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Chronic under-investment in the rail sector: is there a need for an independent rail-subsidy authority?

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Much of the rail networks in Australia and in many other OECD countries seem to suffer from a problem of chronic under-investment. But why is this? I suggest that under-investment in rail is primarily a result of how government subsidies to the rail industry are administered. It has long been recognised that regulated firms investing in sunk assets are subject to a potential hold-up problem. If the government is short-sighted, it will reduce prices after the investment is made to benefit consumers. Governments solve this problem by delegating the regulatory task to an independent authority charged with giving due weight to allowing the regulated firm to recover the costs of prudent investment. Analogous problems arise with subsidies. A short-sighted government authority has an incentive to cut on-going subsidies after needed investment is made.
Viewing the problem in this way helps to understand why rail subsidies are usually tied to infrastructure projects and suggests potential solutions such as delegating responsibility for subsidy levels to an independent authority charged with maintaining the competitive balance between road and rail.

Introduction

On 1 December 2005 a headline in *The Age* newspaper announced that Victoria's rail freight network was 'on the brink of collapse'. This is just the latest in a long series of articles expressing concerns about the lack of investment in Australia's rail freight infrastructure (see box 1).

Concerns over under-investment in rail go back several years at least. In 1998 an inquiry by the House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform declared that the Commonwealth 'must address the chronic deficiencies in the national track infrastructure and must, as a matter of urgency invest in the national track'.[1] As shown in box 1, over the past 18 months many different authorities have pointed to problems from a long-term lack of investment in other parts of Australia's rail network.

If there is, in fact, a problem of chronic under-investment in the rail system, this would not be unique to Australia. Many other OECD countries have also experienced problems with chronic under-investment in rail.

For the purposes of this article I will take it as given that parts of the rail sector in Australia, and in many other (but not all) OECD countries, suffer from chronic under-investment. That is, for many years there have been socially valuable investment projects in rail which, for whatever reason, have not been carried out. Why is this? What is it about the rail sector that makes it prone to systemic under-investment, not just in Australia but in many other OECD countries?

What is the cause of chronic under-investment in rail?

Although there are potentially many causes of under-investment in rail, I wish to highlight the link between the provision of subsidies and an observed pattern of chronic under-investment. In particular, within Australia and around the world, paradoxically, it seems to be those networks that receive government subsidies that are most prone to chronic under-investment.

Within Australia there is a stark and dramatic contrast between the experience of the rail system in the eastern states of Australia and the iron ore railways in the Pilbara region of WA. The Pilbara railways are privately owned, vertically-integrated, self-funding and unregulated. They have achieved world-best productivity and efficiency levels, and have significantly increased their productivity over time. Kilsby, Laird and Bowers write:

> The iron ore railways in the Pilbara Region of WA were constructed in the 1960s with the expectation that each line would carry less than 10 million tonnes per annum (mtpa). Each of the two main lines (to Port Hedland and to Dampier) now haul in excess of 60 mtpa. Accommodating a surge of tonnage during the 1970s led to Australia becoming a world leader in rail heavy haulage with major advances in axle loads, performance, productivity and energy efficiency.[2]

In the *2001 Infrastructure Report Card* the Institute of Engineers rated these railways A+ (worlds best practice) on their scale of A-F. At the same time they rated much of the rail system in the rest of Australia as a D– citing 'the lack of Government commitment to adequately fund or encourage private sector investments in both rail passenger and freight infrastructure'.[3] Furthermore, the Pilbara railways have rapidly expanded their capacity in response to a recent increase in demand:

> There has been 'a rapid pick-up in transport capacity in response to strong global demand and prices. Accelerated investment in ship-loading and rail capacity has been undertaken over the past year to match expanding iron-ore production. Port capacity is estimated to have increased by 19 per cent since 2003, more than sufficient to support recent growth in iron ore exports. Company announcements suggest that another 15 per cent increase in transport capacity will come on line in the next two years, with further substantial expansion planned for later in the decade'.[4]

Even within the rest of Australia, those parts of the network that are self-funding seem to be better equipped than the remaining parts. For example, in Queensland, Engineers Australia rated the coal-related parts of the rail network (which are financially self-sufficient) as B+, but rated the non-coal regional rail networks as D+, citing in part problems of 'inadequate funding'.[5]

Looking across the OECD, the integrated, self-funding freight rail networks in the US broadly do not appear to suffer from a problem of under-investment[6] whereas there have been on-going complaints of chronic under-funding in the government-funded Amtrak passenger service. Long-term under-investment has repeatedly been noted as a problem in many rail systems in Europe.

Why does reliance on subsidies lead to under-investment?

It seems that government-subsidised rail networks often suffer from a problem of chronic under-funding and under-investment. But why is this? After all, we might have expected that public funding of an industry would be equally likely to lead to over-investment as under-investment. What is it about the presence of subsidies (or the way that they are administered) that seems to contribute to a problem of under-investment?

I argue that we can learn much about the causes of under-investment in subsidised industries by looking at the causes of under-investment in regulated (i.e. price-controlled) industries. Although there are occasional complaints about regulators deterring investment, important lessons have been learned about how to induce regulated firms to invest. These lessons include the need for regulatory authorities to be independent from government, and the importance of establishing a framework of regulatory incentives to induce productive efficiency and investment.

Yet, the lessons that have been successfully applied in the context of regulation have not been extended to the task of subsidisation. The next sections recall the potential for under-investment in regulated industries and discuss how the solutions might apply in the context of a subsidised industry.

Overcoming the 'administrative hold-up' problem

Most regulated firms must make substantial sunk investment in durable, specific assets. The return on this investment, once made, is highly dependent on government decisions, especially decisions over regulated prices. Levy and Spiller explain the problem as:

> The combination of significant investments in durable, specific assets with the high level of politicization of utilities has the following result: utilities are highly vulnerable to administrative expropriation of their vast quasi-rents. Administrative expropriation may take several forms. Although the easiest form of administrative expropriation is the setting of prices below long-run average costs, it may also take the form of specific requirements concerning investment, equipment purchases, or labour contract conditions that extract the company's quasi-rents. Where the threat of administrative expropriation is great, private investors will limit their exposure.[7]

Private investors can limit their exposure either by simply not investing or by selecting technology that (although implying lower quality and/or higher operating costs) requires a lower level of specific investment.

In short, the problem is that, due to the pressures of the political cycle, the government is induced to take a short-term perspective. It cannot commit itself to not reducing regulated prices in the future and thereby expropriating the investment of the regulated firm. Awareness of this regulatory risk drives up the required rate of return and the cost of capital, dramatically reducing investment.[8] The inability of the government to commit leads to a classic 'time inconsistency' or 'hold-up' problem.

Historically, faced with under-investment by the regulated private sector, one solution has been direct government funding of parts of the infrastructure. Another possible solution has been public ownership of the regulated firm as a whole. Both of these approaches have significant drawbacks which are discussed further below.

More importantly, this commitment problem can also be solved by delegating responsibility for setting tariffs to an authority independent of the government, responsible for ensuring that the regulated firm at least receives an adequate return on its investment. By delegating the tariff-setting task to an independent authority, the government can insulate the regulator from political pressures. This 'depoliticisation' allows the government to effectively make a commitment to the regulated firm that it will not expropriate its investment in the future.

Precisely this argument was used to establish independent price control authorities in Australia. Specifically, it was argued that establishing the Queensland Competition Authority would 'depoliticise' the price-setting process.[9]

Regulation is not the only area in which governments have discovered the benefits of committing themselves (effectively 'tying their own hands') by delegation to an independent authority. Another example is the delegation of monetary policy to an independent central bank. In the absence of such delegation, short term political pressures give rise to an 'inflation bias' in monetary policy. Delegation of monetary policy to an independent central bank is now considered to be part of sound economic policy. But as Levine et al. note:

> The hold-up problem in regulation turns out to be more serious than the inflation bias problem in monetary policy in that the reputational equilibrium is far more difficult to sustain. This makes more attractive the solution to strategically delegate to independent regulatory agencies.[10]

There is some evidence to suggest that regulatory independence is, in fact, linked to higher rates of investment in practice:

> Wallsten (2002) finds that installing a regulatory agency separate from the relevant Ministry before privatisation is positively and significantly associated with several indicators of investment … The study of 86 non-OECD countries by Fink, Mattoo and Rathindran (2003) … finds that the existence of an independent regulatory authority significantly augments the (positive) effect on mainline penetration of competition and privatisation … Gutierrez (2003) estimates the effect of a 7-item index of regulatory governance on mainline density and efficiency for 22 Latin American and Caribbean countries. He finds that both the index and the three main sub-components have a positive and significant effect … on mainline penetration, after controlling for competition and privatisation.[11]

Some commentators have observed that when a government is directly involved in tariff-setting a cycle in government policy towards the regulated industry is likely to emerge. The chronic under-investment results in declining service quality and increasing capacity constraints. Eventually this results in political pressure to change the system in some way. This reform inevitably allows an increase in the regulated prices, leading to new investment. At this stage, the cycle of under-pricing and under-investment begins again. José Gómez-Ibánez has offered a detailed explanation of how this cycle operated in the passenger bus industry in Sri Lanka[12].

The implications of this discussion for subsidy policy should be clear. Although it is now broadly accepted that tariff-setting should be delegated to an independent authority, most governments have not adopted the same policy for subsidies. Instead, subsidies and funding level are typically decided by the government itself.

In the absence of an independent authority charged with setting an efficient level of on-going subsidies into the indefinite future, investors in the subsidised firm will fear a cut in subsidies in the future, effectively expropriating their investors. To compensate for this risk they will require a much higher 'hurdle rate' for new investment, leading to a problem of chronic under-investment.

As noted above, governments may respond to this under-investment problem in two ways: by directly funding certain infrastructure projects or by government ownership of the subsidised firm. Direct funding of certain infrastructure projects carries its own risks. There is no guarantee that the overall level of investment is appropriate or that the right projects are funded. Large high-profile projects which attract media attention may be funded at the expense of smaller, less visible, but valuable upgrades of existing services.

With direct government control of subsidies the industry is likely to experience the 'cycle' noted above—under-investment leads to declining service quality and capacity constraints, leading to a crisis and calls for major reform. The reform will lift the level of subsidy, starting the cycle again. There is at least some suggestion that such a cycle could be occurring in the rail sector. In both Sweden and the UK, for example, recent reforms of the rail sector led to an increase in the size of the subsidy for rail. A key question in both countries is whether this level of subsidy can be maintained or whether under-investment will recur.

As before, the basic problem is the on-going discretion of the government over the levels of subsidy. The solution is the elimination of that discretion, through delegation of the subsidy policy decision to an independent authority that would ensure a level of subsidy consistent with the subsidised firm earning a normal rate of return on its investments.

This policy would restore the incentive for the subsidised firm to invest. A secondary benefit is that it would enhance the efficiency of subsidy funds. Rather than subsidies being directed at specific infrastructure projects, subsidies for the rail sector could be targeted as part of an overall regulatory incentive mechanism. In particular, if the objective of the subsidy is to increase the share of the rail mode in the overall transport mix, the subsidy could be targeted to freight traffic which is the most 'marginal' on the rail mode, allowing the government to better achieve its modal-shift objectives for a given level of subsidy spending.

Not wanting to throw 'good money after bad'

Delegating the task of setting tariffs or subsidies to an independent authority is a significant step towards improving the conditions for investment. However it does not, in itself, guarantee that an optimal level of investment will emerge. Among other things, the independent authority must allow the subsidised/regulated firm an adequate rate of return, taking into account the risks to which the firm is exposed. These cost-of-capital issues are well-known and regularly hotly debated between regulators and regulated firms.

However, setting an adequate weighted average cost of capital (WACC) is not the only requirement for achieving an efficient level of investment. The regulated firm must also have an explicit incentive to maintain or expand its service quality or quantity.

Without explicit incentives to enhance the range or quality of services, the regulated tariffs may prove to be too low to justify further investment, but at the same time the regulator may be reluctant to raise tariffs without any certainty that the investment will be made.

Furthermore, without incentives for productive efficiency, the regulator might argue that the funds for needed investment should come from internal efficiencies and cost savings—in effect attempting to use the need for new investment as an incentive to induce productive efficiency. However, this approach in itself is unlikely to yield strong incentives for productive efficiency. The firm could simply respond by allowing the quality or quantity of services to decline.

If a regulator is unsure whether needed investment will be made, it is unlikely to offer a tariff sufficient to permit such investment. Therefore, to ensure an adequate level of investment effective regulatory incentives for maintaining and expanding the range and quality of services and maintaining and enhancing productive efficiency are needed.

Exactly the same issues arise with subsidies. A subsidy authority may recognise that additional investment is required, to enhance the quality or range of services, but may not be able to guarantee that any increase in subsidy will be used for that purpose (and not just increase the profitability of the subsidised firm). A subsidy authority which cannot guarantee that an increase in subsidy funding will be directed at increasing investment is unlikely to grant such an increase. Therefore, an adequate level of investment needs effective regulatory incentives for maintaining and expanding the range and quality of services, and maintaining and enhancing productive efficiency.

This argument suggests that the problem of under-investment in subsidised industries is, in part, the result of a regulatory failure—the failure to establish the right incentives for the use of the subsidy funds. Presumably, if the subsidy authority established the right incentives for efficiency and productivity, governments would be more willing to provide the needed subsidies.

Do subsidies 'crowd out' private investment?

Delegating the task of administering subsidies to an independent authority which (a) allows the firm an adequate return on its investment and (b) establishes effective incentives to maintain productive efficiency and the range and quality of services is likely to significantly improve the under-investment problem. However, there is at least one more potential problem that might lead to under-investment.

A regulated firm may be reluctant to invest today if, in so doing, it can increase the credibility of its claim for higher regulated tariffs in the future. If the level of allowed revenue of a regulated firm depends in part on the assessed future 'need' for investment, the regulated firm may have an incentive to under-invest (or to invest in inappropriate projects), to maximise the perceived 'need' for investment and therefore the level of future allowed revenue. For example, an electricity transmission company may not invest in building out transmission constraints today if it believes that it will receive more funding for building out the same transmission constraints in the next regulatory review.

Again, there is a close analogy here with the incentives faced by a subsidised firm. A subsidised firm may choose to under-invest today if it believes that doing so will increase its chances of increasing the level of subsidies in the next subsidy review. In effect the possibility that subsidy funds will increase

in the future 'crowds out' the private investment of the firm.

The solution is to develop regulatory mechanisms that ensure the incentives to invest are maintained. In part, this will require decoupling of the level of subsidy from the investment choices of the regulated firm.

Solutions to the under-investment problem

I have argued that the problem of under-investment in rail is linked to reliance on government subsidies and the way those subsidies are administered. By viewing the task of administering subsidies as a 'regulatory' problem we can gain insights into why chronic under-investment may occur and what can be done about it. The above discussion suggests the following possible solutions:[13]

1. ***Remove the government discretion over the level of funding for the rail sector***

   I have argued that direct government control over funding levels affects long-term investment similarly to direct government control over prices in a regulated industry. Part of the solution must therefore include the 'depoliticisation' of the subsidy process through some form of commitment to not directly controlling the subsidy levels.

   It may be theoretically possible to remove that discretion through, say, a government commitment to a long-term subsidy path. But, as with a long-term commitment to a regulatory price-path, it is likely to be difficult for a government to make a credible commitment (perhaps through a tendering process) to a given subsidy path for more than a relatively short period of, say, five years.

   In my view, the most promising solution is to delegate the task of setting the subsidy level to an independent authority charged with maintaining subsidies high enough to allow the subsidised firm to earn an adequate return on its investment and with achieving a specified outcome (such as maintaining the competitive balance with road).

   The original reform of the rail sector in the UK did, in fact, have an arrangement of this kind—that is, it delegated much responsibility for determining subsidy levels to the Rail Regulator. Under the UK approach, the regulator would determine the investment requirements of RailTrack which would then affect the level of the track access charges. Changes in the access prices, in turn, affected the amount of subsidy paid by the government to the train operating companies. In this way, the regulator indirectly determined the subsidy payments of the British Government. In principle, this system could have allowed the government to remain somewhat detached from the process of determining the level of subsidies and how the money was to be spent.

   In practice, the system turned out to be unsustainable. After the state of the RailTrack network became apparent, there was a need for significantly increased maintenance and renewal investment. The government could not tolerate large increases in the subsidy demands and eventually effectively renationalised RailTrack.

   This experience shows that independent setting of subsidy levels is politically sensitive. Possibly, with the benefit of hindsight, the regulator should have shared more risk with RailTrack to ensure that the subsidy payments would not balloon (as they did) when there was an adverse outcome. In effect, the regulator did not protect the 'consumer' (in this case the government) against rapid changes in the price it was paying. It is possible that, with the benefit of hindsight, it would have been possible to develop a regulatory mechanism that placed more risk on RailTrack and insulated the government to a greater extent from rapid changes in the rail subsidy.

   Governments are, perhaps inevitably, particularly sensitive as to who has control over the 'purse strings'. However, government spending in many areas is not precisely determined in advance. For example, government expenditure on, unemployment benefit depends on the number of unemployed which is not known with certainty in advance. In the same way, under this proposal the government would not necessarily know with certainty the precise level of subsidy for the rail industry. However, with an effective regulatory mechanism the government may be able to develop confidence that the subsidy demands are reasonable and the subsidies utilised efficiently.

2. ***Treat the provision of subsidies similarly to a sophisticated regulatory problem with the same concern for the establishment of the correct long-term incentives***

   I have argued that achieving efficient levels of productivity, service quality and investment in the rail sector requires not just efficient levels of subsidy but also effective mechanisms to ensure that rail providers have an incentive to improve quality, efficiency and to continue to invest. The subsidy problem should be treated analogously to a classic regulatory problem. This may mean using the mechanisms devised to establish effective regulatory incentives such as benefit sharing arrangements or yardstick competition.

   Once the government has committed to a given subsidy level by delegating the task to an independent authority, it may choose precisely how the subsidies will be implemented. In particular, the rail subsidies could be targeted to reduce rail freight tariffs for certain categories of end-users—notably, those categories of rail freight that are most marginal on the rail mode and most likely to respond to changes in the rail freight price through increases in rail volumes.

   Furthermore, it is likely that this regulatory task could be enhanced by permitting competition in the provision of train services. Such competition has several advantages. First, it reduces the risk that rail subsidies will simply enhance the returns of train operating companies, without being used to enhance infrastructure provision. Second, it improves the incentives for efficiency and innovation in train services, reducing the burden on the regulatory regime to deliver these incentives. Vertical structural separation may also have a role to play in facilitating such competition.

Conclusion

Chronic under-investment seems to be a feature of rail networks that rely on external funding. I argue that the basic problem is that the task of subsidisation has not been treated by governments as a regulatory task. As a result, governments have retained direct control over subsidy levels, even though they have for some time delegated direct control over price setting in other industries to independent bodies. In addition, governments have not given attention to designing incentive mechanisms to ensure desirable outcomes in subsidised sectors, as have been adopted in other regulated industries. As a consequence, subsidised industries have suffered from chronic under-investment. The experience in the UK suggests that delegating control over subsidies to an independent body is politically sensitive but the difficulties are not necessarily insurmountable.

Box 1: Under-investment in the rail sector in Australia and other OECD countries

In recent months, concerns have been raised about a lack of investment in Australian infrastructure industries in general, and the rail sector in particular.
For example:

- In August 2004 the Australian Council for Infrastructure Development commissioned Econtech to prepare a report on the economic effect of under-investment in Australian infrastructure, which identified $8 billion worth of economically justifiable projects in the rail sector that have not been carried out.[14]
- The Reserve Bank of Australia in its monetary policy statement of February 2005 noted concerns that 'a lack of capacity in transport infrastructure is constraining the ability of the resources industry to expand export supply'.[15]
- In March 2005 the Business Council of Australia released a report by Port Jackson Partners which highlighted problems in various infrastructure areas, including long-distance interstate rail freight transport.[16]
- In May 2005, the report to the Prime Minister of the Exports and Infrastructure Task Force noted that 'in the absence of decisive policy action, significant infrastructure bottlenecks constraining Australia's exports are likely to develop over the next five to 10 years. The areas of principal concern are port channels, road and rail access to major ports and rail track'.[17]
- In May 2005 in a presentation to the BTRE Transport Colloquium 2005, David Gargett identified as a major problem with future provision of freight infrastructure 'un- or under-funded growth leading to chronic constraints on networks'.
- In June 2005, a report of Engineers Australia on the quality of infrastructure in Victoria, rated Victoria's rail network C– overall and D for freight, noting that 'The overall rail rating of C– is a result that owes much to good sustainability and the relatively high performing suburban light and heavy rail but masks the very poor country freight lines which remain at a level of D or less'.[18]

General concerns over a lack of investment in infrastructure have become particularly acute as capacity constraints in the coal logistics chains in Queensland and NSW have limited the ability of coal mines to increase coal export volumes in response to a rapid increase in the world demand for coal. Capacity constraints have emerged, in particular, at Dalrymple Bay in Queensland and in the Hunter Valley/Port Waratah coal logistics chain in NSW, despite a substantial recent and forecast increase in the capacity of the ports and the rail network.[19]

A mere lack of investment is not necessarily a sign of under-investment. In a declining industry, there may be few or no socially-valuable investment opportunities. In a declining industry it may be socially efficient to simply allow the existing capital stock to run down. There are probably some rail lines in Australia that it would be inefficient to renew or replace. The lack of investment in these rail lines is not evidence of under-investment.

Similarly, the emergence of capacity constraints is not, in itself, evidence of under-investment. In a market in which demand is volatile, or for which capacity must be added in discrete lumps, it is likely that episodes of capacity constraints will periodically emerge even on a fully efficient expansion path. Whether or not expansion of the coal networks in NSW and QLD is justified depends on several factors including the sustainability of current levels of demand for coal. In any case, the coal export networks in Queensland and NSW have expanded capacity significantly over the past few years and further expansions are planned.[20]

Nevertheless, there seems to be a consensus that there is a long-term lack of investment in other parts of Australia's rail network.[21] But what exactly are the socially-valuable projects that have not been carried out in a timely manner? In 2001 the ARTC carried out an audit of the interstate rail network at the request of the Federal Minister for Transport and found that projects with a total cost of $507 million would provide benefits to the Australian community of $1.5 billion—that is, a benefit–cost ratio of 3:2. The projects identified by the ARTC include improvements in freight movements in the Sydney region, and in signalling, longer passing loops, removal of height limits and an improved planning and operations management system.[22] Other commentators cite the need to straighten track to accommodate higher train speeds.[23] In addition Philip Laird points out that 'four federal inquiries . . . found that there is a demonstrated need to upgrade 'substandard' mainline track between Melbourne, Sydney, Brisbane for Fast Freight Trains'.[24]

As already noted, if there is in fact a problem of chronic under-investment in the rail system in Australia, this would not be unique to Australia. Many other OECD countries have also experienced problems with chronic under-investment in rail.[25] In many OECD countries, a primary driver of the substantial reforms in the rail sector that have been carried out over the past decade has been a concern over under-investment, often combined with rising subsidies and low productivity.

Telecommunications

Telstra's unconditioned local loop service (ULLS) and line sharing service (LSS) undertakings

In December 2005 the ACCC issued its final decision rejecting Telstra's ULLS and LSS monthly charges undertakings. The ACCC also released a draft decision to reject Telstra's ULLS and LSS connection charges undertakings.

These two services allow access to the most basic elements of Telstra's customer access (copper) network. They are considered key inputs into the development of infrastructure-based competition in Australian telecommunications and can be used by all telecommunications companies to provide a wide range of services to end users.

The ACCC has formed the view that the monthly access charges proposed by Telstra are higher than what is required to recover these costs in full. The key issue in dispute is the way the $5 million in costs should be recovered. The ACCC considers Telstra's approach—recovering them over too few services—leads to unreasonably high charges distorting competition and investment outcomes.

In January 2006 the ACCC released a discussion paper on Telstra's latest ULLS monthly charge access undertaking. Telstra withdrew its ULLS connection charge undertaking provided to the ACCC on 13 December 2004. The ACCC had issued a draft decision in December 2005 to reject that undertaking. It will now not be able to make a final decision on that undertaking.

A significant change made by Telstra in its new undertaking is its proposal that a single averaged $30 monthly charge be levied in all geographic areas for the period 2006–08. Previous Telstra undertakings have proposed different prices for different geographic regions.

Telstra claims a single average charge for ULLS for all regions is needed for it to meet the government's retail price parity requirements for basic line rental products.

The discussion paper gives interested parties the opportunity to comment on Telstra's proposed monthly price and supporting arguments.

Telstra has not withdrawn its LSS connection and disconnection charge undertaking. The ACCC continues to seek submissions on its recently issued draft decision on Telstra's connection and disconnection undertakings.

Access disputes

The ACCC is vested with powers to arbitrate telecommunications access disputes and make a final binding determination to resolve a dispute. Arbitration hearings are conducted in private and the ACCC generally does not make any public comment on disputes except to announce when a dispute has been notified.

ULLS access disputes

Access disputes in relation to the ULLS notified to the ACCC under Part XIC of the Trade Practices Act (the Act) for the October 2005–March 20, 2006 period.

- Optus Networks Pty Limited notified the ACCC of an access dispute with Telstra Corporation Limited.
- November 2005—Chime Communications Pty Ltd notified the ACCC of an access dispute with Telstra Corporation Limited.
- March 2006—Primus Telecommunications Pty Limited notified the ACCC of an access dispute with Telstra Corporation Limited.
- March 2006—XYZed Pty Limited notified the ACCC of an access dispute with Telstra Corporation Limited.

The ULLS involves the use of unconditioned cable, primarily copper pairs, between end users and a telephone exchange. The declared ULLS is being used by access seekers to support and connect to their own infrastructure for the supply of new and innovative voice and data services, such as those involving voice over IP and digital service line (DSL) technologies.

The ACCC has commenced the arbitration process for these access disputes.

Optus has also withdrawn an earlier notification of an access dispute with Telstra about the ULLS. The ACCC will therefore not be making a determination about that notification.

LSS access disputes

Access disputes in relation to the LSS notified to the ACCC under Part XIC of the Act for the October 2005–March 20, 2006 period are:

November 2005

- Chime Communications Pty Ltd notified the ACCC of an access dispute with Telstra Corporation Limited. This access dispute is about price and non-price terms of supply.

March 2006

- Amcom Pty Limited notified the ACCC of an access dispute with Telstra Corporation Limited. This access dispute is about the connection and disconnection charges associated with the supply of the line sharing service from Telstra to Amcom.

The line sharing service involves an access provider providing a voiceband PSTN service to an end-user, whilst providing access to another carrier (the access seeker) to simultaneously provide services to the same end-user over the high-frequency portion of the unconditioned local loop.

The ACCC has begun the arbitration process for these access disputes.

Domestic transmission capacity service access dispute

In November 2005 Chime Communications Pty Ltd notified the ACCC of an access dispute with Telstra Corporation Limited.

The domestic transmission capacity service is a generic service that can be used for the carriage of voice, data or other communications using wideband or broadband carriage. Carriers or carriage service providers can use transmission capacity to set up their own networks for aggregated voice or data channels, or for integrated data traffic such as voice, video and data.

The ACCC has begun the arbitration process for this access dispute.

Mobile terminating access service (MTAS) access disputes

In October and November 2005 the ACCC released interim determinations, together with the statements of reasons, in nine telecommunications MTAS arbitrations.

The arbitrations involved the following parties:

- AAPT Ltd (access seeker)—Vodafone Network Pty Ltd (access provider)
- Hutchison Telecommunications (Australia) Ltd

(HTAL) (access seeker)—Vodafone Network Pty Ltd (access provider)

- Hutchison 3G Australia Pty Ltd (H3GA) (access seeker)—Vodafone Network Pty Ltd (access provider)
- PowerTel Ltd (access seeker)—Vodafone Network Pty Ltd (access provider)
- Primus Telecommunications Pty Ltd (access seeker)—Vodafone Network Pty Ltd (access provider)
- AAPT Ltd (access seeker)—Optus Networks Pty Ltd, Optus Mobile Pty Ltd & Optus Vision Pty Ltd (access provider)
- HTAL (access seeker)—Optus Networks Pty Ltd, Optus Mobile Pty Ltd & Optus Vision Pty Ltd (access provider)
- H3GA (access seeker)—Optus Networks Pty Ltd, Optus Mobile Pty Ltd & Optus Vision Pty Ltd (access provider)
- PowerTel Limited (access seeker)—Optus Networks Pty Ltd & Optus Mobile Pty Ltd (access provider).

Under the Act the ACCC may make an interim determination in a dispute before making a final determination.

The interim determinations set out the charges to be paid by the access seekers for the supply of the MTAS, except when agreed otherwise by the parties. The statements of reasons set out the ACCC's reasons for the interim determinations.

The domestic MTAS is a wholesale input, used by providers of fixed-to-mobile and mobile-to-mobile calls, to allow their customers to call mobile phone users. It allows consumers (either fixed-line or mobile) to call mobile users connected to another network. The carrier whose customer initiates the call pays the carrier whose customer receives the call for the MTAS.

MTAS access disputes notified to the ACCC under Part XIC of the Act for the October 2005–March 20, 2006 period are as follows:

February 2006

- HTAL and H3GA each notified the ACCC of an access dispute with Telstra Corporation Ltd.
- Telstra Corporation Ltd notified the ACCC of an access dispute with Vodafone Network Pty Ltd.

January 2006

- AAPT Ltd notified the ACCC of an access dispute with Vodafone Network Pty Ltd.
- Optus Networks Pty Ltd notified the ACCC of an access dispute with Telstra Corporation Ltd.

December 2005

- Telstra Corporation Ltd notified the ACCC of an access dispute with Optus Mobile Pty Ltd and Optus Networks Pty Ltd.
- Telstra Corporation Ltd notified the ACCC of two access disputes, with HTAL and H3GA respectively.
- HTAL and H3GA each notified the ACCC of an access dispute with Vodafone Network Pty Ltd.

The ACCC has begun the arbitration processes for these access disputes.

Hutchison MTAS access undertaking

On 7 October 2005 Hutchison Telecommunications (Australia) Limited (HTAL) and Hutchison 3G Australia Pty Ltd (H3GA) (together Hutchison) lodged six ordinary access undertakings with the ACCC relating to the MTAS. Three of the undertakings have been submitted on behalf of HTAL and the remaining three on behalf of H3GA. Hutchison provided a submission in support of the undertakings on 13 October 2005.

The prices proposed by Hutchison in its undertakings differ depending on whether a call is made from a public mobile telecommunications system (PMTS) network or a fixed line (non-PMTS) network. The terms and conditions upon which access is granted to the service also differ according to which network a call is made from.

In November 2005 the ACCC issued a discussion paper on the undertakings.

The ACCC is considering the undertakings and expects to release a draft decision in relation to all of the undertakings shortly.

Optus MTAS access undertaking

On 23 December 2004 Optus lodged an ordinary access undertaking with the ACCC relating to the supply of its digital GSM terminating access service (DGTAS)—a subset of the MTAS.

Optus' proposed price terms are based on a model that estimates the 'forward-looking long-run incremental cost' of Optus supplying its DGTAS, plus two mark-ups: one to reflect the recovery of 'fixed and common costs' based on Ramsey-Boiteux principles and one for the inclusion of a network externality surcharge. Optus proposed two different options for the price of the service to effectively trend towards this estimate.

The ACCC released a discussion paper on Optus' DGTAS undertaking on 25 February 2005. The ACCC announced its draft decision to reject the Optus access undertaking in November 2005. The ACCC rejected the undertaking because it considered the target price estimated by Optus was substantially above the cost of supplying this service.

In February 2006 the ACCC announced its final decision in rejecting the Optus access undertaking. This decision was made on the grounds that the target price estimated by Optus was substantially above the cost of supplying this service. The ACCC remains concerned with the theoretical underpinnings of the methodology employed by Optus' consultant and the application of this methodology. The ACCC also has concerns with some of the inputs used to generate the Optus estimate of 17 cents per minute (cpm) for 2007.

On 20 February 2006 Optus applied to the Australian Competition Tribunal for review of the ACCC's decision to reject the Optus access undertaking.

Vodafone MTAS access undertaking

On 23 March 2005 Vodafone submitted an ordinary access undertaking with the ACCC in respect of the supply of the MTAS on its GSM network.

Vodafone's proposed price terms were based on modelling that estimated the 'forward-looking efficient economic costs' of Vodafone supplying this service using a 'fully allocated top-down cost model' was 16.15 cpm. Based on this estimate, Vodafone proposed that the access price of the MTAS on its 2G network should trend toward a target price of 16.15 cpm over the period 2005–2007.

In December 2005 the ACCC announced its decision to reject the access undertaking submitted by Vodafone with respect to supply of the MTAS on its second generation GSM network. The ACCC has a number of concerns with application of the methodology and concerns with some of the inputs used by PricewaterhouseCoopers to generate its estimate. The ACCC also had concerns with some of the specific requirements on fixed-network operators to pass-through changes in the MTAS price to end-users making fixed-to-mobile calls.

The ACCC expects to make a final decision in relation to the Vodafone access undertaking shortly.

ACCC initiates broad ranging strategic review of fixed network services

In December 2005 the ACCC announced an inquiry that would examine the future regulation of certain key fixed network and wholesale services and issued a discussion paper seeking industry and public views.

The inquiry is a result of the ongoing need to review a number of existing declarations of certain fixed services, as required by the Trade Practices Act. These reviews must be completed during 2006.

The ACCC inquiry will also look at the broader question of whether regulation of certain fixed services is required. This will include looking at what combination of services may still need to be regulated, having regard to emerging market, technological and network developments.

The adoption of such a broad inquiry departs somewhat from the ACCC's traditional approach of reviewing declarations individually. However, in addition to the price parity issues noted above, there is currently before the ACCC a range of related issues which, taken together, strongly suggest that the assessment of the need and form of regulation are best undertaken jointly.

These current and emerging developments are:

- the pending expiry of declarations of a number of key network services, in particular the ULLS; the domestic public switched telephone network originating and terminating access (domestic PSTN OTA) services, and the local carriage service (LCS)
- Telstra's recent announcements regarding its plans to introduce a IP core network, and indications it will consider rolling out 'fibre-to-the-node' (FTTN) covering some four million addresses
- the continued evolution of potential substitute technologies such as new generation mobile and other wireless services and their impact on the sustainability of the existing fixed customer access bottleneck
- on-going competition concerns surrounding the wholesale supply of certain currently non-declared services such as wholesale line rental (WLR) service, and various forms of wholesale DSL services.

Broadband snapshot—December quarter 2005

In March 2006 the ACCC released its latest 'Broadband Snapshot', which details the deployment of broadband services throughout Australia as at 31 December 2005.

The report is based on data provided by major carriers of broadband services and includes aggregated data in relation to the availability of broadband services and gives estimated numbers of services in operation in respect of cable, satellite, asymmetrical digital subscriber line (ADSL), other DSL and miscellaneous offerings. However, not all broadband providers are included in the ACCC's survey.

The main findings of the survey are:

- At the end of December 2005 there were 2 884 500 broadband services connected across Australia.
- The take up of ADSL services continues to be significant, with more than 2.1 million ADSL service connections in the December 2005 quarter.
- Consistent with the results observed in the September 2005 quarter, the annual growth in satellite broadband uptake continues to be strong, at 73 per cent for the year to 31 December 2005.

Enforcement work

Investigations

In relation to telecommunications, the ACCC made progress with five in-depth investigations and commenced two new in-depth investigations during the period October 2005 to March 2006. During the same period one consultation notice was issued and three in-depth investigations were finalised.

Transport and prices oversight

Airports price monitoring and financial report

On 14 February 2006 the ACCC released *Airports price monitoring and financial reporting 2004–05*. The report provides information on the prices, costs and profits of Adelaide, Brisbane, Canberra, Darwin, Melbourne, Perth and Sydney airports.

This is the third year of the ACCC's role limited to price monitoring of airport charges. Prior to this, aeronautical charges were subject to price caps and prices surveillance. The removal of price caps and prices surveillance means airports are no longer required to notify the ACCC before increasing charges for aeronautical services.

The report shows that aeronautical revenue per passenger increased by between 50 and 228 per cent between 2000–01 and 2004–05. However, in 2004–05 increases in average revenue were less (up to 11 per cent).

In 2004–05 the change in average airport costs ranged from reductions of 8.8 per cent to increases of 21 per cent. Greater security requirements at airports since 2001 contributed to these increases. However, the increases in unit costs since 2000–01 are small in comparison with the price rises and, combined with increased traffic, the ACCC reported significant increases in several measures of airport profitability. Aeronautical margins, as well as returns on assets, generally increased.

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

Australian Energy Regulator (AER)

Pass-throughs and revenue cap re-openers—position paper

On 21 December 2005 the AER released a position paper on pass-throughs and revenue cap re-openers in order to clarify its position for the Powerlink review process. That paper considered approaches available to the AER to vary a transmission network service provider's (TNSP's) revenue cap allowance within a regulatory period in response to exogenous events. In the position paper, the AER indicates a preference for replacing the revenue cap re-opener provisions specified in the *Statement of principles for the regulation of electricity transmission revenues (SRP)* with pass-through arrangements. A copy of the SRP is available on the AER website: http://intranet.accc.gov.au/content/index.phtml/itemId/660012.

On 16 February 2006 the Australian Energy Market Commission (AEMC) released its Draft National Electricity Amendment Rule in which the AEMC proposes to adopt substantially the same pass-through categories as set out in the AER discussion paper.

The AER has suspended its consideration of this matter pending finalisation of the AEMC's review.

Regulatory accounting methodologies—position paper

As reported in *Network 21*, the AER released a position paper on regulatory accounting methodologies. The AER's preliminary position was in favour of all TNSPs in the national electricity market (NEM) applying an 'as-incurred' accounting approach. The AER sought public comments and expected to release a decision in early 2006.

The primary consideration in finalising the choice of regulatory accounting methodology is the impact on the capex incentive framework in the SRP. The AEMC has recently released draft rule change proposals as part of its review of electricity transmission regulation. These draft rule change proposals have amended the SRP capex incentive framework by removing the reward or penalty on an under-spend or overspend, respectively, for the return of capital.

The AEMC's proposals may have implications for the final approach adopted by the AER. Accordingly, the AER has decided to delay the release of a decision on regulatory accounting methodologies until the AEMC has finished its process.

Regulatory test rule change proposals

On 24 February 2006 the AER submitted two submissions to the AEMC on the following Ministerial Council on Energy (MCE) rule change proposals.

Reform of regulatory test principles

The AEMC has extended the deadline for its draft determination on the creation of regulatory test principles until 17 August 2006. The AER will monitor the progress of this proposed rule change closely, particularly in light of the strengthened links between the regulatory test and the revenue cap decision making process that have been included in the AEMC's draft rule for chapter 6 of the National Electricity Rules.

Reform of dispute resolution process for the regulatory test

The AEMC has issued its draft determination in relation to regulatory test dispute resolution. Submissions on the draft rule are due on 2 June 2006. The AER will be making a submission on the draft rule in due course. The AER previously submitted that further progress to clarify the definition of a reliability augmentation is required to assist in the timely resolution of reliability augmentation disputes, as well as revenue regulation.

AER submission in response to the MCE consultation paper on a national framework for energy distribution and retail regulation

The MCE has agreed to transfer economic regulation of distribution networks to a national regime by 1 January 2007. Enabling legislation for the transfer of specified retail and distribution functions to national regulatory arrangements is scheduled for development by the end of 2006.

In January 2006, the AER made a submission in response to the MCE's consultation paper 'Public Consultation on a National Framework for Energy Distribution and Retail Regulation'.

The AER's submission discusses consistency in price regulation arrangements across gas and electricity, and across transmission and distribution. It also considers service standard incentives and notes that service performance incentive mechanisms are a necessary component of incentive-based economic regulation, and should be incorporated into the national regulatory framework. The submission also considers the consultation paper's proposal for governments to issue mandatory directions to the AER on certain matters. The submission suggests that any jurisdiction-specific arrangements which are put in place should be subject to some form of oversight.

In November 2005 the MCE established an expert panel to advise on a model to achieve a common approach to revenue and network pricing across the energy market. The panel provided its final report to the MCE on 13 April 2006. The MCE will implement the panel's recommendations for transmission and distribution revenues and network pricing through amendments to the gas and electricity legislative frameworks.

AEMC Chapter 6 Review

On 16 February 2006, the AEMC released its draft rules governing electricity transmission network revenue regulation. The requirement for the AEMC to review this section of the National Electricity Rules is a legislative requirement, pursuant to the National Electricity Law.

The AER provided the AEMC with a submission on the draft rules on 24 March 2006, a copy of which is available from the AER's website.

In part the draft rules reflect current regulatory practice, in other areas they represent a significant change in approach. The AER supports changes that move towards best practice regulation or address problems with current arrangements. However, the AER's submission expresses concern that the AEMC has not explained its reasons for the substantial changes proposed, either in terms of identifying problems with current practice, or explaining how its changes will address the problems.

The AER's comments fall into four main categories:

- the impact of the proposals on incentives for efficient expenditure
- the balance between regulated businesses users
- the capacity of the regulator to flexibly respond to the individual circumstances of each transmission business and to changing circumstances over time
- transparency.

The AER's submission covers these issues in detail and also provides an analysis of other elements of the AEMC's package, including the new definition of prescribed services.

MCE expert panel

On 13 April 2006, the final report of the MCE expert panel's review of energy access pricing was released. The AER had previously lodged a submission in response to the draft report of the expert panel. The submission noted that the adoption of the panel's recommendations would improve the regulation of Australia's energy infrastructure and have subsequent benefits for users and service providers.

In summary the AER:

- agreed that separate legislative regimes should exist for gas and electricity, although with a common objective and structure
- supported the recommendation that objectives for both regimes should be to promote economic efficiency
- agreed that methodologies and guiding principles should exist for applying price and revenue caps
- argued that the process for choosing the form of regulation should be set in law, and that the body responsible for advising on coverage decisions (currently the National Competition Council) be responsible for recommending the form of regulation in the case of gas networks to the relevant minister as decision maker
- supported the concerns with the propose-respond model highlighted by the expert panel
- argued that it is not necessary to review chapter 8 of the new Gas Rules at this time
- proposed that regulator-issued guidelines should be recognised in law, along with penalty provisions to ensure compliance.

Confidentiality guidelines—draft for consultation

Under the National Electricity Rules the AER is required to develop and issue guidelines relating to the confidentiality of information obtained, used and disclosed for the purposes of resolving a dispute under the dispute resolution process established by chapter 8 of the rules.

The AER released draft confidentiality guidelines for consultation. The closing date for submissions was Thursday 6 April 2006. A draft report on the confidentiality guidelines consultation process will be issued in June 2006.

National electricity market outcomes

The AER published weekly market analyses that set out the spot price for each trading interval in each region of the NEM .These reports highlight prices more than three times the weekly average. They compare the demand and price forecasts with actual outcomes, and publish the most probable reasons for significant variations between actual and forecast prices. The performance of the frequency control ancillary service markets is also examined. The reports are available on the AER website www.aer.gov.au

Wholesale market prices for the March quarter averaged $58/MWh in South Australia, $53/MWh in Victoria, $46/MWh in New South Wales and $38/MWh in Queensland. The quarterly average spot price in Tasmania was $33/MWh

Basslink, the interconnector between Victoria and Tasmania was declared commercially available from

midnight Friday 28 April 2006, with a capability of 600 MW north and 480 MW south.

On 4 April 2006 the AER published its first quarterly compliance report detailing the AER's compliance monitoring activities during the period from October to December 2005.

Directlink—final decision

On 3 March 2006 the AER made its final decision on Directlink's Joint Venturers' (DJV) application to convert Directlink from a market network service to a prescribed service and revenue cap. The decision sets out the AER's consideration of issues raised by submissions, and matters requiring resolution following the draft decision.

Seven submissions were received in response to the draft decision, issued on 8 November 2005. No substantive new material was presented in relation to the decision to allow Directlink to convert to a prescribed service. No submissions objected to the AER's approach of setting the asset value based on the expected market benefits of Directlink.

The AER determined that Directlink meets the requirements under the National Electricity Rules and should therefore be allowed to convert. The AER then set an asset value based on the expected market benefits—$150.55 million. This value was adjusted for lifecycle operating costs, benchmark equity raising costs and depreciation to provide an opening asset value of $116.7 million.

The opening asset value was used to determine a maximum allowed revenue for DJV of between $11.8 million in 2005–06 to $13.6 million in 2014–15. The decision includes an operating cost allowance of around $2 million per annum and a post-tax nominal return on equity of 11.50 per cent.

ACCC activities relating to energy

PNG gas project application for authorisation—draft determination

On 8 May 2006 the ACCC released its determination authorising the joint marketing in Australia of gas from the PNG gas project for a period of 16 years. The ACCC released a draft determination on 16 January 2006.

In making the determination the ACCC took into account written submissions received in response to the draft determination and oral submissions from interested parties at a pre-decision conference which was held on 1 March 2006. The authorisation approved by the ACCC in its determination is the same as that proposed in its draft determination.

The PNG gas project is a joint venture enterprise involving the production and sale of PNG gas to customers in Australia. The project is expected to begin gas sales into Australia in 2009. The Australian component of the gas pipeline is being developed by a consortium of AGL and Petronas.

Joint marketing means that the joint venture partners (ExxonMobil Group, Oil Search Group, the Mineral Resources Development Company Limited Group, the Merlin Petroleum Company and AGL Gas Developments (PNG) Ltd) can agree on common terms and conditions including the price at which they will offer the gas for sale to potential customers.

Such conduct could potentially breach the Trade Practices Act unless the parties involved can demonstrate there are sufficient public benefits to outweigh any anti-competitive detriment.

Public submissions supported the need for joint marketing arrangements in order for the project to proceed. However, concerns were raised about the applicants' proposal for the authorisation to apply for the life of the project (about 30 years) and to be extended to all future participants.

The ACCC considers that the project will generate substantial public benefits. However, it cannot be certain that the benefits will outweigh any potential anti-competitive detriment for a period as long as the life of the project. Nevertheless, the ACCC considers that investors and the project's financiers require a reasonably long-term authorisation for the project, which involves substantial upfront investment, to proceed and the public benefits to be realised. For the reasons outlined in the determination, the ACCC proposes to grant authorisation for a period of 16 years and to extend authorisation to future participants who meet certain criteria.

To address concerns raised in submissions about the possibility of commercially sensitive information being used in an anti-competitive manner, the applicants proposed to establish ring fencing measures to restrict the transfer of commercially sensitive information obtained through the joint marketing conduct. The ACCC agreed with this approach. Any joint marketing undertaken outside the framework of the ring fencing arrangements is not authorised.

The determination is subject to appeal to the Australian Competition Tribunal. The Tribunal must review the determination if the person applying for review is either the applicant or the Tribunal is satisfied that the person has a sufficient interest in the matter (s. 101 of the Trade Practices Act).

Roma to Brisbane pipeline: revised access arrangement

On 31 January 2006 the ACCC received a revised access arrangement for the Roma to Brisbane pipeline from APT Petroleum Pipelines Ltd (APTPPL) for asessment under the *National Third Party Access Code for natural gas pipeline systems* (Gas Code). The access arrangement describes the terms and conditions under which APTPPL proposes to offer third party access to the Roma to Brisbane pipeline. The AER is assisting the ACCC in this assessment.

This current assessment is the first full assessment by the ACCC of the access arrangement for the Roma to Brisbane pipeline under the Gas Code. Under transitional arrangements for the *Natural Gas Pipelines Access Agreement* the tariff arrangements to 28 July 2006 have been covered by the Access Principles approved by the then Queensland Minister for Mines and Energy in accordance with amendments to the *Petroleum Act 1923* (Qld) which came into effect on 1 July 1995. Accordingly the previous ACCC assessment, covering the period 2002 to 28 July 2006, included only non-tariff elements.

On 18 April 2006 the ACCC released an issues paper to assist interested parties to prepare submissions on any issues relevant to the proposed access arrangement. The ACCC's *Access arrangement process guideline*, which was released on 9 December 2005, also provides information that may assist interested parties. Submissions closed on 18 May 2006.

The proposed revised access arrangement application and associated documents, including the public issues paper, are available from the AER's website at: http://intranet.accc.gov.au/content/index.phtml/itemId/692572/fromItemId/692272

Application by GasNet Australia under section 8.21 of the Gas Code

On 23 December 2005 GasNet lodged an application under s. 8.21 of the Gas Code seeking the ACCC's agreement that forecast capital expenditure (New Facilities Investment) in constructing the Corio Loop will meet the requirements of section 8.16(a) of the Gas Code for roll-in to GasNet's capital base. The effect of such an agreement would be to bind the ACCC's decision when it considers revisions to GasNet's access arrangement in 2007. This is the first application of this nature made to the ACCC.

GasNet is the owner-operator of the Victorian Principle Transmission System (PTS), which is the primary transmission system for the delivery of gas throughout Victoria. In its annual planning review VENCorp, the independent system operator of the PTS, identified a major system capacity constraint that would face the PTS in winter 2008. VENCorp recommended that GasNet undertake a major

system augmentation to ensure that the PTS has sufficient useable system linepack to cover supply-demand imbalances at this time.

VENCorp identified a number of ways to achieve the required augmentation and, on the basis of cost-benefit analysis, has recommended the extension of the Southwest Pipeline from Lara to Brooklyn (Corio Loop). The proposed project involves construction of a 57 km, 500 mm diameter pipeline, running from the Brooklyn compressor station for 12 km using an existing easement, and then along a greenfields route to meet the Southwest Pipeline in Lara. The total capital cost of the project is expected to be $70.7 million.

Interested parties were invited to make submissions and provide supporting information on any issues relevant to the application by GasNet by Friday 10 February 2006. The ACCC released a draft decision on 5 April inviting submissions. The ACCC is considering submissions received in response to the draft decision and expects to release a final decision no later than June 2006.

state developments

Victoria

Essential Services Commission (ESC)

Energy

2006–10 electricity distribution price review

Under the provisions of the Essential Services Commission Act 2001, CitiPower, Powercor, SP AusNet and United Energy appealed the ESC's final determination. AGLE was the only distributor not to appeal.

The four distributors appealed the ESC's decisions on the following issues:

- CitiPower, Powercor and SP AusNet appealed the operating and maintenance expenditure allowed for compliance with the Electricity Safety (Electric Line Clearance) Regulations 2005 which set out requirements for maintaining vegetation clear of electric lines.
- Powercor appealed the methodology used to reverse Powercor's movements in employee entitlement provisions and the peak demand forecasts used to calculate the growth adjustment to the operating and maintenance expenditure benchmarks.
- SP AusNet appealed against its momentary average interruption frequency (MAIFI) targets and the ESC's assumption, when calculating the P_0, that the proportion of customers on time-of-use tariffs will not increase over the period.
- United Energy appealed the calculation of the S-factor and the ESC's decision on the level of 2004 operating and maintenance expenditure used to estimate the 2006–10 operating and maintenance expenditure benchmarks.

There were nine appeals on 12 grounds. Of these, the appeal panel upheld the ESC's determination on four appeals and set it aside on two appeals. Three appeals were withdrawn by the appellants. The decisions, and reasons, are available on the ESC website: http://www.esc.vic.gov.au.

The determination was set aside in relation to SP AusNet's appeal against the MAIFI targets and Powercor's appeal against the peak demand forecasts used to calculate the growth adjustment to the operating and maintenance expenditure benchmarks.

The effect of the appeal panel's decision is to ease the target against which SP AusNet's MAIFI performance will be assessed. This decision will not impact upon the X-factors in the CPI-X formula. However, it is likely to increase the potential for SP AusNet to earn rewards under the service incentive scheme because SP AusNet does not have to achieve as high a level of MAIFI performance on its rural network, as set out in the final determination, to access those rewards. This is likely to result in higher prices during the regulatory period than previously anticipated.

In relation to Powercor's peak demand forecasts, the appeal panel remitted this decision to the ESC for further consideration and review.

The ESC will be undertaking a process for re-determination over the coming months. It is expected that this process will conclude in June 2006. Any variation to Powercor's price path as a result of the re-determination will be confined to 2007–10 and will not affect the P_0 calculations contained in the final determination. Therefore, the approved 2006 distribution network tariffs will remain unchanged for all distributors.

The determination and other information about the review can be found at: http://www.esc.vic.gov.au/electricity699.html.

Total factor productivity (TFP)

The ESC is continuing to research the application of TFP indexing to the regulation of monopoly network services.

New developments include the preparation of a submission to the MCE's expert panel addressing the implementation issues associated with the design, implementation and transition to a TFP-based approach.

In April 2006 PEG (Pacific Economics Group) updated the productivity trend for the Victorian electricity distributors to include 2004 data. The ESC also released an information paper that set out why there is less incentive for distributors to misrepresent costs under TFP-based approaches to utility regulation than under a building blocks method. In July 2006 the ESC anticipates that it will release an update to the Victorian electricity distributors' productivity trend to include 2005 data. It will also be commencing a project to estimate a national TFP trend for electricity distribution.

For information on the progress of the ESC's TFP project and to download copies of the various research papers and transcripts visit: http://www.esc.vic.gov.au/electricity994.html.

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

The Interim Operating Procedure—Compensation for Wrongful Disconnection has been issued to assist retailers to meet their obligations under the new wrongful disconnection provisions of the Energy Acts. These provisions require compensation to be paid where a small retail customer is disconnected from supply otherwise than in accordance with the requirements of the Energy Retail Code. As reported in *Network* 21, the Operating Procedure is currently under review. The draft decision was published in April 2006 and can be found at: .http://www.esc.vic.gov.au/electricity196.html

In March 2006 the ESC and ESCOSA commenced respective reviews of their Energy Retail Codes to determine whether all obligations should remain for larger energy consuming business and residential customers, to maximise harmonisation of regulation across the jurisdictions.

Retail compliance, monitoring and reporting

The ESC has audited all local retailers on the obligations in the retail codes on disconnections and capacity to pay, as well as auditing a sample of EWOV cases on alleged non-compliance by retailers with the Energy Retail Code. A draft report is currently with the retailers and will be published in March 2006. Workshops will be held with retailers and consumer groups on the issues arising for retailer practices from these audits.

The SA, NSW, ACT and Victorian jurisdictional regulators are coordinating efforts on the 2006 audits. A workplan has been published on these regulators' websites, which demonstrates a commitment to avoid duplication of resources and to ensure that licensed retailers are not unnecessarily audited in individual jurisdictions.

The ESC published the 2004–05 Comparative Performance Report for Retailers in early December 2005.

The revised performance indicators to better monitor whether customers who do not appear to have the capacity to pay their accounts are being disconnected by retailers took effect from 1 January 2005, and have enabled more focussed targeting of specific retailers for further investigation. Other jurisdictions are considering their national implementation through the Utility Regulators Forum.

In 2005–06 the ESC will monitor and report on competitive market offers.

Price disclosure and comparison

Retailers are generally complying with the requirement to publish, on the internet, indicative offers generally available to the majority of customers. The requirement for retailers to provide information in writing took effect from 1 March 2006.

The ESC has decided not to proceed with a comprehensive interactive website price comparison tool after consultation and further consideration. Efforts will be directed to providing information to low income and vulnerable customers on how to access the current tools available, if they wish to enter the competitive market. Ways of providing this information will be considered and developed in consultation with relevant consumer organisations.

Market conduct

Further to the information reported in *Network* 21, there has been a marked decrease in marketing complaints in the Victorian energy market in the past 6–9 months.

Energy retailer of last resort

Following a detailed review of all submissions responding to the ESC's draft decision paper, the ESC published its final decision in February 2006. The issues paper, submissions and decision can be found at: http://www.esc.vic.gov.au/gas960.html

End–to end–transactions

Further to the report in *Network* 21, submissions responding to the ESC's issues paper were received until 14 December 2005. The draft decision on issues relating to the electricity customer transfer process has been published and is available at: http://www.esc.vic.gov.au/electricity204.html#E2E.

The draft decision proposes amendments to the Electricity Customer Metering Code, and Energy Retail Code. It also establishes a monitoring framework to examine the performance of elements of the electricity process over time. Submissions responding to the draft decision closed on 21 April.

South Australia

Essential Services Commission of South Australia (ESCOSA)

Corporate

Review of the Essential Services Commission Act 2002

In October 2005 the Treasurer commenced a review of the *Essential Services Commission Act 2002* (ESC Act) in accordance with s. 53 of the ESC Act. The review sought to determine the effectiveness of the work of ESCOSA and the attainment of the objects of the ESC Act.

A steering committee was appointed by the Treasurer to conduct the review in accordance with the legislative requirements and the specified terms of reference. Interested parties were invited to make written submissions to the review.

The Treasurer has now released the final report on the outcome of the review. This report is available on the Department of Treasury and Finance's website at www.treasury.sa.gov.au.

The report concluded that ESCOSA has established a well-documented governance framework. Its approach to regulation and consultation was considered appropriate. Case studies examined as part of the review presented a credible case for ESCOSA's effectiveness in implementing procedures to meet the objectives of the ESC Act.

The report recommended that ESCOSA should:

- expand its website content to include an ongoing presence devoted to consumer information and assistance
- adopt a proactive and vigorous approach to enforcement.

In response to the first of these recommendations ESCOSA developed a consumer information website that was launched in April. The 'Energy Consumer Toolkit' is accessible via ESCOSA's homepage (www.escosa.sa.gov.au) and provides a range of information to assist consumers with choices relating to electricity and gas contracts.

While acknowledging ESCOSA's initiatives and its consultative, transparent approach to its regulatory responsibilities, the report concluded that various legislative amendments should be considered to further the effectiveness of ESCOSA. These include:

- authorisation of the disclosure of confidential information to consultants of ESCOSA
- lengthening of the period (from 10 to 20 business days) in which a party can lodge a review application regarding a price determination of ESCOSA and
- enabling the chairperson to delegate certain powers.

8th Annual SA Energy Industry Summer Briefing - presentation by ESCOSA chairperson

On 8 December 2005 Patrick Walsh, Chairperson of ESCOSA, gave a presentation to the 8th Annual SA Energy Industry Summer Briefing. Titled 'Essential Services Commission of SA and energy reform in South Australia', the presentation highlighted the major energy-related issues dealt with by ESCOSA during 2004–05.

Energy

2004–05 annual performance reports

In November 2005 ESCOSA released two reports which summarise the performance of the SA electricity and gas supply industries during 2004–05. Each report deals with both electricity and gas, with one report focusing on the retail sector and the other on the distribution sector.

This is the sixth year that ESCOSA has reported on the performance of licensed electricity retailers and the electricity distributor, and the second year it has reported on licensed gas retailers and the gas distributor.

Energy retail market

ESCOSA continues to monitor the energy retail market in South Australia, and is currently undertaking a customer survey concerning retail

market issues. Full retail contestability for electricity customers commenced in January 2003, and for gas in July 2004. As at 31 January 2006 the level of completed small customer transfers to electricity market contracts was 51 per cent of the small customer base of 755 000; while for gas (with a customer base of 370 000) the equivalent figure was 41 per cent.

Revised Energy industry guideline no. 2

ESCOSA has finalised and issued a revised *Energy Industry Guideline No.2 (Energy Regulatory Information: Energy Retail Code Retailer)*. The guideline addresses ESCOSA's information requirements from those retailers selling electricity and/or selling and supplying gas to small customers (i.e. those consuming less than 160 MWh electricity or 1 TJ gas per annum) in South Australia.

A final decision paper has also been issued, outlining how ESCOSA has dealt with the issues raised in submissions in developing its final position.

Electricity

Inquiry into ETSA utilities network performance and customer response January 2006

From 19–22 January 2006 there were power outages affecting a significant number of electricity distribution network customers. Some customers experienced prolonged supply interruptions, and delays and difficulties in contacting, or obtaining information from, ETSA Utilities. During this period, much of South Australia experienced a severe heatwave, with Adelaide's maximum temperature exceeding 40°C for the period 19–22 January.

In the week following these events ESCOSA prepared and submitted a preliminary report for the Minister for Energy regarding the performance of ETSA Utilities' Distribution Network. The report provided an overview of the reliability performance, customer service performance and quality of supply performance during this period and was compiled from information provided by ETSA Utilities. The report did not address the question of compliance with regulatory obligations.

In response to the events the Minister for Energy referred the matter to ESCOSA under Part 7 of the ESC Act.

ESCOSA has prepared an issues paper, which provides background information relating to the events of 19–22 January 2006 and a summary of the Service Standards Framework which applies to ETSA Utilities. In addition, the issues paper incorporates a questionnaire for customers affected by an outage. ESCOSA anticipates that the inquiry will be finalised by 30 June 2006.

Excluded services guideline finalised

Following consideration of submissions made to the draft released for comment on 2 November 2005, ESCOSA finalised its report and guideline in December 2005. These cover the implementation of the pricing principles that now apply to excluded services—as set out in the 2005–10 Electricity Distribution Price Determination (EDPD). The EDPD requires that ETSA Utilities charge for excluded services on a fair and reasonable basis. ESCOSA plays a role in resolving disputes between ETSA Utilities and customers, regarding charges made for an excluded service.

Licensing

Issue of electricity and gas retail licences

Since 1 November 2005 ESCOSA has issued an electricity retail licence to Red Energy Pty Ltd (ACN 107479372) on 3 February 2006. Red Energy Pty Ltd also holds an electricity retail licence in Victoria.

ESCOSA has not issued any gas retail licences during this period.

Gas

2006 review of Envestra Gas Access Arrangement

Consultation on Envestra's proposed revisions to the SA Gas Distribution Access Arrangement closed on 18 November 2005. ESCOSA has received seven submissions to the proposed revisions from:

- Origin Energy
- TRUenergy
- AGL South Australia
- Energy Consumers Coalition of South Australia
- Minister for Energy
- SACOSS
- EA–IFR partnership
- Council of the Ageing.

ESCOSA released the draft decision on 28 March 2006 and it is available at http://www.escosa.sa.gov.au/site/page.cfm?u=4&c=1703.

Transport

Review of the AustralAsia Railway (Third Party Access) Code (the Code)

The Northern Territory and South Australian ministers responsible for the *AustralAsia Railway (Third Party Access) Act 1999* (which contains the Code) have requested that ESCOSA commence the Code review, as required under cl. 50 of the Code. The review will assess how effective the Code is in facilitating users' access to the AustralAsia (Tarcoola-Darwin) railway. Any recommendations arising from the review are to have regard to the requirements for certification of a state-based access regime arising under Part IIIA of the Trade Practices Act. As the Code is a certified regime, ESCOSA released an Issues Paper on the review. Submissions for the review were due by 17 March 2006.

Water

Inquiry into 2006–07 metropolitan and regional water and wastewater pricing processes: Final report

Pursuant to s. 35(1) of the ESC Act, in September 2005 the Treasurer referred to ESCOSA an inquiry into the 2006–2007 metropolitan and regional water and wastewater pricing processes. The focus of the inquiry was on the adequacy of the government's application of the 1994 COAG pricing principles in establishing 2006–07 prices.

In undertaking the inquiry ESCOSA considered the 'Transparency Statement — Part A: Water and wastewater prices in metropolitan and regional South Australia 2006–07', dated August 2005.

On 30 November 2005 ESCOSA forwarded to the Treasurer and the Minister for Administrative Services the 'Final report—Inquiry into 2006–07 metropolitan and regional water and wastewater pricing process'. ESCOSA confirmed compliance with the 1994 COAG pricing principles but stressed the desirability of more significant development in the areas of efficient business costs and contributed assets.

As required by the Act, the final report was released on 28 December 2005, along with the Treasurer's Interim Response. Subsequent to that the government has released its formal response to ESCOSA's report (Part C).

Western Australia

Economic Regulation Authority (ERA)

References and research

Inquiry on country water and wastewater pricing in Western Australia

In October 2005 the ERA was directed by the Western Australian Treasurer to conduct an inquiry, with direct input from the public, into the Water Corporation's country potable water and wastewater (sewerage) prices. The ERA will examine the appropriateness, efficiency and effectiveness

of the current approaches to country water and wastewater pricing, and the merits of potential alternative approaches.

The ERA published an issues paper on 9 December 2005 inviting submissions from industry, government, other stakeholder groups and the general community. It published a draft report on 31 January 2006. Submissions on the draft report closed on 17 March 2006.

During the consultation period following the draft report, the ERA held public forums in Mandurah, Geraldton, Kalgoorlie-Boulder, Albany and Northam to discuss the findings in the draft report.

The final report for the inquiry will be delivered to the Treasurer by 26 May 2006. The Treasurer will have 28 days to table the report in parliament.

Contact: Greg Watkinson (08) 9213 1965

Industry access

Gas

Dampier to Bunbury natural gas pipeline (DBNGP)

Revisions to the DBNGP access arrangement

The ERA drafted and approved its own access arrangement on the DBNGP on 15 December 2005. This revised access arrangement became effective on 30 December 2005.

Stage 5 expansion of the DBNGP

Under section 8.21 of the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) DBNGP (WA) Transmission Pty Limited (DBP) made application seeking the ERA's approval in relation to its proposed stage 5 expansion of the DBNGP. DBP specifically seeks the ERA to approve that its forecast capital cost of undertaking the stage 5 expansion of the DBNGP will meet certain requirements of the Code, and thus agree that the forecast capital expenditure be automatically rolled into the capital base of the DBNGP at the next access arrangement review, which is scheduled to commence in 2010.

DBP is seeking the ERA's approval in respect of its stage 5 expansion by early June 2006. Public submissions were sought and the ERA released its draft decision on the 27 April 2006. The ERA also sought public submissions in response to its draft decision. The closing date for submissions was Monday 15 May 2006.

Contact: Russell Dumas (08) 9213 1900

Tubridgi pipeline system

Following an application to NCC for Revocation of Coverage, the Minister for Energy has revoked coverage of this pipeline from 1 May 2006. Revisions to the access arrangement will no longer be required.

Electricity

Networks access

Access arrangement for Western Power's south west interconnected network (SWIN)

The ERA published its draft decision on Western Power's proposed access arrangement for the south west interconnected network on 21 March 2006. Public submissions were invited and seven were received by 19 May 2006, including a revised proposed access arrangement from Western Power.

The ERA will review the public submissions received and release a final decision within 30 business days.

Further information on the assessment of the proposed access arrangement and the public submissions received are available at www.era.wa.gov.au/electricity.

Contact: Annette Stokes (08) 9213 1962

Technical rules for Western Power's south west interconnected network (SWIN)

Along with its proposed access arrangement, Western Power submitted technical rules which consist of network benchmarks and standards, procedures and planning criteria. The ERA published the proposed technical rules concurrently with the proposed access arrangement.

The Technical Rules Committee provided its preliminary report to the ERA in December 2005.

The ERA published draft technical rules for Western Power's regulated electricity networks in the south west interconnected system (SWIS) on 11 April 2006. In accordance with section 12.11(c)(ii) of the Electricity Networks Access Code 2004 (access code) the ERA has published technical rules based on Western Power's proposed technical rules, amended only to the extent necessary to comply with chapter 12 of the access code and the code objective.

The technical rules were prepared based on advice received from the Technical Rules Committee, the ERA's technical advisers, PB Associates, and subsequent discussions with Western Power.

Interested persons were invited to make submissions on the draft technical rules by 4:00pm WST on Friday 5 May 2006. No extensions were possible to the closing date. Three submissions were received.

The access code requires the Technical Rules Committee to provide a final report to the ERA within 30 days before the last day by which the ERA must make its final decision.

The final technical rules must be published at the same time as an approved access arrangement for Western Power's regulated electricity network in the SWIS.

Contact: Annette Stokes (08) 9213 1962

Metering

Communication rules and model service level agreement

On 4 January 2006 Western Power submitted proposed 'communication rules' and a proposed 'model service level agreement' under the Electricity Industry Metering Code 2005.

On 16 February 2006 the ERA approved Western Power's proposed communication rules and on 30 March 2006, the ERA made a decision to approve the proposed model service level agreement.

Contact: Nick Parkhurst (08) 9213 1933

Registration process

On 10 March 2006 Western Power submitted its Contractor Connector Scheme to the ERA as a proposed Metering Service Provider Registration Scheme for approval as a registration process pursuant to clause 6.9 of the Electricity Industry Metering Code 2005.

On 9 May 2006 after reviewing comments by Energy Safety, Western Power advised the ERA it wished to withdraw the Contractor Connector Scheme as a registration process.

Contact: Nick Parkhurst (08) 9213 1933

Rail

Review of cost allocation methodologies

The ERA established a working group comprised of railway owners and rail network users, to review methodologies for allocating common costs to rail routes. The current methodology used has created anomalies on some rail lines, particularly those with relatively short routes that carry heavy traffic. A report was prepared recommending changes to the current methodology for allocating common costs

to provide better outcomes for railway owners and users of rail networks.

Contact: Mike Jansen (08) 9213 1952

Licensing, monitoring and customer protection

Licensing

Electricity licensing

The ERA has received 37 licence applications from existing and prospective electricity service providers. Under the *Electricity Industry Act 2004* (the Act) electricity supply licences are classified in five ways: generation, transmission, distribution, retail and integrated regional.

Currently, the ERA has issued four licences for generation, and one integrated regional licence. The ERA is considering a further eleven applications for generation; four for transmission; five for distribution; nine for retail and three for integrated regional.

Under s. 19 of the Act, the ERA must, if satisfied that it would not be contrary to the public interest, grant a licence if also satisfied the applicant has and is likely to retain, or will acquire within a reasonable time after the grant, the financial and technical resources to undertake the activities authorised by the licence. The ERA expects to complete the assessment of, and make a decision on, all the electricity licence applications by June 2006.

Considerable interest has been shown by potential new entrants into the electricity generation market. Given that the legislation prohibits the construction of generators until a licence has been issued, the ERA has given priority to these licence applicants.

From 1 April 2006 the state's largest electricity supplier, Western Power, was separated into four new stand-alone energy corporations. The ERA granted generation, transmission, distribution, retail and integrated licences to Western Power on 30 March 2006. These licences were subsequently transferred to the relevant corporations on 1 April 2006 as part of the statutory arrangements to establish the new corporations. Copies of the licences are available on the ERA website.

As part of the Western Power licence application, the ERA has assessed and approved Western Power's standard form contract for its retail division and regional division. These contracts now apply to the relevant new corporations of Synergy and Horizon Power respectively.

Monitoring

Audits

The ERA has received 20 operational audits and asset management reviews from local government licensees of non-potable water supply and sewerage services. The ERA is currently reviewing the audits and asset management reviews prior to providing performance reports to the minister of water resources. Following the release of these audits to the minister, the ERA will place results of the audits on its website.

Audit scope

The ERA has developed a standard audit scope for service providers of electricity, gas and water in Western Australia. This audit scope describes the ERA's requirements for performance/operational audits and asset management system reviews. The audit scope also provides guidance for auditing smaller organisations in the utility industry. The audit scope is available on the ERA's website.

Energy and water licensing enforcement guideline

The ERA is preparing guidelines for licensees regarding the factors the ERA may take into account in deciding whether enforcement actions should be undertaken, the form of that action, and the procedures that a licensee may follow if it does not agree with a decision made by the ERA.

The guidelines outlines the procedures the ERA proposes to follow when investigating compliance matters and when taking enforcement action in response to a contravention of a licence condition. The guidelines are expected to be available for comment on the ERA's website in June 2006.

Electricity compliance reporting manual

The ERA has prepared an electricity compliance reporting manual for electricity licensees. The manual provides a consolidated list of the terms and conditions of the various types of electricity licences. It is designed to provide a sound basis for the ERA in monitoring and reporting licence compliance matters, including determining the information that licensees must provide to the ERA for this purpose. The manual is expected to be available by June 2006.

A guide for preparing the financial plans for asset management systems

The ERA has developed a guide to assist smaller electricity, gas and water service providers to prepare financial plans for asset management systems. The financial plan provides for the operations, maintenance, administration and capital expenditure requirements of the utility service.

The financial plan is one of the most important components of the licensee's asset management system, and it brings together the financial elements of the utility to ensure the licensee's financial viability over the longer term. The guide should be available for comment on the ERA's website in June 2006.

Contact: Adam Phillips (08) 9213 1960

Consumer protection

Standard form contracts

Western Power, Alinta Sales, Perth Energy and the Rottnest Island Authority have recently submitted applications for retail licences, as required by the Act. These applications are for the sale of electricity to small use customers, defined in Part 3 of the Act as those who consume not more than 160 megawatt hours of electricity per annum. Under s. 49 of the Act, these organisations must have a standard form contract outlining the terms and conditions of supply approved by the ERA prior to it issuing an operating licence.

Drafts of the standard form contracts under which each organisation proposes to supply electricity were submitted with their licence applications and were available for comment by interested parties on the ERA's website. A number of submissions from interested parties were received. For updates see the News section of the ERA website.

Customer charters

The ERA has reviewed and approved customer service charters, including minor amendments, for the following licensees:

- the Shire of Denmark (Peaceful Bay)
- the Shire of East Pilbara.

Public consultation guidelines

The ERA has developed draft public consultation guidelines designed to provide a consistent approach to procedures undertaken in the assessment of licence applications for the amendment, grant, renewal, and/or transfer of a licence. The draft guidelines also outline the process the ERA intends to use to review standard form contracts and customer charters.

The compilation of the draft public consultation guidelines seeks to assist electricity, gas and water licence applicants with their licence applications, standard form contracts and customer service charters.

The draft public consultation guidelines were published on the ERA's website in January 2006 and currently the ERA is reviewing submissions received from the public and interested parties. The ERA will shortly release a final version.

Contact: Mark Dominkovich (08) 9213 1912

ACT

Independent Competition and Regulatory Commission (ICRC)

Electricity

Draft report on retail prices for non-contestable electricity customers

In 2003 the government agreed to retail contestability for electricity supply in the ACT, subject to transitional measures designed to provide a safety net for customers. The three-year transitional arrangements were to cease on 1 July 2006 subject to a further review. The arrangements provided for a regulated retail ceiling tariff and for customers to revert to franchise contracts if negotiated contracts failed. The ICRC was referred a review of the competitiveness of the retail electricity market late in 2005. The outcome of the review will determine whether a further transitional period would be required with a new transitional tariff direction.

In its draft report the ICRC recommends that there is sufficient competition in the ACT retail market to warrant removing the transitional arrangements. However, it has outlined other options available to the government and expects advice on the government's decision in relation to the transitional arrangements in the near future. If the government opts to retain the transitional arrangements, a new transitional tariff would need to be available by 30 June 2006.

The draft report was released on 3 February and the final was published in April.

Greenfield electricity infrastructure development

The ICRC's final decision on greenfield electricity infrastructure developments was released on 20 December 2005. The final decision honoured the ICRC's commitment to introduce a light-handed regime for the infrastructure developments, based on supervision and periodic audit of activity to ensure that, in the absence of competition, the process of developing infrastructure was as fair and efficient as possible. The decision took into account the imminence of the national regulatory arrangements for distribution networks, and the costs and benefits of a more intrusive regime for both suppliers and customers.

Prepayment metering code

The ICRC has received a draft prepayment metering code from Aurora. Aurora indicates that it intends to become active in the ACT with prepayment meters as the product platform. The proposed code reflects the code approved in South Australia and the practice in Tasmania. The ICRC is obliged to consult widely on codes proposals: an issues paper and the draft code have been circulated for comment.

The ICRC has discussed the approach to prepaid meters with Aurora in 2005, including consultation with community organisations in the ACT. There are concerns amongst those groups about the use of prepayment meters as a means of managing financial delinquency.

The ICRC's issues paper was released on 3 February and submissions closed on 6 March 2006. Given the high level of interest shown by retailers and consumer protection groups the ICRC released a draft decision and sought further comments. Submissions on the draft decision closed on 28 April.

Incentive carryover mechanism and service standards incentives

The ICRC released its final decision on carryover mechanism and service standards on 9 January 2006. In the final decision the ICRC declined to introduce a carryover mechanism to the ACT. It was satisfied that the service standards currently reported on in the compliance and performance assessment process were adequate.

Electricity network price reset

ActewAGL will submit its information for the annual price reset for the distribution network in March, with the ICRC due to approve a price for 2006–07 by May.

Water

The information paper, *Water and Wastewater Annual Price Reset 2004–05*, was released in February. The paper considers both applications for pass-through of costs and the annual reset of prices within the current direction. The pass-through application is associated with capital works to secure water supply (Cotter/Googong Bulk Water Transfer System), catchment remediation costs in the Lower Cotter relating to the 2003 bushfires and operating costs associated with analytical work undertaken in relation to options for water security projects (Future Water Options). Work is also being done on the price resets for the period July 2006 to June 2007. The final decision was announced on 12 May 2006.

Compliance reporting for utilities

Compliance report for 2005

The annual compliance report for utilities licensed under the *Utilities Act 2000* was released in February. The report observed no significant areas of non-compliance.

Compliance audit program

The ICRC has determined a compliance audit program for utilities licensed under the *Utilities Act 2000*. The program is designed to gain assurance that the information supplied in the compliance reporting process is accurate, meaningful and comprehensive. Areas of high significance will be the initial focus and will be more frequently audited than less significant issues. Initial audits will commence early in the new financial year.

Transport pricing

ACTION pricing

The ICRC is investigating ACTION prices effective from 1 July 2006. The price direction is to provide prices for 2006–07 only, the current direction ceases to have effect from 30 June 2006. The government is considering, or is about to consider, a package of recommendations about ACTION services that introduce a high level of uncertainty. A longer-term price path inquiry is expected to commence later in 2006, for implementation from 1 July 2007. ACTION prices are usually set for a period of three years.

Other regulatory matters

Capital Linen Service review

The ICRC was asked to review the Capital Linen Service—a large government-owned commercial laundry that provides linen to public and private hospitals, the hospitality industry and restaurants. It is the largest laundry operation in the ACT. The laundry was subject to claims of cross-subsidising private sector clients with revenue from public hospitals. The final report of the review released in March concluded that there were no cross-subsidies from public to private sectors but the reverse pertained. The linen service is commercially and competitively neutral. The ICRC made a recommendation about improvements for the business, including potential corporatisation.

ACT Ambulance Service (ACTAS) pricing

The ICRC has been asked to comment upon and make recommendations about the pricing policies of the ACTAS. The inquiry is to comment on a pricing paper prepared by the Essential Services Authority on behalf of the ACTAS, consider the outcomes of the Independent Pricing and Regulatory Tribunal's

review of ambulance services (undertaken recently in NSW), and recommend ways in which ACTAS might better recover its costs. The ICRC released a draft report in April.

New South Wales

Independent Pricing and Regulatory Tribunal (IPART)

Electricity distribution

Reliability licence conditions and cost pass-through

In August 2005 the Minister for Energy and Utilities imposed additional conditions relating to reliability performance on licences held by distribution network service providers (DNSPs). DNSPs have indicated that meeting these conditions will require additional expenditure on their part, leading to a cost pass-through review. In December 2005 the DNSPs lodged formal cost pass-through applications, and these are currently being assessed by IPART.

Gas

Review of access arrangements completed in 2005

In 2005 IPART approved revisions to access arrangements for two gas distribution networks in NSW. Revisions to AGL Gas Networks' access arrangement for its NSW network commenced on 1 July 2005 and revisions to Country Energy Gas' access arrangement for the Wagga Wagga network commenced on 1 January 2006.

In December 2005 IPART also approved an access arrangement for a proposed distribution network in the Central Ranges region. The Central Ranges Pipeline access arrangement was the result of a competitive tender process conducted in accordance with the Gas Code. The review process was run in parallel with the AER/ACCC's review of the Central Ranges transmission pipeline.

Transport

CityRail Services

IPART is currently undertaking a review of maximum fares for CityRail services under the IPART Act. Submissions have been received and a public meeting held. The determination will be released on 23 June 2006.

Taxi fares

IPART is currently undertaking a review of maximum fares for taxi services. Submissions have been received. The Tribunal's report setting out its recommendations to the Minister for Transport is expected to be released in early June.

Water pricing

Metropolitan water pricing

IPART has recently completed an investigation into the charging arrangements for backlog sewerage properties in the Mooney Mooney and Cheero Point areas of the Gosford local government, just north of Sydney. This review was prompted by a government decision to reduce the amount of subsidy it was prepared to make available to some backlog areas. The review focused on how to spread costs appropriately between government, residents and the wider Gosford community to reflect private, environmental and public health benefits.

The review has continued into water, sewerage and stormwater charges for the Gosford and Wyong local government areas for the period from 30 June 2006 to 30 June 2009. The Gosford and Wyong areas are suffering from a protracted drought and the councils have developed augmentation options to secure water supplies into the future. These options will have implications for prices. This review is expected to be completed by June 2006.

Bulk water pricing

IPART is undertaking a review of the charges to apply from 1 July 2006 for the extraction of bulk water by farmers, industrial users and town water suppliers from water sources managed by the Department of Natural Resources (DNR) under the Water Administration Ministerial Corporation and State Water Corporation.

Both agencies have submitted their proposals and public submissions have been received. IPART has released a number of consultants' reports to assist it in this review. IPART released its draft determination in May 2006 and expects to release a final determination in July 2006.

Water licensing

IPART has completed its review of the operating licence for the Sydney Catchment Authority. The revised licence took effect from January 2006.

IPART has submitted the operational audit reports for 2004–05 to the relevant minister.

Greenhouse gas abatement scheme

As of 1 March 2006 there were 33 benchmark participants (24 of these were compulsory participants as prescribed in the legislation). Recent amendments to the Electricity Supply Act and Regulation will extend the range of acceptable corporate arrangements for elective benchmark participants.

At 1 March 2006 IPART had accredited 151 projects that are eligible to create certificates. More than 20 million abatement certificates have been registered in the scheme. Details of accredited abatement certificate providers and the certificates they have registered are available at www.ggas-registry.nsw.gov.au.

At this stage of scheme development more certificates are being created than are needed for surrender by benchmark participants. However, abatement certificates are bankable—enabling those registered early in the scheme to be used for compliance in future years. The number of certificates required for benchmark participants to meet the benchmark levels in future years will be significantly higher. This should provide an incentive for the development of more abatement projects in both the short and medium term.

In late 2005 two of the five Scheme Rules, which are made directly by the minister were amended. These were the Demand Side Abatement Rule, which was amended to allow for extension of the Greenhouse Gas Abatement Scheme to the ACT, and the Generation Rule, which altered the method of calculation of abatement for some electricity generation projects.

Other reviews

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

- Review of burden of existing regulation
    - The purpose of the review is to identify priority areas where regulatory reform could provide significant immediate gains to business and the community, and to develop recommendations to improve the efficiency of government regulation. Submissions closed on 24 February 2006 and a final report is due to be provided to the Premier by 30 June 2006. Further information on the review (including an issues paper, submissions and timetable) can be found on the IPART website.
- Review of the skill base in NSW
    - The Minister for Education and Training has asked IPART to conduct a review of the skills base in NSW and comment upon the future challenges for vocational education and training.

IPART released an issues paper in December 2005 and expects to release its draft report for public

consultation in July 2006, with a final report provided to the Minister for Education and Training by the end of 2006.

- Investigation into water and wastewater service provision in the greater Sydney region
    - In early November 2005, IPART provided its final report on its nvestigation into water and wastewater service provision in the greater Sydney region to the NSW Government. Later that month the report was publicly released and the Government announced its intention to adopt the recommendations of the report.
- Review into the pricing of recycled water
    - IPART has also commenced an investigation into the pricing of recycled water. A public hearing was held on 31 March 2006. The investigation is expected to be completed in July 2006.

Tasmania

Office of the Tasmanian Energy Regulator (OTTER)

Jurisdictional transmission planning criteria

Transend Networks Pty Ltd licence requires that Transend Networks:

- procure all network augmentations or other works or services that are shown to satisfy the regulatory test
- plan, propose and procure augmentations required to meet the licensee's service obligations, including obligations imposed by jurisdictional transmission planning criteria.

The regulator has requested the Tasmanian Reliability and Network Planning Panel (RNPP) to develop transmission network planning and security criteria for the Tasmanian jurisdiction. The criteria, once accepted by the jurisdiction, may be used by Transend Networks to justify network augmentations under the reliability augmentation limb of the regulatory test.

The RNPP has sought comment on its proposed transmission planning criteria. The criteria specify the maximum load that may be interrupted during normal operating conditions. They also place a limit on exposure in terms of unserved energy where a network element has been withdrawn from service. Normal conditions and conditions when an element has been withdrawn from service have both been covered.

The RNPP intends to make its recommendations to the regulator in May 2006.

Review of capacity reserve and frequency operating and standards for the Tasmanian power system

The RNPP has completed its annual review of the frequency operating and capacity reserve standards for the Tasmanian power system. Although Tasmania has entered the NEM, a derogation under the National Electricity Rules provides for the Tasmanian determination of power system and reliability standards to apply until the date that the Basslink interconnector enters commercial operation. The derogation also provides for the Tasmanian determination on power system frequency operating standards to apply until the second anniversary of Tasmania's entry into the NEM (29 May 2007).

The RNPP sought comment on both standards and has amended the frequency operating standards noting that a number of issues relating to frequency control have arisen since Tasmania's entry into the NEM. These are issues that may be resolved to some degree with Basslink interconnection. The RNPP noted that any future review of the standards would have the benefit of Basslink operational experience.

From 30 May 2007 the AEMC Reliability Panel will be responsible for the determination of frequency operating standards for Tasmania.

Update on electricity licences

In January 2006 the regulator issued an electricity generation licence to each of Woolnorth Studland Bay Wind Farm Pty Ltd, AGL Energy Services Pty Limited and Landfill Management Services Pty Ltd.

In December 2005 the regulator granted Bell Bay Power Pty Ltd's application for an amendment to its generation licence in respect of three additional gas turbines.

Licences and accompanying statements of reasons can be found on the regulator's website: www.energyregulator.tas.gov.au.

Tasmanian Electricity Code

Draft Prepayment Meter Retail Code

In December 2005 the regulator referred a proposal to include a section in the Tasmanian Electricity Code on electricity supply via prepayment meters to the Code Change Panel. The proposal relates to the prepayment meter service option offered to residential customers who prefer prepayment for their electricity consumption by the use of a prepayment meter and associated smart card.

The Code Change Panel published an issues paper in December 2005 on the regulator's website inviting submissions on the proposed Code change.

In preparing its report to the regulator the panel is currently considering submissions regarding the proposed Code change.

Distribution Powerline Vegetation Management Code

In December 2005 the regulator referred three proposed changes to the Distribution Powerline Vegetation Management Code to the Code Change Panel for consideration. The proposed changes concern:

- the standards on clearances of overhanging foliage
- the algorithm for determining clearances for long span conductors
- removing reference to the Vegetation Management Code as being 'advisory'.

A working group has been established to provide advice to the panel.

Electricity pricing

Decision on pass through of NEM costs

Aurora Energy Pty Ltd, Tasmania's distribution network service provider, made a submission to the Regulator in September 2005 seeking a pass-through of costs associated with its NEM entry project. A pass-through is permissible under the Regulator's 2003 Price Determination. The regulator issued their Decisions and Statement of Reasons in February 2006. In summary, the regulator determined that:

- All costs in the Aurora submission are related to NEM entry although the costs relating to managing compliance with Government policy-related NEM preconditions will be excluded from the pass-through.
- Pre 2002–03 costs will be included in the consideration of pass-through costs, given the principles for assessment of validity and efficiency.
- No efficiency factor will be applied to either operating or capital costs.
- The difference between the approved NEM-related expenditures for the tariff customer base in 2006 and what would have been approved if no discount had been applied to the incurred NEM-related expenditures will be taken into account in 2007.

2007 Distribution pricing review

The present determination of electrical services pricing made under the Electricity Supply Industry (Price Control) Regulations 2003 expires on 31 December 2007. The regulator will undertake an investigation into electricity distribution prices on mainland Tasmania during 2007.

The regulator must give two-years notice to the distribution network service provider (Aurora

Energy Pty Ltd) should the regulator decide to amend the form of economic regulation. The regulator is also required to publish a description of the process and timetable prior to the commencement of the regulatory control period. This must be done in a timeframe which provides all affected parties with adequate notice to prepare to participate in, and respond to, that process.

The regulator released the proposed decision in December 2005 in a discussion paper, 'Form of Regulation for the 2007 Determination'. After considering submissions, the regulator decided that a revenue cap will be the form of regulation to apply during the next regulatory period.

Further detailed papers on the regulator's proposed approach to the review will be published during the second half of 2006.

A copy of the discussion paper and the regulator's decision and Statement of Reasons can be found at: www.energyregulator.tas.gov.au.

Government Prices Oversight Commission (GPOC) pricing investigation

Metro pricing policies investigation

On 12 October 2005 the Minister for Finance directed the GPOC to conduct an investigation into the pricing policies of Metro Tasmania Pty Ltd (Metro).

The terms of reference for the investigation require GPOC to investigate Metro's pricing policies for services in the urban areas of Hobart, Launceston and Burnie. In undertaking this investigation GPOC has been asked to make recommendations in relation to:

- the efficient cost of delivering the services required of Metro and the potential for Metro to secure efficiency savings
- the principles for the determination of appropriate fares
- the impact on the Community Services Agreement and fares of:
  - Metro supplying services that are at the fringe of its service area
  - the provision of services contracted by the government that are supplied by the private sector within Metro's areas of operation
- the incentive properties of setting maximum prices by reference to maximum revenues, maximum prices or another basis.

GPOC released its draft report in April 2006. Submissions in response to the draft report were due by 28 April 2006.

A copy of the draft report, the terms of reference, Metro's initial submission and other submissions received to date are available on GPOC's website www.gpoc.tas.gov.au. The draft report and all submissions received in response to it will also be made available on GPOC's website.

Motor accidents insurance board (MAIB) pricing policies investigation

The Minister for Finance issued terms of reference for the fourth investigation into the MAIB's pricing policies on 16 February 2006.

Under the terms of reference, GPOC is required to investigate the prices levied on motorists to fund the current provision of motor accident personal injury insurance for all persons injured in motor vehicle accidents involving Tasmanian registered vehicles. GPOC is also required to consider a number of related matters including:

- whether any cross-subsidies remain in the current pricing structure, the benefits and costs of retaining these cross-subsidies and, if not desirable, the appropriate mechanisms to remove these
- the appropriateness of MAIB's use of current insurance industry prudential requirements as a benchmark to measure long-term sustainability
- the growth in the number of interstate registered vehicles on Tasmanian roads as a result of increased tourism
- the impact on claims cost of the amendments to the *Civil Liability Act 2002*, which reduced the statutory discount rate from 7 per cent to 5 per cent
- the impact of MAIB's requirement to report under the Australian Equivalents of International Financial Reporting Standards
- the effect on the long-term sustainability of the scheme of increasing premiums by a lesser amount than the maximum recommended.

GPOC must provide a copy of the final report to stakeholders by 31 July 2006.

To assist interested parties in making submissions GPOC will prepare and publish an issues paper. The paper will highlight matters raised in the terms of reference and issues arising from the MAIB's initial submission.

A copy of the terms of reference and the MAIB's initial submission are available on GPOC's website. The issues paper, draft report and all submissions received in response to these will also be made available on GPOC's website www.gpoc.tas.gov.au.

Queensland

Queensland Competition Authority (QCA)

Electricity

The QCA's 'Final Determination Regulation of Electricity Distribution April 2005' sets out the regulatory arrangements that apply to Queensland's electricity DNSPs, Energex and Ergon Energy, for the five-year period commencing on 1 July 2005.

The final determination raised a number of issues relating to the pricing approaches adopted by the DNSPs and required the DNSPs to submit medium-term pricing proposals to address these issues. The QCA received both proposals by late 2005. The QCA is currently reviewing these proposals with the aim of working with the distributors to finalise the medium-term pricing approaches by mid-2006.

In the final determination, the QCA also required the DNSPs to produce price paths for contestable customers whose prices were currently below cost reflectivity. The price paths were to move their prices to cost reflectivity by the end of the new regulatory period (2009–10).

Following discussions with the distributors it appears that cost reflectivity is not an issue in relation to Energex customers but is a significant issue for a number of Ergon Energy customers. While it was hoped that the issue of appropriate price increases could have been resolved by now, that has not been possible. The QCA continues to work with Ergon Energy to resolve this issue.

The QCA released the DNSPs' December quarter 2005 service quality reports in March 2006, as well as the 2004–05 annual reports on the financial and service quality performance of the DNSPs. The annual report provides an overview of the year's performance relative to previous years. It is based on information provided in the regulatory reporting statements and the quarterly and annual service quality reports.

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Gas

The current access arrangements for the Allgas and Envestra gas distribution networks in Queensland are due to expire on 30 June 2006. Accordingly, Allgas and Envestra submitted revised access arrangements to the QCA on 30 September 2005.

The QCA released draft decisions on the revised access arrangements on 21 December 2005. The draft decisions required both service providers to make numerous amendments in order for the access arrangements to be approved.

Key features of the draft decisions include:

- acceptance of both service providers' proposed rates of return (Allgas 8.75 per cent and Envestra 8.80 per cent)
- forecast operating expenditure of $52.4 million for Allgas and $66 million for Envestra compared to $56.1 million and $95.5 million proposed by Allgas and Envestra
- forecast capital expenditure of $114.1 million for Allgas and $66.7 million for Envestra compared to $164.4 million and $102.5 million proposed by Allgas and Envestra
- required amendments to terms and conditions relating to, for example, network curtailment priorities, invoicing practices and capacity management.

The QCA calculated a revenue requirement of $203 million for Allgas and $172.1 million for Envestra over the coming five-year regulatory period. Based on the revenue requirements, prices for Allgas' smaller volume customers are likely to change by CPI + 0.41 per cent each year on average, while prices for large demand customers are likely to vary by CPI - 3.44 per cent each year on average. For Envestra, prices for small volume customers are likely to change by CPI - 2.51 per cent each year on average, and for large demand customers by CPI - 8.1 per cent each year on average. Prices for individual customers will vary depending on their particular circumstances.

The QCA had a number of concerns with the adequacy of data provided by both service providers in relation to capital and operating costs. Allgas and Envestra were expected to address these deficiencies in their submissions on the QCA draft decision. Several submissions from other interested parties were also received by the QCA.

The QCA will consider all submissions in preparing its final decision, expected to be released in May 2006.

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Local government

The QCA is finalising its review of progress of Queensland's 125 councils' implementation of competition, as reported in *Network* 21.

As funding of the scheme is linked to competition payments from the Commonwealth the report, originally due by 28 February 2006, has been delayed until the National Water Commission report on implementation of COAG water reforms by the states is released.

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Water

Gladstone Area Water Board—investigation of pricing practices

In April 2004 the Premier and the Treasurer directed the QCA to undertake an investigation of the pricing practices of the Gladstone Area Water Board (GAWB). QCA was also directed to investigate the appropriate framework for monitoring pricing practices (including prices and contractual arrangements) relating to the declared activities.

The QCA's final report of recommendations regarding GAWB's pricing practices was provided to ministers in March 2005. The ministers subsequently decided in July 2005 to accept, with qualification, four of the QCA's recommendations and to accept without qualification the remaining recommendations.

In relation to ongoing monitoring, the ministers accepted the QCA's recommendation that GAWB publicly report on service quality against contractual standards annually, and submit the report to the QCA. The QCA anticipates that GAWB will submit its first service quality report mid-year.

The QCA's final report of recommendations is available from the QCA or can be downloaded from the QCA's website at www.qca.org.au.

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Rail

In December 2005 the QCA issued its final decision on the Queensland Rail (QR) draft access undertaking. In that decision, the QCA rejected the draft access undertaking and issued a second undertaking notice requiring QR to submit a conforming undertaking within 60 days. The 60 days expired on 10 February 2006.

On 6 January 2006 QR initiated an application in the Supreme Court for judicial review of the QCA's final decision. A directions hearing was held on 3 February 2006. QR's application for judicial review was granted, as was QR's application for a stay of the operation of the QCA's second undertaking notice until the judicial review application is determined. At that time, the Queensland Resources Council was made a party to the proceedings.

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Ports

Draft access undertaking

On 20 April 2005 the QCA released its decision in relation to the Dalrymple Bay Coal Terminal (DBCT) draft access undertaking (DAU). In finalising its decision, the QCA considered a range of issues where both the terminal lessee (Babcock and Brown Infrastructure—BBI) and terminal users often had diametrically opposed views, including in relation to capital expansion, price, cost of capital and asset values.

Since that time BBI and terminal users, represented by the DBCT User Group, have engaged in extensive negotiations to resolve all outstanding matters relating to the DAU and the standard access agreement (SAA).

While the QCA considered that there was a good prospect that these discussions would result in an agreed DAU and SAA, the QCA had some concerns about the length of time being taken to finalise these negotiations. As a consequence, on 21 October 2005 the QCA issued an initial undertaking notice to BBI giving it 90 days (to 19 January 2006) to submit a DAU.

On 4 January 2006 BBI formally submitted a revised DAU and related SAA for DBCT.

On 9 January 2006 the QCA issued a notice of investigation requesting submissions on the DAU by 31 January 2006. Copies of these submissions and the DAU are available on the QCA's website at www.qca.org.au

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Northern Territory

Utilities Commission of the Northern Territory

Annual power system review

The Utilities Commission has released its review for 2005 of trends in the adequacy and security of the Northern Territory's power system. The 2005 review included an assessment of the arrangements for power system planning and reliability in the Northern Territory.

The Utilities Commission noted that, for all practical purposes, power system planning and reliability in the Northern Territory continues to be managed, as it had been prior to the market reforms of 2000 and in contrast to practice in other jurisdictions, as an internal matter by the Power and Water Corporation. While acknowledging that Power and Water has achieved relatively good system reliability outcomes to date in a harsh environment, the Utilities Commission advised the minister that while current power system planning arrangements continue the Utilities Commission is not in a position to provide an assessment of the prospective capacity and reliability of the Northern Territory's electricity networks.

Network pricing principles

In February 2006 the Utilities Commission approved the pricing principles statement submitted by Power and Water, under cl. 75(6) of the Northern Territory's Network Access Code. The Utilities Commission approved the statement on the grounds that it is not inconsistent with the principles laid down in cl. 74 of the Code. The statement is approved for use during the second regulatory control period.

The statement now forms the basis upon which the Utilities Commission will assess proposed network tariffs and charges submitted for approval annually by Power and Water.

Review of cost allocation practices and procedures

As part of the Utilities Commission's review of Power and Water's allocation of costs—both operating and capital—between products and customer groupings, the Allen Consulting Group has presented a draft report. The principal draft finding was that, while Power and Water has generally implemented a single and internally consistent model of cost allocation across its entire business, the associated cost allocation and transfer pricing mechanisms are poorly documented.

The Utilities Commission's review is expected to be finalised during May 2006.

Energy Loss Factors Code

Following a compliance review of Power and Water's calculation of energy loss factors undertaken in late 2004, the Utilities Commission has developed a draft Energy Loss Factors Code. The code sets out the desired outcomes (or characteristics) to be met by any methodology used by the network service provider in future to calculate energy losses in the Northern Territory context.

A draft code has been provided to interested parties, and the code was finalised in April 2006.

Standards of Service Code

In December 2005 the Utilities Commission published a Standards of Service Code. The code establishes the basis on which minimum standards of service benchmarks apply to regulated electricity networks and at the retail level for non-contestable customers. These are to be met by 30 June 2006. The code also establishes the process by which actual standards of service are to be reported against the benchmarks (commencing with the 2005–06 financial year).

The code does not include any incentive or penalty mechanisms. These are, instead, to be considered at the time of the network's next regulatory reset.

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International

Commerce Commission New Zealand

Telecommunications

On 9 December 2005 the Commerce Commission released its final determination on TelstraClear's resale of several Telecom broadband retail services for business. The Commerce Commission determined the price and non-price terms for five of Telecom's services, setting the wholesale prices at 16 per cent off Telecom's retail prices. The Commerce Commission also released a final determination on 20 December 2005 providing TelstraClear with regulated access to a wholesale bitstream service supplied by Telecom.

TelstraClear and Telecom both applied for a review of the broadband retail services for business decision at the beginning of January 2006 but withdrew all pricing applications after both parties reached a commercial agreement relating to a range of services.

In December 2005 the Commerce Commission also released its draft report to the Minister of Communications recommending that mobile termination be regulated. In June 2005 the Commerce Commission had recommended that the termination of voice calls on a cellular mobile telephone network should be regulated. In August 2005 the minister asked the Commerce Commission to reconsider this recommendation in light of offers he had received from the mobile phone companies to voluntarily reduce rates.

The Commerce Commission was still of the opinion that regulation would bring greater benefit to end users. It did, however, change its view on third generation networks. The Commerce Commission had previously recommended that third generation, or 3G, be excluded from regulation to preserve incentive for investment in services. In the new draft report 3G termination was included in the regulation as there had been an extensive rollout of the technology since the initial report. The Commerce Commission anticipates making its final report to the minister later this year.

The Commerce Commission also completed its monitoring of the uptake of Telecom's residential broadband services. The monitoring programme tracked Telecom's progress against a target of 250 000 residential broadband connections, of which more than a third were to be supplied by Telecom's wholesale customers by the end of 2005. Telecom reported a total of 279 123 residential connections (111.6 per cent of the aggregate total) and 63 495 wholesale connections (76.5 per cent of the wholesale target).

Electricity lines

In September 2005 the Commerce Commission published an intention to declare control of Unison Networks Limited, one of 28 electricity distribution businesses. This was the first time the Commerce Commission had published an intention to declare control of an electricity distribution business since it was given powers to do so in August 2001.

The intention to declare control followed an inquiry into the business' breach of its initial price path threshold, set by the Commerce Commission in June 2003. A subsequent breach of the price path threshold set from April 2004 occured with a further price increase by the business in 2004.

In December the Commerce Commission published an intention to declare control of the electricity transmission services of Transpower, the owner and operator of the national grid. Transpower had breached the price path threshold in each of the three assessment dates. The Commerce Commission determined that Transpower's breaches of the price path threshold in the 2004–05 and 2005–06 pricing years could not be justified, and that the company was likely to be earning excess profits. For the latest information see media release no. 116 on the commission's website at www.comcom.govt.nz.

In October 2005 the Commerce Commission published its 'Regulation of Electricity Lines Businesses: Valuation of the Regulatory Asset Base Decision Paper'. The Commerce Commission decided that the system fixed assets for distribution electricity lines businesses should be valued using the optimised deprival value methodology. The Commerce Commission also decided in principle that system fixed assets for Transpower should be valued using an indexed historic cost method. This decision will be assessed in light of any implementation issues arising from the development of Transpower's pricing methodology.

The Commerce Commission also published its 'Regulation of Electricity Lines Businesses: Review of the Information Disclosure Regime Decision Paper'. The paper outlines decisions the Commerce Commission made following consultations as part of its review of the information disclosure regime. During November and December the Commerce Commission held two information disclosure workshops with auditors and representatives from the electricity lines industry. The workshops were aimed at developing regulatory financial statement

specifications and performance measures to enable new financial information disclosure requirements to be issued for application to the 31 March 2006 disclosure year. This is the first stage of a two stage implementation, with quality and technical information to be reviewed in 2006.

Gas Pipelines

Work continues on a final authorisation for the gas pipelines services of Powerco and Vector after the Commerce Commission issued a provisional authorisation implementing control in August 2005. The provisional authorisation set a price reduction of 9.5 per cent for Powerco and 9 per cent for Vector on the average price charged at 30 June 2005. The Commerce Commission must now consult on the form of control to be used before determining a final authorisation of price, revenue and/or quality.

Notes

1 Australia, Parliament, House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform, *Tracking Australia: an inquiry into the role of rail in the national transport network*, Canberra, July 1998. http://www.aph.gov.au/house/committee/cita/rail/contents.htm.

2 D Kilsby, P Laird and D Bowers on behalf of the National Committee for Transport of Engineers Australia, 'Australian Transport Infrastructure: Fit for Purpose?', paper presented at the 27th Australasian Transport Research Forum, Adelaide, 29 September–1 October 2004.

3 Institute of Engineers, *2001 Australian Infrastructure Report Card*, 2001, p. 26.

4 Reserve Bank of Australia (RBA), *Statement on Monetary Policy*, 7 February 2005, p. 50.

5 Engineers Australia, *2004 Queensland Infrastructure Report Card*, November 2004, p. 44. The 2001 Infrastructure Report Card rated the Central Queensland coal trains as A–.

6 The American Association of Railroads (which is admittedly an advocacy organisation) speaks of 'Massive investments in infrastructure and technology' in American Association of Railroads, *Overview of US Freight Railroads*, January 2006, (http://www.aar.org/PubCommon/Documents/AboutTheIndustry/Overview.pdf). The US railroads may not have needed to invest in substantial new track infrastructure due in part to historic over-capacity; see Brennan, US Department of Agriculture, 'Long-Term Capacity Constraints in the US Rail System', July 1998, (http://www.ams.usda.gov/TMD/summit/ch4c.pdf). There do seem to be capacity constraints in certain specific areas such as around Chicago and the 'mid-Atlantic' region where freight trains interact with suburban and inter-city passenger trains.

7 Brian Levy and Pablo T Spiller 'The Institutional Foundations of Regulatory Commitment: A Comparative Analysis of Telecommunications Regulation', *Journal of Law Economics and Organization*, vol. 10(2), October, 1994, pp. 201–46.

8 See Levine, Paul, Stern and Trillas, 2004, Independent Utility Regulators: Lessons from Monetary Policy, Working Paper, Dept of Economic History, Universidad Autonoma de Barcelona, July 2004; Levy and Spiller, 1994, p. 201.

9 Queensland Competition Authority Bill 1997, Explanatory Note p. 5. In India, one of the arguments given for the creation of a railway regulatory authority was to 'depoliticise fixation of rail tariffs', *Economic Times*, New Delhi, 6 December 2002. One of the primary arguments for rail reform in Europe was the desire to 'depoliticise' the process of setting subsidies. 'One of the most important drivers of privatisation and deregulation [in the rail industry] was the expectation that the provision of transport infrastructure services would be depoliticised and the implementation of hard budget constraints would lead to substantial benefits for the fiscal sector'. See ECMT, 'Conclusions of Roundtable 129: The Limits of (De-)Regulation of Transport Infrastructure Services', CEMT/SC(2004)32, 24 September 2004.

10 Levine et al, 2004. p. 1.

11 Levine et al, 2004, p. 23. Cited articles are: S.J. Wallsten, 'Does Sequencing Matter? Regulation and Privatization in Telecommunications Reforms', World Bank Policy Research Working Paper No. 2817, 2002; C. Fink, A. Mattoo, and R. Rathindran, 'An Assessment of Telecommunications Reform in Developing Countries', World Bank Policy Research Working Paper No. 2909, 2002; L.H. Gutierrez, 'The Effect of Endogenous Regulation on Telecommunications Expansion and Efficiency in Latin America', *Journal of Regulatory Economics*, 23:3, 2003, pp. 257–86.

12 Gómez-Ibánez points to a cycle of privatisation-regulation-nationalisation suggested by John Diandas, former chairman of Sri Lanka's National Transport Commission; see José Gómez-Ibánez, *Regulating Infrastructure: Monopoly, Contracts and Discretion*, Harvard University Press, Cambridge Massachusetts, 2003, p. 58 and following.

13 There is arguably a need for a preliminary step—that is, clarifying precisely why subsidies are deemed necessary in the rail industry. If, as argued here, they are necessary to correct under-pricing in the road mode, this suggests that the rail subsidies should be targeted to those services which suffer the most from the mis-pricing of the road mode.

14 Econtech, 'Modelling the Economic Effects of Overcoming Under-Investment in Australian Infrastructure', Report prepared for the Australian Council for Infrastructure Development (AusCID), 2 August 2004, Table 6, p. 17.

15 Reserve Bank of Australia, *Statement on Monetary Policy*, 7 February 2005, p. 48.

16 Port Jackson Partners Limited, 'Reforming and Restoring Australia's Infrastructure', Business Council of Australia, March 2005.

17 Exports and Infrastructure Taskforce 2005, *Australia's Export Infrastructure*, Report to the Prime Minister, Canberra, May, p. 5.

18 Engineers Australia, 2005 *Victorian Infrastructure Report Card*, June 2005, p. ix.

19 'According to currently available information on planned coal port expansions, committed investment will increase port capacity by an estimated 13 per cent over the next two years or so. Growth in rail capacity is expected to be broadly in line with the expansion of port capacity. However, this is unlikely to match the expansion in production potential or export demand, so transport capacity is likely to remain a constraint on export supply, at least until a number of proposed large infrastructure projects are completed later in the decade.' Reserve Bank of Australia, *Statement of Monetary Policy*, 7 February 2005, p. 50

20 In its submission to the House of Representatives Standing Committee the ARTC notes that 'over the past 3–5 years, supply chain throughput has increased from around 60 mtpa to around 80–85 mtpa . . . ARTC is currently refining, with the industry, a Hunter Valley corridor capacity improvement strategy that is intended to increase capacity from current levels to nearly 140 mtpa by 2009, requiring infrastructure investment of around $270 million. The coal industry has indicated support and willingness to pay for this investment which ARTC considers to be a prerequisite to making the investment'. See Australian Rail Track Corporation Ltd (ARTC), Submission to the House of Representatives Standing Committee on Transport and Regional Services, 23 May 2005.

21 In submissions to the 1999 PC review of progress in rail reform, the Australasian Railway Association notes 'Progress in rail reform has been severely hampered by inadequate infrastructure investment'. The National Rail Corp writes 'The poor quality of infrastructure used for interstate rail operations increases the cost of rail operations and affects service quality'. In an ARTC submission to the PC in 2004, the ARTC writes: 'On north-south corridors … the infrastructure suffers from historic under-investment resulting in inferior performance and limited capacity'. The Institute of Engineers *Infrastructure Report* of 2001 said that 'Victoria's under-investment in rail infrastructure had left many trunk routes with too many curves and gradients, obsolescent signalling, bridge-weight and speed limitations, lack of adequate track duplication and passing loops, and insufficient paths through suburban passenger traffic to key freight destinations. Victoria's railways held premier position in the 1930s but were now unequivocally the poorest performer of all the state's systems'. (Reported in *The Age*, 25 March 2004). The report by EconTech for AusCID found a deficit of $8.06 billion of infrastructure spending on rail (65 per cent of existing capital stock) and noted that 'It is well known that there have been decades of chronic under investment in Australia's rail system and in particular the interstate rail network and the Sydney urban network'. 'An over-riding feature of railways since the introduction and subsequent dominance of the car and road infrastructure is its lack of investment by government owners', Stewart Smith, 'Transport in NSW', Briefing Paper, 10/99.

22 ARTC Press Release, 'Rail Audit Shows $500 million Investment needed', 1 May 2001. See also the examples cited in Railway Technical Society of Australasia, Supplementary Submission to the Productivity Commission Re: National Competition Policy, December 2004.

23 For example: 'About 23 per cent of the track between Junee and Campbelltown is on curves with a radius of less than 800 metres and so speed has to be reduced. Most of this 'steam age' alignment could be eliminated by construction of three major deviations as identified in the ARTC Track Audit. On the North Coast line between Maitland and Brisbane over 40 per cent of track is on curves of radius less than 800 metres'. D Kilsby, P Laird and D Bowers, 2004, p. 5.

24 P Laird, 'Australian Transport and Greenhouse Gas Reduction Targets', 26th Australasian Transport Research Forum, 1–3 October 2003.

25 UK: 'We have a legacy of under-investment in transport … Successive governments have devoted insufficient resources to upgrading and modernising the transport system, while travel on our road and rail networks has increased to levels that were never anticipated when they were built', UK Dept. of Transport, Future of Transport White Paper, July 2004. South Africa: 'Much of the problems lies in the current age of the Spoornet fleet as well as in a chronic under-investment in maintenance over a number of years', 'Rail boss tackles 'intolerable' accident levels', *Mining Weekly*, 19 July 2005. USA passenger services: 'The fundamental problem undermining the nation's rail system, after all is chronic under-investment', *New York Times*, 19 February 2002. 'Politics, not efficiency considerations, are the basis for the chronic underinvestment in rail', 'Amtrak Privatisation: The Route to Failure', Elliot Sclar, Columbia University. China: 'China is suffering the effects of chronic under-investment in its transportation infrastructure', China Transport Briefing, converger.com. Ireland, 'A number of factors have contributed to the current situation … Chronic under investment in public transport until recently', Iarnrod Eireann, Dart upgrade. Sweden: 'Public and political concern about the lack of investment and growing levels of congestion within cities led to the 1988 Transportation Act', Swedish Submission, Railways: *Structure, Regulation and Competition Policy*, OECD, 1998. Korea: 'This led to … chronic shortages of investment funds needed for expanding railroad services to meet increasing demand', Korea Submission, *Railways: Structure, Regulation and Competition Policy*, OECD, 1998.

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