

# NETWORK

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# Reforming Port Botany's Links with Inland Transport

James P Cox and Dennis Mahoney

In 2007 IPART undertook a review of the ways that road and rail transport link up with the two container terminals at Port Botany with a view to increasing the efficiency of those linkages. Port Botany is the largest container port in New South Wales (NSW) and plays a critical role in the state's economy. It handles 95 per cent of the state's container trade, and generates \$1.5 billion in business activity each year. The urgency of the review arose from both immediate and long-term considerations. The immediate concerns were recurring physical congestion at or near the terminals' landside facilities and 'virtual congestion' in the access booking systems. An added consideration was the NSW Government's target that the share of containers moved by rail should be increased from 20 per cent to 40 per cent. The long-term concern was that containerised trade through the port is likely to grow rapidly and current landside access arrangements would not be able to cope. This is so even though a third container terminal operator may operate in Sydney after 2012.

The Bureau of Infrastructure Transport and Regional Economics (BITRE) has forecast annual average growth of 5 per cent in Sydney container throughput over the next 20 years. Such a rate of growth will more than double the port's total annual throughput – taking it from an actual 1.62 million twenty-foot equivalent units (TEUs) in 2006-07 to 3.63 million TEUs in 2024-25. In 2006-07, 1.32 million TEUs were transported from the port by road. The remainder, 300,000 TEUs, were carried by rail. Obviously, as many containers enter Port Botany (called import containers or 'import boxes') as leave it (called export containers or 'export boxes'). However, Sydney consumes far more containerised imports than it exports, so that about half of the export boxes are loaded as 'empties'. For this reason, there is greater flexibility in the delivery of export boxes and efficient handling of import boxes is the 'stress point' for the operation of the terminals. This paper discusses the matters at Port Botany primarily from the perspective of the import arrangements.

## Current Landside Arrangements

Two stevedores – Patrick and DP World – work 24 hours a day, seven days a week to ensure that all ships are unloaded and loaded within the terms and conditions of their contracts with the shipping lines. These contracts provide most of the stevedores' revenue. The 1.62 million TEUs moved in 2006-07 translate into a movement of containers of about 3,300 per day, based on a six-day week (few containers are moved on the landside on Sundays) and an average 1.5 TEUs per container (BITRE *Waterline 42*). Containers cannot be allowed to build up because high stack densities reduce the efficiency of both the shipside and the landside. To keep moving containers on the landside, four train operators and around 250 trucking companies and freight forwarders/customs brokers seek access to Port Botany.

Freight trains must cross the main metropolitan line on which passenger trains have priority. They then use a single-track line to access Botany Yard where they are repositioned prior to entering the stevedores' terminals at specified 'rail window' times. They are then unloaded and loaded, exit at the expiry of the window (whether finished or not) and proceed to the main metropolitan line for clearance by RailCorp. The co-ordination difficulties and possibly lengthy delays that must be faced during this process are considerable.

The 250 road transporters gain access to the terminals chiefly via the vehicle booking systems (VBSs). Other methods of access are available for casual port users and for empty export container runs of 50 boxes or more. The VBSs are online systems that allocate slots to each road transporter based on their classification (at DP World) or past volume of business (with Patrick). The actual allocation of these slots takes place two business days ahead of access in a 'scramble' that occurs early each weekday morning at the computer desks of the road transporters around Sydney. The scramble occurs because the number of VBS timeslots that the stevedores can supply in the most desirable time periods is less than the number demanded. To minimise their costs, road transporters primarily work during the hours that freight owners work. That way, owners are open for business and able to receive containers.

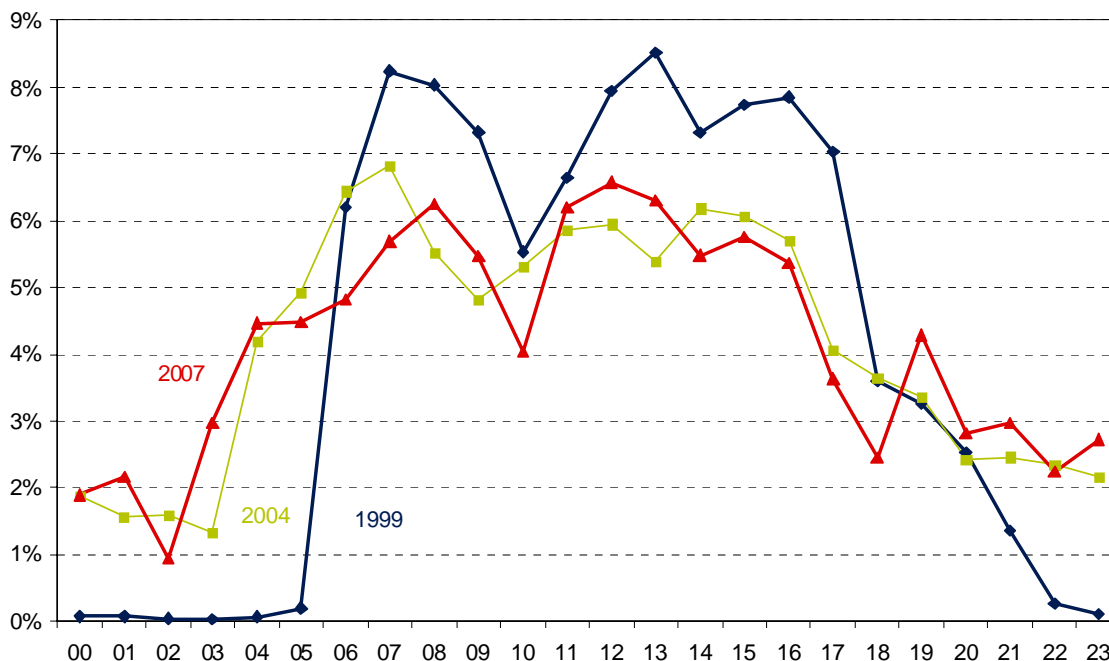
For road transporters, the most desirable times of access to the port are during weekday mornings. Picking up an import box in the morning means that it can be transported through Sydney to the importer's warehouse, unloaded and then returned to an empty export container depot near the port. There may then be sufficient time to repeat the process before the freight owner and empty container park closes for the day.

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To minimise their costs, the stevedores prefer to offer VBS slots across the 24 hours of each day, including Saturdays and Sundays. When disruptions to terminal work plans occur (for example, ships arrive early or late, equipment breaks down, workers report in sick or the weather is inclement), the landside experiences delays outside the terminal or congestion in the VBSs. The disruption to road transporters' work plans and driver patience can be very extensive if delays are prolonged. However, each stevedore holds a monopoly position in relation to each landed container and has no contractual relationship with the road transporter. Further, many features of the VBSs are not transparent. These includes the method of allocating the slots available in each hour, the total slots on offer per hour and the mutual obligations of the parties involved (especially when delays occur). A lack of transparency has also fostered suspicions that road affiliates of the stevedores may receive favourable treatment, although IPART received no verifiable evidence to this effect.

Road transporters have changed the way they operate to minimise the effects of road congestion. The most obvious way around daytime congestion is to shift activity to night-time. As is indicated in Figure 1, a shift in truck entry times towards entry before 6am and, to a lesser extent, after 9pm, is noticeable. Most of the shift occurred between 1999 and 2004.

**Figure 1. Weekday truck entries in the stevedores' terminals by hour of day**



Source: Survey data collected by Sydney Ports Corporation (SPC) for the same week in each year that SPC collects data on truck waiting and turnaround times.

In summary, the inter-relationships between the terminals and the participants in this complex supply chain raise a number of important economic issues:

1. access to the terminals in peak periods is rationed rather than priced and the costs of this in terms of roadside delays and track underutilisation can be significant
2. these costs are either absorbed by the transport companies or passed on in demurrage charges to freight owners. Some costs, such as the noise and air pollution around the port, are borne not by the supply chain but by the local community
3. participants in the supply chain may not consider the costs that their actions impose on other participants
4. Terminals may be operating efficiently and reducing their costs but increasing the costs to truck operators. In turn, truck operators may not be able to pass on these costs in a way that encourages freight owners or shipping lines to respond by extending their hours of operations (freight owners) or by switching stevedores (shipping lines).

## IPART's Task

IPART's task was to review the landside arrangements and recommend ways in which their efficiency could be improved. IPART published an Issues Paper in May, followed by a roundtable in July and a Draft Report in October. Stakeholder submissions were sought in response to the Issues Paper and the Draft Report and were considered before IPART released its Final Report in March 2008.

On the roadside, four inefficiencies stand out:

1. the supply of VBS slots is often less than demand, but that there is no mechanism for measuring unmet demand
2. VBS slots are allocated to road transporters without regard to the value of the slots to the transporters
3. the mismatch of hours between the operations of the stevedores and many of the road transporters results in excess demand for VBS slots during weekday business hours
4. there are limited mechanisms for reducing the impact of uncontrollable delays at stevedore terminals on road transporters.

On the railside, the main issue is service quality that is poor relative to road. A secondary consideration is that rail is also a higher cost mode around Sydney than road. IPART identified five specific causes of rail's poor service quality:

- the inadequate configuration of Botany Yard, which makes it a bottleneck
- the inefficient length of the DP World rail siding, which requires time-consuming marshalling and shunting associated with the need to split trains
- the slow train strip and reload rates currently achieved by both stevedores, which limits the number of containers that can be handled in a rail window
- coordination problems among the various rail entities involved in the movement of trains leading to unnecessary delays and a failure to capture opportunities for optimisation of rail logistics
- the unavailability of freight paths through the suburban passenger network during peak hours, which creates further bottlenecks.

## IPART's Recommendations

The recommendations in the Final Report addressed as many of the inefficiencies as possible. They fell into three categories; those that applied within the framework of the current arrangements, those that altered structural features of those arrangements and those that introduced a completely new element in those arrangements. One recommendation did not fit this categorisation. It was that only light-handed regulation should be employed towards the landside at Port Botany because all the major participants in the supply chain are private sector companies except for Sydney Ports Corporation, RailCorp and ARTC. In the light of this predominance of private sector companies, IPART felt that voluntary solutions and market-based solutions to the current inefficiencies was a better way of addressing the issues – unless argument or evidence could be marshalled to the contrary.

Of 18 recommendations, 14 are in the first category and almost all relate to the roadside (see appendix).

Some sustained operational gains were made, especially at the Patrick terminal, from November 2007 onwards. This was due in part to the introduction of some new terminal equipment and in part to the IPART review process which encouraged changes to stevedore information flows, management structure and manning practices.

On the railside, one recommendation of the review supported initiatives of the NSW Government to:

- assist the ARTC to secure AusLink funding for Botany Yard works
- expedite the lengthening of the rail siding from 300 meters to 600 meters inside the DP World terminal, and
- press for funding of further dedicated freight access across the Sydney rail network that will supplement the Southern Sydney Freight Line that will provide freight-only access between Port Botany and south-west Sydney (Moorebank).

A second rail-related recommendation seeks to improve the operational aspects of the current rail arrangements by improving the co-ordination of all the parties who have assets involved in the rail-side supply chain. A Port Botany Rail Logistics Team (PBRLT), modelled loosely on the successful Hunter Valley Coal Chain Logistics Team, should be formed between ARTC, the stevedores, train operators, RailCorp and SPC. The aim of the PBRLT is to improve the operational aspects of the rail landside by means of voluntary association and agreement.

An important aspect of the recommendation, and one that met resistance among the roadside stakeholders, is that the PBRLT should exclude Port Botany stakeholders who have an interest, but not a direct commercial stake, in improved rail landside arrangements. This recommendation was made to give the PBRLT a focus on improving rail operations at Port Botany.

#### **Fundamental Structural Efficiency Improvement – Auction-Based Pricing of Firm Slots**

IPART made one recommendation for major structural reform: the introduction of auction-based pricing of firm slots. It has been by far the most controversial recommendation. The VBS system would continue to operate, but in two tiers – the first tier is the current system of ‘interruptible’ slots and the new, second, tier is to be ‘firm’ slots priced by auction.

The first tier is currently provided by the stevedores on a ‘best endeavours’ basis. The slots carry no or a very low price with penalties for late arrivals and ‘no shows’. IPART calls these slots ‘interruptible’ slots to signify that they provide no guarantee of entry, even for trucks that arrive on time.

By contrast, a firm slot comes with a service guarantee and two-sided penalties for non-performance. The provision of firm slots would, for the first time, create a contractual obligation between the stevedore and the road transporter. Such a contractual obligation would be a major step forward in clarifying the mutual expectations of the parties involved in the road landside. Further, because firm slots are more valuable than interruptible slots, they should carry a higher price.

Firm slots will be offered during peak times at prices that are higher than for interruptible slots. The response by road transporters and the downstream freight owners who will ultimately pay the price, will be to spread demand into the off-peak periods. Such spreading will both ease congestion and save on terminal capital investment.

Since off-peak access implies the use of overnight storage facilities, there is likely to be increased demand for warehousing facilities. This includes the warehousing that is provided, in effect, by inter-modal terminals. Since access from the port to inter-modal terminals is specifically designed to be done by rail, the use of peak pricing for road access is likely to increase the volume of containers that are transported by rail.

IPART was reluctant to make a detailed, specific recommendation on the dimensions of a firm slot. It did, however, offer illustrative suggestions on how the standard of service might be defined and how penalties for missed firm slots might be applied. For example, by offering a firm 8am slot, a stevedore would be committing itself to guarantee a.) entry to its terminal by 8:59am, and b.) completion of the unloading or loading of the (pre-specified) container within, say, 40 minutes of the actual entry time. (The commitment may be to complete service within 60 minutes if the road transporter has both an export box to unload and an import box to load.)

In return for offering a firm slot, the stevedore would be paid the extra costs involved in hiring the resources required to meet the service guarantee. These costs, including a reasonable return on capital, would be paid from the proceeds of the firm slot auctions (of which more below). The exact sum paid per firm slot is a matter to be resolved.

If the stevedore failed to meet its service obligations, it would be penalised. At the Draft Report stage, IPART thought a simple penalty scheme would be 'double your money back.' If the road transporter paid \$100 for a firm slot, the stevedore would be penalised \$200 for missing it. The stevedores expressed reservations about this scheme, not least because it made the size of the penalty depend on the price paid for the firm slot. There were also questions raised in contract law as to whether such a penalty was punitive and not related to the loss caused by missing the service guarantee. In the end, IPART left open the question of the size and nature of the penalty to be paid by the stevedore.

By buying a firm 8:00am slot, a road transporter would be committing itself to arrive at the port precinct by 8:30am. If late, the transporter would lose the right to a firm slot and the amount paid for it. Because it is in the interests of all parties to have boxes moved off the wharf, however, the transporter should still be served. There are three degrees of lateness:

- If the transporter was less than 10 minutes late into the firm slot queue, its (now) interruptible slot could still be serviced, ideally, but not of necessity, within the remaining one-hour slot window.
- If the transporter were more than 10 minutes late, but less than a half-hour late, it should join the interruptible queue to be served at the stevedore's discretion. Since the road transporter has arrived, the no-show and other penalties on interruptible slots could not be incurred.
- If the road transporter arrived an hour or more late, the slot would be void. It would not convert into an interruptible slot, and neither stevedore nor carrier could exercise any discretion in this matter. No carrier should miss a booking by an hour and think entry might still be gained.

Because they come with an entry and exit time guarantee, firm slots are obviously more valuable than interruptible slots. But how much more? Since the size of unmet demand is unknown, IPART believes that the question is best decided by auction. The slots would then go to those who value them the most and there would be no need to allocate slots by some other means.

IPART considered other pricing methods, including prices set or fixed by administrative decision. The advantage of a fixed price is that it is known with certainty. This advantage has particular appeal to road transporters who would find on-charging to freight owners easy to explain and therefore straightforward to do. This would be true even if there were two fixed prices, one set high during the peak hours and the other set lower in off-peak times. The former would be a price designed to reflect both the high demand for access during the peak and the better quality of firm slots compared to interruptibles. The lower off-peak price would simply reflect the better quality of firm slots over interruptibles.

The chief disadvantages of fixed price(s) are that they do not clear the market so that slots do not necessarily go to those who value them the most. A quota mechanism is still required to allocate the firm slots to those who want them (especially in peak times).

IPART considered various aspects to an auction as it might apply at Port Botany, including how it might be conducted, whether participation might be limited and whether special provisions would need to be made to prevent collusion and gaming. It considered that an online descending Dutch auction would be best suited to Port Botany. Each potential bidder would observe a 'clockface' of prices for, say, 8am Monday firm slots. The 'clock' would start at a high price and tick down each few seconds. Bidders then would place their bid online at the then-current price. The process would continue (possibly for several minutes) until all the firm slots on offer were sold or until the reserve price was reached. In the former case, all slots would have been sold at the last, lowest bid price. In the latter, all slots sold would have been sold at the reserve price. The remaining firm slots would be converted to interruptibles and placed in the interruptible system. The reserve price would be somewhat above the price of an interruptible slot to reflect the fact that all firm slots carry a service guarantee that makes them more valuable than an interruptible slot.



Participation might occur in stages as stakeholders become familiar with an auction system. With over 250 road transporters, customs brokers and freight forwarders, the possibilities of collusion and gaming appear to be limited. In particular, one misplaced fear of the auction system is that a major non-Port entity might seek to capture all the firm slots and resell them at a higher price. But that possibility only exists if slots were sold below their market value in the first place, as often happens with tickets to theatre performances or Grand Finals.

The proposal recognised that landside circumstances may change in the two days between the auction and the required terminal access. Unforeseen changes could go either way and so the value of slots could sometimes rise and sometimes fall. If a buyer of a slot no longer needs it, he or she can trade it or nominate a different container for pick-up.

Some of the net proceeds from the auction system – which on reasonable assumptions might be in the order of \$10 million per annum – would be paid to the stevedores to cover the costs of meeting their service guarantee on firm slots. The remainder of the funds should be retained in a 'port infrastructure trust' with strict guidelines for their use in improving the efficiency of the landside operations at the port.

### **Regulation Instead of a Market Mechanism?**

IPART received a proposal from NSW Maritime that made two suggestions that were widely divergent from the IPART approach. First, NSW Maritime made a case for taking control of the number of slots offered in any hour out of the hands of the stevedores and placing them under the control of an Independent Gateway Authority (IGA). Second, it wanted to make all slots firm.

IPART's view is that an IGA was not necessary and that it might create greater inefficiency if it were in place. An IGA would not be able to forecast with sufficient accuracy the necessary slot numbers or their timing. This inability to forecast the landside task accurately starts from the shipside where the ships vary in size from 5,000 gross tonnes to over 55,000 and only around one-third to one-half arrive within an hour of the time they stipulated just 24 hours before. In June quarter 2007, for example, 43 per cent were 'on time' (BITRE *Waterline* 43 p. 46 cited in the IPART *Final Report* p. 35).

In practice, an IGA would depend on the stevedores for advice about ship arrivals and the number of hourly slots required. However, when delays occur, it is the IGA that would likely to be held responsible for outcomes over which it had no control. To ensure that there were sufficient slots offered on the landside to meet demand, an IGA may err on the side of caution and offer more slots than demanded. Such a practice would then induce underutilisation of the most expensive equipment in the supply chain – the wharf cranes, straddles and gantries – thereby adding to inefficiency and costs along the supply chain.

If all slots were declared 'firm', there would no longer be a choice for road transporters between certainty and flexibility. Firm slots offer certainty, at a price, while interruptible slots offer access at a low or no price, but with no certainty of timely access. 'All slots firm' also would give the stevedores no way to adjust in unexpected circumstances, which means that risk-adverse stevedores would insure that they met their service obligations by being willing to offer fewer slots, especially in peak times.

In IPART's view, the NSW Maritime proposal was very prescriptive and should only be considered if the voluntary actions among (mostly) private-sector entities recommended by IPART were to fail.

### **Implementation Issues**

There are still detailed matters of implementation to be decided by the parties at Port Botany in consultation with the NSW Government, SPC and each other. Prior to such considerations, the NSW Government is to decide its response to the IPART recommendations. Meanwhile, the number of TEUs passing through Port Botany continues to rise, reaching at least an estimated 1.75 million in 2007-08. This is up 9 per cent on the previous year and much faster than the 5 per cent annual average growth assumed by the BITRE in its projections to 2024-25.

## Appendix: IPART's Roadside Recommendations

1 That each stevedore provides real-time information to the road transporters that would help them understand the shipside and landside tasks and the state of the terminal and, during delays, to convey the length of the truck queue at its terminal, and an estimate of the time that trucks with booked VBS slots will need to wait after their booked slot to enter the terminal.

2 That road transporters invest in the communication devices they need to receive and act upon the stevedores' real time communications.

3 That stakeholders adopt a non-discretionary set of communication rules that establish how the stevedores will adjust the number of VBS slots when delays occur in their landside service. SPC should take the lead in this matter by acting as the forum convenor.

4 To foster goodwill, that the stevedores provide basic amenities such as toilets and cold drinking water to truck drivers who are required to queue to gain access to the stevedores' terminals. IPART supports efforts by SPC to progress a truck marshalling location at Port Botany.

5 That each of the stevedore ensures that its terms of access for road transporters specifies, in clearly expressed terms, how it operates its VBS, the complete terms and conditions of access to this system, and what a holder of a booking to this system is entitled to.

6 That SPC engages an independent auditor to conduct regular audits of each stevedore's compliance with their terms of access for road transporters.

7 That if the current 'super B-double' trial at Port Botany is successful, the RTA approve permanent access for these trucks as soon as practicable.

8 That SPC investigates, in consultation with the stevedores, the creation of compatible VBSs that encourage two-way loading, covering the wider port precinct. SPC should also take into account the views of the road transport operators.

9 That the stevedores provide less lenient 'grace periods' to the road transporters for late arrival. SPC can help to facilitate negotiations between the stevedores and the road transporters for more clearly defined rules on when penalties for late arrival should not apply.

10 That the NSW Government approach the Australian Government to consider the possibility of the Australian Customs Service making the following changes:

- Releasing containers on presentation of invoice for duty, and
- Extending Container Examination Facility operating hours.

11 That the stevedores grant two extra days of free storage rather than the present practice of granting one extra day for containers that have less than 24 hours of free storage available when they are cleared by the Australian Customs Service.

12 That the road transporters invest in the technology needed to fully automate the gate processing for trucks.

13 That the stevedores use whatever container numbers that have been provided 24 hours in advance to do more housekeeping to reduce truck turnaround times.

14 That the Minister legislates to enable SPC to collect information for the purposes of monitoring performance and investment in landside activities at the port.



## Critical Issues in Regulation – From the Journals

### Relative and Individual Regulation: An Investigation of Investment Incentives Under a Cost-Plus Approach

Nikos Ebel and Yassine Lefouili, *MPRA Paper no. 7314*, available online: <<http://mpra.ub.uni-muenchen.de/7314/>>

This paper investigates the effect of a modified yardstick competition on firms' investments in cost reductions. This regulatory approach is then compared with an individual cost-plus regulatory approach.

The modified yardstick competition studied in this paper differs from existing literature because firms are granted a mark-up, rather than a lump sum transfer, on the basis of other firms' performances, in order to compensate them for their cost-saving investments. More precisely, modified yardstick competition modelled in this paper is a *relative* cost-plus approach. The cost reduction efforts of symmetric firms are analysed under a price cap that is equal to the average of the marginal costs of the other firms, plus a relative mark-up.

The paper shows that, under this *relative* regulation, the regulated firm's investment in cost reduction increases as the mark-up decreases. This contrasts with individual regulation, where cost-reducing investment increases only as the mark-up increases. The individual approach thereby involves a trade off between the goals of encouraging efficient investment (cost reduction) and of minimising prices.

### Productivity at the Post: Its Drivers and its Distribution

E Grifell-Tatje and C.A.K. Lovell, *Journal of Regulatory Economics*, 33, pp. 133–158, 2007

This paper examines the performance of the United States Postal Service (USPS) during the 'post-reorganisation era', which is characterised by the service's modest but accelerating rate of productivity change since reorganisation in 1971.

The USPS has experienced gradual improvement in financial performance, first turning to operating profit in 1992. Since reorganisation, the USPS has been regulated by the Postal Rate Commission (PRC) which has the power to determine postal rates and enforce cost-saving and profit-maximisation objectives.

The paper discusses the implications of the reorganisation in light of the subsequent productivity and financial performance, measured in three ways:

- total factor productivity change;
- changes in cost efficiency, including technological change and scale economies, and
- the distribution of gains to stakeholders, including consumers, employees and other input suppliers, and residual claimants (the US Government).

The paper's analysis shows that the productivity gains come exclusively from technical progress originating in the adoption of new sorting and delivery technologies and work-sharing arrangements. Cost savings have improved substantially over time, in spite of some offsets from decreasing returns to scale and constant cost efficiency.

In terms of distributional consequences, the paper finds consumers of postal services were the losers, due to the highly inefficient operation of the USPS. In particular, the inability to constrain labour costs contributes to a substantial proportion of USPS's gains being transferred to postal employees. Other suppliers and the residual claimants are found to gain modestly throughout the period.

The results quantified many of the hypotheses made regarding the regulatory regime in place during the post-reorganisation era. The findings support the recommendations made by the 2003 President's Commission on the United States Postal Service for a more powerful regulator, responsible for capping postal rates and putting downward pressure on cost.

### Service Oligopolies and Australia's Economy-Wide Performance

R Tyers and L Rees, *ANU Working Papers in Economics and Econometrics*, No. 490, March 2007

This paper examines the impact of market power rents on the Australian economy, using an economy-wide macroeconomic model that expressly accounts for monopoly and oligopoly behaviour. The impact of three 'what if' scenarios is modelled, with a view to understanding the implications for policy setting in price cap regulation.

In modelling production sectors, the authors assume constant marginal cost oligopolistic structures in differentiated product markets. This permits the incorporation of market power, and of price-to-marginal cost mark-ups, in the model's behavioural equations of various industries. The behavioural equations capture the effects of regulatory policy, including price cap regulation. An import-export sector is also captured, along with government taxation and expenditure, and markets for productive inputs. It is calibrated using real historical data on the Australian economy.

The impact on economic welfare of cartelisation of certain Australian oligopolistic industries is examined, with an emphasis on telecommunications, electricity, gas, and aviation. The authors find that, if all sectors had been allowed to cartelise, the economic impact would have been substantial, with real GDP down by a quarter and real wages lower by almost half. If only the 'recently privatised services' had been allowed to cartelise, GDP would have been lower by a tenth and real wages by a seventh.

The authors then consider the effects from a tightening of price caps on these cartelised oligopolistic sectors. Somewhat unsurprisingly, they found that this leads to a substantial increase in economic welfare, although particularly in large manufacturing and 'other services' sectors, and less so in the 'recently privatised services'.

Finally, the potential impact of positive external shocks is simulated (with an eye on the present China boom) under different levels of tightness of price cap regulation, with a view to analysing policy implications for regulatory regimes. Tight price cap regulation is found to enhance welfare gains, both short-run and long-run (post-boom), that arise from a positive terms of trade shock. The gains are enlarged and further distributed than otherwise. Secondly, the effect of regulation is shown to have been to prevent excess entry into 'boom industries' (mining, etc.) and thereby avoided some of the welfare losses arising from post-boom economic dislocation caused by exit from the 'boom' industries.

### Relationship between Franking Credits and the Market Risk Premium

Stephen Gray and Jason Hall, *Accounting and Finance*, 46, 2006, pp. 405-428

The paper discusses the relationship between two individual capital asset pricing model (CAPM) input parameters – the market risk premium (MRP) and gamma. The theory regarding MRP and gamma parameters is influential in finding regulatory estimates of the appropriate return on equity capital across regulated industries.

The MRP in an Australian domestic CAPM is a measure of the forward looking required return to the Australian equity market, above and beyond the risk-free rate of return. Gamma is the (equity) market value of franking credits. Franking credits are 'attached' to the franked dividends of equity capital (shares) by the Australian Tax Office so that tax paid on the income generated by the firm may be credited to the tax bill of equity owners. The rationale for the system is to attempt to eliminate double taxation on company dividends under Australia's imputation tax system; once on the firm's income, then a second time on the investors' dividend income.

Gamma, or the market value of franking credits, is important in estimating the amount of tax paid on the returns to equity capital and therefore the allowance a regulated firm receive for this tax. For example, the AER's post-tax revenue model (PTRM) compensates regulated companies for projected company tax to be paid, less the value of franking credits to investors.

Gray and Hall argue that there is an inconsistency in the way in which the MRP and gamma are estimated by regulators. The paper examines the theoretical and empirical relationship between the assumed value of franking credits and the market risk premium. The authors attempt to show that there is a mathematical relationship between gamma and the MRP which is violated when gamma is set to 0.5. The paper also suggests that a gamma of zero and an MRP of 6 per cent (including franking credits) are inconsistent with historical dividend payout ratios and the historically observed MRP.

Gray and Hall argue that the appropriate adjustment to make the MRP and gamma values consistent with observed market data is to adjust the gamma value to zero, for any value of the MRP.

The ACCC/AER currently sets the value for gamma at 0.5 from a possible range of 0-1, and sets a value of 6 per cent for the MRP. Using a gamma of zero would result in higher compensation for regulated businesses through greater tax allowances for the cost of equity capital. Similarly a larger value for the MRP will also result in higher allowed compensation for the cost of equity capital.

Although this paper does not prove that regulated firms are incorrectly compensated, it might indicate that further work could be done to reconcile simplified financial models with actual market data.

## International Round-Up of Regulatory Decisions

### **Brazil: Regulator to Assess Telecoms Deal**

Brazil's largest and fourth largest telephone companies, Telemar and Brazil Telecom, have announced their plans to merge. The merger cannot proceed until a review of legislation preventing mergers between companies who own fixed line services in different regions is completed. If the merger is cleared, the merged entity could have enough market power to compete in the Brazilian market with the dominant telecommunications providers in Latin America, Telefonica and America Movil.

### **Belgium: Electrabel Demands Investigation - of Itself**

Electrabel is Belgium's largest electricity company, with approximately 75 per cent of both retail and production markets. On 20 May 2008 Electrabel announced it will ask the country's Competition Authority to investigate whether it has abused its dominant position in the industrial electricity market.

### **Canada: Canadian Radio-Television Telecommunications Commission Public Hearings**

The Canadian Radio-Television Telecommunications Commission (CRTC) plans to hold public hearings next year into extending its regulatory responsibilities to the internet. The CRTC released a final 75-page report that summarises research and stakeholder opinion on a wide range of issues. [Link](#)

### **Canada: Telecommunications Guidelines Released**

The Competition Bureau has published guidelines outlining how it will address issues related to anticompetitive conduct in the telecommunications industry under the abuse of dominance provisions of the *Competition Act*. The guidelines will apply in markets no longer subject to regulation by the Canadian Radio-Television and Telecommunications Commission.

### **European Union (EU): Energy Unbundling Proceeding**

More choice, investment and security for Europe's energy lie at the heart of the third energy package given first reading approval in Parliament on 1 June 2008. Central are plans to separate production and supply of electricity and gas. Supporters claim this will encourage greater competition and lead to more investment in infrastructure. The proposals attracted opposition from eight member states who thought the extent of 'unbundling' (the separation of firms' generation assets from their transmission networks) went too far. They tabled counter-proposals that were accepted in the compromise text agreed by Ministers and MEPs – although Energy rapporteur Elenud Morgan thought it went too far in accommodating the objections of the eight. [Link](#)

### **EU: International Roaming Prices Show Clear Evidence for Further Regulatory Action**

On 29 and 30 May, the European Regulators Group reached conclusions on key deliverables in order to strengthen the European single electronic communications market. [Link](#)

### **France: ARCEP Announces Consultation on FTTH**

The French communications regulator, ARCEP has commenced a public consultation on its document examining ways to expedite the deployment of fibre-to-the-home (FTTH). The purpose of the consultation is to examine the sharing of the fibre local loop between operators, and more specifically to examine the question of the location of the sharing point. The consultation will comprise three stages: the role of the building operator; the agreement practice between operators and building owners/managers; and the degree of sharing the fibre local loop among operators, including the location of the sharing point. [22 May 2008 news release](#)

### **Italy: Reduction in Termination Rates of Alternative Fixed Network Operators Proposed**

The European Commission has welcomed reforms proposed by the Italian communications regulator, [AGCOM](#), in regard to the reduction of termination rates of alternative fixed network operators. The Commission has approved AGCOM's proposal for a 'cost-oriented approach leading to a symmetric termination rate of 0.57 euro cent/minute for all fixed network operators by 1 July 2010'. Despite this positive development in Italy, the EC says that it still remains concerned with the inconsistent levels of termination rates applied across the EU. [Press release](#)

### **Sweden: Government Approves Functional Separation Bill**

On 18 March 2008, the Swedish government approved the Bill of 'Functional separation for better broadband competition'. The proposed act was due to come into force on 1 July 2008. The Bill gives more power to the regulator, PTS, to intervene through functional separation in order to improve competition in the broadband market. It is aimed at ensuring TeliaSonera cannot discriminate in providing access to its copper wire network. It means that functional separation will become a new tool for PTS much earlier than the EU Framework proposal, which is due to come into force by 2010, and where functional separation is listed as a 'last-resort' remedy. [Link](#)

### **Sweden / Denmark: Danish and Swedish National Post Offices to Merge**

A merger of Danish and Swedish national postal services, Post Danmark and Posten Sverige AB, has been announced and is planned to be complete by the end of 2008. [Posten Sverige Link](#)

**United Kingdom (UK): Consultation Proposing an Incentive-Based Approach to Self- and Co-Regulation in Communications**

The UK communications regulator, Ofcom, has published its proposals for the steps to be taken when making an initial assessment of whether to adopt self- or co-regulation. [Ofcom consultation](#)

**UK: Ofcom Consultation on Next Generation Networks**

On 16 April 2008 Ofcom launched a consultation aimed at clarifying the regulatory treatment of next-generation broadband networks for new building developments, so that potential investors are able to make informed decisions. [Ofcom summary](#)

**UK: Ofcom to Review BT Openreach's Main Service Prices**

Ofcom, announced on 30 May 2008 a review of the prices that BT Openreach – an operationally separate business unit providing wholesale access telecommunication services to communications providers on an equivalent basis – can charge for its services. The review will examine Openreach's main services, being Wholesale Line Rental (WLR) and Local Loop Unbundling (LLU). Ofcom notes that since Openreach's fees were initially set, there has been 'a transformation' in the telecoms market – there are now more than four million unbundled lines in the UK. Link to [Ofcom Media Release](#) and [BT Openreach](#)

**UK: Deregulating the UK's Wholesale Broadband Markets: 70 per cent of the country to be liberalised**

Ofcom announced on 21 May 2008 that, following a public consultation, it will deregulate almost 70 per cent of the UK wholesale broadband market where, it argues, there is now strong competition. Ofcom is committed to reviewing and, where appropriate, removing regulations in markets where there is effective competition, further promoting innovation and investment. [Link](#)

**UK: Ofwat Sets Out Its Approach to 2009 Price Review**

Ofwat has published its guidance on how it will go about setting price limits for customers' water and sewerage bills for five years from 2010-15. The guidance takes account of responses to its consultation paper published in October 2007. [Ofwat price review](#)

**UK: Ofwat Recommends Opening Water and Sewerage Markets to Competition**

On 16 May 2008, Ofwat published the second part of its review of competition in the water and sewerage sectors. It recommends that contestable water and sewerage markets are opened to competition where it will benefit consumers, and describes how it will enable this. [Link](#)

**UK: OFT Makes Further Inquiries into Grocery Sector**

The Office of Fair Trading (OFT) has reportedly commenced another round of investigations into the consumer goods and groceries sectors, coinciding with the release of the grocery sector inquiry report by the Competition Commission. Tesco, Proctor & Gamble and Unilever are among the companies that have received requests for information from the OFT. [Link](#)

**UK: Energywatch Informs Energy Market Inquiry**

Independent observer of the gas and electricity sectors, Energywatch, has given evidence to the parliamentary committee as it starts its inquiry into the UK energy market. Energywatch CEO, Allan Asher, stated that 'The level of competition in the energy market has been allowed to degrade over recent years. Consumers have paid for this with high prices and poor service.' Asher went on to list three steps which may improve the sector. These are: the Competition Commission conduct an investigation of the energy sector and devise remedies to improve the market; introduce more openness into the UK electricity market; and cut the link between oil and gas prices. [Link](#)

**United States (US): Verizon Announces Commitment to Providing Open Access to Spectrum**

In a petition filed with the Federal Communications Commission (FCC), Google has raised concerns about Verizon Wireless's commitment to the C Block spectrum 'open platform' provision contained in the FCC's 700 MHz auction rules, and stated it wants the FCC to ensure that Verizon keeps to its 700 MHz spectrum obligations. Google maintained that Verizon had introduced 'uncertainty publicly regarding its compliance with the open access obligations'.

**US: Net Neutrality Bill Proposed**

A bill was introduced on 8 May 2008 requiring ISPs to interconnect with the facilities of other network providers on a reasonable and non-discriminatory basis. It also requires ISPs to operate their networks in a reasonable and non-discriminatory manner so that all content, applications, and services are treated the same and have an equal opportunity to reach consumers. The Internet Freedom and Non-discrimination Act would subject broadband providers to antitrust violations if they block or slow Internet traffic. [Link](#)

**US – Agencies Disagree over AT&T**

The US Federal Trade Commission (FTC) has declined to join the Department of Justice in recommending the country's Supreme Court review a price squeeze case. The FTC's decision relates to a suit brought in 2003 by several small internet service providers alleging that AT&T (then known as SBC Communications) breached competition law by squeezing prices on its network. The suit alleges that AT&T kept its own internet service prices very close to the wholesale price it was charging for access to the network, effectively pricing the ISPs out of the market.

## Regulatory Decisions in Australia and New Zealand

### New Zealand

#### Delay on Decision Regarding Price Regulation for National Roaming Service

New Zealand's Minister for Communications, David Cunliffe, announced on 8 May 2008 that the government has accepted the Commerce Commission's (NZCC's) recommendation regarding the amendment of the terms of the national roaming service, but has reserved its decision on the recommendation that the service not be subject to price regulation. [News release](#)

#### Vector Escapes Regulatory Control

The NZCC has accepted a settlement proposal put forward by Vector as an alternative to regulatory control being imposed on its electricity distribution business. Vector has proposed to initiate a tariff rebalancing program so consumer groups that were being overcharged will have their prices reduced. The NZCC has accepted the proposal, describing it as requiring significantly lower compliance costs than if regulatory control was imposed and creating a more stable regulatory regime. [Link](#)

#### Decision to Accept Transpower's Administrative Settlement Offer

Transpower reached agreement with the NZCC on 13 May 2008, when the Commission confirmed its acceptance of Transpower's administrative settlement offer. The Commerce Commission had intervened under the Commerce Act when the company breached its price path thresholds in 2003-04 and then announced in November 2005 its intention to increase prices by 19 per cent, and on average 13 per cent over the next five years. [Commerce Commission Media Release](#)

#### Regulatory Principles and Guidelines

The NZCC has commenced a new project to develop a series of regulatory guidelines and principles which aim to provide increased transparency and ensure consistent decisions in relation to its regulation of the electricity and gas sectors. The regulatory guidelines are anticipated to be similar to the Mergers and Acquisitions guidelines and will involve three stages: Development of principles, development of guidelines and the application of these guidelines to develop industry-specific methodologies. [Link](#)

#### Regulator Limits Power Grid Price Rises

The NZCC announced on 13 May 2008 that a settlement reached with state-owned corporation Transpower in 2005 to reduce proposed price rises by the national grid operator, had saved consumers around NZ\$240 million. [Link](#)

#### Commission Releases March Quarterly Report on Telecommunications Markets

The Commerce Commission has released its March quarterly monitoring report containing key statistics about telecommunications markets in New Zealand and overseas. This report is the Commission's fifth quarterly monitoring report, and builds on the previous four reports and its annual monitoring report for 2007. [Link](#)

#### Final Determinations for Backhaul Services

The Commerce Commission has today released its final determinations on the price and non-price terms for the backhaul services that support the unbundled copper local loop (UCLL) and unbundled bitstream (UBA) broadband services. These services will allow Telecom's competitors to get access to transmission capacity between Telecom's local exchanges or data switches, and the competitors' networks. [Link](#)

#### Commission Releases Draft Paper on Accounting Separation Of Telecom

The Commerce Commission today issued a draft paper on the principles and regulatory reporting requirements for the accounting separation of Telecom. The draft paper outlines the financial information that Telecom must provide and the guidelines it must follow. Under accounting separation, Telecom will be required to prepare financial information about several of its business units including the Retail, Wholesale, Chorus (fixed network access) and other fixed network services. This information will be publicly available and is designed to inform a wide audience about the operation and behaviour of these business units. [Link](#)



### **Australian Competition and Consumer Commission (ACCC)**

#### **ACCC Issues Draft Legislative Instruments on Digital Radio Access Regime**

The ACCC issued draft legislative instruments on 11 April 2008 — decision-making criteria and procedural rules. Stakeholders' views were sought by 28 April 2008 on the access regime that will apply to digital radio. [Link](#)

#### **ACCC Issues Final Telecommunications Transmission Cost Model to Guide Pricing of the Service**

The ACCC issued on 16 April 2008 the final version of the Telecommunications Transmission Cost Model. The model has been designed with the flexibility to calculate cost-based pricing for backhaul on any land-based (terrestrial) or under-sea (submarine) telecommunications transmission route in Australia. The price of backhaul on routes without effective competition has often been cited by access seekers as a key obstacle to the deployment of high-speed broadband into regional and rural Australia. [Link](#)

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#### **ACCC Proposes to Grant Telstra Local Carriage Service and Wholesale Line Rental Exemptions**

The ACCC issued on 29 April 2008 a draft decision proposing to grant Telstra exemptions from its obligations to supply two 'declared' services in parts of metropolitan Australia. The decision relates only to wholesale voice services, not broadband services — which are not subject to open access regulation. [Draft Decision](#)

#### **ACCC Issues Draft Decision on ARTC Interstate Rail Access Undertaking**

The ACCC issued the draft decision on 29 April 2008, which is to accept the interstate access undertaking subject to ARTC addressing a number of issues raised. The ACCC sought submissions from interested parties on the draft decision by 26 May 2008 before it issued a final decision. [Link](#)

#### **ACCC Releases Issues Paper for Water Market Rules**

The ACCC released on 4 April 2008 an issues paper seeking submissions by Friday 9 May 2008 on the development of water market rules. The water market rules form a key component of the *Water Act 2007*, which creates new institutional and governance arrangements to address the sustainability and management of water resources in the Murray-Darling Basin. The rules will ensure that the policies or administrative requirements of irrigation operators holding a group water access entitlement do not unreasonably prevent or delay trade. [Link](#)

#### **ACCC Releases Issues Paper for Water Charge Rules**

On 30 May 2008 the ACCC released an issues paper seeking submissions on the development of *water charge rules* for fees and charges payable to irrigation infrastructure operators. Submissions are due by 5 pm on Tuesday 15 July 2008. [Link](#)

#### **ACCC Issues Legislative Instruments on Digital Radio Access Regime**

On 27 May 2008, the Australian Competition and Consumer Commission issued legislative instruments— the *Digital Radio Multiplex Transmitter Licences (Decision-Making Criteria) Determination 2008* and the *Digital Radio Multiplex Transmitter Licences Procedural Rules 2008* in regard to the access regime that will apply to digital radio. The access undertakings will specify the manner in which the multiplex licensees are to provide access to transmission capacity to individual digital radio broadcasters in each licence area. [News Release](#)

#### **ACCC Begins Consultation on Procedural Rules in Telecommunications Regulation**

On 22 May 2008, the ACCC began consultation on a set of Procedural Rules to apply to the Telecommunications-specific regulatory provisions under the *Trade Practices Act 1974*. Submissions on the rules were due by 23 June 2008. [News Release](#)

#### **ACCC Issues Final Copper Local Loop Indicative Prices For 2008-09**

On 4 June 2008, the ACCC announced it had set the final copper local loop indicative prices to apply from 1 July 2008 to 31 July 2009. The ACCC also issued a discussion paper on Telstra's unconditioned local loop service (ULLS) undertaking. The ACCC says that metropolitan (Band 2) indicative prices will increase from \$14.30 to \$16. The ACCC maintains that the copper local loop indicative prices 'will provide greater certainty and guidance to industry'. Telstra is seeking a monthly charge of \$30 for each ULLS in Band 2 Exchange Service Areas applying for the period to 31 December 2010. [ACCC Media Release](#)

#### **ACCC Issues Telstra Accounting Separation Report for March Quarter 2008**

On 10 April 2008, the Australian Competition and Consumer Commission issued its report for the quarter ending 31 March 2008 under the enhanced accounting separation regime for Telstra. The report tests whether there is systematic discrimination in the price or non-price terms offered to Telstra's retail and wholesale customers, and so provides general guidance on the potential for competing service providers to supply consumers. It is not intended to detect all forms of potentially anti-competitive conduct. [News Release](#)

### **ACCC Issues Declaration on DDAS-ISDN Services**

On 4 June 2008, the ACCC issued its Final Report on declaring the Digital Data Access and Integrated Services Data Network Services (DDAS-ISDN) and accompanying pricing principles. The ACCC says that DDAS-ISDN services are becoming 'outdated, legacy technologies,' and notes they are being used less in regional areas. Declarations of the DDAS-ISDN services in CBD and metropolitan areas of Australia's capital cities were removed in 2006. According to the ACCC, 'Extension of the declarations for 12 months will provide an appropriate transition period for users to migrate to alternative technologies or services in regional areas'. [ACCC discussion paper on the DDAS-ISDN declarations review](#) and [ACCC Media Release](#)

### **Telecommunications Access Disputes**

The Australian Competition and Consumer Commission has recently received notification of six telecommunications access disputes under Part XIC of the *Trade Practices Act 1974*. Primus Telecommunications Pty Ltd, Optus Networks Pty Ltd, XYZed Pty Ltd, Request Broadband Pty Ltd, PowerTel Limited and Chime Communications Pty Ltd separately have notified the ACCC of six separate access disputes relating to the supply of the Unconditioned Local Loop Service by Telstra Corporation Limited in the past few weeks. [News Release](#)

### **ACCC Approves GasNet Revised Access Arrangement**

On 25 June 2008, the Australian Competition and Consumer Commission issued its further final decision to approve GasNet's amended revised access arrangement for the Principal Transmission System. [News Release](#)

### **ACCC Issues Preliminary View not to Oppose Australia Post's Draft Price Notification**

On 20 June 2008, the Australian Competition and Consumer Commission issued its preliminary view on Australia Post's February 2008 draft price notification. Australia Post proposes to increase the basic postal rate for a standard letter from 50c to 55c. It also proposes to increase the prices of other reserved services (i.e. those services over which Australia Post has a statutory monopoly) including large letters and pre-sorted mail. The last time prices for reserved postal services were increased was in 2003. [News Release](#)

### **ACCC Sets ULLS Indicative Prices for 2008-09, Issues Discussion Paper on Telstra's ULLS Undertaking**

On 4 June 2008, the Australian Competition and Consumer Commission set final copper local loop indicative prices for 2008-09 and issued a discussion paper on Telstra's ULLS undertaking. The final indicative prices for the ULLS monthly charge to apply from 1 July 2008 to 31 July 2009 increase from the previous period. For instance, metropolitan (Band 2) indicative prices will increase from \$14.30 to \$16. This increase reflects the rise in interest rates and input costs. [News Release](#)

### **ACCC Telecommunications Reports Show Continued Investment and Lower Prices for Consumers**

Two annual statutory reports prepared by the Australian Competition and Consumer Commission on telecommunications competitive safeguards, and changes in the prices paid for telecommunications services were tabled in parliament. The *Telecommunications competitive safeguards for 2006-07* report consider the competitive developments that occurred in the telecommunications industry as well as an overview of regulatory activities. The *Changes in the prices paid for telecommunications services in Australia 2006-07* report documents trends and changes in the prices paid by consumers for telecommunications services. These reports are available on the ACCC website. [News Release](#)

### **Australian Energy Regulator (AER)**

#### **AER Issues Final Decision on VENCORP Transmission Determination**

On 14 April 2008, the AER issued its final decision on the transmission determination applicable to the Victorian Energy Networks Corporation (VENCORP) for the regulatory period 1 July 2008 to 30 June 2014. The determination is designed to assist VENCORP manage cost pressures and meet emerging system constraints. [Link](#).

#### **AER to Review Rate of Return for Energy Network Businesses**

The AER will begin a full review of the rates of return that should apply to energy network businesses. The review is required by the new national electricity rules. It will be carried out during 2008, with a final report due by March 2009. [Link](#)

#### **AER Issues Proposed Regulatory Arrangement for Electricity Distribution Businesses**

On 2 April 2008 the AER issued proposed regulatory arrangements to assist with its regulation of electricity distribution businesses. The arrangements are issued for public comment, as required under the National Electricity Rules. The AER invites written submissions by 14 May 2008. [Link](#).

## **Australian Energy Markets Commission (AEMC)**

### **WACC Parameter Values Equity Beta and Gamma Reviewed by AEMC**

On 21 April 2008, the Australian Energy Markets Commission (AEMC) received a Rule change proposal from the Energy Users Association of Australia (EUAA). The EUAA's Rule change proposal seeks to amend the prescribed values of certain parameters, equity beta and gamma, used in the weighted average cost of capital (WACC) for revenue determinations for the provision of transmission and distribution services. On 22 May 2008, the AEMC published a notice under section 95 of the National Electricity Law (NEL) advising of its intention to commence the Rule change process and initial consultation on this Rule proposal. The AEMC invites interested parties to provide submissions on the Rule change proposal by 20 June 2008. [Link](#)

## **National Competition Council**

### **Draft Decisions on Pilbara Rail Access**

The NCC received three applications for declaration under Part IIIA of the Trade Practices Act in late 2007 and early 2008. These were all made by The Pilbara Infrastructure Pty Ltd in relation to the Hamersley Railway (16 November 2007); the Goldsworthy Railway (16 November 2007) and the Robe Railway (18 January 2008). In each case the applicant provided supplementary information and the NCC sought submissions from interested parties. The NCC released its draft recommendations on the three applications on 20 June 2008. The NCC has invited submissions on its draft recommendations (by 21 July 2008) and anticipates making its final recommendations before 29 August 2008.

## **Australian Capital Territory**

### **Independent Competition and Regulatory Commission (ICRC)**

See items on 'Water and Wastewater Price Review' and 'Electricity Charges for Customers who have not moved to Negotiated Contracts' under 'Notes On Interesting Decisions'.

## **New South Wales**

### **Independent Pricing and Regulatory Tribunal (IPART)**

See also reports under 'Interesting Decisions'.

### **Deciding on the Structure and Level of CityRail Fares**

The NSW Government has requested the Independent Pricing and Regulatory Tribunal (IPART) review the fares that CityRail charges for passenger rail services within the Greater Sydney region. On 6 June 2008, IPART released a discussion paper, focussing on the introduction of a new economic regulatory framework to create better incentives for CityRail in its provision of passenger rail services at efficient cost levels. In addition, IPART will review current fares and determine new fares to commence from the beginning of 2009. [Link](#)

### **Regulated Retail Tariffs for Gas**

On 5 May 2008, Country Energy submitted a proposal to IPART for average price increases to regulated tariffs of \$1.97 per GJ to apply from 1 June 2008, which is different to the standard arrangements of a CPI price increase on 1 July of each year. On 26 May 2008 IPART decided that Country Energy may increase the average prices for regulated gas customers by \$1.97 per GJ as proposed. [IPART decision](#)

### **Final Report and Determination – Prices for Water, Sewerage and Stormwater Services – Sydney Water Charges**

On 16 June 2008, IPART released its final report and determination into prices for water, sewerage and stormwater services that Sydney Water Corporation will be permitted to charge for the period from 1 July 2008 to 30 June 2012. In the first year of the determination, bills for water and sewerage services will increase by \$126 or 17 per cent for households consuming the average amount of 200 KL of water a year. Over the four years of the determination, bills for a 200 KL per year property will increase from \$752 to \$997 or \$245 per year by 2012 (in \$ of 2008-09). [IPART report](#)

## **Northern Territory**

### **Utilities Commission**

### **Approval of Network Access Tariffs 2008-09**

In accordance with clause 78(3) of the Electricity Networks (Third Party Access) Code, the Commission has approved the network access tariffs and charges for 2008-09, effective 1 July 2008.

### **Review of NT Electricity Ring-Fencing Code**

In February 2008, the Commission published a Proposed Variations Paper, in accordance with clause 7.1 of the Code, which sets out the nature of the proposed changes to the Code.

Following consideration of submissions from interested parties and its own further deliberations in consultation with its legal advisers, the Commission has decided to proceed with the proposed variations to the Code, although with some modification to the specific drafting detail set out in the earlier Consultation Paper, mainly in response to submissions received.

The Commission has now released its 'Proposed Draft Code'. Submissions are invited from interested parties concerning the issues raised in this Proposed Draft Code paper and related matters. The closing date for submissions was Friday 27 June 2008.

### **2009 Regulatory Reset - P<sub>o</sub> Publication Model**

Following the publication of its Final Decision on price control mechanism issues, the Commission has now published its P<sub>o</sub> adjustment model. The Commission's P<sub>o</sub> adjustment model sets out the manner in which Power and Water's efficient costs of supplying standard control services in a single regulatory year are to be calculated. As part of its regulatory proposal, Power and Water must submit to the Commission a proposed P<sub>o</sub> adjustment factor calculated using the Commission's P<sub>o</sub> adjustment model.

### **2009 Regulatory Reset – Price Control Mechanism**

In March 2008, the Commission released its Draft Decision on price control mechanism issues. The price control mechanism involves the practical and technical detail for the administration of network price control regulation over which the Commission as regulator - in consultation with stakeholders - has a degree of discretion.

Following consideration of the views in submissions and in light of its own further analysis, the Commission has now published its Final Decision on price control mechanism issues.

## **Queensland**

### ***Queensland Competition Authority (QCA)***

#### **QCA Draft Decision on Energex's Costs Incurred as part of the Transition to Full Retail Contestability (FRC)**

On 30 April 2008, the QCA released its Draft Decision regarding Energex's cost pass-through application in relation to costs incurred as part of the transition to Full Retail Contestability (FRC). The QCA has concluded that \$20 million of the Stage 1 capital costs and the majority of the operating costs (\$29.9 million) are justified. Submissions from interested parties were sought by 30 May 2008. [Link](#)

#### **QCA Directed to Review Queensland Retail Gas Market**

The Queensland Minister for Mines and Energy has directed the QCA to review small-customer gas pricing and competition in the Queensland retail gas market. The review is to examine current market issues in Queensland's small customer gas market, including the current level of competition in the markets for reticulated natural gas and substitute fuels such as reticulated and bottled LPG; the impact on retail prices of movements in prices and costs in the upstream gas market and whether current small customer retail prices are reflective of actual costs incurred in the upstream gas supply chain; and the extent of current small customer gas market activity, including consumer switching behaviour, impediments to small customers exercising informed choices regarding their retailer of choice and consumer perceptions of natural gas as a product of choice compared to other energy supply options. [Link](#)

## **South Australia**

### ***Essential Services Commission of South Australia***

#### **2008-09 – 2010-11 Gas Standing Contract Price Review: Final Inquiry Report and Final Price Determination**

The Commission has released its Final Inquiry Report and Final Price Determination into gas standing contract prices for the three-year regulatory period 1 July 2008 to 30 June 2011.

#### **Envestra's 2008-09 Adjustment of Gas Distribution Tariffs**

This application is Envestra's statement to the Commission, relating to the adjustment of its 2008/09 reference tariffs in accordance with the Reference Tariff Policy set out in the Access Arrangement.

#### **AGL SA's 2008-09 Adjustment of Electricity Retailer Tariffs**

This application is AGL SA's statement to the Commission, relating to the annual adjustment of electricity retailer tariffs.

#### **ETSA Utilities 2008-09 Adjustment of Electricity Distribution Tariffs Adjustment**

This application is ETSA Utilities' statement to the Commission, relating to the annual alternation of electricity distribution tariffs.

## 2008-09 Electricity and Gas Regulated Price Adjustments

The Commission has approved the electricity and gas standing contract prices to apply from 1 July 2008 to 30 June 2009.

### Victoria

#### *Essential Services Commission*

##### Comparative Performance Reporting

On 28 April 2008, the Essential Services Commission (ESC) released its comparative performance report on Victoria's urban water businesses for the 2006-07 year. From 1 July 2004 all urban water businesses were required to report performance information consistent with the indicators and definitions outlined in the Commission's performance reporting framework. [Link](#)

##### Gas Access Arrangements Review

On 7 March 2008, the ESC released the final decision of its review of gas access arrangements (gas distribution pricing) for the 2008-2012 period. The ESC's final decision did not approve the revised access arrangements submitted by the distributors, instead requiring amendments be made to their revised access arrangements consistent with the final decision by 28 March 2008. Upon receipt of these amended revisions, the Commission is required to either approve the amended revisions (if they meet the above requirements as set out in the final decision) or draft and approve its own amended revisions to the access arrangement. [Link](#)

##### Melbourne Water Waterways and Drainage 2008 – 2013

Melbourne Water submitted its Water Plan on 19 December 2007 to the ESC for assessment, setting out the prices it proposes to charge for drainage and waterways services for the five-year period commencing 1 July 2008. The Plan also outlined the strategies and initiatives proposed and the revenue needs of Melbourne Water from 2008 to 2013. The ESC has delivered the final decision of its review of Victorian water prices, setting average annual real price increases of between 4.3 and 14.9 per cent for urban water customers across the state. [ESC Media Release](#) and [Submissions to ESC](#)

### Tasmania

#### *Office of the Tasmanian Energy Regulator*

See item under 'Notes On Interesting Decisions'.

### Western Australia

#### Pilbara Rail Plan

The Western Australian Government's planned solution to the Pilbara rail access stalemate has been cautiously welcomed by BHP Billiton and Rio Tinto. Third party access to the rail infrastructure by BHP and Rio has become increasingly controversial, with Fortescue Metals Group taking action through the courts to get the two mining companies to enforce older state agreements on access for other miners. Under the WA Government's draft third party rail access regime, BHP and Rio would be obliged to haul smaller miners' iron ore on their railways to the Pilbara's ports. [Link](#)

#### *Economic Regulation Authority (ERA)*

##### Notice – Authority Guidelines – Gas Access Arrangement Revision Process

On 16 May 2008, the Economic Regulation Authority released guidelines setting out the process it will follow in revising the access arrangements for the three principal covered gas pipelines in Western Australia. [Link](#)



## Notes On Interesting Decisions

### Change in Costing the New Zealand Telecommunications Service Obligation

The New Zealand Commerce Commission on 13 May 2008 released a revised draft Telecommunication Service Obligations (TSO) determination for 2004-05. The Local Residential TSO is the successor to the Kiwi Share. The TSO was established to recognise the economic costs that New Zealand Telecom carries in providing service to commercially non-viable residential customers who it would not otherwise provide service to at an affordable price. Once the TSO costs have been determined, the costs are shared among liable persons – Telecom and other operators whose networks are interconnected with the Telecom fixed network. Prior to the revision of the Telecommunications Act this cost apportionment was part of the TSO determinations. Now, under the revised act, the apportionment is provided in a separate cost allocation determination.

The initial 2004-05 draft TSO, released in July 2007, had been assessed at \$71.4 million. The revised draft TSO cost has been reduced to \$57.3 million. Following the release of the initial 2004-05 draft TSO in July 2007, submissions were received on the impact of introducing mobile technologies in the Commission's cost model and a conference was held on this issue.

The Commission concluded that because there was the potential for asset stranding to occur, it should no longer introduce mobile technologies into the TSO modelling process. The Commission considers that this action has reduced the systematic risk associated with Telecom's modelled investment, leading to a decrease in the asset beta value used to calculate the cost of equity and the weighted average cost of capital (WACC). The revision in the beta value from 0.4 to 0.2 has led to a decrease in the post-tax nominal WACC from 7.1 per cent to 5.7 per cent, and resulted in a decrease in the overall TSO cost calculated by the Commission in its revised TSO draft.

Telecom bears 69 per cent of the TSO cost. The remainder is carried primarily by Vodafone and TelstraClear. The cost for 2004-05 when finalised will also be shared between WorldxChange Communications Limited, CallPlus Limited, Compass Communications Limited, Teamtalk Limited and ihug Limited in proportion to their net liable revenues. [Draft determination](#)

### Regulated Gas Prices for AGL, ActewAGL and Country Energy (NSW)

Following a special circumstances application by AGL in January 2008, IPART approved an increase to the average price for regulated gas customers of \$0.75/GJ from 1 April 2008. This was above the 1 July CPI increase allowed for under AGL's voluntary transitional pricing agreement. It translated to a 5.24 per cent increase to a customer's annual bill for a typical AGL residential customer in NSW with annual consumption of 23 GJ. The special circumstances, under which AGL sought approval to increase gas prices by more than the CPI, arose from AGL not securing sufficient capacity on the Eastern Gas Pipeline and subsequently contracting gas supply from the Cooper basin. AGL also faced higher distribution costs on the Moomba to Sydney Pipeline due to the introduction of park charges and imbalance charges.

ActewAGL is supplied by AGL Wholesale Gas, and as such it applied to pass through AGL's additional costs to customers. IPART approved a \$0.75/GJ increase in ActewAGL's regulated gas prices. This translated to a 6.1 per cent increase to a customer's annual bill for a typical residential customer in Queanbeyan with annual consumption of 46 GJ, and a 5.8 per cent increase in the typical customer's annual bill in the Capital Region with annual consumption of 38 GJ.

Country Energy also applied for a special circumstances price increase due to substantial increases in wholesale gas and transportation costs. Following VPTS compression problems during winter 2007, Country Energy entered into alternative supply arrangements at higher costs. Country Energy also faced increased transportation costs due to contracting increased capacity to meet winter demand in 2008. Under these circumstances IPART approved an increase in Country Energy's average prices for regulated gas customers of \$1.97/GJ from 1 June 2008. For a typical Country Energy residential customer in NSW with annual consumption of 35 GJ, this translated into a 12.2 per cent increase in the customer's annual bill. [Link](#)

### 2007 Determination on Regulated Electricity Retail Tariffs and Charges for Small Customers (NSW)

IPART is responsible for setting the regulated retail electricity tariffs charged by the Standard Retailers in NSW – Country Energy, EnergyAustralia and Integral Energy – to small retail customers on standard form customer contracts.

In June 2007, IPART released its determination on regulated electricity retail tariffs and charges for small customers from 2007 to 2010 (the 2007 determination). IPART included an annual review of the market-based electricity purchase cost allowance (the review), to factor into the determination material step-changes in this allowance, if required. The annual review is a mechanical review in the sense that it does not involve any policy decisions and applies the pre-determined methodology that is set out in the 2007 determination.



In May 2008 IPART decided that electricity prices in 2008-09 or 2009-10 had not moved by more than 10 per cent relative to those included in the 2007 determination and, therefore, IPART's determination of the retail component of prices remains unchanged from the 2007 determination. In deciding not to change the market-based electricity purchase cost allowance from that provided in the 2007 determination, IPART considered submissions made by stakeholders and external advisers. [Link](#)

### **Recommended Fare Increases – NSW Taxis**

In June 2008, IPART made recommendations to the Minister for Transport on taxi fares for NSW from 1 July 2008. The recommendations were for fare increases, on average, of:

- 3.8 per cent for urban taxis
- 3.3 per cent for country taxis.

These fare increases reflect the estimated increase in the costs involved in providing taxi services over the past year as measured by the Taxi Cost Index, after adjusting for productivity gains and for the fact that last year's fare increases occurred in late August 2007 (at a higher value than if they had been implemented at 1 July).

IPART was specifically asked to address the issue of LPG price rises as part of its review. It included the most recent LPG price information available in the Taxi Cost Index. LPG price information was included for the 14 months to 31 May 2008. All other costs in the Taxi Cost Index were measured over the year to 31 March 2008. In addition, to address concerns regarding LPG price volatility, IPART recommended that it should undertake an additional limited review of LPG fuel costs in December each year. If fuel costs for the six months to the end of November have varied by more than 10 per cent (up or down) then the distance-based component of fares will be adjusted by the change in the fuel costs plus the cost of the additional meter change. If average fuel costs have changed by less than 10 per cent, then IPART will not recommend a mid-year fare change.

The above recommendations were accepted by the Minister.

IPART also recommended that booking fees for premium taxi services should be deregulated on a trial basis but subject to a maximum charge of \$11, as an interim measure. In addition, IPART recommended that the Government increase the \$30 cap on the taxi transport subsidy scheme to take account of taxi fare increases that have occurred since the cap was last adjusted in 1999. The Taxi Transport Subsidy Scheme (TTSS) is a fare relief scheme administered by the NSW Ministry of Transport. It provides eligible participants who have a qualifying severe and permanent disability with a 50 per cent subsidy for the metered fare, up to a maximum value of \$30 per trip. These recommendations are still under consideration.

### **ICRC ACT Water and Wastewater Price Review – Final Decision**

On 11 April 2008, the ICRC released its final decision and price determination for ACTEW Corporation's water and wastewater services for the five years from 1 July 2008. The decision came after an 18-month period of review, analysis and consultation, during which the Commission released three discussion papers, a Working Conclusions paper and a Draft Report, received submissions and held a public hearing.

In recent years, water and wastewater customers in the ACT have endured both substantial price increases and water shortages. ACTEW Corporation's urban water prices are currently the highest in Australia and stage 3 restrictions remain in place. In 2007-08, larger water customers – those using more than 300 kilolitres per annum – are paying more than double the price for water than they did in 2004-05. The higher prices and restrictions are primarily due to factors that could not reasonably be foreseen. Bushfires in 2003 and an unprecedented drought have imposed additional costs on ACTEW Corporation and substantially reduced supply.

The determined price path means a significant combined price increase for water and wastewater services in the first year (2008-09) of 8 to 16 per cent depending on the volume of water consumed (an increase of \$3 for the average household), and then an annual increase in water prices of 1 per cent plus CPI, and 4.76 per cent plus CPI for wastewater services for the following four years.

The price increases will help fund a fourfold increase in investment in new water capture and treatment infrastructure designed to provide greater long-term water security in the ACT. ACTEW Corporation is shortly to commence work on the expanded Cotter Dam and is expected to finalise arrangements for the construction of a pipeline connecting the Murrumbidgee River at Angle Crossing to the Googong Reservoir allowing for the transfer and storage of water.

In terms of tariff structure, the Commission moved from a two-step tariff structure to a single step. The determined tariff sets the price for the first 200 kilolitres of water at half the price per kilolitre (\$1.75) charged for all consumption above this point (\$3.50). [Link](#)

### Electricity Charges for ICRC Customers who have not moved to Negotiated Contracts – Final Decision (ACT)

On 20 June 2008, the Commission determined a 'transitional franchise tariff' to apply for one year from 1 July 2008. This is a regulated tariff for customers who choose not to move to a negotiated contract offered by the incumbent retailer, ActewAGL Retail, or move to a contract offered by a competing retailer. The Commission approved a 7.11 per cent increase in the annual average transitional franchise tariff price cap.

For the average household, the new tariff means an increase of around \$85 on a total annual bill in 2007-08 of \$1300. The final price outcome was not as high as anticipated in the Commission's April 2008 draft report, principally as a result of more current generation cost estimates becoming available.

To help address the issue of pricing for households with different energy needs, the Commission adopted a form of average price cap regulation. This allows ActewAGL Retail to provide a suite of tariffs that address the particular energy needs of consumers.

The Commission's final decision discusses the difficulties associated with the Government's one-year reference for the price decision. The short reference period has constrained the Commission in how it was able to allow cost changes resulting from wholesale electricity market supply-demand imbalance to be passed through to consumers by the incumbent retailer. The short reference period meant the Commission was unable to transition any price changes over a longer period, as has been allowed in other jurisdictions.

In coming to its final decision, the Commission was mindful of the impacts of continuing and multiple price rises on less well-off ACT consumers. The final decision reiterates the position expressed in the Commission's draft report that the transitional franchise tariff was never intended to be a safety-net measure for more vulnerable customers. That said, the final decision provides a degree of certainty and stability for customers' likely electricity costs over the next 12 months and the price increases that will be experienced in the ACT for electricity as a result of the Commission's determination will be at a lower rate than that applying in NSW. Prices for electricity in the ACT will still be lower than those applying in surrounding areas.

The Commission's final decision encourages all consumers at present on the regulated retail tariff to exercise their choice of retailer and to seek lower prices for electricity supply, where these are available. The Commission recognises, however, that major shifts in the underlying generation costs will flow through to retail prices at all levels and that there has been a marked reduction in number of competitive suppliers offering contracts for residential customers in the ACT market. [Link](#)

### Public Benefit Assessment of Full Retail Contestability in Electricity in Tasmania

Tasmania has been progressively introducing competition in the electricity retail market since July 2006, when the largest industrial customers were first able to elect their retailer. The market is being opened to tranches of progressively smaller consumers, with the Tasmanian Government intending to extend competition to all customers in 2010, following completion of a public benefit assessment of doing so.

In September 2007 the Regulator received a request and terms of reference from the Treasurer to undertake an assessment of the public benefits of establishing full competition in the Tasmanian electricity retail market. Draft assessments and recommendations have been made regarding the public benefit of full retail contestability (FRC) and are now available on the Regulator's website.

The subsequent report prepared for the Treasurer addresses four fundamental aspects of the possible introduction of full retail competition in Tasmania:

- the context into which FRC might be introduced;
- the nature of FRC;
- the societal costs and benefits of FRC; and
- the impact of FRC on a range of stakeholder groups.

The Regulator considers that significant longer-term benefits might be expected from FRC, though the nature of these benefits generally precludes quantitative analysis. These benefits include:

- extending to Tasmanian electricity customers the benefits enjoyed by consumers in other NEM jurisdictions;
- increasing the volume of energy in the contestable market and thus encouraging a more competitive retail market;
- developing competition in upstream markets (the generating sector) in the longer term;
- the evolution of more cost-reflective retail pricing; and
- a reduced risk of regulatory failure, as the contestable market is deregulated.

The assessment found that customer protection arrangements would be needed in the medium term. Most notably, a continuation of retail price regulation would be needed until the development of effective retail competition.

Further findings include that FRC network costs for small customers would total around \$20 to \$30 per customer per year for the seven years of the analysis. If FRC is introduced, all small customers would pay this additional amount, whether they accept a market contract or remain on the regulated standing offer tariff.

Customers who remain on the regulated standing offer tariff would see an additional increase of between \$28.30 and \$46.90 arising from the increased allowed retail margin and cost to serve, or a total increase of \$50 to \$75 per customer per year.

While it is certain that there would be costs in extending competition to all customers, the benefits are less certain in the current conditions and will only be realised if there is dynamic competition in the retail market.

The Draft Report recommends that competition in electricity retailing should be extended to all customers consuming more than 50 MWh per year from 1 July 2010.

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