

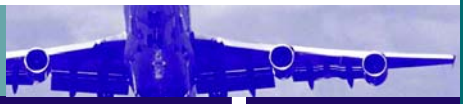

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A publication of the Utility Regulators Forum

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Is the building block model based on a static, perfectly competitive market paradigm?

Dr Darryl Biggar, consulting economist, ACCC

Introduction

A few of the submissions to the Productivity Commission review of the gas access regime have raised particular concerns about the approach to regulation used by the ACCC and other regulators in Australia. Specifically, these submissions claim that the ACCC's approach, known as the 'building block model', is inherently focused on static efficiency (to the exclusion of dynamic efficiency) and is based on a perfectly competitive market paradigm.

The same submissions point to the decision of the West Australian Supreme Court in the Epic case.[1] In that decision the Supreme Court considered the meaning of the phrase in the gas code which states that the regulatory regime should be designed to, among others, replicate the outcomes of competitive markets.[2] The court held that this phrase did **not** refer to the theoretical notion of perfectly competitive markets. Instead, the court emphasised the need to take into account dynamic efficiency.

Since the ACCC's approach is allegedly based on static efficiency and perfect competition, it is, by this argument, in breach of the gas code as interpreted by the Supreme Court. These arguments are made, for example, by Allgas:

> [The ACCC] fails to reveal or recognise that the regulatory approach currently applied by the ACCC ('building blocks–WACC' rate of return model) is in fact the replication of the static neoclassical concept of perfect competition ...
> It therefore fails to recognise that the WASC [West Australia Supreme Court] decision to specifically exclude perfect competition under the law also must exclude the ACCC's model in formulating determinations.[3]

The same points are also made by Prof. David Round of the University of South Australia:

> The ACCC supports an approach based on a building blocks model that seeks to replicate the static efficiency outcomes of a perfectly competitive market. This type of approach was found to be unacceptable by the WASC, which argued strongly that regulation should aim to achieve outcomes consistent with those that would be found in a workably competitive market.[4]

Allgas and Prof. Round are both quite clear in their view that the current approach of the ACCC and other Australian regulators is in breach of the gas code:

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1 *Re Michael; Ex parte Epic Energy (WA) Nominees Pty Ltd* [2002] WASCA 231.

2 Gas code, clause 8.1 (b).

3 Allgas, *Supplementary submission to the Productivity Commission review of the gas access regime*, November 2003, available at http://www.pc.gov.au/inquiry/gas/subs/sub069pdf1.zip, p. 7.

4 David Round, Prof., 'Workable competition: a modern interpretation of the dynamic process of competition', attachment 1 in Allgas's submission (note 3 above).

The current regulatory model (building blocks, WACC) applied by all Australian regulators to construct alternative determinations to that proposed by regulated companies is incorrect under the law and should be clearly prohibited.[5]

If in applying the Code the ACCC fails to adopt the WASC's view in the Epic decision, it leaves itself open to a formal challenge to its methods. Equally, as the Epic decision is currently the only decision by a superior court interpreting the concept of competition that underlies the Code, the ACCC's next consideration of an issue under the Code may result in a decision that fails to endorse the WASC's view … [T]he ACCC may consciously be ignoring the Epic decision and may have elected to continue to regulate under its traditional perfect competition model, until this approach is challenged.[6]

Does the ACCC seek to replicate outcomes of a perfectly competitive market?

Is it the case that the ACCC seeks to replicate the outcomes of perfectly competitive markets? There are many desirable outcomes of competitive markets which the ACCC does seek to replicate in its regulatory processes. Highly competitive markets (including perfectly competitive markets) have many desirable features such as strong pressures on suppliers to maintain cost efficiency and constant pressures to innovate in marketing, pricing, products and production processes, to best meet consumer preferences as efficiently as possible.

Highly competitive markets also have the desirable feature that each firm chooses to produce at a level of output where its own marginal cost is close to (or equal to) the market price. This is one of the theoretical requirements of an efficient outcome. If buyers are so small as to have no influence on the market price, and if each firm chooses a level of output where its own marginal cost is equal to the market price, no consumers are deterred from consuming a product which they value more (at the margin) than the marginal cost of its production.

All markets which can sustain a high level of competition have the property that the minimum efficient scale of each firm is small relative to the total market demand. In such markets, for each firm which is active in the market, the marginal cost of the firm is above the average cost of the firm. When this condition is satisfied, pricing at marginal cost is fully consistent with full cost recovery.

But, as is well known, some industries cannot sustain a large number of simultaneously active firms. In fact some industries have a cost function such that the entire market demand can be most efficiently met by a single firm. These industries, which are known as natural monopolies, have the property that the marginal cost is below average cost at the level of output equal to the total market demand. These are precisely those industries in which price regulation is required.

In an industry in which the marginal cost is less than the average cost, pricing at marginal cost will not yield sufficient revenue to allow the regulated firm to recover its total cost. A firm must earn sufficient revenue to cover its total cost if it is to continue to sustain the quality of its services and invest to meet future projected demand. If the shortfall in revenue from pricing at marginal cost cannot be made up through other mechanisms (for example, through the use of government subsidies or two-part tariffs), the regulator must increase the price above marginal cost, at least up to the level of average cost.[7]

Although pricing at marginal cost is desirable for efficiency, it is not always compatible with full cost recovery of the regulated firm. In these cases the ACCC regulates in a manner which ensures the regulated firm is able to recover sufficient revenue to cover all efficient and prudently incurred costs. This often requires setting a price above marginal cost.

The answer to the question 'does the ACCC seek to replicate the outcomes of a perfectly competitive market?' is therefore as follows: the ACCC seeks to replicate all those outcomes of highly competitive markets which are feasible and desirable in the context of the industry in question. In choosing which outcomes are feasible and desirable the ACCC is guided by principles of economic efficiency. These principles often rule out, for example, marginal cost pricing.

Does use of the building block model imply a focus on static efficiency?

Is it the case that a regulator which makes use of the building block model is showing itself to be focusing on achieving market outcomes 'compatible with the static theoretical norms of productive and allocative efficiency achieved in long run equilibrium in perfectly competitive markets?'[8] and that therefore dynamic efficiency is being 'overlooked'?[9] Is the use of the building block model fundamentally inconsistent with a regulatory approach which places due weight on dynamic efficiency considerations?

In fact, the use of the building block model reveals very little about the overall approach of the regulator. Some use of the building block model could be made in a regulatory regime which places a very high emphasis on dynamic efficiency. The fact that a regulator makes use of the building block model says no more about its focus on static efficiency than it does about its focus on any other form of efficiency.

Of course, the building block model **may** be used in a manner which is inconsistent with placing due weight on dynamic efficiency considerations. In particular, if the regulated prices (and/or revenues) of the regulated firm are frequently adjusted to be close to the observed costs of the regulated firm, (as given from the building block model) the firm will have very weak incentives for exerting effort or developing innovations to reduce its total costs. Such an approach significantly undermines the incentive on the regulated firm to invest or innovate to reduce its (financial) costs.

Economic theory suggests that, in this case, by breaking the link between the regulated prices and the regulated firm's own costs the firm's incentives to innovate to reduce its costs can be enhanced. Once the link between the firm's prices and its own costs is broken, the regulated firm can increase its profits by reducing its costs (at least until that cost reduction is passed through to consumers). Allowing the regulated firm higher profits in exchange for socially beneficial actions can benefit both producers and consumers.[10]

5 Allgas, op. cit., p. 9.

6 Round, op. cit., p. 5. These arguments are also echoed elsewhere. For example, see the supplementary submission of the Australian Pipeline Industry Association available at http://www.pc.gov.au/inquiry/gas/subs/sub074.pdf, p. 54.

7 See, for example, Kenneth Train, *Optimal regulation*, MIT Press, 1995 or Darryl Biggar, publication prepared for the OECD: *Access Pricing in Telecommunications*, 2004, http://www.oecd.org/dataoecd/26/6/27767944.pdf

8 Round, op. cit., p. 6.

9 Round, op. cit., p. 7.

10 This point is emphasised by Prof. Round: 'It must also be recognised that for firms to behave in the social-welfare maximizing ways …, they must be allowed, if regulated, to retain some positive profits as a reward for their initiatives.

This principle is, of course, widely recognised among regulators in Australia. The principle lies behind, for example, the use of the five-year regulatory period. By limiting the ability of the regulator to adjust prices to only once in five years, the regulated firm retains the ability to keep any cost savings it makes for up to five years.

Regulators in Australia have also often raised the possibility of placing greater reliance on 'exogenous' rather than 'endogenous' cost measures. This issue is discussed in detail in the ACCC's recent consultation on the revision of its draft regulatory principles.[11] The Utility Regulators Forum has also, for some time, been exploring the use of index-based approaches (including total factor productivity or TFP) as an alternative to primary reliance on the regulated firm's own costs.[12] This work is on-going. Some greater reliance on benchmarking practices might be expected in the future.

Nevertheless, economic theory does not suggest that it is **always** efficient to break the link between regulated prices and the regulated firm's costs entirely. As discussed in more detail in a paper I prepared for the ACCC, incentives for reducing cost should be balanced with other desirable objectives.[13] If the incentive to maintain service standards is weak the greater the 'power' of the incentive scheme on cost savings (i.e., the greater the reliance on exogenous cost measures), the greater the incentive of the regulated firm to cut service quality and the greater the likelihood of large deviations between prices and apparent costs. A regulatory regime under which the regulated firm dramatically cuts service quality or appears to be either exceptionally profitable or making significant losses is not likely to be one which is sustainable in the long run.

This point has been made in the economics literature on incentive regulation. In an article in the *Rand Journal of Economics* (1989), entitled 'Good regulatory regimes', Richard Schmalensee compares pure 'price cap' regimes (in which prices are set independently of costs) and 'cost based' regimes (in which prices are closely linked to costs). He concludes: 'regimes in which price depends in part on actual cost generally substantially outperform pure price caps, particularly in terms of consumers' surplus'.[14] Dennis Weisman in the *Journal of Regulatory Economics* (1993) writes:

> We prove that the hybrid application of cost-based and price-cap regulation that characterises current regulatory practice in the US telecommunications industry may generate qualitative distortions greater in magnitude than those realised under cost-based regulation. It follows that price-based regulation in practice may be welfare inferior to cost-based regulation.[15]

The Productivity Commission has on more than one occasion come to the conclusion that it is not possible to completely break the link between a firm's prices and costs:

> . . . the Commission remains unconvinced that prices can be fully decoupled from costs. In this regard, it concurs with the observations of Professor Forsyth (2001). While Forsyth recognises the significant limitations of cost-based approaches, he suggests that eliminating cost considerations entirely would increase risks for both regulators and providers:
>
> 'The extreme opposite to cost-plus regulation is regulation which pays no attention at all to the firm's own costs . . . This form of regulation is not costless; it imposes considerable risk on the firm, and risk is costly. Since prices are not related to actual costs, there is a risk that prices will fail to cover costs and the firm will be driven into bankruptcy (p. 18).'[16]
>
> . . . as the Commission noted in its review of the national access regime, the setting of access prices cannot be fully decoupled from a business's costs. Doing so creates a risk that efficient businesses will be forced to bear losses due to the use of inappropriate benchmarks.[17]

The optimal regulatory approach will differ from industry to industry and from case to case. Nevertheless, the optimal regulatory approach is likely to be one which places at least some weight on the regulated firm's own costs. This might be through, for example, periodically assessing the profitability of the regulated firm or through periodically readjusting a price cap to bring it in line with revealed costs. In both cases the building block model (or some variant) would be used to assess the costs of the regulated firm. Economic theory does not allow us to assert that there should be no connection between a regulated firm's prices and the regulated firm's costs.

We therefore cannot conclude that if regulators make use of a building block model they are not acting in an economically efficient manner, properly taking into account allocative, productive and dynamic efficiency considerations. Put another way, the use of the building block model does not imply that the regulator is using a model which is focused on 'static' or 'short-run' considerations to the exclusion of dynamic efficiency.

Is the ACCC's current regulatory model incompatible with the WA Supreme Court decision in the Epic case?

As noted above, some commentators believe that the ACCC's current approach is in breach of the law. The claimed reason is that the current regulatory model is based on the notion of perfect competition (which was dismissed by the WA Supreme Court as a theoretical notion) and that the current regulatory model (which is based on the building block model) places undue weight on static efficiency at the expense of other forms of efficiency which were highlighted by the court.

In my view, it is perfectly consistent with the gas code for the ACCC to seek to replicate the desirable outcomes of highly competitive markets.

Too restrictive an approach by a regulator will discourage such dynamically efficient market conduct, lowering social welfare in the process. Regulators must understand that the competitive process is a dynamic long run phenomenon that responds to positive incentives and rewards.'

11 See 'Discussion Paper 2003: Review of the draft regulatory principles', August 2003, available at: http://www.accc.gov.au/content/index.phtml/itemId/359996/fromItemId/54361

12 See, for example, the workshop held on 9 May 2003 (at http://www.accc.gov.au/content/index.phtml/itemId/259470/fromItemId/3894). The Productivity Commission mentions this work in its draft report on the review of the gas access regime, page 220–21 available at http://www.pc.gov.au/inquiry/gas/draftreport/gas.pdf. Allgas also mentions the TFP approach in their submission, loc. cit., p. 13.

13 See 'Incentive Regulation and Benchmarking', http://www.accc.gov.au/content/item.phtml?itemId=360002&nodeId=file3f4e999d5e1f2&fn=Attachment per cent20B.pdf

14 Richard Schmalensee, 'Good regulatory regimes', *Rand Journal of Economics*, 20(3), Autumn 1989, 417.

15 Dennis Weisman, 'Superior regulatory regimes in theory and practice', *Journal of Regulatory Economics*, 5, 355–366, 1993.

16 Productivity Commission, (2001), 'Productivity Commission inquiry report: review of the national access regime', report no. 17, 28 September 2001, p. 349.

17 PC's draft report at http://www.pc.gov.au/inquiry/gas/draftreport/gas.pdf, p. 220.

The ACCC does not blindly seek to replicate the outcomes of perfectly competitive markets or any other form of competitive markets, rather it uses the concept of economic efficiency to provide guidance as to which outcomes or which competitive markets are desirable. The pursuit of economically efficient outcomes is, in my view, entirely consistent with the decision of the court.

In light of the argument above, we cannot conclude that the ACCC's use of the building block model places undue weight on dynamic efficiency without an assessment of the regime as a whole. There is not scope here to carry out such an assessment. However there are, I believe, clear elements in the ACCC's approach which show that due weight is being placed on dynamic efficiency. In particular, I note the use of the five-year (or longer) regulatory period, which allows the firm to keep the gains from any cost efficiencies for up to five years (or longer)—strengthening the incentives to find such efficiencies in the first place. The ACCC's greenfield guidelines explicitly allow for an even longer regulatory period. I also note the use of an efficiency carry-over mechanism (for GasNet, and under consideration in the case of electricity transmission) which further strengthens the incentive to reduce costs to a minimum. These elements of the current regulatory approach show that the ACCC is taking at least some account of dynamic efficiency considerations. As reliable and accurate benchmarking measures are developed there may be opportunity for placing further emphasis on dynamic efficiency.

Finally, the issue as to whether or not the ACCC's current approach is compatible with the gas code (as interpreted by the WA Supreme Court) is a legal rather than economic issue. But, in the light of the discussion above, I find little support for the view that the ACCC's current approach is incompatible with the emphases of the WA court.

In particular, it seems likely that the building block model will have a continuing role to play in economic regulation in Australia for some time into the future. Reports of the death of the building block model are therefore greatly exaggerated. Although the need for regulation and the optimal structure of the regulatory regime in the future may change due to changes in technology or demand, in my view, the decision of the court in the Epic case does not yet sound the death knell of the building block model.

national developments

Telecommunications

Pricing principles for non-geographic number portability

In October 2003 the ACCC issued final pricing principles for non-geographic number portability, setting out the principles that it will generally apply if it is required to arbitrate a dispute over the terms and conditions of porting non-geographic numbers between service providers.

Non-geographic numbers are used to provide freephone (1800), local rate (1300) and premium rate (1900) services. Freephone services include home and community care, referral and counselling services. Local rate services include taxi bookings, airline reservations and customer inquiry services. Premium rate services include competition lines, adult and psychic information services.

The release of the pricing principles coincides with the ACCC's recent decision to mandate premium rate number portability—which allows a service bureau or content provider (customers) to change their carrier and/or service provider while retaining the same premium rate service number(s).

Corporate competition

In June 2003 the Minister for Communications, Information Technology and the Arts issued the ACCC with a direction regarding accounting separation. Included in this direction was a requirement to monitor and prepare six-monthly reports on competition in telecommunications services to corporate business customers.

In November 2003 the ACCC released a discussion paper outlining the issues it proposed to consider in the first report and seeking comment from interested parties on the state of competition in the supply of services to corporate business customers. The ACCC is currently preparing its first report to the minister at the end of May 2004 to be tabled in parliament within 15 sitting days of receipt.

Guide to the use of competition notices

In February the ACCC released draft guidelines on matters to consider before deciding whether to issue a competition notice in response to allegedly anti-competitive conduct. The issuing of guidelines is a requirement under the Act, as amended in December 2002.

Line sharing services undertaking

In December 2003 the ACCC issued a discussion paper calling for submissions on Telstra's proposed access undertaking for its line sharing service. The undertaking specifies the terms and conditions under which Telstra proposes to provide access to the line sharing service until 31 December 2004.

The line sharing service enables two separate providers to provide separate services over a single metallic pair (or line). For example, one provider can provide voice services to an end-user while another simultaneously provides high speed data services over the same line.

Exemption granted to Foxtel/ Telstra for digital pay TV services

In December 2003 the ACCC announced its final decision to accept applications from Foxtel and Telstra which provide up-front certainty about the terms of access to digital pay TV services.

The applications relate to the content supply agreement between Foxtel and Optus, approved by the ACCC in November 2002, subject to various undertakings made under s. 87B of the Act. These undertakings included a commitment by Foxtel and Telstra that if they digitised their pay TV networks before 31 December 2007, they would provide third parties with access to these networks. The terms of access were outlined in access agreements appended to the s. 87B undertakings.

An individual exemption order would exempt Foxtel and Telstra from future access regulation under the Act. Telstra and Foxtel have made their exemption applications in reliance on the terms of access in the access agreements that were part of the s. 87B undertakings accepted by the ACCC in 2002.

ACCC calls for submission on revised access undertakings for core services

In December 2003 the ACCC released a discussion paper calling for submissions on Telstra's revised access undertakings for core telecommunications services. The undertakings specify the price and some non-price terms and conditions proposed by Telstra for access to the PSTN originating and terminating services, the local carriage service (LCS) and the unconditioned local loop service (ULLS) over the next three years. These services enable Telstra's competitors to provide local, long-distance, international, fixed-to-mobile and mobile-to-fixed calls, as well as certain broadband services.

The undertakings are substantially different from those lodged in January 2003, which were withdrawn following the ACCC's release of model terms and conditions for these services.

Given the considerable work and wide consultation conducted by the ACCC about the previous undertakings and in determining model prices for these services, the ACCC also indicated that its preliminary view was that it should accept the undertakings.

Court declares that NTG misled consumers after ACCC action

In December 2003 the Federal Court declared that National Telecoms Group (NTG) engaged in misleading and deceptive conduct when offering its Synergy telephony package. The court also declared that NTG made false and misleading representations about the price of its telephony services. (Full story: *ACCC Journal* 49, p. 30.)

ACCC issues first accounting separation reports

The ACCC issued its first round of reports on the accounting separation of Telstra in December 2003.

The reports are intended to provide greater transparency of Telstra's operations to ensure that it does not unfairly discriminate between access seekers using its network services and its own retail operations.

The three reports issued were:

- current cost financial reports for 'core' telecommunications access services
- imputation analysis comparing Telstra's retail prices with the prices of the core telecommunications services supplied to access seekers
- key performance indicators on non-price terms and conditions that compare service performance between Telstra's retail and wholesale supplied basic access services.

The reports constitute the information that the ACCC is required to make public under the ministerial direction on accounting separation issued by the Minister for Communications, Information Technology and the Arts in June 2003.

ACCC proposes reducing regulation of transmission capacity services

In December 2003 the ACCC invited comment on its draft decision proposing to remove specified capital–regional routes and potential CBD inter-exchange transmission in the major capital cities from the existing transmission capacity service declaration. The ACCC also outlined its intention to curtail the existing intercapital monitoring program to focus only on the Melbourne–Adelaide and Adelaide–Perth routes for a period of 12 months while there is some uncertainty about market structure on these routes.

The transmission capacity service is a wholesale high bandwidth service (greater than 2Mbps) used for the transmission of voice, data or other communications between points located throughout Australia. It is used as an input in the supply of a wide range of retail voice call and data services.

The existing transmission capacity service declaration expires on 31 March 2004 and under the Act the ACCC is required to complete its review of the declaration before this date.

ACCC preliminary view paper on revised analogue pay TV access undertakings

In February 2004 the ACCC issued a paper calling for submissions on Telstra and Foxtel's revised access undertakings for analogue pay TV services. The undertakings, if accepted by the ACCC, will determine the terms and conditions on which other service providers can obtain access to Telstra's hybrid-fibre coaxial cable (HFC) network and to Foxtel's analogue set top units (STUs) in the absence of a commercial agreement between the parties.

The revised undertakings were lodged in late December 2003 and mainly deal with providing analogue services, although they also provide a transition path to digital services. They specify the price and non-price terms and conditions on which Telstra and Foxtel propose to supply access to the analogue pay TV services.

Lodgment of the undertakings follows the ACCC's decision in mid-December 2003 to reject the previous analogue pay TV undertakings submitted by Telstra and Foxtel. The current undertakings have been varied by the parties to specifically address ACCC concerns.

Subject to any further comments by interested parties, the ACCC considers that these undertakings address the specific concerns it raised regarding the previous undertakings and its preliminary view is that it should accept the undertakings.

ACCC issues consultation notice to Telstra on Bigpond broadband retail price reductions

In mid-March 2004 the ACCC issued a Part A competition notice in relation to Telstra's pricing of broadband internet services. This followed Telstra's announcement in mid-February 2004 of a retail price reduction for its broadband plans without a similar drop in its wholesale charges to provide similar retail services.

In issuing the notice the ACCC determined that it had reason to believe that Telstra had engaged and was engaging in anti-competitive conduct.

The competition notice allows the ACCC to seek pecuniary penalties for conduct in breach of the competition rule for the period during which the notice is in force. It also enables affected parties, such as internet service providers and carriage service providers, to seek damages during that period.

Before issuing the competition notice, the ACCC had issued both a consultation notice and an advisory notice to Telstra on the pricing of its broadband internet services. The advisory notice advised Telstra to reduce its wholesale prices to a level below Telstra's retail prices that would allow Telstra's wholesale customers to provide retail broadband services at prices which did not substantially hinder or prevent them from competing with Telstra. The consultation notice which followed informed Telstra that the ACCC proposed to issue a competition notice and gave Telstra the opportunity to respond to the allegations.

Telstra reduced prices for some wholesale broadband services in response to these notices. The ACCC will consider the status of its competition notice, and any further associated actions, in the light of its evaluation of Telstra's pricing offers and further market inquiries.

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Electricity

Authorisation of amendments to the national electricity code—connection point responsibility

On 23 June 2003 the ACCC received applications for authorisation of amendments to the national electricity code. These applications were lodged by the National Electricity Code Administrator (NECA). The proposed changes related to the:

- development and enhancement of connection point responsibility and relevant metering obligations
- creating deemed connection point responsibility
- allowing for adjustments and revision of settlement statements.

NECA's recommended changes limit the application of the changes to market customers and shift the emphasis onto clarifying the market settlement and transfer system (MSATS) procedures.

The ACCC released a draft determination on 10 September 2003. On 31 October 2003 NECA submitted minor amendments to the conditions of authorisation proposed in the draft determination.

On 19 November 2003 the ACCC released its determination which outlines its views and analysis of the applications. The ACCC granted authorisation for these applications subject to three conditions.

Authorisation of amendments to the national electricity code—prudential framework and settlement residue auction arrangements

(See *Network 15* for more background.)

The ACCC released its draft determination on 3 December 2003. In its draft the ACCC proposed one condition relating to the prudential framework changes and three conditions relating to the settlement residue auctions changes.

In response to the draft determination, the ACCC received a submission from NEMMCO indicating that ASIC had decided to grant it an exemption under s. 911A(2) of the *Corporations Act 2001* from the requirement to hold a licence for dealing, giving general financial product advice, and making a market for settlement residue agreements to wholesale clients. For the ACCC to consider NEMMCO's submission, interim authorisation was sought and granted on 22 December 2003 for those changes relating to the prudential framework.

Subsequently on 21 January 2004 the ACCC released its determination outlining its analysis and granting authorisation to the applications subject to two conditions.

Authorisation of amendments to the national electricity code—inter-regional settlements agreements

On 16 December 2003 the ACCC received applications for authorisation of amendments to the code for provisions facilitating inter-regional transfers. The applications were submitted by NECA.

These provisions relate to paying an importing region the relevant settlements residue auction proceeds on the basis that the importing region makes negotiated payments to the exporting region for use of its network assets. Victoria and South Australia are the only regions to have negotiated an agreement under these provisions. It is proposed that the provisions be extended until 1 July 2006.

The ACCC received no submissions and released its draft determination on 3 March 2004. In its draft determination the ACCC proposes to grant authorisation.

The ACCC will make its final determination after considering any information brought forward in response to the draft determination.

Authorisation of amendments to the national electricity code—despatching the market

On 16 December 2003 the ACCC received applications for authorisation of a derogation to the code relating to the management of network limitations and constraint formulation in the NEM.

NECA states that the proposed code changes address the inadequacy of existing arrangements in managing power system security and efficient use of available transmission capacity in the short term. The changes provide NEMMCO with express powers to manage negative settlement residues and to combine inter and intra-regional limits in the same constraint equations. The derogation has a sunset clause which means it will cease to have effect at the end of December 2004.

The ACCC received one submission on this matter. The ACCC plans to release its draft determination by April 2004.

Authorisation of amendments to the national electricity code—Hydro Tasmania metering

On 16 December 2003 the ACCC received applications for authorisation of a derogation to the code. The applications were submitted by the NECA on behalf of Hydro Tasmania (Hydro).

The proposed derogation exempts any Hydro metering installations that have not been upgraded by the time Tasmania enters the NEM from the relevant provisions of the code for a maximum period of 12 months from NEM entry.

The ACCC did not receive any submissions on this matter. The ACCC released its draft determination in mid-March 2004.

Minor variations to existing authorisations of the national electricity code

On 16 December 2003 NECA lodged two minor variations to the existing authorisations of the code relating to:

- generator registration
- inter-network testing.

The ACCC released its determination on both these matters on 3 March 2004. The ACCC's determination grants authorisation to the minor variations without amendment.

Access arrangements under Part IIIA of the Act

On 10 May 2002 the ACCC received an application from NECA to vary the NEM access code. The application sought to include chapters 1 to 10 of the code. Until this time chapter 3 had not been included. The application also sought to include all amendments to the code made by those authorisations granted by the ACCC up until 10 May 2002.

The ACCC is currently considering whether it is consistent with the objectives of the NEM access code to include chapter 3. In its draft decision of 16 July 2003 the ACCC considered that as chapter 3 included primarily non-access provisions it would not be appropriate for it to be included as part of the NEM access code. The ACCC is also considering whether it is appropriate to include the amendments made by prior authorisations in the NEM access code. In its draft decision the ACCC considered that it would promote consistency between the two codes for the amendments to be included in the NEM access code.

The ACCC released its final decision in March 2004.

Finalised regulatory decisions—Transend

Tasmania is not currently part of the NEM, but is expected to join the NEM in May 2005. As part of an agreement between the Tasmanian and Australian governments the ACCC commenced regulation of Transend Network's (Transend) transmission network on 1 January 2004.

The ACCC released its draft revenue cap decision on 24 September 2003 and held a public forum in Hobart on 17 October.

The ACCC released its final revenue cap decision for Transend on 17 December 2003. The ACCC's review determined the appropriate revenue cap for non-contestable transmission network services provided by Transend for a period of five and a half years from 1 January 2004 to 30 June 2009.

Current regulatory reviews—EnergyAustralia and TransGrid

From 1 July 2004 the ACCC, in accordance with its responsibilities under the code, will reset the maximum allowable revenue for EnergyAustralia and TransGrid for the 2004 to 2009 regulatory period.

On 23 and 26 September 2003 EnergyAustralia and TransGrid submitted their applications to the ACCC. The ACCC determined that these applications failed to provide sufficient information. The ACCC therefore requested that EnergyAustralia and TransGrid submit additional information to substantiate their claims.

EnergyAustralia and TransGrid provided additional information in October and November 2003. The ACCC invited interested parties to comment on the issues raised in EnergyAustralia's and TransGrid's applications by 30 January 2004. The ACCC received five submissions.

The ACCC has engaged a consultant to help in determining the revenue caps for EnergyAustralia and TransGrid. The ACCC expects to publish the consultant's report and call for submissions on its findings by late March 2004.

The ACCC expects to publish a draft decision in May 2004.

Statement of principles for the regulation of transmission revenues—regulatory principles review

The ACCC released its statement of principles for the regulation of transmission revenues (draft regulatory principles) in May 1999. Since that time there has been several developments in the approach to the regulation of network industries. Given the time since the release of the draft regulatory principles and developments during this period, the ACCC is currently reviewing its principles. In August 2003 the ACCC released a discussion paper outlining a number of key issues for review and called for submissions.

Twelve submissions were received. Staff are currently assessing these submissions.

The ACCC proposes to hold a workshop on 2 April 2004 to discuss the key issues of the review. After taking into account discussions at these workshops and issues raised in submissions the ACCC will release a revised version of the regulatory principles. The ACCC plans to release a draft version of this document in mid-2004, with the final to follow at the end of the year.

Statement of principles for the regulation of transmission revenues—service standards working group

The ACCC released its service standards guidelines on 12 November 2003. Subsequent to the release, the ACCC formed a working group of industry participants to provide input to further develop the standards.

The working group has had two meetings to date and is made up of relevant industry participants. Members of the group are currently working on measures to improve transparency and market-based measures.

Review of the regulatory test

The ACCC is currently reviewing the regulatory test, a test that all transmission network investment must satisfy if it is to receive regulated status.

On 10 March 2004 the ACCC released its draft decision which was based on a number of options identified by the ACCC in its earlier discussion paper.

All parties agreed with the ACCC's position on consistency between the regulatory test and the code. As a result the ACCC is proposing amendments to the regulatory test recognising that the distinction between inter and intra-regional augmentations has been replaced with new large and small network augmentations. The ACCC is also proposing to amend the preamble of the regulatory test.

Most parties agreed with the ACCC's suggestions to address concerns that the regulatory test is ambiguous. The ACCC proposes to include definitions which are largely based on the findings of the National Electricity Tribunal and the Victorian Supreme Court on the SNI regulatory test application. However, in defining elements of the regulatory test the ACCC has been mindful of the differences between reliability augmentations and economic augmentations. The ACCC is also proposing that the content of the regulatory test be re-ordered to aid clarity.

An issue that most parties commented on was that of competition benefits. In defining competition benefits the ACCC has turned to its obligations under the code and proposes a definition which is based on increases in economic efficiency.

The ACCC has invited interested parties to comment on its draft decision, to release a final decision in June 2004. The regulatory test will ultimately form part of the ACCC's statement of principles for the regulation of transmission revenues.

National energy market reforms

In 2001 the Council of Australian Governments (COAG) established the Ministerial Council on Energy (MCE) to provide national oversight and coordinated policy development for the energy sector and to oversee an independent review of energy market decisions (the energy market review).

On 11 December 2003 the MCE finalised a report to COAG on the reform of energy markets to respond to the energy market review. The MCE's report sets out a reform program for the energy sector, with the following key reforms:

- a national legislative framework for energy market regulation to be agreed between the Commonwealth, states and territories
- the establishment by 1 July 2004 of the Australian Energy Market Commission (AEMC) responsible for rule making and market development, and the Australian Energy Regulator (AER), responsible for market regulation
- the AEMC and the AER will initially be responsible for electricity wholesale and transmission in the national electricity market, with responsibility for gas transmission from 2005
- the ACCC will retain responsibility for competition regulation under the Act and for industry access code approvals under Part IIIA of the Act. A memorandum of understanding will outline consultation and cooperation arrangements between the AEMC, the AER and the ACCC
- once a national framework for distribution and retailing is agreed, the AER will assume responsibility for distribution and retailing (other than retail pricing) by 2006
- the establishment of a new transmission planning process, including an annual national transmission statement, and implementation of a new regulatory test for transmission
- consideration of measures to enhance user participation in the energy market.

The AER will be established as a constituent part of the ACCC but will operate as a separate legal entity. The ACCC is working with other government agencies to contribute to the implementation of the MCE's reform program. The MCE will meet again in April 2004.

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Gas

Minor variation to VENCorp's MSO rules authorisation

In October 2003 VENCorp applied for a minor variation to the market systems and operations rules (MSO rules) authorisation. This application sought to make the following changes to the MSO rules:

- clarify how authorised maximum daily quantity is reallocated if a tariff D[18] customer's withdrawal point is redesignated as a tariff V[19] site
- defer the mandatory review of chapter 6[20] of the MSO rules by one year
- advance the settlement time by two hours to allow banking to be completed within one day and to align with the national electricity market.

The ACCC issued a determination dated 4 February 2004 granting VENCorp's application to vary the MSO rules authorisation.

Variation to VENCorp's access arrangement—principal transmission system

In October 2003 the ACCC received an application from VENCorp for revisions to its access arrangement relating to the principal transmission system in Victoria. The proposed revisions related to changes to the MSO rules which is incorporated into VENCorp's access arrangement.

The application sought to amend the MSO rules contained in the access arrangement to make it consistent with the MSO rules as authorised by the ACCC. The ACCC released a decision dated 4 February 2004 which revised VENCorp's access arrangement.

Application for authorisation of gas retail market rules in WA and SA

On 20 February 2004 the ACCC received an application from the Retail Energy Market Company (REMCo) for authorisation of chapters 5 and 6 of its retail market rules (RMR).

REMCo has been established by industry participants as the retail market administrator for both the South Australian and Western Australian gas retail markets. The RMR are designed to facilitate the implementation of full retail competition in natural gas by facilitating customer transfers between retailers.

REMCo have requested that the application for authorisation be completed by their market launch dates of 31 May 2004 in Western Australia and 28 June 2004 in South Australia. REMCo has sought interim authorisation of its retail market rules in the event of the application not being finalised before market commencement.

The ACCC sought comments on this application from interested parties in the form of written submissions by Friday, 2 April 2004.

Central Ranges pipeline tender process

The Central Ranges Natural Gas and Telecommunications Association Inc. (the association) conducted a competitive tender process for the development of a transmission pipeline and associated distribution system for the Central Ranges region of NSW.

In November 2003 the association named the successful tenderer as the Europacific Consortium. This consortium comprises Europacific Corporate Advisory, Colonial First State and Country Energy.

The association now intends to lodge a final approval request with the ACCC and IPART. The regulators are required to determine whether the tender process carried out conformed to the previously lodged tender approval request. The regulators must also assess whether the tariffs arising from the tender process meet certain gas code tariff principles.

Regulatory approval of the final approval request will result in the pipelines being classified as covered pipelines for the purposes of the gas code.

18 Tariff D sites have daily meters and tariffs based on demand and volume components. They are typically used by large volume customers and have an authorised MDQ allocation.

19 Tariff V sites have tariffs based only on volume and do not have a site-specific authorised MDQ allocation.

20 Chapter 6 of the MSO rules relates to emergency procedures and market interventions.

Moomba to Sydney pipeline system access arrangement—tribunal hearing

On 19 December 2003 East Australian Pipeline Limited (EAPL) lodged an application to the Australian Competition Tribunal (the tribunal) for review of the ACCC's decision to draft and approve its own access arrangement. EAPL contends that the ACCC erred on the following main issues:

- adopting a value of $545.4 million for the asset base
- using a 5½ year risk-free rate and a benchmark credit rating of BBB+ in the determination of the cost of capital
- excluding the management fee payable to Agility and the marketing fee payable to Petronas from non-capital costs
- rejecting additional annual allowances of $6.73 million for equity issuance, debt raising and asymmetric risk.

The date set for the hearing is 29 March 2003. The access arrangement will remain in operation while the tribunal considers EAPL's application for review.

Coverage of the Moomba to Sydney pipeline system

In addition to the application for review of the access arrangement, the tribunal is also considering whether the MSP should be a covered pipeline under the gas code.

On 19 November 2003 the Minister for Industry, Tourism and Resources, the Hon. Ian Macfarlane, released his decision on EAPL's application for revocation of coverage under the gas code of the Moomba to Wilton mainline and Canberra lateral.

The minister decided that coverage should be revoked between Moomba and Marsden, but that coverage would remain between Marsden and Wilton and also on the Canberra lateral.

On 5 December 2003 five parties, Orica IC Assets Ltd, Endeavour Coal Pty Ltd, Amcor Limited, Energy Users Association of Australia Inc. and Energy Action Group Inc. lodged an application with the tribunal for review of the minister's decision.

The application for review stayed the minister's decision. The Moomba to Marsden section will remain a covered pipeline under the gas code while the tribunal considers the application for review.

Tribunal matters

GasNet

On 31 January 2003 GasNet applied to the tribunal for review of the ACCC's decision on GasNet's access arrangement for its Victorian gas transmission system. The tribunal heard the matter in Melbourne in mid-August 2003.

GasNet applied to the tribunal for review of the ACCC's decision on five aspects of GasNet's capital and non-capital costs (equity beta, risk-free rate, asymmetric risks, debt-raising costs and inflation) totalling approximately $4 million per year on average over the 2003 to 2007 regulatory period.

GasNet withdrew its application for review of the equity beta before the tribunal hearing and the ACCC subsequently accepted that additional allowances for asymmetric risks and debt-raising costs were warranted.

On 23 December 2003 the tribunal handed down its decision which required that the access arrangement be varied for risk-free rate, asymmetric risks and debt-raising costs. These changes raise GasNet's benchmark revenue by approximately $2 million per annum.

Moomba–Adelaide

On 15 August 2002 Epic Energy applied to the tribunal for review of the ACCC's decision on the access arrangement for the Moomba–Adelaide pipeline. The tribunal heard the matter in Adelaide on 1 and 2 September 2003.

Epic Energy applied to the tribunal for review of a range of aspects of the ACCC's decision, such as the valuation of the optimised replacement cost, rate of return issues including beta and the market risk premium, the expansions policy and the decision to include a recent expansion as part of the regulated pipeline.

Epic Energy withdrew its application for review of rate of return issues, expansions policy and many of the elements of the optimised replacement cost before the tribunal hearing.

On 10 December 2003 the tribunal handed down its decision allowing a benchmark tariff for the first year of the access arrangement for the Moomba to Adelaide pipeline system (the MAPS) of $0.4436 per GJ. This compares with a tariff of $0.4958 per GJ proposed by Epic Energy and $0.4052 per GJ determined by the ACCC in its final approval of 31 July 2002.

The tribunal's determination accepted EPIC Energy's arguments on the valuation of the pipeline and the exclusion of the Pelican Point expansion from the access arrangement.

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Transport and prices oversight

Airport monitoring report

On 24 February 2004 the ACCC released its *Airports price monitoring and financial report 2002–03*. The report reviews the prices airlines pay Australia's major airports for aeronautical services such as for the use of runways and terminal facilities. It found that in the two years from 2000–01 to 2002–03 average prices have increased significantly at all major airports with increases ranging between 40 per cent and 160 per cent.

Aeronautical charges were subject to price caps and price surveillance until 2000–01. This approach has since been gradually replaced by price monitoring. The removal of price caps and price surveillance means airports are no longer required to notify the ACCC before increasing charges for aeronautical services.

The monitoring report also shows that average airport costs have increased between 2000–01 and 2002–03, with greater security requirements at airports being a contributing factor. However, the changes in unit costs and volumes were small by comparison to price rises, resulting in significant increases in several measures of airport profitability. Aeronautical margins, as well as returns on assets, have risen.

The measures employed in the ACCC's analysis are commensurate with standard measures employed both domestically and internationally in studies of airport performance. These include aeronautical revenue, costs and margin per passenger, as well as returns on tangible non-current assets.

The full report is available on the ACCC website, www.accc.gov.au.

Petrol

Shopper docket petrol discounts

The ACCC recently conducted an extensive review of the tying of petrol discounts to grocery sales by both Coles and Woolworths. The ACCC consulted

with oil companies, independent petrol retailers, grocery retailers, industry bodies, lobby groups and consumer representatives in its inquiries.

The review found that the introduction of the shopper docket schemes has encouraged competition and lower prices in the fuel market resulting in substantial benefits for consumers. It also found that the shopper docket discount offers are pro-competitive because they drive competition between supermarkets and petrol retailers. Apart from the effect on price, retailers must become more innovative in non-price factors, such as additional services, to gain or maintain market share.

The ACCC issued a report *Assessing shopper docket petrol discounts and acquisitions in the petrol and grocery sectors* on 6 February 2004. This report outlines the reasons for the ACCC's decisions and examines more broadly the evolution of the competitiveness of the grocery and petrol sectors. The report is available on the ACCC's website www.accc.gov.au.

In its investigations, the ACCC heard claims that the discount schemes would reduce the number of independents operating. However, the ACCC concluded that there were several factors that had seen the number of retail petrol outlets fall from 20 000 in 1970 to about 8000 in 2003. This has also happened overseas. New fuel standards, the trend to larger sites offering more pumps and other services at prime locations such as highways or major intersections, and an anticipated shortfall of petrol in the Asia-Pacific region are expected to continue influencing the petrol market and, as a consequence, site numbers.

Some concerns were raised that, with fewer independents, the shopper docket discounts would entrench the dominance of the majors with long-term effects on competition and prices. In view of other developments affecting competitiveness in petrol and grocery retailing, the ACCC considered that the shopper docket discounts will be only a marginal determinant of whether independent retailers remain in these sectors. It also noted that the discounting of petrol prices was still occurring in the United Kingdom where major supermarkets have been involved in petrol retailing for more than 10 years.

The ACCC also reviewed supermarket acquisitions by Coles and concluded that, although Coles has been active in buying a number of independent supermarkets, there wasn't a substantial lessening of competition.

The ACCC also reviewed the short-term arrangements between Woolworths and Caltex, which is itself a competitive response to the entry of Coles into petrol retailing, and found that it was unlikely to result in a substantially lessening of competition in any relevant markets. When any long-term arrangement is agreed between the parties, the ACCC will have to consider that arrangement if it differs materially from the short-term arrangement.

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National Competition Council (NCC)

Part IIIA of the Act

Virgin Blue at Sydney domestic airport

On 18 February 2004 Virgin Blue applied to the tribunal for review of the decision of the Parliamentary Secretary to the Treasurer (being the relevant minister) not to declare certain services at Sydney airport under Part IIIA of the Act.

The minister's decision followed the final recommendation of the NCC that the services not be declared.

Virgin Blue applied to the NCC in October 2002 for declaration of certain services at Sydney airport. The services were described as those required for the use of runways, taxiways, parking aprons and other associated facilities necessary to allow aircraft carrying domestic passengers to take-off and land using the airport's runways and move between the runways and passenger terminals. They were collectively referred to as the 'airside service'.

In June 2003 the NCC released for public comment a draft recommendation that the airside service be declared. There were two key issues for the NCC in determining whether to recommend declaration. The first was whether declaration would promote competition in another market as required under criterion (a) of s. 44G. The most relevant dependent market for the purposes of the criterion was the domestic passenger market. The NCC concluded that although Sydney airport's operator, SACL, had the ability to exercise market power by increasing prices and engaging in other conduct for the airside service, its incentive to do so was tempered by the threat of re-regulation and the incentive to increase traffic throughput to increase non-aeronautical revenue through, for example, its retail leasing activities. Key questions for the NCC were the degree of SACL's market power and what effect an exercise of this power would have on competition in the domestic passenger market.

In its draft recommendation the NCC noted the difficulties in assessing this question. The NCC concluded that an exercise of market power by SACL would lead to a fall in passenger numbers that would be greater for more marginal price sensitive passengers who are specifically targeted by low-cost carriers such as Virgin Blue. In the NCC's view it would likely affect competition in the domestic passenger market.

The second key issue was whether access to the airside service would be contrary to the public interest; in particular, whether the cost of declaration would outweigh the benefits (criterion s. 44G(f)). The NCC concluded that it could not be satisfied that the costs of declaration outweighed the benefits. Accordingly, it concluded that criterion (f) was met.

The NCC received further information in response to the draft recommendation. On the basis of this information, the NCC concluded that the threat of re-regulation was likely a greater constraint on the exercise of market power by SACL than the NCC had originally considered. The NCC concluded that given the constraining effect of the threat of re-regulation and importance of non-aeronautical revenue, SACL had a strong incentive to maintain prices close to competitive levels for the airside service. Accordingly, the effect of declaration on competition in the domestic passenger market would not be material and criterion (a) was not satisfied.

On the question of whether declaration would be against public interest, the NCC's conclusion that criterion (a) was not satisfied led it to conclude that the costs of declaration likely outweighed the benefits. As such, the NCC concluded that criterion (f) was not satisfied.

Gas code

Goldfields gas pipeline (WA)

In November 2003 the NCC released its final recommendation on the application from Goldfields Gas Transmission Pty Ltd (GGT) to revoke coverage of the Goldfield gas pipeline (GGP). The NCC's final recommendation is that coverage under the gas code of the GGP should

not be revoked. The NCC was satisfied that all four of the criteria in s. 1.9 of the gas code were met for the whole of the GGP.

The NCC's final recommendation followed release of a draft recommendation and receipt of further submissions in response to the draft.

On the issue of whether coverage would promote competition in another market (criterion (a)), the NCC concluded that the GGT's ability to engage in monopoly pricing is not effectively constrained in the relevant downstream markets, namely, the gas sales market within reasonable proximity of the GGP, the retail gas sales market in Kalgoorlie; and the electricity sales market in Kalgoorlie.

The NCC further concluded that the existence of the state agreement does not provide an effective constraint on GGT's ability and incentive to exercise market power.

The minister is yet to make his decision.

Moomba to Sydney pipeline

On 19 November 2003 the Minister for Industry, Tourism and Resources, being the relevant minister under the gas code, decided to revoke coverage of the Moomba to Sydney pipeline (MSP) from Moomba to Marsden (accounting for over 70 per cent of the length of the pipeline). Coverage is retained for that part of the MSP from Marsden to Sydney as well as for the Canberra lateral pipeline.

An application for review of the minister's decision by the Australian Competition Tribunal was filed by several MSP users in December 2003. The matter had its first directions hearing on 4 February 2004 and is expected to be heard in late May/early June 2004.

In November 2002 the NCC recommended to the minister not to revoke coverage because the MSP and Canberra lateral pipelines had substantial market power.

In coming to his conclusion, the minister applied a framework that differed from the approach adopted by the council. In particular, the minister's approach to assessing criterion (b) in s. 1.9 of the gas code differed from that taken by the NCC. (The test in criterion (b) is whether it is 'uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline').

The minister concluded that criterion (b) required an assessment like that for (present and future) natural gas pipeline networks rather than limiting the analysis to whether a single point-to-point pipeline can be economically developed.
The minister concluded (adopting a 10–15 year timeframe) that given the pipeline network currently in place and the expected expansion of the network through interconnection and the development of new pipelines, it was not possible to conclude that criterion (b) was satisfied for that part of the MSP mainline from Moomba to Marsden.

In relation to the interconnect and regional NSW laterals, the minister concluded that they continue to rely solely on the gas transportation services provided by the MSP mainline. He also concluded that as the Canberra lateral was not part of an integrated gas network system, a point-to-point assessment of the pipeline was warranted in considering criterion (b). In summary, the minister concluded that criterion (b) was not satisfied for that part of the MSP from Moomba to Marsden but was satisfied for the part from Marsden to Sydney, regional spurs and the Canberra lateral.

In relation to criterion (a), the minister accepted the council's broad framework, based on advice from Ordover and Lehr, for assessing whether access regulation will promote competition by limiting the ability and incentive of pipeline owners and operators to exploit market power. The minister did conclude, contrary to the NCC's findings, that given development of the gas pipeline network and gas supply markets, the MSP was unlikely to have sufficient market power upstream to charge monopoly tariffs.

For downstream markets, the minister concluded that the Sydney gas market does not have the structural conditions necessary to allow adequate competition for gas pipeline services. In particular, the lack of an independent third pipeline to compete with the MSP and the EGP was seen as significant by the minister. The minister concluded that access to those parts of the MSP mainline providing downstream services to the interconnect to Sydney, and to regional laterals in NSW, would promote competition in at least one market. Accordingly, criterion (a) is satisfied for that part of the MSP from Marsden to Sydney and the Canberra lateral.

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Victoria

Essential Services Commission (ESC)

Energy

2006–2010 electricity distribution price review

In March 2004 the ESC started a review of the price controls applying to electricity distribution tariffs. The current price controls are due to expire on 31 December 2005 and a new set of price controls must be developed for the regulatory period commencing 1 January 2006.

To commence the review process, the ESC has released consultation paper no. 1. That paper set out the principal issues that need to be addressed during the distribution price review and indicates the ESC's preliminary thinking on the regulatory framework and its proposed approach to the review. It also describes the consultation process proposed by the ESC for the review.

The ESC will release consultation paper no. 2 in April 2004. This paper identifies several issues about service reliability targets and service incentives mechanisms during the current period. It proposes for comment and discussion options to improve the regulatory approach to those issues in the next regulatory period.

Information on the progress of the review and the consultation process can be found at the website the ESC has created for the price review. This website is located at http://www.esc.vic.gov.au/electricity699.html.

To indicate your interest in the review, please contact the ESC at edpr@esc.vic.gov.au.

Energy FRC effectiveness review

On 8 December 2003 the Minister for Energy Industries directed the ESC to undertake a review into the effectiveness of retail competition in both the gas and electricity markets. The terms of reference were published in the Victorian Government Gazette and direct the ESC to investigate the extent to which retail competition in the gas and electricity markets has been or might be effective to consider measures which could enhance the effectiveness of retail competition; and to consider the need for consumer safety net arrangements in the gas and electricity retail markets after 31 December 2004, or such modified form as recommended by the ESC.

Under the terms of reference the ESC is required to release a draft report to the minister no later than 14 May 2004 and a final report no later than 15 June 2004.

The ESC released an issues paper on 22 December 2003 and sought submissions from interested parties by 2 February 2004. The ESC has now released its draft report for public comment following consideration and analysis of issues raised in stakeholder submissions and the information provided in customer and retailer surveys. Submissions on the draft report must be submitted by Tuesday, 27 April 2004.

Review of electricity and gas customer protection framework for full retail competition

The ESC published its draft decision, 'Energy retail code' in January 2004. The objectives of the review were to improve the effectiveness of retail competition by reducing the complexity of the codes, their compliance costs and inconsistency with the codes of other states and ensure that there are adequate consumer safeguards, particularly for dual fuel (electricity and gas) energy contracts and consumers experiencing financial hardship.

Key proposals are to increase incentives for retailers to improve the accuracy and timeliness of their customer billing systems by reducing their capacity to recover funds if bills are not sent; and to allow retailers to charge late payment fees on overdue bills with additional safeguards for consumers having payment difficulties.

Submissions were received by 27 February and most attention has been directed to the proposal to allow retailers to charge late payment fees, which has created concern in some sectors in Victoria. The draft decision reflected the view that transparent, cost related late payment fees are likely to provide an incentive for prompt payment of bills by customers who pay late and who have demonstrated capacity to pay. Specific safeguards have been proposed for the protection of low income and vulnerable customers who may be having difficulty in paying their bills. Those safeguards would be primarily based on the criteria used by IPART. Consistency would be sought with the approaches adopted by other jurisdictions, all of which allow late payment fees.

The ESC's final decision will consider the views expressed in submissions and be published in mid-April and a revised code published in May 2004.

Retail performance monitoring and reporting

Final reports of the audits of gas and local electricity retail businesses (AGL, Origin, TXU), covering compliance for the calendar year 2002 were presented to the ESC in September. The ESC did not accept Origin Energy's audit report and has required a re-audit of calendar year 2003 compliance by an auditor nominated by the ESC and at the company's expense.

The final audit report of AGL and TXU, which overall demonstrates a high degree of compliance with the licence obligations, will be published in late March.

The calendar year 2003 comparative performance report for retailers is being prepared and will, for the first time, provide information on all retailers selling to customers in Victoria.

National consistency and market monitoring

The ESC continues to consult with other jurisdictions to develop consistency in its customer protection regulatory instruments and convenes the steering committee on retail consistency under the auspices of the Utility Regulators' Forum. Priority is given to achieve as much consistency as possible in the retail and market codes of conduct. In consultation with other jurisdictions the ESC will

shortly commence a review of options for a system for monitoring price, service and efficiency of transfers in the retail market.

In October 2003 the ESC published a consultation paper on price information disclosure in the competitive energy market. A draft decision will be published in late March 2004, which will include a cooperative approach developed with ESCOSA that facilitates customers' access to comparative information.

Reliability of gas retail dupply

In late 2003 the ESC concluded a project on the development of a policy for the reliability of retail supply consistent with the head of power provided in s. 33 of the *Gas Industry Act 2001*. The project included a general review of the s. 33 provision (in consultation with VENCorp) within the context of the current contestable retail market for gas. A recommendation was forwarded to government in January 2004. The government is currently reviewing this advice before determining whether to repeal the provision.

Electricity transmission augmentation and land access guideline

The ESC will shortly release an issues paper concerning the guidelines to govern the provision of third party access to a transmission company's land to construct, operate and maintain augmentations to the electricity transmission system. The ESC is canvassing issues to determine its approach to meeting its obligations under amendments to the *Electricity Industry Act 2000* arising from the *Energy (Consumer Protection and Other Amendments) Act 2003*. These provisions empower the ESC to develop a guideline for land access for augmentation works.

Once the ESC has considered comments on the issues paper, it will publish draft combined guidelines on electricity transmission augmentation and land access for further consideration before publishing the guidelines in their final form in June 2004.

Distribution business cost recovery

Under s. 68 of the Gas Industry Act, the Victorian Government issued a cost recovery order in council (OIC) to establish a process for full retail competition (FRC) cost recovery. Under the OIC the ESC is required to make various determinations to allow a gas distribution business to recover certain expenditure in preparing for the introduction of full retail competition in the Victorian gas industry.

The ESC released a final determination in August 2002, which documented approved recoverable capital expenditure, operating and maintenance expenditure and fees and charges. At the same time the ESC determined the adjustment factor process by which prices, fees and charges would be adjusted to account for actual FRC related expenditure. On 1 October 2003 the ESC received submissions from Multinet, Envestra and TXU networks consistent with the requirements of the OIC adjustment mechanism.

The ESC issued its final determination on 1 December 2003. The determination outlines the adjusted prices, fees and charges which each distributor is entitled to charge gas retailers for the period from 1 January 2004.

Retailer of last resort

The ESC is currently finalising a paper for the implementation of retailer of last resort arrangements in both the gas and electricity markets. This follows earlier consultation papers/processes and focuses specifically on customer allocation and pricing.

Gas extensions

At the last state election, the state government announced a program to provide funding for the reticulation of natural gas extensions to rural and regional Victoria. The ESC is assisting in facilitating such projects by clarifying the regulatory requirements with all key stakeholders. The first of these projects concerns a proposal by Envestra to reticulate Bairnsdale. The ESC anticipates releasing its draft decision on Envestra's submission by 26 March 2004.

Interval meter rollout

The ESC is currently finalising a draft decision paper on the mandatory rollout of interval meters for electricity customers. This follows the ESC's indication in its 2001–05 electricity distribution price determination that it was prepared to consider requiring interval meters for domestic and small business customers if the benefits of interval metering justified the additional cost. The draft decision takes into account consultation undertaken following the release of the ESC's position paper in November 2002. The ESC will seek responses from interested parties on the draft decision by April 2004 and anticipates the release of its final decision in May 2004.

Joint jurisdictional review of metrology processes

State energy regulators released a draft report in connection with the review of metrology processes in December 2003. The ESC, in conjunction with the other state energy regulators, is currently considering responses received to the draft report. The report makes substantial recommendations to harmonise metrology arrangements across the NEM and to remove some current uncertainties.

Key recommendations include:

- developing a single national metrology procedure while retaining some jurisdictional elements
- varying the metering chapter (chapter 7) of the national electricity code to include first tier metrology
- that distributors remain responsible for small customer metering.

The regulators recommend that NEMMCO be responsible for the single national metrology procedure and lead the revision of chapter 7 of the code.

The final report is due for release by April 2004.

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Western Australia

Economic Regulation Authority (ERA)

Establishment of the ERA

On 27 November 2003 the WA Government passed legislation to allow the establishment of the ERA to oversee the electricity, water, gas and rail industries in Western Australia. The previous Office of Gas Access Regulation, the Office of the Rail Access Regulator and the regulatory functions of the Office of Water Regulation were subsumed by ERA.

ERA has also been empowered to inquire and report on matters referred to it by the WA Government. These matters can relate to either the regulated industries (gas, rail and water) or other non-regulated industries, and can include, but are not limited to:

- prices and pricing policies in the relevant industry
- quality and reliability of goods and services in the relevant industry

- investment and business practices in the relevant industry
- costs of compliance with written laws that apply to the relevant industry.

ERA will also have responsibility for licensing in gas and water. When the regulatory framework for electricity is finalised, this function will also be performed by the ERA including a licensing function.

ERA was established on 1 January 2004 with a governing body to include a chairman and such members as considered necessary for the proper performance of its functions. Dr Ken Michael AM, previously the Gas and Rail Access Regulator, was appointed to the position of alternate chairman until a new full-time chairman is in place.

On 4 February 2004 the WA Treasurer, the Hon. Eric Ripper MLA, announced that Mr Lyndon Rowe, CEO of the WA Chamber of Commerce and Industry, had been appointed as the inaugural full-time chairman of the Economic Regulation Authority. This appointment is from 8 March 2004 for a period of five years.

Mr Chris Field, the executive director of the Consumer Law Centre of Victoria and national chair of the Australian Consumers' Association, has been appointed as a part-time member of the governing body for five years. The current alternate chair of the authority, Dr Ken Michael AM, will continue as a part-time member for one year.

Information on the status of any issues relating to the Economic Regulation Authority in Western Australia is available on the ERA website, www.era.wa.gov.au.

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Water division

Inquiry on water and wastewater pricing

A reference from the WA Government to the ERA for an inquiry into the charges and tariffs for the Water Corporation's metropolitan water and wastewater services, and the Bunbury and Busselton water services is expected by April 2004. It is likely that ERA will be required to make its recommendations to government by August 2005 on tariffs and charges to apply from 1 July 2006.

The inquiry is necessary to satisfy Western Australia's obligations under the Council of Australian Governments' water reform agreement.

It is also anticipated that ERA will receive a future reference for an inquiry into the tariffs and charges that apply to water and wastewater services in rural Western Australia.

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Gas division

Access arrangements

Following the release of the regulator's final decision on the proposed access arrangement for the Dampier to Bunbury natural gas pipeline (DBNGP) on 30 December 2003, there are now only two covered pipeline systems in Western Australia for which a proposed access arrangement still has to be approved, the Goldfields gas pipeline (GGP) and the Kalgoorlie to Kambalda pipeline. An extension has been granted to the operators of the Kalgoorlie to Kambalda pipeline until 1 July 2004 by which date a proposed access arrangement is to be submitted.

Dampier to Bunbury natural gas pipeline

The final decision not to approve the proposed access arrangement for the DBNGP was issued on 23 May 2003.

Epic Energy submitted a revised proposed access arrangement and access arrangement information on 8 August 2003. This revised proposed access arrangement was substantially different to that originally submitted extending the time of its application by five years to 31 December 2009 and included new capital and operating expenditure programs.

The original access arrangement proposed by Epic Energy and assessed by the regulator did not provide for expansion of the pipeline during the initial five-year access arrangement period.

The regulator examined the revised proposed access arrangement submitted by Epic Energy on 8 August 2003 to determine whether it incorporated, substantially incorporated or otherwise addressed the reasons for the amendments required in the final decision issued on 23 May 2003. The regulator did not consider that the substantial revisions to the proposed access arrangement were appropriate at such a late stage in the process of his assessment of the access arrangement and issued a further final decision on 30 December 2003 to not approve this revised proposed access arrangement.

The regulator issued his own access arrangement effective on 14 January 2004 in accordance with the provisions of the code.

Some of the required amendments of the final decision that are reflected in the approved access arrangement are:

Initial capital base:
$1 550 million

Return on equity:
12.5 per cent, nominal post-tax

Weighted average cost of capital:
7.4 per cent, real pre-tax

Tariffs as at 1 January 2000 from Dampier to delivery points located in:

Zone 9
(Perth)
Excl. GST $0.91/GJ *Incl. GST* $1.00/GJ

Zone 10
(Kwinana and Rockingham laterals)
Excl. GST $0.97/GJ *Incl. GST* $1.06/GJ

Zone 10
(Downstream of compressor station 10)
Excl. GST $0.98/GJ *Incl. GST* $1.08/GJ

The above tariffs apply from 14 January 2004 after adjustment for inflation at a rate of 67 per cent of the consumer price index. The tariffs are for 100 per cent load factor excluding delivery point charges.

The approved tariffs are consistent with a revenue stream that would be realised at a tariff of $1.00 per gigajoule as introduced on 1 January 2000.

A copy of the approved access arrangement is available from the ERA website, www.era.wa.gov.au.

After the regulator approved his own access arrangement, several appeals were lodged with the WA Gas Review Board. On 10 February 2004 Mr Robert Edel was appointed as the presiding member of the WA Gas Review Board to hear and determine these applications. Other members of the board are currently being appointed.

Epic Energy is required to lodge revisions to the existing approved access arrangement by 1 April 2004.

Goldfields gas pipeline

The draft decision on the proposed access arrangement for the GGP was issued on 10 April 2001.

Legal action initiated by the owners of the GGP in the Supreme Court of Western Australia was discontinued after the regulator issued a notice on 6 November 2002 stating he will amend his draft decision. Although the owners of the GGP applied on 27 March 2003 to the National Competition Council for revocation of coverage of GGP under the code, ERA is proceeding toward issuing an amended draft decision.

On 10 June 2003 WMC Resources Ltd sought a writ of prohibition that would forbid the regulator considering or determining whether, under clause 21(3) of the *Goldfields Gas Pipeline Agreement Act 1994*, the code shall not have effect regarding the GGP. This matter was heard by the court on 6–7 October 2003 and its decision issued on 2 December 2003.

The court found that clause 21(3) of the state agreement cannot be enforced as a binding contractual provision. The court indicated that, whatever legal force and effect of clause 21(3), it was not able to read its provisions as conferring, or purporting to confer, any role or function or jurisdiction on the regulator. The court therefore found that stage two of the assessment proposed by the regulator in his notice of 6 November 2002 was not one which he is required or authorised to take.

As the parties (WMC and GGT) could not agree on the declaratory orders, these remain to be settled. The hearing to consider the issues relating to the orders was held on 3 March 2004. The court has reserved its decision.

Mid-west and south-west gas distribution systems

The approved access arrangement for the mid-west and south-west gas distribution systems is scheduled for review commencing 1 April 2004.

Rate of return methodologies and practices

A discussion paper on the review of rate of return methodologies and practices prepared by the Institute for Research into International Competitiveness at the Curtin University of Technology was released on 31 December 2003 for comment. The aim of the report was to consider evolving best practice in the determination of allowed rates of return in utility regulation. The review draws from literature and regulatory practice in both Australia and other parts of the world. A special focus of the review has been on the treatment of diversifiable and non-diversifiable risk.

The report also examines and comments on the approach taken by the Gas Pipelines Access Regulator in Western Australia in setting regulatory rates of return. This report and submissions are accessible on the ERA website, www.era.wa.gov.au.

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Rail division

The rail division of ERA has started a review of the floor and ceiling costs for specified grain lines in the freight network and for two rail lines in the suburban rail network. It is expected that both determinations will be completed by 30 June 2004.

The floor and ceiling costs determinations are a requirement of the railways (access) code to establish the appropriate bands in which the track owner and access seekers can negotiate prices for access.

The rail division has also started a study into determining what the CPI-X escalation of costs should be for the WA rail freight industry.
This study seeks to determine a methodology for the calculation of an X factor and to establish what the X factor is in the escalation formula.
A presentation on the findings of this study will be made at the Regulators Forum in Hobart in March 2004. The study follows a preliminary review in July 2003 of various methodologies undertaken by consultants from the Curtin Business School.

The completed determinations and the preliminary CPI-X study are available for review on the ERA website, www.era.wa.gov.au.

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South Australia

Essential Services Commission of South Australia (ESCOSA)

Electricity supply industry

2004 Electricity standing contract price review

ESCOSA completed its review of the cost components comprising the electricity standing contract prices charged by AGL SA in late December 2003.
The final report released on 31 December 2003 was the end result of a process of consultation which ESCOSA undertook in early October 2003 on the changes (if any) to the component costs of the standing contract electricity retail prices to take effect from 1 January 2004. AGL SA is the only retailer obliged to offer a standing contract to small customers.

ESCOSA concluded that the wholesale energy costs component applicable in 2004 should be reduced from the $71 per MWh applicable in 2003 to $68.5 per MWh. Increases in network charges payable to ETSA Utilities essentially offset this reduction. ESCOSA's concluded that there was no justification for a change in the standing contract prices.

Peak demand on the ETSA Utilities electricity distribution network

As part of the electricity distribution price review (to establish new arrangements for the 2005–2010 regulatory period) ESCOSA examined whether the use of demand-side management (DSM) programs may be more cost effective than building additional distribution capacity to meet increases in peak demand. ESCOSA engaged consultants to identify the customer types and end uses that contribute to peak distribution network demands and evaluate those options that could potentially reduce peak demand on ETSA Utilities' network. This process is the second phase of a four-phase review.

The report has been released for consultation and ESCOSA is actively seeking any additional information on customer class contribution to peak demand.

Return on assets

ESCOSA released a discussion paper in August 2003 setting out the capital cost issues associated with determining allowable revenue and canvassing issues relating to asset roll forward,

depreciation and the regulatory rate of return that should be applied to the regulatory asset base. ESCOSA released a preliminary views paper in January 2004 which is part of the series of papers released by ESCOSA on the electricity distribution price review. It outlines the key issues that ESCOSA must resolve before developing a working conclusion on return on assets that should be included in ETSA Utilities' regulated revenue base.

Given the financial significance of this aspect of the price review, ESCOSA feels that additional consultation in this matter is required before making a working conclusion. ESCOSA intends releasing its working conclusion in April 2004.

Review of chapter 3 of the distribution code

Chapter 3 of Part A of the electricity distribution code deals with the procedures followed by ETSA Utilities to establish connections to the distribution network in situations where network extension and/or augmentation is required.

The review of chapter 3 was first started in December 2001. A position paper was released in June 2003 which was supplemented by two issues papers in August 2003.

ESCOSA released its final determination in December 2003 which proposed a new cost model for extension and augmentation charging. The final determination will impose, effective from February 2004, a range of administrative improvements to the current system. The major reforms are:

- a requirement that no augmentation charges will be payable for sites which have been disconnected for up to two years, provided there has been no change in demand profile at the site and there is no increase in the maximum demand at the connection point
- ETSA Utilities will only be able to require up to 50 per cent of the total cost of the connection works as an up-front fee, with the remainder payable when the connection or modification work for the connection point is completed.

The distribution code was varied on 1 February 2004 in accordance with the final determination.

Consumer advisory committee inquiry into pre-payment metering

ESCOSA has requested the consumer advisory committee (its peak consumer stakeholder advisory body) to undertake an inquiry into the conditions under which there may be a potential role for prepayment electricity meters for residential customers in South Australia, and to address issues about consumer protection, monitoring and reporting.

ESCOSA has advised the committee that it recognises prepayment electricity meters are a difficult and sensitive issue and that there are differing views in Australia and overseas about such meters. The committee has formed a sub-committee to manage the prepayment electricity meter inquiry. KPMG has been appointed by the sub-committee to undertake the consultancy.

Gas supply industry

Since assuming regulatory responsibility for a number of aspects of the gas supply industry in South Australia, ESCOSA has undertaken to develop appropriate gas industry codes and is reviewing the licensing of existing or proposed entities to either amend or issue licences (retail, distribution, and retail market) that reflect the new regulatory regime.

ESCOSA has, where possible, sought to streamline industry codes and guidelines by issuing joint energy codes dealing with both the electricity and gas industries.

In late July 2003 ESCOSA released an issues paper entitled 'Gas licensing and code regime', seeking stakeholder views on the appropriate form of gas licences and industry codes within the policy setting and legislative framework established by the South Australian Government.

Energy codes and gas licences

Energy codes

In December 2003 ESCOSA released a draft decision paper detailing the need for and appropriate form of retail, marketing and customer transfer and consent codes for the energy supply industry in South Australia.

The final paper will outline ESCOSA's final regulatory position on these codes.

Gas licences and codes

The amendments to the Gas Act required ESCOSA, as a minimum, to incorporate new mandatory requirements in licences.

To initiate the wider review of the gas licensing and code regime, ESCOSA released a gas issues paper in July 2003 which canvassed, at a high level, various broad issues associated with the review. It recognised that subsequent stages of the review involving the release of draft licences and codes would provide an opportunity for consultation on the detailed issues. To this end, a draft decision was released in December 2003 dealing in particular with the:

- gas metering and distribution industry codes
- gas licences (retail, distribution and retail market administrator).

ESCOSA intends to issue final licences and codes by early March 2004.

AGL SA wholesale gas exemption

ESCOSA granted an exemption, subject to certain conditions, to AGL Wholesale Gas Limited from the requirement under Part 3 of the *Gas Act 1997* to hold a retail licence associated with the sale and supply of gas to AGL South Australia Pty Limited for use in a back-up boiler connected with the Coopers Brewery Cogeneration project.

The technical regulator had previously granted AGL Wholesale Gas an interim exemption from the requirements to hold a retail licence in South Australia under s. 77 of the Gas Act on 16 September 2002.

Form of price regulation for REMCo

The Retail Energy Market Company (REMCo) has submitted to ESCOSA its recovery of costs associated with acting as the retail market administrator (RMA) for gas FRC in South Australia. REMCo sought to recover around $3.4 million in 2004–05 for services as the RMA in South Australia

This submission follows from a discussion paper released by ESCOSA in September 2003 on the appropriate form of regulation to apply to REMCo. ESCOSA released a preliminary view on the form of regulation following from this consultation process in November 2003.

Envestra gas FRC cost recovery

Envestra has submitted to ESCOSA its application for the recovery of costs associated with implementing the necessary systems required to introduce full retail contestability (FRC) in the South Australian gas market by 30 June 2004. These costs specifically relate to services that Envestra is required to provide in accordance with the retail market rules. Envestra is seeking to recover around $30 million in capital costs and $14 million in operating expenditure for the two-year period ending 30 June 2006.

ESCOSA has engaged specialist consultants to assist in reviewing whether these cost amounts are justified. ESCOSA expects to release the draft report prepared by the consultant by early March 2004.

Rail

Tarcoola–Darwin railway

The sectors of the Tarcoola–Darwin railway to which the AustralAsia Railway (Third Party Access) Code were to apply were declared by the SA and NT ministers on 15 January 2004. This declaration necessitates that ESCOSA finalise those guidelines and determinations which had previously been released on a provisional basis pending the declaration of the railway. ESCOSA is currently undertaking to finalise these codes and determinations.

Rail industry guidelines

ESCOSA has issued two guidelines under the AustralAsia Railway (Third Party Access) Code, which sets out the access regime for the Tarcoola–Darwin railway.

The first guideline is the 'access provider reference pricing and service policies' guideline, which sets out the pricing and service policy obligations placed upon the access provider (Asia Pacific Transport Pty Ltd).

The second guideline is the 'arbitrator pricing requirements' guideline, which sets out certain pricing principles and methods that an arbitrator would need to apply if an access dispute would arise and reach arbitration.

The guidelines took effect from 16 February 2004.

Water

Under s. 35(1) of the *Essential Services Commission Act 2002* the Treasurer has referred an inquiry into urban water pricing processes to ESCOSA.

ESCOSA has published an issues paper along with the transparency statement and the notice of referral.

ESCOSA is required to provide a draft report to the minister by 24 March 2004 and a final report by 7 April 2004. Given the limited time to conduct the inquiry, submissions were sought by mid-March 2004.

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New South Wales

Independent Pricing and Regulatory Tribunal (IPART)

Dr Tom Parry, foundation executive chairman of IPART, has announced that he will be leaving IPART at the end of April.

Dr Parry has been chairman of IPART and its predecessor, the Government Pricing Tribunal, for 12 years.

To quote Dr Parry 'I have enjoyed enormously the past 12 years, having worked with both sides of politics and many people in the public sector in NSW as well as the outstanding people in IPART. I thank all my colleagues, past and present, for their support and friendship' .

Dr Parry will continue as (Part-time) Natural Resources Commissioner of NSW.

Electricity

2004 review of distribution network prices

IPART's current determination on the regulatory arrangements applying to NSW distribution network service providers (DNSPs) expires on the 30 June 2004.

To prepare for a new determination, IPART reviewed the form of regulation that should apply from 1 July 2004. The new arrangements will include a weighted average price cap for the distribution component of network tariffs, a pass through of transmission charges and a price cap for miscellaneous charges and monopoly fees.

In January 2004 IPART released a draft report and determination which are available from the IPART website.

Submissions on the draft report and the draft determination were due on 5 March 2004.
The tribunal aims to release its final determination in May 2004, for 1 July 2004 implementation.

2004 review of regulated retail tariffs

IPART's current determination of regulated retail tariffs expires on 30 June 2004. The Minister for Energy and Utilities has asked IPART to determine appropriate default retail tariffs and charges for a further three years until 30 June 2007.

IPART released an issues paper on 3 October 2003. Public submissions were due on 2 February 2004. IPART will provide a draft report in April and a final report in June 2004.

Gas

2004 review of retail voluntary pricing principles

IPART has commenced a review of the gas voluntary pricing principles in conjunction with its review of electricity default tariffs.
Public submissions were due on 2 February 2004. IPART will provide a draft report in April and a final report in June 2004. This review is being run in conjunction with the review of regulated electricity retail tariffs.

2004 review of access arrangements

The next review of the access arrangement of AGL Gas networks (AGLGN) will occur in 2004. AGLGN lodged their reviews just before Christmas 2003. AGLGN made a public presentation on their proposal on 19 February 2004. A copy of the slides is on IPART's website.

The next review of the access arrangement of Country Energy Gas (CEG) will also occur in 2004. Country Energy's proposed revised access arrangement is also on the IPART website.

Transport

IPART will assess the real, pre-tax rate of return to be applied to the opening and closing regulatory asset base and the remaining mine life of the Hunter Valley coal mines as required under the NSW rail access regime.

IPART will undertake a review of maximum fares that can be charged on NSW government-owned public services. This includes Sydney's CityRail passenger train network and State Transit Authority buses and ferries in Sydney and Newcastle.

IPART has a five-year standing reference to recommend fare changes for private transport operators. IPART will review fares in the private ferry and taxi industries and, after the release of the findings of the Unsworth inquiry, the NSW private bus industry.

Water pricing

Metropolitan water

On 22 September 2003 the Premier of New South Wales issued proposed terms of reference to IPART for an investigation into the use of pricing structures to reduce demand for water in the Sydney Basin. This investigation will consider a range of issues, such as:

- the use of a step in the wholesale water price paid by Sydney Water Corporation to Sydney Catchment Authority for extractions above the estimated sustainable yield
- the establishment of pricing principles and a framework that might be adopted for moving from current retail tariff structures to alternative tariff structures, including inclining block tariffs
- the affordability and equity impacts of alternative pricing structures including inclining block tariffs.

IPART released an issues paper for this review on 18 December 2003 which called for submissions by 27 February 2004. IPART held a public hearing for this review on 25 March 2004 and anticipates releasing the final report before 30 June 2004.

IPART anticipates commencing its next periodic pricing review for the metropolitan water agencies with the release of an issues paper in June 2004. The review will set prices for water, wastewater and stormwater services provided by Sydney Water Corporation, Hunter Water Corporation, Gosford City Council and Wyong Shire Council, as well as the Sydney Catchment Authority. The determination will set prices from 1 July 2005.

Bulk water

IPART intended commencing a review of bulk water prices to apply from 1 July 2004. IPART previously set prices charged by the Department of Land and Water Conservation through its business unit, State Water. However, following the NSW election in March 2003, State Water has been transferred to the Ministry for Energy and Utilities and the relevant functions of the Department of Land and Water Conservation have been incorporated into the new Department of Infrastructure, Planning and Natural Resources. IPART's proposed review will be deferred pending resolution of responsibility and cost allocation matters arising from the functional realignment.

Water licensing

IPART has commenced an end of term review of the operating licences for Sydney Water Corporation and Sydney Catchment Authority. The current operating licences for these agencies will expire on 31 December 2004. IPART is required to review these licences and recommend to the ministers responsible the terms of new operating licences to take effect from 1 January 2005. An issues paper on the licences was released in October 2003 and a second paper on the water supply and demand balance was released in January 2004. A public workshop for this review is anticipated in April 2004, with a final report to the respective ministers expected to be released in August 2004.

Household survey

IPART commissioned Taverner Research Company to undertake a survey of over 2600 households to collect data matched with water, electricity and gas billing.

IPART intends to release two research reports detailing the results from an analysis of the survey data. The first, focusing on the water data, is anticipated to be released in March 2004. The second will focus on the energy data, and is likely to be released in May 2004.

Greenhouse gas abatement scheme

The Greenhouse Gas Abatement Scheme commenced on 1 January 2003 and remains in force until 2012. The scheme imposes mandatory greenhouse gas benchmarks on all NSW electricity retailers and certain other parties including those who elect to manage their own benchmark to abate the emission of greenhouse gases from the consumption of electricity in NSW. These parties are referred to as benchmark participants. To date eight large users of electricity have elected to manage their own benchmarks.

The scheme sets a state greenhouse gas benchmark expressed in tonnes of carbon dioxide equivalent (tCO2-e) per capita. The initial level set for 2003 is 8.65 tonnes and the benchmark progressively drops to 7.27 tonnes in 2007 and will continue until 2012.

Each benchmark participant is allocated a share of the electricity sector benchmark based on the level of their electricity sales as a percentage of the total state electricity demand, as published by the tribunal. This allocation is used by benchmark participants as their individual greenhouse gas benchmarks.

Benchmark participants are required to reduce their emission of greenhouse gases to the level of their greenhouse gas benchmark by off-setting their excess emissions through the surrender of abatement certificates. These certificates are created by accredited abatement certificate providers and can be traded to benchmark participants.

The administrative processes supporting the scheme were fully implemented by August 2003. Since then IPART has accredited 29 abatement certificate providers, which have collectively registered over 1.4 million abatement certificates. IPART is processing a further 87 applications for accreditation and expects to accredit most of them in February and March 2004.

Details of accredited abatement certificate providers and the certificates they have registered are available at www.ggas-registry.nsw.gov.au.

Full details of the scheme, including application forms, guides to applying and other documents are available from the scheme website at www.greenhousegas.nsw.gov.au. IPART has published case studies of an initial group of trial accreditations. These explain how each applicant was accredited, the costs of auditing their application and the ongoing conditions of accreditation to which they are subject. Further case studies will be published in coming months.

IPART has extended the date for benchmark participants to surrender abatement certificates and report on their compliance against their benchmarks during 2003 to 30 April 2004. A standard reporting format for benchmark participants' annual compliance statements has been trialled with two electricity retailers and will be released shortly.

In June 2004 IPART will report to the Minister for Energy on benchmark participants' compliance with their 2003 greenhouse gas benchmarks and on the overall performance of the scheme.

Other reviews

IPART also undertakes reviews outside the utility regulation functions at the request of the NSW Government or others. Recently completed and current reviews include:

- A review of gaming harm minimisation measures at the request of the Minister for

Gaming and Racing. This review commenced in September 2003. The report is due by May 2004.

- A review of the gaming machine central monitoring fee paid by clubs and hotels to the TAB.
- A review of rental charges for waterfront tenancies on Crown land in NSW, at the request of the Minister of Transport Services and the minister assisting the Minister for Natural Resources. An issues paper was released in October 2003 and submissions closed in December 2003. A final report is due by April 2004.
- A review of the methodology used by the Essential Services Commission of South Australia (ESCOSA) in its recent decision on the electricity standing contact price. The review will focus on the methodology and not consider the levels of prices set by ESCOSA. The report is expected to be finalised in March 2004.

Tasmania

Office of the Tasmanian Energy Regulator (OTTER)

Tasmanian electricity code changes

In September 2003 the minister notified the regulator that he had, in accordance with the *Electricity Supply Industry Act 1995* (ESI Act), amended the Tasmanian electricity code as follows:

- Parts A and B of chapter 6 of the code have been amended to align with the equivalent provisions of the NEC. The ACCC assumed responsibility for determining transmission prices in Tasmania from 1 January 2004. The amendments enabled the ACCC to make a transmission pricing determination under the Tasmanian regulatory regime (pre-NEM entry) which can then 'roll forward' into the NEM.
- Chapter 7 of the code has been replaced and reflects a jurisdictional obligation on Transend Networks Pty Ltd to upgrade metering installations for approved connection points that will be market connection points for the purposes of the NEC.

In December 2003 the regulator received further notification from the minister that he had amended Part C of chapter 6 of the code to require Transend to adopt a pricing policy that is consistent with the requirements of the national electricity code.

Electricity supply industry performance report 2002–03

In December 2003 the regulator released the third annual ESI performance report. This report provides a comprehensive review of Tasmania's electricity industry, with an additional section on the gas industry which will be expanded in future years as the gas distribution network is constructed and operated.

The report details the performance of the three major industry entities—Transend Networks, Aurora Energy and Hydro Tasmania. It analyses the principal industry performance measures including electricity prices and reliability.

A full copy of the report can be accessed at the regulator's website, http://www.energyregulator.tas.gov.au.

Natural gas distribution and retail

Construction of stage 1 of the distribution network started at Longford in October 2003 and at Bell Bay in December. It is expected that Longford will be commissioned early in March 2004 and Bell Bay shortly thereafter. Work has also commenced at Sandy Bay and Lutana, near Hobart.

In December 2003 Aurora Energy Pty Ltd applied for a licence to retail natural gas in Tasmania.

The regulator invited written submissions on the application but none were received. The licence was issued on 12 February 2004 and the regulator's report is available on the website.

Duke Energy's Australian assets, including the Tasmanian gas pipeline (TGP), are for sale. It is not expected that the sale of the TGP will have any adverse effect on the supply of gas to Tasmania or the development of the Tasmanian gas industry.

In December 2003 the regulator released, for public comment, a draft customer transfer and reconciliation code for the Tasmanian natural gas industry.

The draft code sets out arrangements for:

- the identification of metering installations
- the transfer of customers between retailers
- the provision and testing of meters
- meter reading and the application of metering data
- the allocation and reconciliation of gas quantities between retailers, including audit and dispute resolution.

The regulator has also been assisting Powerco in the development of use of system agreements and a ring fencing policy for the separation of its retail and distribution activities.

Gas and electricity licences

In September 2003 Roaring 40's Wind Pty Ltd, a wholly owned subsidiary of Hydro Tasmania and the holder of a licence for stage 1 of a wind power generation facility at Woolnorth in Tasmania, applied to amend its licence to include stage 2, that is, an additional 31 turbines with generating capacity of approximately 54.25 MW.
The regulator undertook consultation on the application but no submissions were received. The regulator amended the licence in December 2003 and the report is available on the website.

In November 2003 Green Pacific Energy Bell Bay Pty Ltd applied to have the electricity generation licence held by Energy Equipment Pty Ltd transferred to it. This licence relates to a proposed 20 MW green-waste fired generator situated at George Town. One submission was received. The regulator has approved the transfer and the report is available on the website.

Pay As You Go electricity—review

The regulator has commenced a review into the Pay-As-You-Go (APAYG) service offered by Aurora.

APAYG is an option offered for those residential customers who prefer prepayments for their electricity through the use of a prepayment meter and associated electronic card.

The Pay As You Go service was first introduced by the Hydro Electric Corporation in 1995 with 500 customers. The current system and pricing structure commenced in 1997 with a rollout to 2000 customers, which included the initial 500 customers changing to the new system. Approximately 13 per cent of Aurora's residential customers may use APAYG, with further penetration likely.

Although the regulator determines maximum prices, which may be charged by Aurora for tariff customers, the regulator did not include APAYG in the suite of services subject to regulation of prices. The reasons for not setting the prices for APAYG were recorded in the *Price control of electrical services—reasons for declaration of distribution*

and retail services and proposal to revoke declaration of certain services, November 2002.

During the 2003 electricity pricing investigation the pricing issues focus group (PIFG) and the regulator's electricity customer consultative committee were advised of the high level of acceptance of APAYG by customers and by financial advisers. The Electricity Ombudsman also confirmed the lack of systemic complaints. However, during the 2003 pricing investigation the PIFG did express the view that due to the fact that a significant proportion of residential tariff customers now use APAYG and because the pricing structure does not allow a ready comparison of price, APAYG should be investigated. In view of the growth of APAYG and the importance of an informed consumer choice, the regulator has decided to undertake a review of APAYG, to consider what if any regulation of the terms and conditions of this service is appropriate.

This review will consider the prices, terms and conditions of APAYG, the extent to which APAYG is a genuine 'product of choice' for residential customers, the interaction of APAYG and Aurora's credit policy and the extent to which regulation of APAYG may be necessary to protect the interest of consumers.

The regulator will seek an initial submission from Aurora, and will also seek public submissions following the release of an issues paper in April 2004. A final report will be published by 30 June 2004.

Reliability and network planning panel (RNPP) update

2003 reliability review

The Tasmanian electricity code requires the RNPP to annually review the reliability of the Tasmanian power system. The RNPP recently completed its second review and submitted its report, *The 2003 reliability review of the Tasmanian power system,* to the regulator on 23 January 2004.

The report provides an assessment of the outlook for power system reliability in the medium term (the next two years) and supports this assessment with reliability performance data for the power system for 2002–03 and, where available, relevant data from previous years.

The report is based on the system controller's planning statements for 2002 and 2003, Transend Network's annual planning review, performance information submitted by the entities to the regulator and the outcomes of a workshop where code participants and interested parties discussed the issues affecting the reliability of the Tasmanian power system.

The report is available on the regulator's website www.energyregulator.tas.gov.au.

Jurisdictional appointments

The NEM ministers' forum has agreed to amend the national electricity law for Tasmania to become a participating jurisdiction. The local regulator will be the jurisdictional regulator in Tasmania. The local regulator will also be the metrology coordinator for the jurisdiction.

Government Prices Oversight Commission (GPOC)

Urban water and wastewater full cost recovery compliance review

In November 2003 the Treasurer issued terms of reference to the Government Prices Oversight Commission (GPOC) for the review of councils' compliance with urban water pricing guidelines.

The terms of reference for the review required examining whether councils are meeting the requirements for full cost recovery for their water and wastewater businesses. The GPOC was also required to consider several other issues, such as asset valuations, the cost of asset consumption, cross subsidies, community service obligations, own-use transfers and, where relevant, the appropriateness of two-part pricing structures.

The GPOC has completed the review and tendered the report to the Treasurer and the Minister Assisting the Premier on Local Government. The report will be made available on the GPOC's website after it is released by the Treasurer and the minister.

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Queensland

Queensland Competition Authority (QCA)

Electricity

The QCA is establishing new depreciated optimised replacement cost (DORC) asset valuations for Queensland electricity distribution network service providers to support the regulatory arrangements for the next regulatory period commencing 1 July 2005. The first stage of the valuation project, which entails resolution of practical issues associated with a DORC valuation, is expected to be completed by March 2004.

In September 2003 the QCA released a draft report by consultants Meyrick and Associates/Pacific Economics Group titled, *Development of an electricity distribution service quality regime to take effect in future regulatory periods*. The draft report presented a service quality incentive scheme that could be incorporated into the next set of regulatory arrangements.

In February 2004 the QCA released a draft decision proposing a somewhat different service quality incentive scheme based on a regulatory contract to be agreed as part of (and tied to) the QCA's 2005 electricity determination. This proposal would retain many of the features of the Meyrick/PEG approach but would reduce the complexity associated with implementing the scheme and increase the transparency of outcomes for both the distributors and customers. The scheme would target specific service quality outcomes to be achieved by the end of the next regulatory period rather than requiring annual assessments of service quality and corresponding financial adjustments to be made. The closing date for submissions on the draft decision is 15 March 2004.

The QCA's *Electricity distribution: ring-fencing guidelines* require that a distribution network service provider must not carry on a related business within that legal entity. In October 2003 Ergon Energy applied to have its existing (and all future) grid-connected generation sites, used for network support, exempted from the relevant provision of the QCA's guidelines because the administrative cost of compliance would outweigh the benefit to the public. The QCA released its final decision in February 2004, which was to issue a notice waiving Ergon's requirement to comply with ring-fencing obligation section 1(b) in respect of its four existing grid-connected generation sites

used for network support. The QCA did not extend the waiver to future generation sites.

The distributors' service quality reports for the September quarter 2003 were posted on the QCA's website in February 2004. A report on the distributors' financial and service performance for 2002–03 is expected to be available on the QCA's website in March 2004.

In December 2003 the QCA released an initial metrology procedure for metering installation types 5, 6 and 7 for Queensland. As metrology coordinator for Queensland, the QCA is responsible for the ongoing administration of this procedure. On 23 February 2003 the Queensland Government announced its intention to lower the threshold level of retail contestability for electricity consumers from 200MWh to 100MWh per annum from 1 July 2004. To meet the requirements of the national electricity code, the QCA commenced a public consultation process in March 2004 that will culminate in the release of a revised metrology procedure by the end of June 2004.

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Gas

Allgas Energy Ltd submitted a proposed associate contract between itself and Energex Ltd to the QCA for approval on 5 January 2004. The proposed contract is for the provision of operation, maintenance and management services for the Allgas gas distribution network. Following a public consultation process, the QCA determined that the proposed contract is unlikely to have the effect of substantially lessening, preventing or hindering competition in a market, and therefore decided to approve the contract. A copy of the decision and other relevant documents is on the QCA's website, www.qca.org.au.

The Queensland gas distribution service providers have submitted annual ring fencing compliance reports for 2002–03 to the QCA. The service providers have demonstrated further progress towards achieving full compliance with the code.

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Water

Gladstone Area Water Board—investigation of pricing practices

In September 2000 the QCA was directed to undertake an investigation of the pricing practices of the Gladstone Area Water Board (GAWB).

The QCA was also directed to monitor prices included in contractual arrangements entered into during and after the period of the investigation.

The QCA subsequently released its final report of recommended pricing practices, *Gladstone Area Water Board: investigation of pricing practices* in September 2002. The ministers accepted the QCA's recommendations in August 2003.
The QCA is now awaiting a formal direction from the ministers to proceed with the next review to enable prices to be set from 1 July 2005.

Extraordinary circumstances

The QCA has been directed to identify the general pricing principles which should underpin the treatment of infrastructure investments made in response to extraordinary circumstances across all regulated industries.

The direction was in response to proposals to construct a major pipeline from Rockhampton to Gladstone to address Gladstone's drought-related water supply problems. Although substantial rainfall in early 2003 averted the immediate need for this investment, the ministers perceived a need to develop principles that could be applied to similar circumstances for the various regulated industries in the future.

In August 2003 the QCA released an issues paper, *General pricing principles for infrastructure investments made in response to extraordinary circumstances.* Submissions received in response to the issues paper have been considered in the preparation of a draft report which is due to be released by March 2004. A copy of the issues paper is available from the QCA or can be downloaded from their website, www.qca.org.au.

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Local government

The sixth and final review of councils' progress in implementing competition reforms leading to annual payments under the local government financial incentive payments scheme has been completed.

This assessment was limited to the 117 of Queensland's 125 councils which were granted a one year extension to 30 June 2003 by the Minister for Local Government and Planning to complete the reforms. These councils operate 691 business activities and 103 are eligible for payments relating to the implementation of COAG water reforms. Of the eight councils that did not seek an extension, Brisbane had previously agreed to implement the reforms in five years, one year less than most other councils.

Overall, progress by the 125 councils in implementing the reforms has been assessed at 88 per cent. The 19 largest councils have mostly completed the agreed reforms to their nominated activities. Substantial progress has been achieved by the remaining 106 councils.

As in previous years, the QCA continues to note beneficial changes in the conduct of council business activities brought about by the combination of commercial incentives, greater autonomy and increased accountability.

The QCA's report and accompanying recommendations for payments under the local government financial incentive payments scheme have been submitted to the ministers.

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Rail

Initial undertaking notice

Queensland Rail's (QR) existing access undertaking expires on 30 June 2005. To ensure that a replacement access undertaking is approved by 1 July 2005, the QCA has issued QR with an initial undertaking notice. The notice requires QR to provide a draft access undertaking by 30 April 2004. Once the QCA has received QR's draft access undertaking, an investigation (in accordance with Part 6 of the *Queensland Competition Authority Act 1997*) will be commenced.

Standard access agreements

At present QR's standard access agreements do not contain a performance regime. However, QR is currently in the process of developing such a regime. The regime encourages compliance with contractual commitments within the agreements, but in a way that avoids recourse to legal action. The performance regime will form part of the overall performance provisions contained within the agreements. QR has proposed five key performance indicators which were to be trialled for 12 months before finalising the performance regime. Given delays in developing the performance indicators, QR now anticipates that it will finalise the performance regime as part of its 2005 access undertaking.

Reference tariffs

QR has sought approval for reference tariffs for train services for new coal mines in central Queensland. These reference tariff applications identified a number of new issues.

On 1 April 2003 QR provided an indicative reference tariff application to the QCA for a train service for the new Hail Creek mine. The application indicated that the Hail Creek mine did not satisfy the requirements for inclusion into an existing reference tariff. In particular, at an existing tariff the new mine would not cover its incremental costs (47 km spur line). QR therefore proposed that Hail Creek form a new Central Goonyella Cluster.

In September 2003 the QCA decided not to endorse QR's application. In particular, the QCA accepted stakeholder criticisms that QR's proposed method for determining a new mine's common cost contribution lacked transparency; was highly subjective; would be difficult to apply consistently across new mines and over time and was inequitable.

The QCA indicated it would be prepared to approve a reference tariff based on a fixed ($0.90/'000 gtk) contribution to common costs which broadly equates with the current lowest contribution currently made by any mine in the central Queensland coal region. In December 2003 QR submitted a revised reference tariff that was consistent with the QCA's earlier decision. The QCA approved that revised reference tariff on 5 February 2004.

It is anticipated that in future reference tariff applications QR will develop an alternative approach to common cost contributions for outlying mines. It is also anticipated that QR will seek a management premium (i.e. operating and maintenance costs based on industry averages rather than efficient costs) and the recovery of additional insurance costs for risks that had not previously been recognised.

Draft amending access undertakings

In the second half of 2003 QR submitted several draft amending access undertakings to the QCA for consideration. Generally, the amendments were of a minor or administrative nature. However, some amendments were more substantial. For example, the QCA approved changes to rail infrastructure which included transferring to QR's below rail group (network access) management responsibility for the Callemondah and Jilalan marshalling yards on the central Queensland coal network. The QCA rejected proposed amendments to the information ring fencing arrangements and to the revision of access charges in the event of material change.

Annual report

In December 2003 QR's network access group published its second audited and certified regulatory financial statements and annual network access annual performance report for 2002–03.

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Ports

The Dalrymple Bay Coal Terminal (DBCT) has been declared by the Queensland Government for the purposes of third party access under Part 5 of the *Queensland Competition Authority Act 1997* (the QCA Act). A draft access undertaking was submitted to the QCA in June 2003 and 10 submissions have been lodged.

DBCT Holdings (a government corporation) is the owner of the facility which is operated by Prime Infrastructure (Prime) under a 50-year lease (with an option to extend this by an additional 49 years). The day-to-day operation of the terminal is conducted by a separate company (DBCT P/L), in accordance with an operations and maintenance (O&M) contract with Prime. DBCT P/L is jointly owned by the mines that export coal from the terminal. These ownership and leasing arrangements have complicated the QCA's analysis of the draft access undertaking.

As part of its investigation, the QCA has commissioned Dr Martin Lally of Victoria University (New Zealand) to assess the various cost of capital assumptions and parameters proposed by Prime and stakeholders. This assessment is part of a wider review to develop a comprehensive and internally consistent framework for determining the cost of capital across all industries regulated by the QCA. A copy of Dr Lally's report was made available for public comment in late February 2004.

The QCA has also commissioned Maunsell to undertake the DBCT asset valuation. A copy of Maunsell's report was made available for public comment in early April 2004. Existing capacity is subject to existing contracts. Prime and the users are currently renegotiating access charges under existing user agreements. This price renegotiation only applies to existing agreements, with the new prices to apply from July 2004. If negotiations fail, the QCA may be asked to arbitrate the dispute.

While the draft access undertaking focuses on providing capacity and pricing arrangements, the QCA's investigation also covers non-price issues, such as conditions of access; the scope of the undertaking; provision for review; the negotiation framework; confidentiality requirements and the terminal regulations.

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Northern Territory

Utilities Commission of the Northern Territory

In late February 2004 the Utilities Commission issued its final determination implementing a revised price regulation methodology for the second regulatory control period. This followed the issue of a final methodology decision in November 2003 and a draft determination in January 2004.

The determination involves adoption of a price cap form of regulation based on a weighted average tariff basket. The effect of the determination is that, on average, network access prices are to escalate annually in line with the consumer price index less an X factor of 2 per cent, subject to no individual network user's tariff escalating by more than 5 per cent annually. The 2 per cent X factor comprises a 1¾ per cent industry-wide efficiency improvement allowance (X_1) and a ¼ per cent stretch factor (X_2) in view of the network service provider's lower-than-average efficiency levels. The value chosen for the X_1 factor is at the lower end of the observed range of relevant X values, in recognition both of the smaller size and dispersed nature of network service providers' operations and of the role that statistical errors may play in the underlying cost studies. The sum of these two X factors is less than the weighted average of the equivalent combined X factor of 3½ per cent that applied during the four years of the first regulatory control period.

In addition, an increase of 4.4 per cent in opening network access tariffs is being allowed in 2004–05 only, both on average and at the individual network user level, to ensure such tariffs at least recover the efficient costs of supply.

Network loss factors

The Utilities Commission's draft findings of its compliance review of the methodology used by Power and Water to calculate energy loss factors

for the 2000–01 and 2001–02 years were provided to the parties involved in October 2003. Power and Water has raised a number of substantive objections to the draft findings. The Utilities Commission is considering these objections in consultation with its technical advisers.

CSO valuation

In late February 2004 the Utilities Commission finalised its report advising the regulatory minister on the amounts of, and methods for, setting the community service obligations (CSOs) payable to Power and Water for electricity provision principally associated with the government's policies of uniform (franchise) retail tariffs across the territory and a below-cost (franchise) retail price cap in Darwin. While details of the Utilities Commission's recommendations are confidential, they imply a substantial increase in the value of the CSOs since the first valuation undertaken in 2001. This gives rise to a range of policy issues for the government.

Generation prices oversight

In September 2003 the government approved details of the oversight of Power and Water's wholesale generation prices proposed by the Utilities Commission following withdrawal of Power and Water's only competitor from the territory's electricity market. Against the background of the findings of the network reset and CSO valuation exercises, the Utilities Commission will now commence working with relevant parties on implementing the prices oversight.

Side constraints for pricing to contestable customers

On 27 February 2004 the government publicly announced its decision to impose a 3 per cent real-terms constraint on annual price increases for all contestable customers exiting their grace period on 31 March 2004. Arrangements applying to contestable customers who have already negotiated contracts of supply with Power and Water remain unchanged. The Utilities Commission will be responsible for monitoring Power and Water's compliance with the pricing order, giving effect to this 3 per cent real-terms price constraint.

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International

Commerce Commission, New Zealand

Telecommunications

In December 2003 the Commerce Commission provided its report to the Minister of Communications on unbundling. The Commission recommended:

- no unbundling of the local loop, on the basis that there were modest benefits compared to the cost
- unbundling of a bitstream service with limited functionality
- no unbundling of data tails, on the basis that Telecom had made a commercial offer which had the potential to resolve the issue.

The minister can accept or reject the recommendations, or refer the report back to the Commerce Commission.

In February the Commerce Commission released a position paper describing its proposed approach to implementation of the total service long run incremental cost (TSLRIC) pricing principle in the context of pricing reviews.

A TSLRIC methodology will be used to assist the Commerce Commission in making its final determinations relating to the pricing review applications filed by both Telecom and TelstraClear regarding the Commerce Commission's previous interconnection determination.

Electricity lines

In December 2003 the Commerce Commission issued final decisions on the thresholds for the declaration of control that will apply to lines businesses from 2004.

The Commerce Commission has decided to retain the two existing thresholds set in June 2003:

- a price path threshold, representing the expected annual change in lines business average prices
- a quality threshold, comprising a reliability criterion and a consumer engagement criterion.

However, for the price path threshold, new parameters will apply.

Distribution businesses will be assessed annually against the thresholds over a regulatory period of five years beginning on 1 April 2004. Distribution businesses with below average productivity, or with relatively high prices, will face a steeper price path than more productive businesses or those which have been consistently maintaining low prices. These better performing businesses will be able to retain more of the benefits of any efficiency gains that they can make.

The Commerce Commission has continued its work on the information disclosure requirements to support the thresholds regime. In December 2003 the Commerce Commission released draft information disclosure requirements for large electricity lines businesses, and a draft handbook for the valuation of system fixed assets owned by lines businesses using the optimised deprival valuation (ODV) method. The Commerce Commission intends to develop these requirements over time, with a major consultative review planned during 2004.

Gas pipelines inquiry

The Commerce Commission held a conference in September on its draft framework paper on the legal and analytical frameworks to be used in the gas pipeline inquiry.

The Commission intends to release a draft report of its findings around April 2004. That report will also set out the Commission's analytical framework on which it consulted during the quarter ending 31 December 2003. It will then invite written submissions and hold a conference on this draft report before providing its final report to the minister by 1 November 2004.

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Produced by the ACCC Publishing Unit 4/04