrastructure works. ActewAGL has raised a number of practical, administrative, safety, reliability and 'core competency' issues in objecting to any move to reform the current monopoly arrangements. These issues have been given careful consideration by the commission. However, most can be readily resolved once the design and characteristics of the market that is to be made contestable are defined.

The commission's analysis indicates that there would only need to be efficiency cost savings of 5 per cent in the prices currently charged for customer-funded works for the benefit of introducing contestability to be twice its projected cost. Experience in other jurisdictions indicates cost savings of up to 30 per cent, and the commission believes that the evidence clearly indicates that opening the market to contestability would be to the net benefit of the ACT economy.

The commission was also required to consider any net benefits that continuation of the market restrictions might bring to the ACT economy. This is essentially the reverse of the consideration of the net benefits from

removing the restriction. The commission has found no benefits from the retention of the restriction that outweigh its cost.

Should the monopoly be retained, the commission would be obliged to introduce a more intrusive form of regulatory oversight of prices charged by ActewAGL for these services than has existed to date. This would add to the deadweight monopoly costs of maintaining the present restriction. Furthermore, this would occur notwithstanding that the safety, reliability and quality of service issues suggested as ‘benefits’ of the restriction have been shown to be achievable without the retention of a monopoly.

The commission has therefore concluded that net benefits of retaining the restriction to competition have not been demonstrated, but that there are net benefits of removing the restriction.

Recommendations

The commission finds that there is a net benefit to be gained by the community as a whole from the introduction of competition in the electricity infrastructure works market in the ACT.

Accordingly, the commission recommends that the government initiate action to remove the current restriction on competition in this market. Specifically, the commission recommends that:

1. New connections and work on the existing network, including any design work associated with the work, be potentially contestable, subject to the following:
 - Works must be partly or fully funded by customers.
 - The value of the customer-funded component of the works must be over \$10,000.
 - The works must be able to be safely isolated and not unduly interrupt other customers. Works that fail this criterion should still be subject to market testing and put out to tender.
2. The design of the contestable market should incorporate the following features:

- ActewAGL is to provide contractors with a specified materials list.
- Contractors are to be given the option of acquiring specified material through ActewAGL.
- Customers are to have the option of:
 - waiving the right to have works tendered
 - having ActewAGL manage the tender process or managing the process themselves.
- If a customer elects to use a third party contractor on a jointly funded project, the customer is to pay the full cost of the project up front. ActewAGL is then to reimburse the customer the estimated ‘distributor contribution’ (i.e. the stand-alone cost for the distribution network portion) once ActewAGL has accepted and energised the new works.
- Timeframes for the provision of quotes, design and construction specifications and approval of designs are to be established in consultation between the commission, the technical regulator and ActewAGL.
- Contractors are to be accredited to undertake contestable works. Contractors wishing to work on or near the live network are to be authorised by ActewAGL and such authorisation is not to be unreasonably withheld.
- Construction work is to be audited by ActewAGL after its completion.
- ActewAGL is to be able to charge contractors a refundable guarantee of 5 per cent of the value of the works to cover the costs of fixing defects or faults arising from the contractor’s work within a three-year period following the completion of the work.
- Customers are to meet tendering and audit/acceptance costs incurred by ActewAGL. Such charges are to be fair and reasonable and subject to appeal to the commission.

3. A transitional period is to apply to enable the necessary changes to be made to support contestability. Introduction is to be phased in, with new connections (e.g. greenfield reticulation) to be contestable not less than 12 months from the government's approval of the scheme or by 1 July 2005 at the latest, and the remainder of the market is to be opened not later than 12 months after that.
4. Appropriate changes are to be made to regulatory arrangements governing utilities, namely:
 - The *Utilities Act 2000* to be amended to enable infrastructure works to be undertaken by third party contractors
 - Ring Fencing Guidelines to be amended to provide for separation between the areas within ActewAGL Distribution that are responsible for determining construction and design standards and specifications, approving designs and approving works, and competing for contestable design and construction work
 - Electricity Network Capital Contributions Code to be amended in accordance with contestability arrangements; for example, provision to be made for ActewAGL to reimburse the estimated 'distributor contribution' to customers
 - a scheme to be established to accredit third party contractors to undertake contestable works; consideration to be given to tying in with the New South Wales accreditation scheme.
5. Subject to agreement by the technical regulator, ActewAGL is to be required to put into place appropriate safeguards for third party contractors undertaking new connections, and working on or near the network. ActewAGL is also to be required to make other necessary procedural and systems changes

1 Introduction

In accordance with the ACT Treasurer's reference issued on 1 July 2003, the commission has conducted an investigation into whether there would be a net public benefit to the community as a whole from the introduction of contestable electricity infrastructure works in the electricity distribution network.

The investigation has been conducted subject to section 15 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act), as required by the reference. Notwithstanding this requirement, the questions to be resolved involve a number of related principles, including whether the current arrangements unnecessarily and inefficiently restrict the operation of a competitive market for the construction of electricity infrastructure.

1.1 The commission's review process

The commission is a statutory body established under the ICRC Act principally to investigate and provide advice to the government on industry policy and competition matters. In addition, the commission performs a range of other functions, including regulating prices and access to infrastructure; licensing utility services and ensuring compliance with licence conditions; investigating competitive neutrality complaints and government-regulated activities; and other matters pertaining to regulated industries in the ACT. The principles guiding the commission's activities are spelled out in the ICRC Act and the *Utilities Act 2000* (Utilities Act).

In assessing the benefits of the restrictions on competition in electricity infrastructure works in the ACT, the commission has adopted the legislation review framework provided under the National Competition Policy (NCP). Clause 5 of the Competition Principles Agreement (CPA) acknowledges that, in general, competition produces efficient outcomes when permitted to operate without regulatory constraints. However, it also recognises that in some circumstances competition should be, or may need to be, constrained in the interests of the community as a whole. A restraint on competition should only be retained if it is clearly in the public interest – that is, if there is a clear demonstration that an anti-competitive element will yield a net

benefit to the community. The mechanism for making that assessment is the public benefit test.

1.2 Defining the limits of the investigation

The breadth of the terms of the Treasurer's reference has been a concern to the industry and to the commission. If the terms of the reference had been applied literally, the investigation would have exceeded the scope of the industry complaints that led to the reference being issued. It is clear to the commission that a range of services, which the ACT electricity distribution network operator, ActewAGL, should be able to undertake on its own network as a normal part of its business, could have been included in the reference. Recognising this legitimate interest, the commission confined its inquiries to infrastructure connection, expansion and enhancement services for which a third party must pay ActewAGL directly, either in part or in full (Chapter 5 details the types of works the commission considers could be made contestable). The commission determined that it was inappropriate for this investigation to include maintenance and other works by ActewAGL on its own behalf on its network and for which third parties do not pay any direct contribution. The commission, in its role as price regulator for ActewAGL's overall distribution services, oversees ActewAGL's operating and capital works costs to ensure that these services are performed efficiently.

1.3 Process of review

The commission released an issues paper in October 2003, at the beginning of this inquiry, setting out a number of key issues to be considered and seeking submissions on them. These issues included whether there were any benefits to making infrastructure works contestable, what the costs of doing so might be, and what works had the potential to be made contestable. After considering the submissions received, the commission released a draft report in December 2003 outlining its preferred position on many of the issues raised in the issues paper. Essentially, the commission argued in the draft report that a net public benefit from retaining the current restriction on competition had not been demonstrated, and that there would be a net benefit to the ACT from opening infrastructure works to contestability. In this light, and consistent with the CPA, the commission therefore proposed to

recommend to government that the restriction to competition on these works be lifted.

In support of the draft recommendation, the commission also recommended that:

- the *Utilities Act 2000* be amended to make it clear that these infrastructure works are contestable
- technical standards and requirements be reviewed in consultation with ActewAGL to ensure that, under a contestability regime, they are appropriate and independent, and ensure network safety and reliability
- procedures be put in place for accreditation of contractors
- consideration be given to using the existing New South Wales accreditation scheme, as most, if not all, who would operate in the ACT are already accredited in New South Wales
- those directly benefiting from the tendering of infrastructure works be required to meet the annual ongoing tendering and associated administrative costs of this arrangement (these costs to be fair and reasonable and subject to review by the commission in case of a dispute).

The commission noted that sufficient time would need to be allowed for both ActewAGL and the government to make the necessary regulatory and administrative arrangements to support a contestable market.

The commission also foreshadowed that, whether or not competition were introduced, it intended to review electricity network capital contributions arrangements and Ring Fencing Guidelines as a matter of some urgency, as they were found to be problematic.

The current report brings to a conclusion the review of electricity infrastructure works and sets out the commission's final recommendations on the issues that have been the focus of the review. The commission makes these recommendations after considering the submissions made on the issues paper and the draft report, consulting interested parties, and considering contestability schemes operating in other Australian jurisdictions.

1.4 Submissions on the issues paper and draft report

The commission received formal submissions from eight organisations, as well as a number of informal submissions. Appendix A lists the names of the organisations that provided formal submissions. The submissions can also be viewed on the commission’s website. Some key points are summarised below. Subsequent chapters of this report provide a fuller response to the key issues raised, and outline the commission’s views.

1.4.1 Support for contestability

Many submissions supported making infrastructure works contestable in the ACT¹, arguing that doing so had ‘the potential to lead to more economically efficient outcomes and greater choice for customers, and transparency in construction and installation costs.’² The peak building association in the territory, the Master Builders Association of the ACT (the MBA) advised the commission that it has received a number of complaints from its members specifically about ActewAGL’s monopoly position. These complaints have largely related to:

- perceived excessive overcharging
- failure to provide services in a timely manner.

These concerns have been echoed by NJ Construction Pty Ltd and Madison Constructions. While the MBA has not provided the commission with substantive information about these complaints, the commission notes with some concern the MBA’s comments about overcharging of works that are currently contestable in other jurisdictions, such as disconnection services.

Madison Constructions has also reported to the commission that, after obtaining quotes from two electrical construction companies other than ActewAGL, it was apparent that competitively sourced infrastructure works

¹ Country Energy, *Response to issues paper – Review of contestable electricity infrastructure works*, 7 November 2003; Master Builders’ Association, *Response to the review of contestable infrastructure works*, November 2003; NJ Construction, *Response to the review of contestable electricity infrastructure works*, November 2003.

² Country Energy, *Response to issues paper*, p 1.

could have cost around 20 per cent less than the price charged by ActewAGL. Madison Constructions also noted that it had experienced significant delays in the construction and connection of various electricity services.

Those in support of competition felt that all services for which customers are required to pay should be made contestable, and that the benefits of doing so would outweigh any associated safety and reliability risks.³ Submissions agreed, however, that ActewAGL should continue to be responsible for developing and administering construction and material standards, and for monitoring compliance with those standards.

1.4.2 Support for maintaining the restriction on competition

ActewAGL has argued that the benefits of opening electricity infrastructure works to competition would be minimal for the following reasons:

- ActewAGL already competitively tenders for a large part of its costs and is subject to incentive regulation, and therefore provides construction services at efficient prices.
- Costs of contestability to ActewAGL would be high in terms of staff redundancies, reductions in operational efficiencies, cost of disruptions caused by disputes between ActewAGL and contractors, and general implementation and recurrent costs.
- Cost savings would be captured largely by land developers⁴, and if savings were passed on to end customers the savings to individual customers would be small.

1.4.3 Implementation issues

Submissions agreed that contestability should not inconvenience electricity consumers, or affect the safety and reliability of electricity supply to them.⁵

³ Country Energy, *Response to issues paper*, p 1; NJ Constructions, *Response to review*.

⁴ The Essential Services Consumer Council also argued that the main benefit of opening infrastructure works to competition would accrue to land developers and queried whether this would contribute to the wider public benefit. (*ESCC response to the CRC issues paper – Review of contestable electricity infrastructure works*, 23 October 2003, p 1)

Submissions also pointed to the need to ensure that an appropriate regulatory framework was in place, particularly accreditation or authorisation of contractors and ring fencing of ActewAGL's core distribution business from its contracting arm.

1.4.4 Commission's review process

ActewAGL queried the legislative review approach adopted by the commission in assessing the benefits and costs of contestability.⁶ According to ActewAGL, the commission is not required under the terms of the Treasurer's reference or under the ICRC Act to take into account competition policy considerations.

This is not the view of the National Competition Council (NCC), which has supported the commission's approach and its understanding of the possible consequences for the ACT of failing to meet NCP obligations.⁷ The NCC confirmed that the legislative review approach taken by the commission was consistent with the ACT's ongoing obligations under the NCP, specifically clause 5(6) of the CPA. The NCC also affirmed that a restriction on contestability in certain areas of electricity infrastructure should only be retained if it could be demonstrated that the restriction would provide a net benefit to the community.

⁵ Essential Services Consumer Council, *ESCC response to issues paper*, p 1; Country Energy, Country Energy, *Response to issues paper*, p 2.

⁶ ActewAGL, *Response to the commission's draft report for the review of contestable electricity infrastructure works*, 23 January 2004, pp 11, 19.

⁷ Correspondence from John Feil, National Competition Council, to Paul Baxter, dated 22 January 2004.

2 Assessment framework

In undertaking this assessment the commission has addressed issues required of it under the ICRC Act, the Utilities Act and the Competition Principles Agreement, in particular. These documents set out the principles to be followed in providing advice to the government about electricity infrastructure works contestability and monopoly arrangements.

2.1 The requirements of the Treasurer's reference

The Treasurer's reference issued under section 15 of the ICRC Act (see Appendix B) sought the commission's advice on whether there is a net benefit to the community as a whole in introducing contestable electricity infrastructure works in the ACT electricity distribution network. In considering the infrastructure works undertaken by ActewAGL, and pursuant to section 16 of the ICRC Act, the reference required the commission to consider:

- changes to the existing network
- augmentation of the ACT distribution network by works associated with new subdivision development and greenfield sites.

The commission, therefore, had a wide brief for consideration.

2.2 Considerations in the ICRC Act and the Utilities Act

The commission has also been guided by its legislated objectives under section 3 of the Utilities Act and section 7 the ICRC Act, which require the commission to seek to:

- encourage the provision of safe, reliable, efficient and high-quality utility services at reasonable prices
- minimise the potential for misuse of monopoly power in the provision of utility services

- promote competition in the provision of utility services
- encourage long-term investment, growth and employment in utility service industries
- promote ecologically sustainable development in the provision of utility services
- protect the interests of consumers
- ensure that advice given to the ICRC by the Essential Services Consumer Council, or the technical regulator, is properly considered
- ensure that the government's programs about the provision of utility services are properly addressed
- promote effective competition in the interests of consumers
- facilitate an appropriate balance between efficiency and environmental and social considerations
- ensure non-discriminatory access to monopoly and near-monopoly infrastructure.

These requirements are guiding principles for the commission in its wider role as regulator of the electricity distribution network and must be applied in a balanced manner in order to reflect the overall interests of consumers and the service provider.

2.3 Obligations under the National Electricity Code

The principles embodied in the National Electricity Code (the code) are also relevant to this review. Under clauses 6.10.3(a) and (b) of the code:

Concerns over monopoly pricing in respect of the distribution network will, where economically efficient and practicable, be addressed through the introduction of competition in the provision of distribution services.

The code thus seeks contestability where appropriate. Competition is seen as being a more appropriate market structure than regulation.

2.4 National Competition Policy and the Competition Principles Agreement

Australian national, state and territory governments agreed in 1995 to a National Competition Policy (NCP). The NCP is underpinned by three intergovernmental agreements:

- the Competition Principles Agreement (CPA)
- the Conduct Code Agreement
- the Agreement to Implement the National Competition Policy and Related Reforms (Implementation Agreement).

The aim of the NCP is to promote competition and thereby encourage efficient use of Australia's resources, to which end the policy requires state and territory governments to review and, where appropriate, reform all laws that restrict competition. This is an ongoing obligation: governments are required under clause 5(6) of the CPA to systematically review legislation at least once every 10 years.

In the context of the issues raised in the Treasurer's reference, and consistent with the commission's core objectives under the Utilities Act and the ICRC Act, the degree of restriction of competition in the current arrangements is a key issue for advice.

In preparing advice on this matter, the commission therefore took into account the provisions of the NCP and, in particular, clauses 1 and 5 of the CPA (see Appendix C).

2.4.1 Obligations in clause 5 of the Competition Principles Agreement

Clause 5 of the CPA is central to the forming of the commission's advice to the government. Clause 5(1), in particular, refers to the guiding principle to be applied by all Australian governments to ensure that legislation does not restrict competition, except where there is a net benefit to the community as a whole, or where the objectives of the legislation can only be achieved by restricting competition.

In considering whether a net community benefit exists, it is important to understand how clause (5)(1) is intended to operate. The clause assumes that competition will usually deliver greater benefits to the community than other market structures. Restrictions on competition, particularly monopoly or near-monopoly structures, are described as market failures that require regulatory intervention to ensure that consumers and the community are not disadvantaged. Within the CPA there is a basic assumption that restrictions on competition are a second-best outcome, and that competition is usually preferable.

The issue of efficient resource allocation is central to the principles articulated in the CPA. Competition is seen as the driver of efficient production of services within the Australian economy. This is highlighted in the National Competition Policy report, which recommended the implementation of a national competition policy for Australia:

If Australia is to take competition and competition policy seriously, a new mechanism is required to ensure that regulatory restrictions on competition do not exceed what is justified in the public interest. The Committee recommends that all Australian governments adopt a set of principles aimed at ensuring that statutes or regulations do not restrict competition unless the restriction is justified in the public interest. This would involve ... acceptance of the principle that any restriction on competition must be clearly demonstrated to be in the public interest ...⁸

The effect of the assumptions in the CPA is that to maintain a restriction on competition it is necessary to show that the restriction will provide greater benefits to the community than a competitive market solution. Usually, this means that such restrictions on competition address imperfections, in otherwise competitive arrangements, that result in a distorted market. Imperfections that reduce market efficiency could be information or power asymmetries or a lack of alternative suppliers, making a regulated monopoly more appropriate than a contestable market.

Where restrictions on competition do not deliver greater benefits to the community (for example, where restrictions expose consumers to greater risks from the use of monopoly power), governments are obliged to remove any potential barriers to contestability. The CPA does not mandate

⁸ Independent Committee of Inquiry, National Competition Policy executive overview, August 1993, pp 15–16.

competition per se in these markets but relies on the threat of competition to make prices more efficient.

There are a number of potential competitors to ActewAGL for the provision of electricity infrastructure construction and development services in the ACT. However, the competitors are currently prevented by the legislative restriction that protects ActewAGL's position as the monopoly supplier of electricity infrastructure works. Given the CPA imperative (that, unless demonstrated otherwise, any anti-competitive restrictions should be lifted as a matter of principle), the commission must consider whether or not a potentially contestable market could operate but for the existence of a legislative restriction, and whether this restriction delivers greater benefits to the community than would otherwise accrue if it were removed.

Clause 5(9) of the CPA provides direction to governments reviewing legislative restrictions on competition. The elements of the legislative review process, as specified by this clause, are:

- Clarify the objectives of the legislation.
- Identify the nature of the restriction on competition.
- Analyse the likely effect of the restriction on competition and the economy generally.
- Assess the balance of costs and benefits of the restriction.
- Consider alternative means for achieving the same result, including non-legislative approaches.

2.4.2 Public interest

Consideration of whether or not the move to contestable electricity infrastructure works is in the public interest may produce inconclusive results, as the relative costs and benefits of the reform accruing to individual consumers and producers are likely to counteract each other. However, if the commission is satisfied that contestability is unlikely to yield a decrease in total welfare, it must be guided by the competition principle set out above. That is, any restriction on competition must be clearly demonstrated to be in the public interest; restriction, not contestability, must be shown to benefit the public.

‘Public benefit’ is central to weighing the pros and cons of legislative restraints on competition. Economic efficiency is often central in defining whether there is a public benefit, but its absence does not mean there are not other benefits. The Australian Competition Tribunal has suggested that ‘public benefit’ should be given its widest possible meaning:

... anything of value to the community generally, any contribution to the aims pursued by society as one of its principal elements ... the achievement of the economic goals of efficiency and progress.⁹

The tribunal and the Australian Competition and Consumer Council, in defining public benefit, have identified a number of its characteristics¹⁰:

- the promotion of competition in an industry
- fostering business efficiency, especially where this results in improved international competitiveness
- industry rationalisation, resulting in more efficient allocation of resources and in lower or contained unit production costs
- improvements in the quality and safety of goods and services and expansion of customer choice
- supply of better information to consumers and business to permit informed choice in their dealings
- promotion of equitable dealings in the market
- promotion of cost savings resulting in contained or lower prices at all levels of the supply chain.

Consistent with this interpretation, the commission took a wide interpretation of public benefit for the purpose of this review.

⁹ Howard Smith Industries and Adelaide Steamship Industries, (1977) ATPR, 40-023, pp 17, 334.

¹⁰ These considerations are derived from the list cited by the ACCC in *Re ACI Operations Ltd* (1991) ATPR 50-108 and been published by the ACCC in brochures for public use.

2.4.3 Competition policy considerations

Clause 1(3) of the CPA provides guidance to the commission consistent with the principles in Schedule 1 of the ICRC Act, which are important for the assessment of public benefit when the benefits of a particular policy or course of action are to be balanced against their costs. In determining costs and benefits, the matters to be taken into account are:

- government legislation and policies relating to ecologically sustainable development
- social welfare and equity considerations, including community service obligations
- government legislation and policies relating to matters such as occupational health and safety, industrial relations, and access and equity
- economic and regional development, including employment and investment growth
- the interests of consumers generally, or of a class of consumers
- the competitiveness of Australian businesses
- the efficient allocation of resources

This list is not intended to limit matters that may be taken into account in a review of this type, but provides broad guidance to the commission that can be applied to particular subjects for review.

2.5 Possible outcomes of this inquiry

A number of options are available to the commission for its ultimate advice to government:

- a) *A clear net public benefit to the community as a whole arising from maintaining the restriction on competition is demonstrated.* In this case the provision of electricity infrastructure would remain a monopoly service of ActewAGL, but it would still be possible for the company to use the services of contractors selected by a contestable process. Because

the monopoly for infrastructure works remains, the commission would potentially regulate prices for them.

- b) *A net benefit to the community as a whole arising from making these works contestable is demonstrated.* In this case, the commission would recommend to the government that constraints to competition in the market be removed and the works become contestable.
- c) *Neither a discernible net benefit nor a net cost to the community is demonstrated.* In this case, and in line with the regulatory principles outlined above, the commission would recommend that the works become contestable. Under the NCP, a constraint on competition may be maintained only if there is a net public benefit to the community as a whole from the restriction and if there is no other method of securing a legislative object.

The principles guiding the process of the commission's inquiry and the formulations of its recommendations are informed by the CPA, the Australian Competition Tribunal, the commission's objects under the ICRC Act and the Utilities Act, and the National Electricity Code, which provide for the lessening or removal of restrictions on competition and the adoption of competitive market structures. Therefore, the policy direction provided to the commission is one that favours pro-competition reforms wherever possible. Accordingly, to maintain ActewAGL's monopoly position the commission must be satisfied that the monopoly is providing a net benefit to the community. If not, the commission must recommend that the restrictions to competition be removed. While the immediate benefits from removing these restrictions may not be quantifiable, the commission notes that free and open competition drives Australian economic efficiency.¹¹

¹¹ The Hon. PJ Keating MP, One Nation (statement by the Prime Minister, 26 February 1992).

3 Electricity infrastructure contestability: experience in other jurisdictions

The Competition Principles Agreement emphasised, among other things, the need for structural reform of public monopolies such that there was a separation of:

- regulatory and commercial functions of public monopolies
- natural monopolies and potentially competitive activities

In response, Australian governments have significantly reformed a number of public monopolies. This is especially true of the electricity market, in which pro-competitive and other structural reforms have included:

- introduction of a national electricity market designed to improve competition between electricity generators
- introduction of full contestability in the retail markets in New South Wales, Victoria, South Australia, and the ACT
- reform of the economic regulatory arrangements in the various states and territories, which has now resulted in independent pricing oversight by the various jurisdictional regulators.

In some jurisdictions, mostly notably New South Wales and Victoria and to a lesser degree South Australia, these reforms have also included the opening of electricity infrastructure projects to contestability. In Queensland there is also limited contestability in this area, but instead of being mandated by government the contestability framework has been left to industry to determine. Significant differences exist between jurisdictions in market design and the operation of contestable works; these differences are discussed below.

3.1 New South Wales

Electricity infrastructure works have been contestable in New South Wales for a number of years. Generally, any work for which a customer pays a capital contribution is contestable. New connections are therefore contestable, as well as some augmentation works. Design is also contestable where it forms part of a contestable work project. Distributors have the discretion not to allow third party contractors to undertake work on their networks if a particular project is considered to be risky in terms of network safety or if there are implications for a large number of customers. In those instances the work is, by definition, not contestable and the distributor funds the cost of the work.

Third party contractors are accredited and graded according to their competency under a scheme managed by the Department of Energy, Utilities and Sustainability. There are three levels of service provision in New South Wales:

- Level 1 accreditation allows private contractors to undertake overhead and underground construction work on distribution and transmission networks that are adjacent to roadways.
- Level 2 accreditation allows for the construction of service lines between the electricity network and the point of connection to a customer's premises.
- Level 3 accreditation allows for the design of transmission and distribution networks.

There are also different levels of grading that determine, for example, the number and extent of any inspections or audits of work applicable to the contractor. Contractors must also be authorised by the distributor to work on, or near, the distributor's electricity network.

The distributor specifies construction and design standards or requirements, and approves designs. Distributors may require the payment of a guarantee to cover costs associated with fixing faults or defects arising from the contractor's work. The guarantee is for a maximum of three years but the amount charged is at the discretion of the distributor. Distributors also charge a range of monopoly fees, approved by the Independent Pricing and Regulatory Tribunal, to recover the costs of such services as the provision of

design information, certification of designs, design rechecking, inspections and re-inspections, and authorisations. Distributors may, but are not required to, provide material to contractors.

Distributors must be satisfied that a work meets specified standards before the work is connected to the distributor's network. This may involve an audit of the work.

3.2 Victoria

Electricity infrastructure works have also been contestable for some time in Victoria. Connections are contestable, while augmentation and design works are contestable at the discretion of the distributors. A design market has developed, and customers occasionally refer the distributor's design to third-party design specialists as an independent check on the appropriateness of the design. Although not a requirement, some distributors also call for tenders on customer-funded augmentation works.

Distributors must provide customers with an indicative quote for the proposed work before a decision is made about who is to undertake the work. As a rule, works under \$5,000 (labour and plant only) are not contestable. Customers may call for tenders if they consider the distributor's estimate of the cost of the works to be unacceptable.

Customers may waive the right to have works tendered, in which case the distributor performs the work. In addition, customers can elect to tender and manage the project themselves or have the distributor manage the process on their behalf. The Essential Services Commission has also set timeframes for the calling, evaluating and awarding of tenders. If a project is tendered, customers must pay for the costs associated with the tendering.

Non-contestable service charges must be fair and reasonable. Unlike the Independent Pricing and Regulatory Tribunal in New South Wales, the Essential Services Commission does not approve these fees, but determines and can rule on what is 'fair and reasonable' where a customer disputes the amount. As in New South Wales, any work undertaken must be to the distributor's specifications. In addition, distributors may require the payment of a guarantee from customers or contractors as a safeguard against poor workmanship. The amount of the guarantee and the period for which it is held are not regulated.

Contractors must be authorised by a distributor to perform contestable works. Distributors may, but are not required to, provide material to contractors.

3.3 Queensland

Contestability is not mandated in Queensland. Queensland's *Electricity Act 1994* neither positively encourages contestability nor precludes it. However, the Act requires that any work on power lines running alongside or under a gazetted road must be performed by the distributor. Although augmentation works are not contestable under the Act, they may be tendered out if managed by the distributor. Greenfield reticulation and connections are not captured by the restriction relating to roads, because roads are not gazetted until a new subdivision has been completed, and this work may therefore be undertaken by third party contractors. Likewise, some embedded networks have been constructed by contractors.

Queensland's electricity distributors have taken differing approaches to contestability. Queensland's urban-based distributor, ENERGEX, has chosen to allow connections to be performed by third party contractors. Ergon, the state's mainly rural-based distributor, has not made infrastructure works contestable but is reportedly considering doing so once the current price path has lapsed.

As in other jurisdictions, ENERGEX sets design and construction specifications and standards and requires contractors to be accredited to perform contestable works. The distributor must be satisfied that infrastructure works meet specified standards before accepting them. ENERGEX provides contractors, at no additional handling cost, with materials and fittings for any infrastructure works they perform.

3.4 South Australia

Design work and connections are contestable in South Australia; augmentation works are not. As in Victoria, the distributor is required to make an offer to a customer requesting a connection. The offer must outline certain information, including details of the construction costs, the construction program and the criteria that a third party contractor must meet in the construction of works. The offer is required to be based on the most

efficient and technically feasible solution to meet the customer's electrical requirements and any expected load growth in the next three years. Again, as in Victoria, the customer may accept the offer and thereby waive the right to call for offers.

If a customer chooses to call for tenders, the distributor specifies the construction and design standards for the infrastructure works. Specifications are required to be provided in a specified time. The customer must meet the costs associated with the tendering of works, such as the preparation of specifications. These fees are approved by the Essential Services Commission of South Australia.

Although South Australia does not have an accreditation scheme, the distributor is not required to accept the design and construction of infrastructure works if the distributor considers that the contractor does not have the requisite skills and competence to perform the work.

4 Electricity distribution services in the ACT: current regulatory arrangements

It is ActewAGL's claim that the existing provisions of the *Utilities Act 2000* (Utilities Act) support the maintenance of the current monopoly arrangements for electricity infrastructure works. The objectives of the Utilities Act and the nature of the legislative restrictions on competition are therefore discussed in greater detail in this chapter, which also looks at the regulation of electricity distribution services.

4.1 Regulation of monopoly services

ActewAGL is currently the sole supplier of services associated with the operation of the ACT's electricity distribution network. Services requiring the development or augmentation of the network for the principal benefit of a particular customer are provided on a fee-for-service basis. The customer's capital contribution is determined by ActewAGL. The commission does not regulate capital contributions, despite being the 'jurisdictional regulator' of electricity distribution services in the ACT under the National Electricity Code.

The commission has recently finalised its investigation into prices for electricity distribution services provided by ActewAGL within the ACT. That investigation resulted in the commission determining ActewAGL's maximum average revenue cap for prescribed electricity distribution services. However, the revenue included in the revenue cap was limited to the following sources:

- revenue collected from ActewAGL's customer base for prescribed electricity distribution services
- revenue paid to ActewAGL by any government body or agency to fund a community service obligation on behalf of eligible customers.

Any revenue collected from the construction of electricity infrastructure projects is not regulated under the maximum average revenue cap. In the

market for customer-funded electricity infrastructure works, ActewAGL has an unregulated monopoly position.

The commission's draft report focused on the benefits of moving from a monopoly industry to a competitive market. In its response, ActewAGL argued that, while it is the monopoly supplier of electricity distribution services in the ACT, it is regulated by the commission under the maximum average revenue cap, which provides incentives for ActewAGL to become more efficient. The commission notes that the incentives referred to by ActewAGL only apply to the costs included in the regulatory model used by the commission. Given that infrastructure funded by capital contributions from third parties was excluded from the regulatory model used, the commission does not consider that the incentives are as strong for ActewAGL to be efficient in this market.

The commission considers it appropriate to regard ActewAGL as a monopoly service provider in the current market for electricity infrastructure. As such, ActewAGL does not face the same incentives as a competitive firm to operate efficiently and thus ensure that resources are adequately allocated. It may be the case that ActewAGL is currently operating efficiently despite its monopoly position. The commission notes, for example, that certain elements of electricity infrastructure works are contracted out, such as civil works associated with the infrastructure works, or works for which ActewAGL lacks in-house expertise, as is the case with work on sub-transmission lines. Nonetheless, ActewAGL does not face the long-term competitive pressures needed to ensure that resources are allocated efficiently over time.

4.2 Objectives of the Utilities Act

The Utilities Act establishes the regulatory framework for electricity, gas, and water and sewerage utilities in the ACT. The Act sets out broad objectives for the regulation of utilities, including a licensing regime for each industry. The Act also clarifies the rights and obligations of utility customers and consumers, and of the utility, with respect to utility services and utility assets. Thus, the Utilities Act gives utilities certain access, ownership and protection rights within the ACT.

In addition, the Utilities Act provides for, amongst other things:

- the approval and amendment of industry and technical codes
- the licensing of utility service providers
- the establishment of the Essential Services Consumer Council
- ICRC objectives
- the responsibilities of the technical regulator
- the payment of community service obligations by the ACT Government to licensed utility service providers.

4.3 Competition restrictions on electricity infrastructure works

The focus on this review is on the rights and powers that the Utilities Act gives to ActewAGL to undertake electricity infrastructure works. Table 4.1 identifies the principal restrictions on competition for such works arising directly or indirectly from the Act.

As Table 4.1 shows, the principal legislative constraint to competition in electricity infrastructure works stems from provisions of the Utilities Act, in particular sections 7 and 79, and the Electricity Network Boundary Code. The Act makes provision for certain works to be undertaken by persons other than the network operator. For electrical work, this includes:

- connection of a customer’s premises to the electricity distributor’s network
- variation of the capacity of the connection between a customer’s premises and the electricity distributor’s network.

Table 4.1: Restrictions on competition for electricity infrastructure works in the ACT.

Type of restriction	Form of restriction
Restrictions on entry to the market	Infrastructure development and enhancement work that is the matter of this report is restricted to ActewAGL (or its subcontractors and designers). This principally stems from the Utilities Act and the Electricity Network Boundary Code, which in ActewAGL's opinion exclude contestability. ^a To undertake this work, ActewAGL uses subcontractors at its discretion to provide skills it does not have in-house (for example, work on sub-transmission lines) or when additional resources are needed.
Design and operating processes	In addition to being able to use its design and overall certification powers under the Utilities Act to impede competition, ActewAGL could also obtain useful 'pre-bid' intelligence from these processes to gain a competitive advantage. This is currently hypothetical, but may be an impediment to competition should infrastructure works be made contestable. Appropriate ring fencing arrangements would be needed.
Technical standards, safety and quality requirements	Under the Utilities Act, ActewAGL is the agency responsible for ensuring the overall operational security of the network, and could use this power to discourage or thwart competition. This is currently hypothetical, but may be an impediment should infrastructure works be made contestable. Appropriate ring fencing arrangements would be needed.
Acceptance of works/energisation	ActewAGL is responsible for ensuring the overall safe operation of the network and has the final say on the acceptance of works. It could use this power to discourage or limit competition. This is currently hypothetical, but may be an impediment should infrastructure works be made contestable. Appropriate ring fencing arrangements would be needed.

a ActewAGL, *Response to the ICRC's issues paper – Review of contestable electricity infrastructure works*, 7 November 2003, pp 15, 16.

However, the Utilities Act does not provide, either generally or specifically, for contestability in network infrastructure development. At the same time, while subsection 79(1) of the Utilities Act excludes augmentation, relocation or other alteration of the distributor's network from contestability, it is silent on greenfield reticulation and connections to the network. ActewAGL acknowledges that there is nothing in the Utilities Act to prevent a developer from engaging a contractor to build new electricity infrastructure works in a greenfield development, but argues that under the Electricity Network Boundary Code the connection of such infrastructure would be on the network side (as opposed to the customer's side) of the connection and, as

such, ActewAGL is not required to connect it to its network. In ActewAGL's view, these works would constitute an augmentation or alteration of its network and are therefore not contestable. Thus, ActewAGL uses the wording of the boundary code to confirm its monopoly position for greenfield work.

The restriction on competition in this area has largely evolved from the concept, reflected in the Utilities Act, that ActewAGL is the monopoly provider of electricity distribution services in the ACT, and therefore should have sole responsibility for the design, construction and operational safety of the distribution network. Network design, technical standards, safety and quality need to be considered, because they potentially raise practical questions that may not be resolved other than through the restrictive right of ActewAGL to develop and augment the network.

In this restrictive interpretation of the Act, the boundary code and the circumstances in the ACT, only ActewAGL can develop and augment the electricity distribution network in the territory. Although ActewAGL may use subcontractors for some of these works, the practical implication has been that only ActewAGL is authorised to negotiate with customers for the works or to set charges and conditions for their delivery.

As noted in Chapter 3, other states (notably New South Wales and Victoria) have seen progressive reform and opening of this market to other businesses.

With the nature of the restriction and the objectives of the Utilities Act and the boundary code identified, the following chapters explore more fully the general effect of the restriction, its costs and benefits, and alternative ways to achieve the overall objectives and aims of the underlying regulation and associated codes. First, however, Chapter 5 considers the types of works and activities in which competition might occur.

5 Potentially contestable works

5.1 The commission's view

In its issues paper and draft report, the commission defined potentially contestable works as those involving changes to or augmentation of the electricity network and for which a third party must pay ActewAGL directly, either in part or in full. These works potentially include augmentations or alterations to the existing network, new connections (including the installation of new infrastructure in greenfield developments), and other services requested and paid for by another party. The commission adopted this definition on the grounds that a customer required to pay directly for infrastructure work should have the right to choose who does the work. Accordingly, the commission excluded from its consideration maintenance and other works that ActewAGL undertakes on its own behalf on the network and customer-initiated work for which third parties do not pay any direct contribution.

The rationale for defining contestable works in terms of who pays is directly related to the commission's regulation of electricity infrastructure in the ACT. The commission allows ActewAGL to earn a rate of return on its prudent investments in the electricity network. In doing so, the commission provides for an adequate risk-adjusted rate of return on investment, as required under the National Electricity Code. Before allowing capital investment in the electricity network to earn this rate of return, the commission subjects the investment to a prudence test, which allows the commission to assess the investment's efficiency to ensure that it was necessary and appropriately costed. The prudence test provides ActewAGL with the appropriate incentives to ensure that capital projects are adequate for the needs of the electricity network (that is, the network is not overserviced or 'gold plated') and that projects are completed at least cost.

Works funded by third parties are not subjected to the same degree of scrutiny by the commission. By definition, ActewAGL is not able to earn a rate of return on capital contributed to the network by third parties, as the third parties have effectively paid for those capital works. As such works do not earn a rate of return, the commission does not apply a prudence test to the capital contributions. While the Electricity Network Capital

Contributions Code outlines the circumstances in which a customer may be required to pay a contribution, it does not regulate capital contributions as such.

The commission notes that third party contributions are potentially at risk from a monopoly power that determines the ‘cost’ of the relevant project. Competition policy principles provide that the third party should be able to ensure that it is charged an efficient price for a capital project. Most submissions received during the commission’s inquiry agreed that all works requiring a capital contribution by a customer should be contestable.¹²

Notwithstanding this principle, the commission considers there is practical merit in setting a cost threshold for infrastructure works, under which the works would not be contestable. In circumstances where a customer is only to pay a small capital contribution, for example for the relocation of a backyard pole, the costs of administering the tendering process and managing an external contractor may outweigh any potential savings or benefits from competition. Therefore, the commission proposes to define potentially contestable works as those costing more than \$10,000.

A \$10,000 threshold would still make most customer-initiated works contestable, but would significantly reduce the additional workload and cost to customers that would otherwise arise in managing small projects. This is along similar lines to the threshold-value approach used in Victoria (see Chapter 3).

5.2 ActewAGL’s view

ActewAGL’s suggested approach to defining contestable works differs from the commission’s. The company argued that a decision on whether a customer can choose an alternative infrastructure service provider should be based on an assessment of the technical, safety and efficiency risks and associated impacts, the costs to offset the risks, and implementation issues. Furthermore, ActewAGL submitted that any processes fundamental to the integrity of the electricity network should not be contestable, and raised

¹² NJ Construction, *Response to the review*; Country Energy, *Response to issues paper*, p 1; Master Builders Association, *Response to the review*, p 3.

particular concerns about including in contestable activities those involving shared assets.

ActewAGL also pointed to difficulties in making contestable those works for which both it and the customer pay a contribution, and argued that such works should not be made contestable.

These are legitimate concerns that require careful consideration. However, consistent with the Competition Principles Agreement (CPA) and its guidelines, restrictions on competition should not be applied if these issues can be addressed and resolved in other ways. The commission discusses these issues in greater detail below.

5.2.1 Network safety, reliability and quality of service

ActewAGL expressed concern that the introduction of contestability could potentially threaten network safety and reliability through, for example, contractors cutting costs by using substandard equipment or unsafe procedures, or customers selecting tenders on the sole criterion of price. ActewAGL, in commenting on the apparent improvement in safety standards in New South Wales since the introduction of contestability for infrastructure works, noted that those improvements correspond with general improvements in the regulatory framework and that contestability is but one of a number of initiatives introduced by the NSW Government.¹³

The commission considered the arguments presented by ActewAGL, but was not given any evidence to support the company's contention that contestability necessarily jeopardises network safety. Nor was any evidence presented to suggest that there has been a reduction in safety in other jurisdictions as a result of the introduction of contestability. ActewAGL's concerns about less reliable firms entering the market should be held in check by at least two factors: the need for contractors to be accredited to perform work associated with the network, and the ability of the market to distinguish between 'poor' and 'good' service providers. Indeed, the commission notes that ActewAGL has itself used contractors to undertake work on its network without any negative impact on safety.

¹³ ActewAGL, *Response to the commission's draft report*, pp 13–14.

The outcomes across other Australian states that have adopted contestability do not show a decline in reliability. The commission notes, however, that reliability problems may only become apparent over time and that infrastructure works in other states have only been contestable for a relatively short period. Nevertheless, provided infrastructure works are installed to the required standards currently used by ActewAGL, there should be no adverse impact on reliability.

Quality of service also requires consideration. There has been no suggestion that ActewAGL has not been able to deliver reasonable services in the present restricted market environment. However, there has been anecdotal evidence of delays in ActewAGL's delivery of services.¹⁴ Contestability offers opportunities for some improvement in this area. The introduction of contestability will potentially provide customers with choice, and competition will encourage contractors to have greater customer focus, be more flexible to customers' needs and deliver work to meet customers' timing. While these benefits are difficult to quantify, they are likely to have an important positive impact. The potential for such improvements in quality of service was recognised in many of the submissions received by the commission.

Regarding the quality of work provided by private contractors, no evidence was advanced to indicate that private contractors are inherently less quality conscious than ActewAGL. On the contrary, with appropriate registration and licensing, private contractors have a competition motive to ensure the quality of their services.

The commission agrees that network safety and reliability, and quality of services, are fundamental to the operation of the ACT's electricity distribution services and must be maintained. The commission does not, however, consider safety and supply concerns to be sufficient grounds for excluding contestability in the existing network. The commission has noted that ActewAGL currently already employs third party contractors to work on its network and therefore has in place controls and procedures for the work to be undertaken safely. Nonetheless, the commission acknowledges

¹⁴ Master Builders Association, *Response to the review of contestable infrastructure works*; Madison Constructions, email dated 11 November 2003; information provided by Maunsell Australia Pty Ltd.

ActewAGL's safety concerns and therefore recommends that an additional criterion for assessing whether or not certain works be made contestable should be whether the works can be safely isolated and not unduly interrupt other customers. New connections and much work involving shared assets would clearly meet this criterion.

The commission also recommends the adoption of a number of other safeguards for contestable work (for example, authorisation and accreditation of contractors; ongoing contract management processes, such as site inductions, access permit procedures, and work quality and work practice audits; and the ability of ActewAGL to require firms to provide bonds or guarantees over their work for a certain period).

The commission holds the view that, if adequate controls and measures are in place, network safety and reliability will not be adversely affected by contestability. Many of these safeguards are already in place, but some new controls and measures will need to be developed to supplement existing ones.

There are costs (discussed in more detail in Chapter 8) associated with the required safeguards, but notwithstanding these costs, contestability has the potential to offer benefits to the ACT's economy. The experience in other states confirms that benefits can be achieved where there is viable competition and the practical difficulties of certification, accreditation and performance guarantees can be resolved.

5.2.2 Shared assets

In ActewAGL's submission to the commission's draft report, the company commented that the commission's definition of contestable works was too broad and that it should be refined after consideration of the approaches to contestability in other jurisdictions. ActewAGL's major concern related to the commission's inclusion of what the company described as 'major strategic assets'. ActewAGL argued that these assets are vital to the reliability of the network and that they should not be made contestable because this would 'pose grave risks to the safety and reliability of the network.'¹⁵ While ActewAGL did not define these 'major strategic assets',

¹⁵ ActewAGL, *Response to the commission's draft report*, p 4.

the commission assumes that they are those central to the operation of the network as a whole. This implies that such assets are effectively ‘shared’ assets (that is, they have a function beyond that required by the third party who is being asked to pay for all or part of their direct cost).

Experience in other jurisdictions suggests to the commission that retention of ActewAGL’s monopoly on work on shared assets is not inevitable, and that there are ways to address concerns about work on such assets by external contractors.

In New South Wales and Victoria, work on shared assets (for example, augmentations of the network, and work on high-voltage lines and zone substations) is contestable at the discretion of the distributor. In New South Wales, if a distributor does not allow a third party to work on the existing network, that work is, by definition, not contestable and is funded by the distributor. As a matter of policy, some Victorian distributors have elected to put out to tender any work on shared assets that they have determined, for safety or other reasons, not to make contestable. In South Australia, work on the existing network remains a monopoly function of the distribution business. In Queensland, these types of works are not contestable, but for reasons unrelated to safety and reliability of supply (see Section 3.3).

The commission agrees that major shared assets require important safety and design considerations. ActewAGL itself commented that these risks could be addressed through the accreditation of contractors, but was concerned that this alone would not safeguard network safety and reliability. The commission notes that a variety of safeguards have been adopted in other jurisdictions (for example, specification by the distributor of material and construction standards; authorisation of contractors to work on, or near, the live network; the ability to charge contractors guarantees to cover costs of faulty workmanship; and audit of works before acceptance). These safeguards are discussed in greater detail in Chapter 6.

On the evidence presented, the commission is not convinced that ActewAGL’s concerns are well founded. Rather, an appropriate and properly administered contestability scheme should be adequate to ensure that successful tenderers have the necessary experience and expertise to work on shared assets, and to meet the standard required by the distributor. The commission considers this preferable to maintaining a potentially distorting monopoly.

5.2.3 Joint funding

In its submission to the commission's draft report, ActewAGL contended that there are difficulties in making works contestable where the work is jointly funded by ActewAGL and a third party. ActewAGL's submission indicated that the ACT's funding arrangements are unique, and that this would have an impact on any benefits arising from contestability.¹⁶

Exclusion of all jointly funded projects would effectively rule out contestability in most of the areas in which it could be introduced. This includes greenfield developments, which are typically jointly funded by ActewAGL and a property developer. In such a development, ActewAGL pays the equivalent of the cost of an overhead reticulation system, while the property developer pays the additional cost of undergrounding the relevant infrastructure. In effect, ActewAGL offers a basic service and the property developer pays for additional system requirements.

The commission notes that funding arrangements in New South Wales are significantly different from those in the ACT. In New South Wales, if a customer's contribution is estimated to be greater than 50 per cent of the total cost of a work, the customer pays the full amount; if the customer's contribution is less than 50 per cent, the distributor pays the full amount. There is no shared funding, and so this does not become an issue in relation to contestable works.

Elsewhere, however, the joint funding of works has not proved an impediment to competition. For example, in Victoria customers are required to contribute to the cost of the works to the extent that those costs are not funded directly by the distributor.¹⁷ Payment arrangements vary between distributors. In the case of Powercor, if the customer uses a contractor to construct the infrastructure works, the customer meets the full cost; if a distributor-funded capital contribution is required, the distributor pays the customer the lesser of the actual cost of the infrastructure work and the average cost of equivalent work undertaken by the distributor. In the case of United Energy, while the customer still pays 'up front', the company reimburses the amount in its indicative quote for work that would otherwise

¹⁶ ActewAGL, *Response to the commission's draft report*, p 11.

¹⁷ In addition, customers are required to fund works that are considered to be speculative by the distributor and are at risk of being underutilised or stranded.

be at the expense of the distributor. In Queensland, ENERGEX contributes in kind by providing such material as transformers and cable; these assets are rolled into the business asset base, which continues to earn a rate of return as prescribed under the National Electricity Code.

The experience in other jurisdictions therefore demonstrates that the joint funding of infrastructure works is not a barrier to making the works contestable. However, appropriate rules need to be agreed so that relevant compensation is made.

5.3 The commission's recommendation

The commission's basic premise is that works for which customers must pay should be contestable. The commission has considered ActewAGL's views, the views of other stakeholders, and the experience in other jurisdictions, and acknowledges that there should be exceptions to this rule.

Where the cost of administering and tendering a project is likely to exceed the cost of the project, those works should be excluded from the process of competitive bidding. The commission suggests a threshold of \$10,000 to apply before a project becomes contestable.

A further criterion to determine the contestability of a particular work should be whether the work can be safely isolated and not unduly interrupt other customers. Works that fail to meet this criterion should still be subject to market testing. The commission notes the approach taken by some Victorian distributors, in which such works are put out to tender, and recommends that a similar approach be adopted in the ACT.

In the commission's view, there are no a priori reasons why work on shared assets should be excluded from contestability, provided the necessary safeguards are in place. Nor does the commission see joint funding of contributions as a reason for not allowing a particular project to be contestable. Thus, even if a customer's contribution to the cost of construction of infrastructure is relatively small (for example, 5 per cent of the total cost), but exceeds the \$10,000 threshold (and meets the 'safe isolation' criterion) those works should be contestable.

Table 5.1 shows the commission's suggested criteria for establishing whether works should be made contestable.

Table 5.1 **Criteria for determining contestability**

Criteria	Response	Assessment
1. Is the customer required to pay a capital contribution?	Yes	Work is contestable, subject to criteria 2 and 3.
	No	Work is not contestable
2. Is the likely cost of the customer's component of the works over \$10,000?	Yes	Work is contestable, subject to criterion 3.
	No	Work is not contestable
3. Can the works be isolated safely?	Yes	Work is contestable, provided required safeguards are in place.
	No	Work is not contestable, but must be tendered.

6 Implementation of a contestable market

The definition of contestable works as outlined in the previous chapter embraces a wide range of activity for which third parties are required to make direct payment. While some work should remain non-contestable (for example, small projects), the vast majority of capital works should be contestable if a third party is required to pay directly for the work.

A number of other characteristics of the market for contestable capital works should also be considered as part of this report. These characteristics affect how the market might operate and are broadly defined as ‘features of a contestable market’. They are based on the following considerations:

- the need to ensure that network safety and reliability of supply are not jeopardised
- the need to minimise implementation and operational costs
- the need to maximise customer choice.

These features of a contestable market are outlined below, along with changes to current regulatory arrangements needed for competition in the electricity infrastructure market.

6.1 Features of a contestable market

6.1.1 Indicative quotes

It has been suggested that customers should be given an indicative cost of works to help them decide whether or not they want the works tendered.¹⁸ In Victoria, distributors are required to provide indicative quotes to customers (although United Energy has dispensed with indicative quotes and provides only a firm offer). New South Wales distributors are not required to provide

¹⁸ Information provided by Exigency Consulting

quotes and no longer do so voluntarily. This has reportedly affected the ability of customers to plan and budget for construction works.

Provision of indicative prices by the incumbent distributor could be seen as limiting the distributor's ability to compete against formal bids by competitors. At the same time, it is not unusual in a competitive market for service providers to provide indicative prices before a formal, written 'quote'. The commission therefore favours a process whereby ActewAGL gives some form of indicative price before the customer decides whether to proceed to a formal tender. The commission stresses that such an indication would not be binding; ActewAGL would subsequently be able to revise its price in a firm bid.

It may not be necessary, however, to formalise such a requirement. In a market in which a customer can elect not to proceed with a formal tender process, ActewAGL may take the opportunity to convince the customer that a formal tender is not necessary by giving an indicative price. Alternatively, the customer might sound out the market informally to see what other suppliers offer. These matters should be left to the market without a formal requirement being applied to one bidder, ActewAGL.

6.1.2 Requirement to tender

The commission is as concerned to promote customer choice as it is to encourage efficiencies in the provision of services. While it considers it important that a customer be given the right to choose who undertakes any electricity infrastructure works that they are required to pay for, the commission also believes that customers should have the option of waiving that right. In New South Wales, all contestable works must be tendered. The commission understands, however, that some customers would prefer to have the distributor carry out the work and dispense with the uncertainty and time involved in seeking tenders.¹⁹ Likewise, the commission knows that not all customers have the required skills or the inclination to manage an infrastructure works project. The commission therefore proposes that customers should have the choice of having ActewAGL undertake and manage the project on the customer's behalf, or tender and manage the work themselves.

¹⁹ Information provided by Exigency Consulting.

6.1.3 Timeframes

One of the main criticisms made of the operation of the contestability arrangements in New South Wales is of the uncertainty surrounding the awarding of tenders and the time this is perceived to be adding to projects.²⁰ This may in part be attributed to the particular design of the New South Wales scheme. It is worth noting that in Victoria, where delays do not appear to be an issue, timeframes are mandated for the various stages of the tender process. The commission advocates a similar approach in the ACT. Mandated deadlines, for example for the provision of quotes, design and construction specifications and the approval of designs, will need to be determined in consultation with the industry and using the Victorian experience as a template.

On another timing matter, ActewAGL expressed concern over the potential for delays in the completion of works as a result of possible disputes between contractors and the distributor. The commission acknowledges that there is a risk of this occurring, although the private contractor would have a profit motive to keep disputes to a minimum. A disputes resolution process may need to be formalised, and the commission could play a role in this process. Experience in other jurisdictions suggests that this is not a major limitation on the successful implementation of a contestable market.

6.1.4 Tendering and associated costs

In other jurisdictions, distributors' recurrent costs are passed on to those customers requesting tendered capital works through a variety of fees for services (such as the provision of design information, certification of designs, design rechecking, inspections and re-inspections, and authorisations). The commission envisages a similar arrangement in the ACT to reduce the cost imposed on other ActewAGL customers and effectively apply a 'user pays' principle. Any unavoidable tendering and administration costs charged by ActewAGL should be fair and reasonable and be subject to appeal to the commission.

²⁰ Information provided to Exigency Consulting and Maunsell Australia Pty Ltd.

6.1.5 Joint funding of works

The commission discussed the issue of joint funding of contestable works (that is, both ActewAGL and the customer contribute to the cost of the project) in Chapter 5, and recommended that such projects be considered potentially contestable. Mention therefore needs to be made of how a joint funding arrangement might work. The approach favoured by the commission is one in which ActewAGL determines, as it does now, the stand-alone cost for the distribution network portion of a capital works project. If the customer elects to have ActewAGL undertake the works, ActewAGL's estimated 'distributor contribution' would be deducted from the total amount payable and the customer would contribute the balance of the cost of the work. Alternatively, if a third party contractor undertakes the work, ActewAGL would pay the customer its estimated 'distributor contribution' after the company accepts and energises the new works. In this case, the customer therefore pays for the up-front cost of the entire project, plus tendering costs, and is reimbursed ActewAGL's 'distributor contribution' only after the works are completed and have been accepted by the company.

6.1.6 Procurement

ActewAGL is a major purchaser of a wide range of electrical equipment and fittings used in maintaining or extending the network. As with any work undertaken on its network, before work is undertaken by a third party ActewAGL would need to specify the types and makes of equipment to be used on the network to ensure compatibility and facilitate maintenance. In these circumstances, in which a competing construction firm would be expected to match the prices paid by ActewAGL, major bulk discounts for ActewAGL could place the competitor at a disadvantage.

In other jurisdictions, accredited contractors can choose to source materials from manufacturers and suppliers that supply to the electricity distribution industry, or they can source directly from the distribution businesses. This allows accredited contractors to benefit from volume discounts available to the network operator. The commission considers that a similar arrangement should apply in the ACT if contestability is introduced. This would allow bidders to decide who they will buy from, while allowing access to potential savings through ActewAGL's bulk purchasing arrangements. Equipment and materials not sourced from ActewAGL would still need to meet ActewAGL's technical specifications.

ActewAGL indicated that it does not favour making material and equipment available to contractors because this may reduce its competitive advantage. The commission acknowledges that there may be commercial reasons for taking this view. However, it is in the interests of the network, and hence the long-term interests of ActewAGL and the ACT public, to ensure that contractors source materials from the same suppliers. Indeed, given that these are public assets that will vest in ActewAGL on handover, it seems reasonable that contractors should be allowed to buy them through or from ActewAGL. An option may be to have compulsory purchasing of certain equipment through ActewAGL or, if ActewAGL is unwilling to do this, through an agency such as ACT Procurement Solutions to ensure that this bulk purchasing power benefits the ACT as a whole. The commission considers it appropriate for ActewAGL to include a reasonable profit margin, similar to a distributor's margin, in the price of material on-sold to contractors.

The commission notes that, if access to ActewAGL's supply arrangements were to be included as part of the contestability conditions, the potential for tender price differentiation would potentially be reduced to the wage and salary costs and the profit margin included in the bid for the tendered work. ActewAGL argues that this would severely limit the scope for competition and potentially result in ActewAGL having to lay off employees.

However, this approach misunderstands the scope of competition in this market. Customers are looking beyond price, to their ability to start the project by a particular date, timely completion, interruptions to other on-site activities, and overall quality of service. Opportunities also exist for innovation and competition between contractors in how they do the work (consistent with required design, safety and system security specifications).

Giving bidders for contestable works access to ActewAGL's purchasing arrangements does not necessarily limit ActewAGL's ability to compete in this market, or in any other way jeopardise ActewAGL's position. Access to supplies through the incumbent distributor has not reduced the distributor's competitiveness in other jurisdictions.

Accordingly, the commission proposes that other bidders should have access to ActewAGL's preferential procurement arrangements for the purposes of works designated contestable.

6.1.7 Acceptance of works

Regardless of who undertakes the construction work, ActewAGL will ultimately assume responsibility for managing the assets. ActewAGL would therefore need to specify construction standards and be assured that the works meet those standards before accepting them. Works would need to be audited before acceptance, either by an independent party or by ActewAGL. Consistent with practice in other jurisdictions, it would be appropriate for ActewAGL to do the auditing. As a safeguard against misuse of power, the commission could be appointed as an independent arbiter in disputes. The commission can appoint technical experts to assist in such tasks. Appropriate ring fencing arrangements would also need to be in place.

Other jurisdictions allow distributors to require payment of guarantees or bonds by contractors as an added safeguard against poor workmanship that might not be immediately evident. In Victoria, for example, distributors may require a refundable guarantee for the costs of fixing faults or defects arising from the contractor's work. The guarantee required by Powercor is set at 5 per cent of the distributor's estimate of the total cost of the construction works and is charged to the customer. Any unused portion is returned after three years from the completion of the works. In New South Wales, it is the contractor who pays the guarantee. The guarantee is for a maximum of three years, but the amount charged is at the discretion of the distributor.

The commission proposes that in the ACT a guarantee will be required for a period of three years. As in New South Wales, this should be paid by the contractor. The guarantee should be set at a percentage of the value of the works undertaken, and the commission proposes that the rate be 5 per cent.

6.2 Changes required to regulatory arrangements

Amendments to the Utilities Act and a range of other instruments such as the Ring Fencing Guidelines and the Electricity Network Capital Contributions Code will be needed to allow contestability of customer-funded works to come into effect.

As noted in Section 4.3, it is unclear whether, and to what extent, the Utilities Act allows contestability for infrastructure works. While the Act allows accredited contractors to connect customers' premises to the network or to vary the capacity of the connection, it expressly excludes augmentation,

relocation or other alteration of the network operator's existing network from those categories. The Act does not address the connection of greenfield developments to the electricity network. ActewAGL's interpretation of the Utilities Act is that the regulation restricts competition in the electricity infrastructure network. Should customer-funded electricity infrastructure works be made contestable, the Act would need to be amended to remove its current ambiguities.

Amendments would also need to be made to a range of other regulatory instruments. For example, the commission's Ring Fencing Guidelines only address the separation of the distribution business from related businesses, in particular retail businesses. The guidelines do not specifically address the separation of business units within the distribution business. Assuming that ActewAGL would compete for customer-funded works, the guidelines would need to be amended to ensure that services to contractors, including ActewAGL, are provided in a non-discretionary manner. ActewAGL would need to have in place sufficient separation between the areas within the business responsible for determining construction and design standards and specifications, those approving designs and approving works, and those responsible for preparing designs and carrying out the works to ensure that the last group is not treated more favourably than or differently from its competitors.

The accreditation of contractors is one of a number of mechanisms needed to ensure that contestable works are designed, constructed and installed to provide for the efficient, reliable and safe operation of those works by competent and adequately skilled people. The Contestable Work Accreditation Code requires network operators to develop schemes to allow contractors to be accredited to perform contestable works. The code currently deals only with the accreditation of contractors to perform connection and variation works, not the full range of customer-funded infrastructure works that this report has identified as potentially contestable.

Therefore, there is no accreditation scheme adequate for contestability in the ACT at the time of writing. Contestability requires that the code be expanded and a scheme developed. As noted in Section 3.1, New South Wales has an accreditation scheme in place, which the ACT could seek to join.

From ActewAGL, the introduction of competition will require, for example, the formalisation of an accreditation process for participating contractors and further formalisation of the design and construction standards and associated

procedures for the maintenance, enforcement and oversight of construction, safety and reliability standards for all works undertaken by third party contractors. These requirements are not new to ActewAGL, as some are already used when work on the network is subcontracted. However, it is generally acknowledged that there is a need for a more formal set of instructions, manuals and guidelines to support the operation of a contestable market.

The current Electricity Network Capital Contributions Code does not anticipate a situation in which electricity infrastructure works could be undertaken by anyone other than the network operator, or in which the network operator could be required, for example, to reimburse to a customer the network operator's capital contribution. The code will need to be amended to define clearly what customers are required to pay for and what the distributor contributes, how the respective contributions are determined, and how customers are to be refunded where contractors have been used to design and/or construct contestable works.

There will be a cost to be borne in making these necessary changes in legislation, regulations, codes and operating manuals. However, in a number of these areas, in particular the ring fencing and capital contributions arrangements, changes are required regardless of whether electricity infrastructure works are made contestable. This includes a scheduled review of the Utilities Act, which has begun. Required additional amendments can be part of this process. The review can readily incorporate changes needed to remove any doubt about the legality of the contestability of customer-funded works.

The review of the Utilities Act is a commitment given by the government when the Act was first introduced, and is independent of the commission's current review of electricity infrastructure works. The effect of the Act's implied legislative restriction on competition for customer-funded infrastructure works is therefore not a sufficient reason not to proceed with reviews of other relevant legislation and associated codes.

The updating and formalising of ActewAGL's internal manuals and guidelines should not be seen as a significant additional cost that the company could otherwise avoid. If, as ActewAGL would probably claim, the company uses appropriate good governance and risk management procedures, formal design and construction standards and audit procedures should, to a large extent, already exist within the business. To the extent that

these are further codified and formalised, the overall level of risk management within ActewAGL will improve, to the benefit of the shareholders and the community as a whole.

The commission concludes that continued restriction on competition will not entirely remove the need to improve regulatory arrangements within and outside ActewAGL. The costs of improvement will have to be met, with or without full contestability.

6.3 Introduction of contestability

Should the electricity infrastructure market be made contestable, enough time will need to be allowed for ActewAGL to make the required systems, procedural and organisational changes and for government to change the regulatory framework. The commission recommends that the opening of the market be phased in, beginning with the segment of the market in which contestability is easiest to implement and manage, namely new connections, and progressively extending to works on the existing network. Based on the experience of other jurisdictions and the ACT's own experience with the introduction of contestability in the electricity retail market, the commission recommends that at least 12 months be allowed for the opening of the first segment of the market, followed no more than 12 months later by the rest of the market.

6.4 Summary

The commission has sought to identify the characteristics of the type and form of services that would be made contestable should the government remove the legislative restriction on competition. It is clear from the commission's assessment that not all infrastructure works should be made contestable. However, following the principle that work funded by customers should be contestable, the commission has included as much currently customer-funded work as possible.

The commission has identified a number of key features of a contestable market, namely:

1. ActewAGL is to provide contractors with a specified materials list.

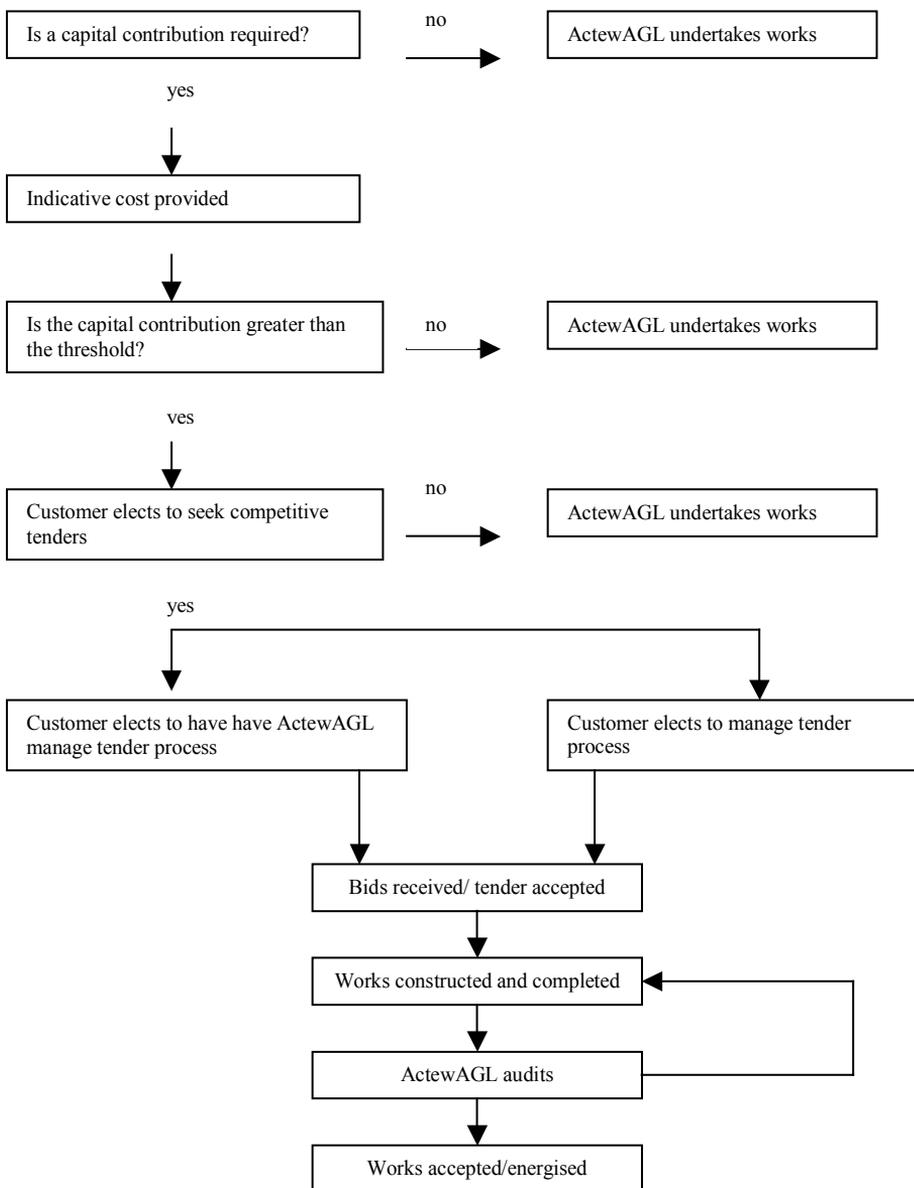
2. Contractors are to be given the option of acquiring specified material through ActewAGL.
3. Customers are to have the option of:
 - waiving the right to have potentially contestable works tendered
 - having ActewAGL manage the tender process or managing the process themselves.
4. If a customer elects to use a third party contractor on a jointly funded project, the customer is to pay the full cost of the project ‘up front’. ActewAGL will then reimburse the customer the estimated ‘distributor contribution’ once ActewAGL has accepted and energised the new works. If the customer elects to use ActewAGL, the customer will pay the difference between ActewAGL’s estimated ‘distributor contribution’ and the total amount payable for the work.
5. Potential delays in the undertaking of contestable works are to be minimised through the imposition of timeframes and the availability of a mechanism whereby disputes can be referred and settled promptly.
6. Contractors are to be required to be accredited for contestable works. Consideration could be given to using the New South Wales accreditation scheme. Contractors wishing to work on or near the live network are also to be authorised by ActewAGL. Such authorisation is not to be unreasonably withheld.
7. Construction works are to be audited by ActewAGL after their completion.
8. ActewAGL is to be able to charge contractors a refundable guarantee of 5 per cent to cover the costs of fixing any defects or faults arising from the contractor’s work within a three-year period following the completion of the work.
9. ActewAGL is to be able to charge a customer opting to seek contestable bids appropriate administration and audit costs. These charges are to be fair and reasonable and subject to appeal to the commission.
10. Customers seeking to tender contestable works are to meet all their own tendering costs.

Figure 6.1 outlines the various steps to be taken in deciding whether works can go to tender in the first place, and then, if tendered, whether they are finally certified. It is this broad model of contestable activity that the commission examines in the following chapters.

The commission recommends that a transitional period apply, to enable ActewAGL to make necessary systems, procedural and structural changes and to enable the government to make any changes required to the regulatory framework.

The introduction of contestability should be phased in. New connections (for example, greenfield reticulation) should be contestable not less than 12 months from the government's approval of the scheme, and the remainder of the market should be opened not later than 12 months after that.

Figure 6.1 Indicative infrastructure works tendering process



7 Competition or regulation

7.1 Introduction

Identifying the ‘market’ that would be opened to contestability allows consideration of the potential for competitors to emerge and offer an alternative supply of services currently provided by ActewAGL. While experience in other states has been that a contestable market emerges over time, it is apparent that a viable, self-sufficient market may not be possible in all circumstances. In a small jurisdiction such as the ACT, there may be insufficient work to attract competition to ActewAGL or provide a market base on which competing suppliers could achieve efficient levels of activity.

The commission’s assessment framework also requires consideration of alternative mechanisms of achieving the overall policy objectives of the current restriction of competition: safety, reliability and availability of service. If the market is too small to support more than one service provider or the overall benefits of restricting competition exceed the costs, alternatives to restricting competition need to be considered.

7.2 Viability of competition

Whether the potential for competition exists in a particular market is relevant to an assessment of the impact of a restriction on such competition. Without the potentially viable alternative service providers, any opening up of the market would be a wasteful and possibly expensive option. One distributor has suggested, for example, that there need to be at least three viable competitors to undertake construction works in order for the market to operate efficiently.²¹

The experience of those jurisdictions that have contestability is telling. Where competition for electricity infrastructure works is limited or non-existent, for example in rural New South Wales and Victoria, there has either been no response to calls for tender, or prices for individual projects

²¹ Email from AGL Electricity Ltd, 12 March 2004.

have risen. The response of Inland Energy to a lack of any viable competition has not been to open construction works to contestability; for to do so would be a pointless and expensive exercise given the costs of making the market contestable and no prospect of any benefits in this environment.

The commission notes that savings are being made in those areas where there is a viable market, for example in Sydney, Melbourne, Wollongong, Newcastle and much of the South Coast of New South Wales. The experience in Queensland is also significant. In that state, contestability is not mandated but distributors may allow customers to use third party contractors to undertake construction works. Interestingly, the urban-based distributor has made certain electricity infrastructure works contestable, whereas its predominantly rural-based counterpart has not.

From the submissions received by the commission, it appears that there are a number of qualified contractors in the southern New South Wales region and the ACT region who may seek to enter the ACT market for infrastructure works if it is made contestable, making competition in this market more likely than in some New South Wales rural regions. In the ACT there is already a competitive market for electricity infrastructure works that are not part of ActewAGL's network, for example works in residential, commercial and industrial buildings, academic institutions, and street lighting. These works are estimated to be worth at least \$40 million per year.²² ActewAGL also currently contracts out some of its customer-funded works.

Table 7.1 summarises the value of customer-initiated work in the ACT for recent years and projects figures to 2008–09. In this table, total customer-initiated works includes those projects funded directly by customers or jointly by customers and ActewAGL. The customer-funded component is also shown.

²² This assumes a construction and building market of some \$400 million per year in the ACT with an electrical works component of some 10 per cent.

Table 7.1 Customer-initiated infrastructure works (\$ million)

	2001– 02	2002– 03	2003– 04	2004– 05	2005– 06	2006– 07	2007– 08	2008– 09
Total customer-initiated infrastructure works	10.4	12.6	10.4	13.3	17.2	20.9	16.8	10.8
Customer capital contributions	4.5	7.8	3.0	6.4	10.6	14.9	10.8	4.1

Source: ActewAGL

As indicated in Table 7.1, the total value of customer-initiated works is currently around \$13 million and is expected to grow to around \$21 million in the short term. Not all the works initiated by customers will be opened to competition if the market is made contestable. The market design as outlined in this report will exclude works for which the customer contribution is less than \$10,000 or that do not meet the ‘safe isolation’ criterion²³. Also, some works are likely to be fully funded by ActewAGL and therefore excluded from the contestable market.

Given the caveats and requirements that the commission proposes to use in the market design, the dollar value of the market cannot be determined precisely, but based on ActewAGL’s predictions it is reasonable to assume that it is currently \$9–10 million and that it will grow in the short term.

This new contestable work will significantly expand the existing market and, unlike other rural-based work, is concentrated in one geographical area. This would be more likely to attract competitors to the ACT market than similar work in some parts of rural New South Wales and Victoria, where the volume of work in any one location is too low to attract new market entrants.

It is clear from submissions received that the current restriction on competition has kept a number of viable competitors from entering the ACT market, and that these competitors are interested in competing for work in the ACT should the market restriction be removed. The potential competitors are big enough and have sufficient technical capability to form the core elements of a competitive market for work in southern New South Wales and the ACT. Some potential new entrants into the ACT are already accredited

²³ These works include, for example, sub-transmission and zone substation works. These works are currently already contracted out.

and registered under the New South Wales arrangements, and would be readily accredited under the proposed arrangements for the ACT.

In its draft report, the commission identified a number of potential entrants into the ACT market and several other accredited contractors operating in the region who may be interested in competing in the ACT. The commission has not received any submissions to suggest that this level of interest has declined since the release of the draft report.

Therefore, the commission does not foresee a lack of potential entrants into the market hindering the effective opening of the ACT market to competition.

The commission noted in the draft report that there would be additional risks if smaller contractors enter the market, such as risks of default by contractors or of contractual disputes. However, such risks can be mitigated by the use of performance bonds or security deposits made by accredited contractors as a surety against default. This is normal practice in other contracting environments, and there is no reason why it should not be equally effective in this market. The availability of a mechanism to resolve disputes promptly will help minimise delays resulting from disputes between contractors and the incumbent distributor. These issues are not likely to be a barrier to entry for firms wishing to enter a new competitive market.

7.3 Alternative to competition

The guiding principle of the National Competition Policy is that competition, in general, will promote community welfare by increasing national income through encouraging improvements in efficiency. In particular, the aim of the policy is to encourage business to use resources more efficiently, reduce prices and respond better to consumer needs. Where competition is not feasible, or where there are overriding benefits to be gained through a restriction on competition, some form of regulation is required to remedy the exercise of the monopoly power that would be held by the sole supplier to the market.

Regulation to guard against the possible use of market power is both complex and costly. Regulation is a second-best option to competition and should only be used where the costs of market failure are sufficiently high or

there are other benefits that outweigh the loss of contestability and the regulatory costs.

ActewAGL is a regulated monopoly in terms of network prices and its returns on the capital it invests in infrastructure. Expenditure on capital equipment that customers invest in ActewAGL's infrastructure (capital contributions) is not regulated. The Electricity Network Capital Contributions Code sets out some fundamental capital contribution rules but does not regulate ActewAGL's charges in this area. Without the constraints of either regulation or competition, there is no incentive for business to act efficiently or to pass on any of the savings achieved through contracting out services to customers. This does not necessarily mean that savings are not passed on, merely that there is no incentive to pass them on.

If electricity infrastructure works are not made contestable, then clearly a more intrusive form of regulation of capital contributions to prevent abuses of market power must be considered. However, this approach would increase regulatory costs and uncertainty for ActewAGL. Appropriate mechanisms would need to be devised to apply some form of regulation to prices charged for infrastructure works.

One option for the commission would be to require ActewAGL to benchmark its costs for different types of infrastructure works against some 'national' comparator. This would effectively mean that the regulator would authorise prices for particular types of work and ActewAGL would 'pick and match' different types of work from this approved list when calculating a final price quote for a project. Under these arrangements, the commission would conduct periodic 'audits' to ensure that the prices being charged by ActewAGL are within the guidelines set using the benchmarks.

Alternatively, the commission could seek to apply a form of 'building-block' cost build-up approach to the infrastructure works of ActewAGL. This could be conducted project by project, or could be applied across ActewAGL's total customer-funded infrastructure program with some form of annual 'unders and overs' catch-up if results fail to match projections.

The form of regulation to be applied should preferably be kept as informal as possible to minimise the deadweight cost of regulation. However, there would still be a need for appropriate ring fencing arrangements and other regulatory requirements for the infrastructure works group within

ActewAGL, to ensure that this work is kept separate from the other activities of the business.

Final details of an appropriate regulatory mechanism would need to be developed in consultation with ActewAGL and the ACT Government should it be necessary to use regulation to counter potential abuse of market power. It is important to note, however, that a decision to retain the existing restrictions on contestability is not without costs. On the contrary, it would force a decision to be taken to resolve the current lack of any formal regulation of the pricing and general behaviour of ActewAGL in the customer-funded infrastructure works market. The associated regulatory costs would ultimately be borne by the wider community, as ActewAGL would seek to pass on the costs in its prices.

8 Balance of costs and benefits

The commission has been asked to examine the relative costs and benefits of retaining the current restriction on competition and of moving to a contestable market. Either decision has implications for competition and the economy as a whole, so it is appropriate to assess the costs and benefits as fully as possible, and judge whether one choice outweighs the other.

The commission has sought to follow the guidance given by the Competition Principles Agreement (CPA), which requires the commission to determine whether the current restriction on competition provides a net benefit to the community. In order to make its assessment, the commission first examined the potential costs and benefits for the ACT's economy of removing the current restriction on competition, and then re-examined the costs and benefits of the restriction as it stands. Upon this assessment can be made a final recommendation that is consistent with the CPA objectives and standards.

The commission's approach to the cost–benefit analysis is consistent with generally accepted economic principles. In this chapter, the commission first identifies and examines the costs that would be incurred by a move to contestability. Primarily, these will be costs incurred or claimed to be incurred by ActewAGL, although there may also be costs attributable to additional regulatory requirements. The commission's goal is to determine fair and reasonable levels of costs. Some costs, however, will 'net out', with benefits accruing to other market participants. In cost–benefit analyses, these are viewed as wealth transfers and do not affect the bottom-line level of net benefits. ActewAGL has called for an asymmetric treatment of wealth transfers; the commission deals with that issue below.

After the cost side is analysed, the potential benefits are considered. Because benefits are not as easily quantified as costs, the commission's approach is to determine threshold levels of efficiency gains necessary for the benefits to outweigh the costs. If these thresholds are achievable in the light of the preponderance of economic evidence and experience elsewhere, then the determination must be that contestability generates a net public benefit. Under the CPA, for restrictions on competition to be retained it is necessary to show that the net benefits are strictly negative.

8.1 Costs

8.1.1 Social costs: job losses

ActewAGL indicated to the commission that the introduction of contestability to electricity infrastructure works will result in a reduced workload and associated redundancies. The company estimated that if it were to lose all works for which customers make contributions it would lose up to 45 employees (linesmen, cable jointers, fitters and labourers). It foreshadowed significant industrial unrest as a result and consequent supply bans and interruptions to work on the network. Furthermore, ActewAGL argued that, should staff be made redundant, there may be an outflow of skills and labour from the ACT.

The commission acknowledges that there may be some redundancies within ActewAGL if infrastructure works are made contestable but believes the impact will not be as severe as predicted by the company. The handling of any industrial unrest would be largely at the discretion of ActewAGL, but appropriate use of redundancy payments, offers of alternative jobs within the company, and the current strong demand for staff with the range of skills available within ActewAGL should mitigate industrial disruption.

In determining whether there will be a cost to the ACT economy as a result of job losses, the commission must first consider how efficiently ActewAGL is performing. The commission defines productive efficiency as production at the least cost method; that is, ActewAGL or any other infrastructure provider is productively efficient if it produces at the lowest cost, given prevailing input prices, while meeting technical regulatory standards and customer service standards. If ActewAGL is producing efficiently, the introduction of contestability is unlikely to affect its labour force, as it is already achieving the best possible outcome given the mix of labour and capital in the market. In these circumstances, if ActewAGL is charging at prices that include a monopoly rent, it should be able to reduce its prices in response to competition and still retain most of its market share. If ActewAGL is currently not productively efficient and can therefore be undercut in its prices, there will be resulting loss of market share and potential job losses. The job losses represent a movement to a more efficient allocation of resources, and the commission notes that they may have associated social costs. In addition, the commission notes there will be some costs to ActewAGL in funding any redundancy packages.

In its draft report, the commission estimated that up to 15 staff positions might be lost. This estimate was made by comparing the volume of ActewAGL's current work with the amount of work it might lose if infrastructure works are made contestable, assuming that the company would not lose more than 50 per cent of these works. ActewAGL subsequently estimated, on the basis of this assumption, that job losses would amount to up to 23 staff. The commission notes, however, that a loss of up to 50 per cent of the market would be the most extreme scenario, and the job loss estimate should therefore be seen as an extreme possible outcome. Even if ActewAGL were to lose 50 per cent of the market, this would not occur instantaneously. On the contrary, the company would most likely suffer a gradual loss of market share. A loss of half of its market share would take at least several years and ActewAGL would make workers redundant (if it comes to that) over that period, during which there would also be a natural attrition of workers as they retired or sought work elsewhere.

It should be noted that both the commission's and ActewAGL's estimates were based on current levels of activity in the market. In fact, the indications are the electricity capital works market is growing in real terms in the ACT and New South Wales. On the basis of ActewAGL's overall estimates, this market is expected to grow from \$13 million to \$20 million per year in the short term. Although the market is then expected to reduce to about its present size, the timing of this short-term growth would help to cushion the effect of contestability on ActewAGL. While a loss of market share might result in a surplus of staff in the current market, in a growing market any slack would be taken up.

ActewAGL is in a strong position. It currently has 100 per cent of the market, knows the network, standards and practices, and has a trained workforce and appropriate equipment. If ActewAGL is operating efficiently and is pricing its services at or near the level of efficient cost, there will not be any redundancies. From a total economy perspective, if ActewAGL is forced to reduce its workforce because it is not operating efficiently, these redundancies should not be seen as a cost of contestability even if they represent a cost to the company. Instead, these redundancies represent a misallocation of resources which would be maintained if the current restriction were not removed. The movement of workers out of ActewAGL to be reemployed more efficiently elsewhere would be an economic gain to the economy. These potential efficiencies are discussed further in the following section.

The commission noted in its draft report a shortage of skilled electricity linesmen in the ACT region, including in ActewAGL, and suggested that any staff who were made redundant would have little difficulty in finding work either with ActewAGL or elsewhere. ActewAGL advised that many of the potentially surplus staff are unskilled or have the wrong skills and could not be redeployed in the areas of skills shortages.

The commission does not accept this argument; nor does the experience in other jurisdictions support ActewAGL's contention. ActewAGL employs staff with a range of skills in its infrastructure works group. The company has a program of progressively training and skilling employees as a means of meeting its staffing needs and ensuring a continuation of a strong corporate culture within its workforce. At a time of shortages of skilled staff, ActewAGL will be looking to 'grow' its own skilled workforce internally while, where possible, attracting skilled staff from other distributors or electrical contractors. This of itself creates demand both within ActewAGL and in other firms for staff who have had at least some experience in the industry. ActewAGL is much more likely to redeploy even semiskilled or unskilled workers who have had experience within ActewAGL and are trainable than to hire 'new starters' from outside the firm and start them on a new entrant training program.

The commission has examined the experience in other jurisdictions and has not found evidence of significant forced redundancies or loss of economic benefit. In New South Wales, there were no redundancies; surplus staff were redeployed or retrained. In Victoria, distributors responded to competition by rationalising their work structures and outsourcing all their construction work. Commercial contracting arms were established to compete for the services of their own distribution companies and, more widely, for contestable works offered by other distributor businesses. Companies were restructured so that there were no redundancies as a direct consequence of competition for electricity infrastructure works. At the same time, efficiency in the market has increased.

ActewAGL also indicated that redundant employees may not necessarily want to seek similar positions elsewhere and instead may choose to leave the industry. This is contrary to information provided to the commission suggesting that while utility staff may not rejoin another utility they are likely to enter private sector firms that are competing for electricity infrastructure works. The commission understands that in New South Wales

the competitor contracting firms largely comprise ex-staff from the various distribution businesses.

The issue of the social cost created by potential job losses is of concern to the commission. The threat of job losses and redundancies is an emotive issue and can unduly influence policy decision making. The commission has endeavoured to examine this issue from an overall Territory perspective, as well as from the perspective of the individual staff concerned.

From an individual staff member's perspective, the experience in other states again supports the commission's view that any dislocation costs will be met by redundancy payments and good prospects for re-employment within the industry.

The opening of the market to contestable bidding will not happen immediately, but will need to await the completion of any necessary regulatory amendments to the Utilities Act, industry codes, and associated documentation. The commission expects that 1 July 2005 would be the earliest date that the market could become contestable. In the intervening period, alternative employment opportunities, training and retraining options, and redeployment of staff within ActewAGL will have begun, thereby minimising any social dislocation that might otherwise be expected from a sudden change in policy and practice.

8.1.2 Reduced operating efficiencies in ActewAGL

ActewAGL argued that it will suffer reductions in operational efficiency if infrastructure works are made contestable, including through:

- possible underutilisation of staff brought about because the company will have to retain a core of employees to fulfil its network obligations under the Utilities Act, despite a likely loss of market share and reduced workload
- reduced ability to respond to emergencies and peak workloads, resulting in delays in the restoration of services, interruptions to critical works and possible legal ramifications
- inefficiencies resulting from the need for further ring fencing of staff and resources

- a loss of flexibility to coordinate different capital work projects or to combine capital projects with customer-funded works, as currently occurs
- reduced ability to deliver economies of scale in areas such as equipment and staff utilisation, materials purchasing and management, and staff training and skills development, with a resultant increase in unit costs across the whole business
- inefficiencies such as disruption and increased costs resulting from managing inexperienced or unreliable contractors or developers
- stranding of resources.²⁴

Each of these alleged areas of possible operational efficiency losses deserves a specific response.

- *Underutilisation of core staff.* Core staff required to meet ActewAGL's obligations under the Utilities Act should either be funded through the payment for the monopoly distribution services provided by the firm (which the commission approves and allows in the distribution use of system charge) or should be recovered through the charges ActewAGL will make to customers who elect to tender infrastructure works. To the extent that these costs are currently being recovered through charges for infrastructure works and the administrative services are still required, ActewAGL will continue to recover the costs.
- *Reduced ability to respond to emergencies and peak workload.* The fundamental question in this argument is where the line should be drawn between sufficient capacity to meet all possible emergency and workload contingencies and the cost that the community is willing to pay. This issue is considered as part of the commission's setting of the distribution use of system charges to achieve an appropriate balance in allowances for the cost of works. The commission notes that ActewAGL was not able to meet all its workforce needs when responding to the January

²⁴ ActewAGL, *Supplementary submission – Review of contestable electricity infrastructure works*, commercial-in-confidence, 9 December 2003, p 7; ActewAGL, *Response to the commission's draft report for the review of contestable electricity infrastructure works*, commercial-in-confidence, 23 January 2004, p 21.

2003 bushfires, despite having a monopoly right for customer-funded works, but was able to draw on external resources in that emergency. ActewAGL drafted approximately 150 additional personnel from neighbouring network operators and private contractors in order to meet extraordinary repair requirements at that time.²⁵ It is important to recognise that ActewAGL will continue to have an ongoing capital works program of over \$20 million per year for non-customer funded works. In addition, the company should retain a significant share of customer-funded works if these are made contestable. This will be a solid base with which to retain necessary skills and resources. ActewAGL's ability to respond to emergencies or increased workload will not be noticeably reduced by a decision in favour of contestability.

- *Further ring fencing of staff and resources.* There will be no additional requirement for ring fencing of staff or resources as a consequence of contestability in customer-funded infrastructure work. As discussed in Chapter 4, the alternative to a contestable market is direct regulation, which would also require the ring fencing of staff and resources used in the work. In practice, this activity is already ring fenced from ActewAGL's regulated distribution services work; further strengthening of this ring fencing is required and will be introduced regardless of the outcome of this inquiry. There are no incremental ring fencing requirements applicable only to a decision in favour of contestability.
- *Flexibility in coordinating different capital work projects or combining capital works with maintenance works.* This objection presupposes that ActewAGL will no longer undertake customer-funded infrastructure works. Any contestable market for such works is expected to be dominated by ActewAGL. On the company's own figures, the \$10,000 cut-off for contestable works will mean that 50 per cent of existing projects will be guaranteed to ActewAGL. The vast majority of customer-funded projects worth more than \$10,000 are likely to remain with ActewAGL in the short term, thereby ensuring its ability to coordinate different capital works and joint capital and maintenance works projects. ActewAGL expressed concern about a potential loss of efficiency and synergy from having to carry out maintenance separately from construction work, but a contestable market (or a regulated market)

²⁵ ActewAGL, *Annual Report 2002–03*, p 24.

for customer-funded infrastructure work does not prevent coordination. What is required, regardless of whether contestability is adopted, is appropriate financial ring fencing of the activity covered by the distribution use of service charge from any works separately funded by customers. This obligation exists whatever the decision about contestability but does not prevent efficient coordination of work.

- *Reduced ability to deliver economies of scale.* Again, ActewAGL has overstated this issue. Opportunities for economies of scale will continue to exist within ActewAGL. The commission is proposing that private contractors will be able to purchase materials under ActewAGL's supply contracts, maintaining economies of scale in this area. Opportunities for joint staff training and staff development within ActewAGL will be maintained. With a total capital works budget of \$153 million over five years and a potential contestable market of less than 30 per cent of this amount, the likely loss of works projects (even if private contractors attract a third of the market) would be little more than 10 per cent of the total works budget. ActewAGL will not lose economies of scale from a market loss of this magnitude.
- *Increased costs from managing inexperienced or unreliable contractors or developers.* ActewAGL already has to deal with developers and customers seeking customer-funded infrastructure works, and is experienced in dealing with them. Similarly, the company has had direct experience in managing contractors on many of its own projects. These are not insurmountable additional responsibilities in a contestable market.
- *Stranding of resources.* 'Stranding' of resources will only become an issue to the extent that ActewAGL loses contracts and the market does not re-employ released resources. As noted above, this is not expected to be a significant problem for human resources. Physical assets and equipment will only be stranded if they cannot be re-employed elsewhere in ActewAGL's much larger capital and maintenance works program. Within an anticipated 12–18 months lead time before the introduction of contestability, any equipment likely to be stranded will in all probability be redeployed or sold at an appropriate market price. Stranding of resources is therefore not a barrier to contestability.

In summary, the commission is of the view that making infrastructure works contestable has the potential to lead to more economically efficient outcomes

through more efficient work practices and quicker turnaround times for infrastructure works. This view was endorsed by a number of submissions to the commission and supported by experience in other jurisdictions.²⁶ Any potential loss of economies of scale or efficiencies within ActewAGL will be relatively minor and will not disadvantage the company or threaten its viability as a service provider.

8.1.3 Implementation and administrative costs

ActewAGL and relevant government agencies, including the commission, will need to develop a number of new processes and systems for the implementation, management and operation of a contestable market. Based on experience elsewhere, the types of processes and controls ActewAGL is likely to be required to develop include:

- accreditation/authorisation of contractors:
 - assessment and authorisation of contractors
 - establishment of gradings of competency and experience
 - maintenance of a record of accredited contractors
- monitoring and/or supervision of contractor performance
- development and maintenance of design and construction manuals and procedures for use by network business staff and by contractors
- provision of design and construction information to contractors
- preparation of specified materials lists
- compliance check and sign-off of works.

Government agencies would also incur costs through having to amend existing regulatory systems or develop new ones. Examples include:

²⁶ Master Builders Association, *Response to the review*, p 4; NJ Construction, *Response to the review*; Country Energy, *Response to issues paper*, pp 3, 5.

- development of a scheme to accredit and authorise contractors to perform contestable works
- review of Ring Fencing Guidelines and making of amendments as necessary
- review of capital contributions arrangements and making of amendments as necessary
- amendment of the Utilities Act to remove current ambiguities about who may operate on ActewAGL's electricity network.

Many of these tasks will need to be undertaken regardless of the outcome of this review into the contestability of the market. For example, as noted in Section 6.2, the Utilities Act is scheduled to be reviewed this year and is likely to be amended as a result. Amending legislation is expected to come before the Legislative Assembly in 2005.

In the course of this inquiry, the commission has also identified a number of aspects of the current ring fencing and capital contributions arrangements that need to be addressed and amended, regardless of any decision on contestability.

The updating of ActewAGL's manuals and certification procedures should be part of an ongoing program within ActewAGL to ensure good governance and best-practice operating efficiency.

Therefore, while some additional administrative costs will have to be met if customer-funded infrastructure works become contestable, these costs are not exclusively the result of contestability. Furthermore, there are regulatory costs that will need to be met if the market is not made contestable and the commission is required to regulate the charges made for infrastructure works.

8.1.4 Quantifying the potential costs of the introduction of contestability

To help assess the likely implications of moving to a contestable market, both ActewAGL and the commission have examined the costs that would be incurred. ActewAGL estimates that its initial implementation costs would be in the order of \$1.3 million for the various tasks required to allow

contestability on projects associated only with new urban developments.²⁷ The company submitted that the bulk of this cost is for staff redundancies (\$450,000 at an average of \$75,000 for six staff) and the development and implementation of standards and procedures (\$500,000, based on three staff for one year). Further discussions with ActewAGL indicate that this estimate also includes the cost of developing other administrative procedures and systems needed to support contestability and to manage the interface between ActewAGL and contractors. Training of staff and contractors at a cost of \$125,000 and IT development costs of \$250,000 are also included in the \$1.3 million estimate.

ActewAGL did not provide the commission with implementation cost estimates for making all customer-funded works contestable in line with the definition of contestable works in Chapter 5 of this report. However, although works associated with new urban developments represent only a portion of customer-initiated works, ActewAGL confirmed that with the exception of redundancy costs all other implementation costs would be largely fixed and unlikely to increase if the quantum of contestable work were to increase as envisaged in Chapter 5. To the extent that there are additional costs associated with the adoption of a wider definition of a contestable market, according to ActewAGL these would mainly be redundancy costs.

Many administrative costs to government agencies will be incurred regardless of any decision to move to a contestable market, but any incremental costs need to be identified and quantified.

The commission has made the following assessment of the costs identified by ActewAGL and of the incremental costs likely to be incurred by government agencies.

Redundancy costs

In its January 2004 submission, ActewAGL estimated that six workers would be made redundant if contestability were introduced only for new residential developments. The company has argued that additional redundancies would occur if the market were opened more widely.

²⁷ ActewAGL, *Response to draft report*, p 6.

Assuming a loss of 50 per cent of the market, ActewAGL estimated 23 redundancies.

ActewAGL has costed its redundancies at \$75,000 per staff member. This is based on an average cost across 45 staff drawn at random from within the company. However, further examination of the data provided by ActewAGL reveals that the estimated redundancy payment per staff member ranges from around \$20,000 to \$105,000. On the basis of a 'last in, first out' redundancy program, and using the ActewAGL data, the redundancy costs of the first six staff members to leave would average around \$30,000 per staff member for a total cost of \$180,000 (compared with the ActewAGL estimate of \$450,000). If up to 23 redundancies occurred, the average cost would be around \$60,000 for a total cost of \$1.4 million (compared with the ActewAGL estimate of \$1.7 million). If the commission's draft report estimate of 15 redundancies is used, the average cost is around \$50,000 per staff member for a total cost of \$750,000.

The extent of necessary redundancies in ActewAGL is debatable. The commission holds the view that projected market growth during a phase-in of contestability arrangements will mean that redundancies will be very few. On ActewAGL's own estimate, the introduction of contestability for new residential development only, which is likely to be the first stage of a phase-in, will result in a maximum of six redundancies. With a 'last in, first out' redundancy policy, this is likely to cost ActewAGL \$180,000, significantly less than the amount claimed by ActewAGL.

Any other 'costs', such as outstanding leave or other entitlements, have already accrued to staff and are not additional costs to ActewAGL. Their payment as part of a redundancy arrangement is merely a timing issue, and they are not considered further in this assessment.

In accounting for the overall costs and benefits of a move to contestability, the commission has to consider the appropriate treatment of redundancy payments. The payment of redundancies is effectively a wealth transfer from ActewAGL to former staff; it is not a cost to the ACT's economy unless former staff decide to leave the territory and move interstate. Regardless of the 'cost' to ActewAGL, from the territory's net cost-benefit perspective the redundancy payments should not be included in the evaluation.

The commission acknowledges, however, that there may be potential social costs of redundancies, borne not by ActewAGL but by the redundant

workers. If the laying-off of workers results in extended periods of unemployment, social costs could arise. The commission believes that in this instance these costs are not likely to be significant for two reasons. First, as discussed in Section 8.1.1, workers in this industry possess levels of skill and experience that would be in demand by new providers of infrastructure works. The experience in other states has been that they are quickly employed elsewhere. Second, if there is a surplus of workers in the industry because of its inefficient monopoly structure, retraining the surplus workers as soon as possible could minimise the social costs. This would allow redundant staff to be re-employed within ActewAGL. Given the current demand for experienced workers in the electricity industry, it would be economically efficient for ActewAGL to retrain these staff members rather than pay redundancies, while at the same time employing new staff to fill current vacancies for which some level of training would still be required.

Standards and procedures

The commission has identified a wide range of administrative arrangements and procedural documentation needed for a move to a contestable market. The commission considers that there are a number of areas in which consistency with the approach adopted in New South Wales would minimise the associated administrative costs and maximise the benefits of introducing competition. The accreditation of contractors is one such area. A consistent approach would reduce the cost of developing a new ACT regulatory regime for contestability. It should also attract more potential competitors to the ACT, ensuring market pressure on prices.

Government agencies would need to undertake, in addition to the accreditation process, amendments to the Ring Fencing Guidelines, the Electricity Network Capital Contributions Code and the Utilities Act. Assuming consistency with the New South Wales accreditation process, the commission has estimated the cost of these tasks to be \$110,000. Some of these tasks have to be undertaken regardless of any decision about contestability, including scheduled amendments to the Ring Fencing Guidelines and the review of the Utilities Act. The commission estimates the net incremental cost to government agencies for one-off administrative tasks associated with contestability to be \$30,000.

As noted above, ActewAGL has claimed that its implementation costs, excluding staff redundancy costs, would be around \$875,000 (\$500,000 for the development and implementation of standards and procedures, \$250,000

for IT development, and \$125,000 for training of staff and contractors). The commission notes that these costs relate to the opening of the market for new residential development.

However, from discussions with ActewAGL and a review of these costs, it is not expected that these costs would be significantly greater if the market were to be opened more fully, as the commission proposes. Therefore, the commission has accepted these estimates as reasonable for purposes of this review. The commission notes, however, that to the extent that any of these costs are recoverable (for example, the training costs for contractors) they do not represent a ‘cost’ that needs to be included in this study.

Ongoing administrative costs

ActewAGL’s estimate for its recurrent and administrative costs is \$600,000 per year. This estimate is based on contestability only for works on new urban residential developments. The costs include the maintenance of standards and procedures for contractors, training contractors, and the location and operation of a separate unit to check designs and inspect and commission contestable works.

ActewAGL estimates that operational costs, unlike implementation costs, would increase significantly if contestability were extended to the full range of customer-funded works. However, most of these higher costs are related to works that fall under the \$10,000 threshold defined by the commission in Chapter 5. Because such smaller works would not be contestable, their extra costs are not relevant to this analysis.

In New South Wales, recurrent costs have been estimated to be 5–7 per cent of the value of the customer-funded works; in Victoria, the estimates are slightly lower. Taking the highest value of 7 per cent, this amounts to around the \$600,000 estimated by ActewAGL, assuming a contestable market valued at \$9–10 million.

These additional recurrent administration costs only become costs for the purposes of this assessment if they are funded by ActewAGL. However, as outlined in Section 6.1, customers wishing to use private contractors will be required to meet the fair and reasonable directly attributable costs of administering the contestable market. This balances with the current situation in which developers meet all ActewAGL’s administrative costs of dealing with customer-funded works. To the extent that these costs are

recovered from participants in the market, they should not be factored into the cost–benefit evaluation.

In New South Wales, where a similar system operates, the Independent Pricing and Regulatory Tribunal has approved a variety of monopoly fees for such services as the provision of design information, certification of designs, design rechecking, inspections and re-inspections, and authorisations. The commission envisages a similar ‘user pays’ approach in the ACT, but rather than setting individual fees the commission will only need to review them when complaints are received about their fairness or reasonableness.

In addition to ActewAGL’s costs, some ongoing administrative and regulatory costs will be incurred by the commission and the technical regulator. The commission estimates these at \$310,000 per year, based on a requirement for two or three full-time staff to administer the accreditation scheme and to monitor and investigate the performance of accredited contractors. The commission already incurs a small proportion of these costs in ensuring compliance with ring fencing requirements and other regulatory tasks. After deducting these existing costs, the incremental costs are estimated to be \$290,000 per year, most of which will be recovered from contractors wishing to be accredited in the ACT. A net cost to the commission and the technical regulator of less than \$100,000 is anticipated.

Summary of the costs

The commission has reviewed the quantification of ‘costs’ and has identified some as actual costs that will be incurred, some as ‘costs’ that will be recovered from those seeking competitive bids for infrastructure works, and some as wealth transfers (and therefore arguably not costs to the ACT economy).

In summary, the costs that will be incurred by ActewAGL and/or government agencies and not recovered from other sources or treated as a wealth transfer are those for the preparation of standards and procedures (a one-off cost of \$900,000) and for ongoing administration (an annual cost of \$100,000).

8.2 Potential benefits

Through competition, the reforms underpinning the CPA have sought to promote greater efficiency, lower prices and greater customer choice,

particularly in the energy industry, than would have otherwise occurred. By forcing businesses to produce at least cost, to charge cost-based prices and to be innovative in product and process design and service delivery, competition can play an important role in achieving more efficient use of the community's resources in the production, supply and consumption of goods and services. A business that does not operate efficiently in a competitive market loses sales to competitors who can provide goods and services more efficiently. While a monopoly business operating in a non-competitive market can operate efficiently, there is no in-built incentive for the business to meet this objective. Therefore, competition for electricity infrastructure works should place downward pressure on infrastructure costs and, at a minimum, provide a check against the use of monopoly power to extract prices higher than can be justified by underlying costs.

Competition encourages firms to adopt new techniques that provide better service or reduce the cost of providing the service. A firm that lags in the adoption of new technologies becomes inefficient relative to its rivals and loses customers. Competition puts constant pressure on firms to innovate either through improving their own practices or adopting new, more efficient ones. Ultimately, this sustained pressure will drive net benefits in the ACT economy. One example of competition encouraging improvement in existing work practices is AGL's experience in Victoria. AGL has indicated that contestability has given it the opportunity to commercially develop its staff. Staff have been forced to compete for previously in-house work as well as for work on other distributors' networks.²⁸ Reform of monopoly arrangements can ultimately achieve such ongoing innovation and productivity improvement.

Submissions to the inquiry held various views of the magnitude of possible cost savings from contestability in the ACT electricity infrastructure market, with some suggesting savings of up to 30 per cent. The commission has been provided with some cost information supporting savings figures, but this is limited and cannot be applied across the entire market.

ActewAGL argued that competitive tendering is already applied to much of the capital works program and that cost savings from contestability for customer-funded infrastructure works are therefore likely to be small.

²⁸ Email from AGL Electricity Ltd, 12 March 2004.

However, there is currently no incentive for ActewAGL to pass current cost savings through to consumers. The act of subcontracting does not guarantee that any efficiencies are passed through to consumers, but instead highlights the fact that ActewAGL is comfortable about allowing other contractors to operate and undertake work on its network.

In addition to the potential cost savings outlined above, the commission considers that there are a number of other benefits associated with the introduction of contestability. These include:

- increasing competitive pressures on prices for electricity infrastructure works
- increasing customers' ability to choose a provider of electricity infrastructure works
- increasing the transparency of costs
- minimising potential distortions in secondary markets, including the new household market
- increasing the ACT's ability to compete with other jurisdictions for development projects in which electricity infrastructure works are a major cost driver.

8.2.1 Competitive pressures

Generally, competitive pressures in markets are sufficient to ensure appropriate incentives for prices to equal the marginal cost of producing an additional unit of production. The existence of two or more suppliers in a market is not necessarily a prerequisite for competitive pressures to exist. Where there are no barriers to entry, it is conceivable that with only one producer there can still be an efficient market (defined as one in which prices equal marginal costs), if the threat of competitors entering the market provides the appropriate incentive to ensure that resources are allocated efficiently.

Anecdotal evidence from the distributors in Victoria, for example, confirms that the threat of competition is forcing them to price at an efficient cost level. Initial quotes are provided by the distributors to customers seeking infrastructure works. If the quote is not accepted, projects are put to tender to

test the market. It is in the interest of a rational supplier to quote a competitive price to avoid the need to go to tender and possibly lose the work. Thus, the threat of competition effectively drives prices to efficient, cost-reflective levels.

A number of qualified contractors have expressed interest in entering the ACT market if it is opened to competition. It is therefore reasonable to expect that some degree of competitive pressure will emerge in the ACT, as has occurred in metropolitan and regional centres in New South Wales and Victoria.

The commission considers that the removal of barriers to entry will be sufficient to ensure that the ACT market for electricity infrastructure works is potentially economically efficient. Contestability and the threat of entry by other suppliers should ensure that ActewAGL prices and services are at the efficient cost level and that efficient subcontractor costs are passed through.

The incentive that competition provides for greater efficiency will be reflected not only in charges for these services, but also in their quality and timeliness. The general view amongst developers appears to be that there are currently delays in having works undertaken and completed in the ACT. In a competitive market, such delays would be reduced because an efficient number of competitors vying for market share would clear the backlog.

8.2.2 Customer choice

The expected benefit of freedom of choice is that it leads, through competition, to the supply of goods and services to society at the least social cost. As noted in Chapter 3, the Victorian scheme gives customers with a number of choices, including the choice of service provider, the decision to have works tendered, and the options of managing the project or having it managed. According to a number of distributors, few customers elect to have works tendered and fewer still choose to manage the process themselves. However, the choice is available and this adds to the competitive pressure on the incumbent distributor.

In the ACT, recent experience with the deregulation of street lighting also confirms the potential for improvements in customer service through greater choice of service provider. Deregulation of this market has resulted in more choice in the design of street lighting (the street lighting on Anzac Parade is a case in point) and greater flexibility in the installation of streetlights by

contractors. Evidence also suggests a downward pressure on installation costs. The potential exists for similar benefits in a contestable market for electricity infrastructure works.

The proposed contestable market design outlined in Chapter 6 would give customers in the ACT not only a choice of service provider, but the ability to choose whether to tender works, and whether to manage the tender process or have ActewAGL manage it. This range of choice reflects the Victorian model and, on a user-pays basis, allows consumers to decide not only on service provider, but on the way in which the process of selection and management is to be handled.

8.2.3 Transparency of costs

The introduction of competition in electricity infrastructure construction in other jurisdictions has led to greater transparency in the charges set for works and in the way projects are undertaken. In the ACT, customers have expressed considerable frustration over not knowing exactly what they are paying for and whether they are being charged appropriately.²⁹ The commission is of the opinion that greater transparency in the pricing of works is beneficial and to be commended, whether or not electricity infrastructure works are made contestable.

Greater transparency in pricing is one of the fundamental principles of the competition reforms undertaken in Australia. It is a feature of a competitive market and facilitates informed decision-making and rational allocation of resources. Competitive pressure encourages more transparent pricing, which is not evident when competition is constrained or lacking.

8.2.4 Distortions in secondary markets

The commission notes that the market for electricity infrastructure works depends on demand in other markets, including overall demand for greenfield and brownfield property development projects. Therefore, any distortion in the pricing of electricity infrastructure works has the potential to significantly distort other markets.

²⁹ Information provided to Maunsell Australia.

In addition to noting the immediate benefits of complementary markets, the commission notes that restrictions on contestability potentially distort the ACT's ability to attract development projects. In a competitive market for new investment and economic growth opportunities, relative infrastructure costs are important. Lack of competitive pressure increases the cost of electricity infrastructure in the ACT and puts the territory at a relative disadvantage to other jurisdictions, such as New South Wales and Victoria, where the costs of infrastructure can be lowered through competition.

8.3 Public and private benefits

The Essential Services Consumer Council has argued that making electricity infrastructure works contestable would directly benefit only a small number of customers, particularly large non-domestic customers and developers of brownfield and greenfield sites.³⁰ ActewAGL similarly cited the approach the Australian Competition and Consumer Commission (ACCC) has taken in assessing public benefits for the authorisation of acquisitions and mergers, which differentiates between benefits captured by individuals (private benefits) and benefits accruing to the community at large (public benefits). ActewAGL argued that gains from making electricity infrastructure works contestable should be considered as private, rather than public benefits, and should therefore be discounted in the commission's assessment.

The question of who benefits from gains is a legitimate one, and is recognised in clause 1(3) of the CPA. Under this clause, consideration is to be given to the balancing of benefits of a particular course of action against the costs, with due regard for 'the interests of consumers generally or of a class of consumer'. The CPA goes further when it notes, in subclauses 4 and 5:

(4) It is not intended that the matters set out in subclause (3) should affect the interpretation of 'public benefit' for the purposes of authorisations under the Trade Practices Act.

(5) This Agreement is neutral with respect to the nature and form of ownership of business enterprises. It is not intended to promote public or private ownership.

³⁰ Essential Services Consumer Council, *ESCC Response to the ICRC Issues Paper*, 23 October 2003, page 1.

In its argument about public and private benefits, ActewAGL claimed that the commission's approach should discount private benefits to developers in the assessment of net benefits. In support, the company cited two merger proposals reviewed by the ACCC. In welfare economics, the convention is to place equal weighting on consumers' and producers' surplus, the implication being that benefits accruing to shareholders should have the same weight as benefits accruing to consumers. In the case of the Qantas – Air New Zealand merger, the ACCC discounted the benefits to Qantas because:

Any such savings are more likely to accrue to shareholders (with around 50 per cent of Qantas' equity foreign owned) than consumers in an environment of reduced competition.³¹

The important clause in this decision is '50 per cent of Qantas' equity foreign owned', which implies that only half the benefit accrues to Australian shareholders. In welfare analysis it is often appropriate to discount benefits flowing outside the defined economy. In the Qantas case, the ACCC treated benefits flowing out of Australia as being of less value than benefits retained in Australia: the issue was not about private versus public benefits, but about where the benefits ultimately accrue.

In the proposed API–Sigma merger, the ACCC indicated that it might differentiate between benefits accruing to shareholders and those accruing to consumers. In that case, the proposed benefits were derived from efficiency gains that appeared to be retained by the merged entity. The relevance of the API–Sigma case to the question of contestability for ACT infrastructure works is limited, because the benefits would either flow to developers if the restriction on contestability is dropped, or remain with ActewAGL if the restriction is retained.

When assessing the net benefits of contestability for electricity infrastructure works in the ACT, the defined economy is the ACT economy. In applying the ACCC principle to the current review, consideration would need to be given to both the benefits and costs.

³¹ Australian Competition and Consumer Commission, *Final Determination, Applications for Authorisation A30220, A30221, A30222, A90862 and A90683, Acquisition by Qantas Airways Limited of ordinary shares in Air New Zealand Limited and cooperative arrangements between Qantas, Air New Zealand and Air Pacific Limited*, 9 September 2003, p iv.

ActewAGL is jointly owned by ACTEW Corporation and AGL. ACTEW is a territory-owned corporation, but AGL is a privately owned corporation based in Sydney. The ACT is home to only 1.6 per cent of Australia's population; given AGL's foreign-owned equity, it is likely that less than 1 per cent of any benefits accruing to AGL will be returned to the ACT economy through increased values of AGL stock or dividends. The implication of this is that, following ActewAGL's prescription and the precedent set by the ACCC decision, the commission should discount all costs to ActewAGL by 50 per cent. On the other hand, if most developers are ACT companies with ACT shareholders, the benefits accruing to them should not be discounted on this basis. Furthermore, to the extent that savings are passed through to the buyers of new houses, these benefits are captured in the ACT and are therefore public benefits.

The commission further notes that the ACCC does not suggest that private benefits should not be taken into account and in fact states that private benefits can be considered of value to the wider community. The ACCC recommends, however, that consideration must be given to whether benefits are passed through: if they are not passed through, they may be given less weight.³²

The commission agrees that it may be valid to give less weighting to private interests in mergers and acquisitions (that is, when reduced competition is being contemplated). It is not necessarily valid when the opposite is occurring (that is, where there is the prospect of reducing or removing monopoly restrictions). In the example cited by ActewAGL in its submission, the ACCC considered discounting cost savings as a factor in its decision because the proposed merger would lead to increased monopoly power, which might lessen the chance of those savings being passed on to the wider community. The present situation is in fact analogous to forcing a 'de-merger' to reduce monopoly power and enable cost savings to be passed on.

The commission acknowledges that, in the first instance, developers would be the primary beneficiaries of any savings accruing from competition in

³² Australian Competition and Consumer Commission, *Final Determination, Applications for Authorisation lodged by Australian Pharmaceuticals Industries Ltd in respect of Proposed Merger with Sigma Company Ltd*, 11 September 2002, p 54.

electricity infrastructure construction in the ACT. In the worst case, if no savings were passed on, the community would not be any worse off than it is now, and there would at least be potential for end customers to share in the savings as developers respond to market competition for housing. However, under the present legislative monopoly arrangements, ActewAGL has far more market power than developers and faces less competitive pressure. While there is no incentive for ActewAGL to pass through cost savings, developers face at least some market pressure to pass savings through.

ActewAGL argued that infrastructure costs have less impact on house prices than demand for land, land availability and interest rates. The commission notes, however, that the Productivity Commission is currently inquiring into the costs of home ownership and in its draft report has drawn particular attention to the infrastructure charges that are levied on new homes.³³ The Productivity Commission has concluded that infrastructure and building costs, and not simply demand, influence new house prices. Therefore, it is likely that cost savings will be passed through in lower prices and not simply captured and retained by developers.

In considering the possible benefit to the ACT from potential lower charges for contestable works, the commission acknowledges that savings to individual customers is not necessarily the only measure of the benefits of contestability. Ultimately, the benefit to the whole community is relevant. To the extent that ActewAGL is able to extract monopoly rents from its customer-funded works, there is inefficiency in the economy and a diminution of social surplus. Furthermore, the capture of these rents by a business that is 50 per cent owned by interests that primarily reside outside the ACT further highlights the loss of social surplus within the ACT from the failure to introduce contestability.

The commission concludes that potential cost-saving benefits from contestability, notwithstanding that they are captured by a particular class of consumers (namely home buyers), are a benefit to the ACT economy and therefore a public benefit.

³³ Productivity Commission, *Draft Report, First Home Ownership*, 18 December 2003.

8.4 Summary

The commission has examined in some detail the costs and benefits associated with a move to contestability in the customer-funded infrastructure works market. In so doing, the commission has sought to identify and quantify them, despite the inherent difficulties of the task.

At the same time, the commission has addressed the issue of ‘public’ and ‘private’ costs and benefits raised by ActewAGL and others in responses received to the draft report. The commission has demonstrated that the alleged precedents created by certain ACCC decisions are not relevant to the commission’s current evaluation. However, if the ACCC views could be said to apply, they would effectively count against ActewAGL’s monopoly position in which benefits flow from the ACT while costs are borne within the territory.

Ongoing administration costs of contestability incurred by ActewAGL and government agencies will primarily be recovered through charges and fees, including licence fees for contractors seeking to be accredited in the ACT. The net unrecovered costs are likely to be as little as \$100,000 per year, and will mainly be borne by government agencies. ActewAGL should recover all its fair and reasonable costs under the fee-for-service regime envisaged for the contestable market.

Quantifying the benefits of contestability to the ACT is more difficult. The commission notes the experience in other states, with claimed cost savings of around 30 per cent. In the ACT, some cost savings will represent the recovery of any monopoly rent that ActewAGL has been able to capture under the current monopoly market arrangement. Effectively, some cost savings will also represent a wealth transfer from ActewAGL to home buyers in the ACT.

There will also be an efficiency savings element that represents the real economic benefit to the territory as a whole. It is difficult to quantify the efficiency saving element because data are not readily available to allow a dissection of any savings into wealth-transfer and efficiency-savings components. However, the commission has discounted the one-off costs (\$900,000) and annual cost (\$100,000) of contestability over a 10-year period to find the level of efficiency cost savings required to match the implementation costs. The analysis indicates that efficiency cost savings of as little as \$250,000 per year will cover implementation costs. Effectively, a

5 per cent efficiency cost saving would be equivalent to twice the annualised implementation costs.

Therefore, if the cost savings of up to 30 per cent evident in other jurisdictions are made in the ACT, an efficiency cost saving to customers of as little as 5 per cent would represent a benefit–cost ratio of 2:1. The commission believes that a 5 per cent efficiency saving is at the lower end of the likely range of savings to be expected, and therefore more than justifies a decision to move to contestability.

The commission also notes that to retain the market restrictions it would be necessary to demonstrate that the benefits to the ACT from restrictions outweighed their cost. The commission has considered the safety, reliability and service quality issues identified by ActewAGL as ‘benefits’ of the current market restrictions, and has found that these can be readily achieved by other means and that the ‘costs’ involved are outweighed by the potential efficiency savings.

The commission has found no evidence to verify the argument that there are net benefits to retaining a restriction on competition.

9 Conclusions and recommendations

9.1 Conclusions

The Treasurer's terms of reference require the commission to advise on whether there is a net public benefit to the community in making electricity infrastructure works contestable in the ACT. In making its assessment the commission has considered the degree of competition in the current arrangements, the potential for contestability, and the costs and benefits of contestability.

In preparing advice on this matter, the commission has been guided by the provisions of the National Competition Policy and, in particular, clauses 1 and 5 of the Competition Principles Agreement (CPA). Clause 5(1) of the CPA requires governments to ensure that legislation does not restrict competition unless there is a net benefit to the community as a whole, or unless the objectives of the legislation can only be achieved by restricting competition. The obligation to review legislation is an ongoing one under clause 5(6) of the CPA, whereby governments are required to systematically review legislation at least every 10 years.

The commission has considered decisions by the Australian Competition and Consumer Commission and the Australian Competition Tribunal for a definition of public benefit. Guidance from these bodies indicates that public benefit can be measured using a range of qualitative and quantitative characteristics, such as improved business efficiency and more efficient allocation of resources, improvements in the quality and safety of goods and services, increased customer choice, and more equitable dealings in the market. The commission has examined all of these areas to assess whether and to what extent benefits are available from reform of the current restriction on competition for customer-funded infrastructure works. At the same time, the commission has also considered the benefits of retention of the current restriction on competition.

The commission has given considerable attention to the definition of contestable customer-funded infrastructure works. ActewAGL has raised a

number of practical, administrative, safety, reliability and ‘core competency’ issues in objecting to any move to reform the current monopoly arrangements. These issues have been given careful consideration by the commission. However, most can be readily resolved once the design and characteristics of the market that is to be made contestable are defined.

For example, the definition of the contestable market to exclude projects for which the customer pays less than \$10,000 removes many of the administrative difficulties associated with handling small projects, where the cost of administering a competitive market would quickly outweigh any price advantage.

Similarly, the proposed requirement that private contractors meet all relevant administrative and regulatory costs on a fair and reasonable basis ensures that ActewAGL will not be required to meet these costs. Provision for ActewAGL to be able to require contractors to charge a three-year financial guarantee to cover any faults or repair costs incurred after completion of the works removes ActewAGL’s concerns that it will be at risk for possible poor workmanship by private contractors.

The proposed phased introduction of contestability, starting with greenfield (new) connections by 1 July 2005, will allow time for the market to evolve and for all parties to gain experience in dealing with the new market rules and conditions. The extension of contestability to include work on shared assets and ‘live’ systems will occur with strict regulation and accreditation of private contractors, and with strengthened capabilities for the ACT’s technical regulator.

The proposed phasing-in of the market reforms and the strong demand conditions predicted in the market over the next few years should ensure minimal negative impacts on staffing and resource utilisation within ActewAGL.

The commission has reviewed the costs and likely impacts of these reforms in some detail and has satisfied itself that they will cause little if any social dislocation in the ACT labour market. Any ‘costs’ that ActewAGL may incur will be significantly less than the estimates provided by the company in its submissions to this inquiry. Any released staff from ActewAGL can be expected to be redeployed quickly within the electricity industry, which is currently facing a shortage of staff with practical experience in the industry.

In assessing the benefits of reforming the market, the commission has given consideration to the benefits that flow from increased contestability, primarily in price, timeliness of service and delivery, and service quality. Price benefits have been considered both in terms of the removal of any monopoly rents that ActewAGL may have been able to capture, and in terms of the efficiency benefits available in the current use of resources by the company. The monopoly rent element has been treated as a wealth transfer within the ACT and discounted from any consideration in the quantification of benefits and costs. However, efficiency benefits are incremental benefits contributing to the overall economic welfare of the ACT and they have been assessed for the purposes of the cost–benefit review.

The commission’s analysis indicates that there would only need to be efficiency cost savings of 5 per cent in the prices currently charged for customer-funded works for the benefit of introducing contestability to be twice its projected cost. Experience in other jurisdictions indicates cost savings of up to 30 per cent, and the commission believes that the evidence clearly indicates that opening the market to contestability would be to the net benefit of the ACT economy.

This analysis has not included an assessment of the impact of competition payments on overall benefits to the ACT. In part, this reflects some uncertainty as to what action if any the National Competition Council (NCC) might take in relation to competition payments. Under the Council of Australian Governments Agreement, a financial penalty can be applied through the Competition Payments made by the Australian Government to the ACT if the ACT retains a restriction on competition when the public benefit test has demonstrated no significant benefit from the restriction. In 2003, the NCC recommended that the ACT be penalised 10 per cent of its Competition Payments for alleged legislative review compliance failures. It remains to be seen whether the NCC would adopt the same approach in relation to a decision to maintain the ActewAGL monopoly for customer-funded electricity infrastructure works. The commission has therefore not included this possible cost to the Territory in its analysis of the costs and benefits of market reform. However, a penalty applied in this way remains a potential cost to the ACT’s economy.

The commission was also required to consider any net benefits that continuation of the market restrictions might bring to the ACT economy. This is essentially the reverse of the consideration of the net benefits from

removing the restriction. The commission has found no benefits from the retention of the restriction that outweigh its cost.

Should the monopoly be retained, the commission would be obliged to introduce a more intrusive form of regulatory oversight of prices charged by ActewAGL for these services than has existed to date. This would add to the deadweight monopoly costs of maintaining the present restriction. Furthermore, this would occur notwithstanding that the safety, reliability and quality of service issues suggested as ‘benefits’ of the restriction have been shown to be achievable without the retention of a monopoly.

The commission has therefore concluded that net benefits of retaining the restriction to competition have not been demonstrated, but that there are net benefits of removing the restriction.

9.2 Recommendations

The commission finds that there is a net benefit to be gained by the community as a whole from the introduction of competition in the electricity infrastructure works market in the ACT.

Accordingly, the commission recommends that the government initiate action to remove the current restriction on competition in this market. Specifically, the commission recommends that:

1. New connections and work on the existing network, including any design work associated with the work, be potentially contestable, subject to the following:
 - Works must be partly or fully funded by customers.
 - The value of the customer-funded component of the works must be over \$10,000.
 - The works must be able to be safely isolated and not unduly interrupt other customers. Works that fail this criterion should still be subject to market testing and put out to tender.
2. The design of the contestable market should incorporate the following features:

- ActewAGL is to provide contractors with a specified materials list.
- Contractors are to be given the option of acquiring specified material through ActewAGL.
- Customers are to have the option of:
 - waiving the right to have works tendered
 - having ActewAGL manage the tender process or managing the process themselves.
- If a customer elects to use a third party contractor on a jointly funded project, the customer is to pay the full cost of the project up front. ActewAGL is then to reimburse the customer the estimated ‘distributor contribution’ (i.e. the stand-alone cost for the distribution network portion) once ActewAGL has accepted and energised the new works.
- Timeframes for the provision of quotes, design and construction specifications and approval of designs are to be established in consultation between the commission, the technical regulator and ActewAGL.
- Contractors are to be accredited to undertake contestable works. Contractors wishing to work on or near the live network are to be authorised by ActewAGL and such authorisation is not to be unreasonably withheld.
- Construction work is to be audited by ActewAGL after its completion.
- ActewAGL is to be able to charge contractors a refundable guarantee of 5 per cent of the value of the works to cover the costs of fixing defects or faults arising from the contractor’s work within a three-year period following the completion of the work.
- Customers are to meet tendering and audit/acceptance costs incurred by ActewAGL. Such charges are to be fair and reasonable and subject to appeal to the commission.

3. A transitional period is to apply to enable the necessary changes to be made to support contestability. Introduction is to be phased in, with new connections (e.g. greenfield reticulation) to be contestable not less than 12 months from the government's approval of the scheme or by 1 July 2005 at the latest, and the remainder of the market is to be opened not later than 12 months after that.
4. Appropriate changes are to be made to regulatory arrangements governing utilities, namely:
 - The *Utilities Act 2000* to be amended to enable infrastructure works to be undertaken by third party contractors
 - Ring Fencing Guidelines to be amended to provide for separation between the areas within ActewAGL Distribution that are responsible for determining construction and design standards and specifications, approving designs and approving works, and competing for contestable design and construction work
 - Electricity Network Capital Contributions Code to be amended in accordance with contestability arrangements; for example, provision to be made for ActewAGL to reimburse the estimated 'distributor contribution' to customers
 - a scheme to be established to accredit third party contractors to undertake contestable works; consideration to be given to tying in with the New South Wales accreditation scheme.
5. Subject to agreement by the technical regulator, ActewAGL is to be required to put into place appropriate safeguards for third party contractors undertaking new connections, and working on or near the network. ActewAGL is also to be required to make other necessary procedural and systems changes.

Appendix A Submissions on the issues paper

- ACT Council of Social Services Inc: letter dated 5 November 2003
- Country Energy: Response to Issues Paper, 7 November 2003
- Madison Constructions, email dated 11 November 2003
- Essential Services Consumer Council, 23 October 2003
- NJ Construction Pty Ltd: NJ Construction response to the issues paper, review to contestable electricity infrastructure, November 2003
- ActewAGL: Response to the ICRC's issues paper – review of contestable electricity infrastructure works, 7 November 2003
- Master Builders Association of ACT, 26 November 2003
- National Competition Council, letter dated 22 January 2004

Appendix B Reference issued by the ACT Treasurer

Independent Competition and Regulatory Commission (Reference for Investigation)

Determination 2003 (No 2): Disallowable instrument DI2003—182 made under the *Independent Competition and Regulatory Commission Act 1997*, s15 (Nature of industry reference) and s16 (Terms of industry references)

Reference for Investigation under s15

Pursuant to subsection 15(1) of the Act, I issue a reference to the Independent Competition and Regulatory Commission (the ‘Commission’) to investigate and provide advice on whether there is a net benefit to the community as a whole in the introduction of contestable electricity infrastructure works in the electricity distribution network.

Reference for requirements in relation to investigation under s16

Pursuant to subsection 16(1) of the Act, I specify the following requirements in relation to the conduct of the investigation:

1. In conducting the review, the Commission is to take into consideration:
 - a. changes required to the existing network undertaken exclusively by the ACT electricity distribution network operator; and
 - b. augmentation of the ACT electricity distribution network by works associated with new subdivision development and greenfield sites.
2. The Commission is to undertake this review and provide the final report by 12 December 2003.

Ted Quinlan
Treasurer
1 July 2003

Appendix C Competition Principles Agreement

Below are extracts from the Competition Principles Agreement between federal, state and territory governments

Interpretation

- 1 (3) Without limiting the matters that may be taken into account, where this Agreement calls:
 - a) for the benefits of a particular policy or course of action to be balanced against the costs of the policy or course of action; or
 - b) for the merits or appropriateness of a particular policy or course of action to be determined; or
 - c) for an assessment of the most effective means of achieving a policy objective:

the following matters shall, where relevant, be taken into account:
 - (d) government legislation and policies relating to ecologically sustainable development;
 - (e) social welfare and equity considerations, including community service obligations;
 - (f) government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
 - (g) economic and regional development, including employment and investment growth;
 - (h) the interests of consumers generally or of a class of consumers;
 - (i) the competitiveness of Australian businesses;
 - (j) the efficient allocation of resources.

Legislation review

- 5 (1) The guiding principle is that legislation (including Acts, enactments, ordinances or regulations) should not restrict competition unless it can be demonstrated that:
- (a) the benefits of the restriction to the community as a whole outweigh the costs; and
 - (b) the objectives of the legislation can only be achieved by restricting competition.
- ...
- (6) Once a Party has reviewed legislation that restricts competition under the principles set out in subclauses(3) and (5), the Party will systematically review the legislation at least once every ten years.
- (9) Without limiting the terms of reference of a review, a review should:
- (a) clarify the objectives of the legislation;
 - (b) identify the nature of the restriction on competition;
 - (c) analyse the likely effect of the restriction on competition and on the economy generally;
 - (d) assess and balance the costs and benefits of the restriction; and
 - (e) consider alternative means for achieving the same result including non-legislative approaches.

Glossary and abbreviations

ACCC	Australian Competition and Consumer Commission
commission	Independent Competition and Regulatory Commission
CPA	Competition Principles Agreement
ICRC Act	<i>Independent Competition and Regulatory Commission Act 1997</i>
Implementation Agreement	Agreement to Implement the National Competition Policy and Related Reforms
MBA	Master Builders Association of the ACT
NCC	National Competition Council
NCP	National Competition Policy
Utilities Act	<i>Utilities Act 2000</i>

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