

# NETWORK

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# Competition in the Water and Wastewater Industry

Lyndon Rowe

The main challenge faced by the water and wastewater industry is to ensure security of supply is maintained at least cost. This is highlighted by recent water shortages in many Australian cities and the subsequent decisions to invest in significant augmentations. Competition between potential suppliers, and associated dynamic efficiencies, can offer benefits through the identification of alternative ways of maintaining security of supply. The identification of as wide a range of alternatives as possible is necessary to ensure security is maintained at least cost. However, competition between potential suppliers is currently underutilised. The existing institutional and regulatory arrangements limit the opportunity and incentive for the private sector to identify and offer alternative options. As a result, more costly options may be being developed.

The Western Australian Economic Regulation Authority (the Authority) considered this matter in a recent inquiry. The Authority concluded that, in order to create an environment which would encourage the participation of the private sector, and therefore identify the widest possible range of options, there was a need to alter the current institutional and regulatory arrangements. The Authority recommended the establishment of a statutory authority, an Independent Procurement Entity (IPE), with responsibility for ensuring that security of supply was maintained at least cost. The IPE would be responsible for establishing a competitive environment for the procurement of supply source and demand management options. The level of security would be set by the Government.

This article is separated into three parts. The first provides the background and context within which the inquiry took place. The second analyses the current arrangements in Western Australia. The third outlines the Authority's preferred model for increasing competition in the water and wastewater services sector.

## Background and Context

The Authority received a Terms of Reference from the Western Australian Treasurer in July 2007. The Terms of Reference required it to undertake an inquiry into competition in the water and wastewater industry and provide advice on possible competitive enhancements. After three rounds of public consultation, the Authority provided its Final Report to the Treasurer on 30 June 2008. The Final Report was released publicly on 25 July 2008.

The water and wastewater industry is a network industry and is often described as a 'natural monopoly'. As such, water and wastewater services have traditionally been supplied by vertically integrated monopolies. The vertically integrated monopoly has traditionally been responsible for all elements of the supply chain, including water procurement; water treatment; water network; water and wastewater retailing; wastewater network; wastewater treatment; and wastewater disposal. However, it is likely that the only elements of the supply chain that truly exhibit natural monopoly characteristics are the water and wastewater pipe networks.

While it may not be feasible to duplicate pipe networks, competition and competitive pressures can be harnessed by the monopoly supplier in the construction and maintenance of the network. For example, the Water Corporation (the main water utility in Western Australia) currently tenders out approximately 90 per cent of its capital works and 50 per cent of its operating works. Oversight by regulators and government, together with competition between suppliers keen to provide services to network owners, should ensure that these services are provided efficiently.

The introduction of competition and competitive pressures into the remaining non-natural monopoly segments of the supply chain is possible and could potentially lead to new and better ways of operating and lower prices for customers. These segments include water procurement, water and wastewater treatment and retailing. Of these segments, water procurement is likely to offer the greatest potential for benefits from increased competition due to the variety of possible options and the often relatively large costs of augmentation events. Notably, wastewater treatment can also be considered a possible supply source.

Competition between potential suppliers in procurement (through the offering of alternative source and demand management options) could lead to significant dynamic efficiencies. Under current regulatory and institutional arrangements, the incentive and ability of vertically integrated monopolies to pursue such dynamic efficiencies are limited. This is further discussed below in the context of the Water Corporation.

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Note: Lyndon Rowe is Chairman of the Economic Regulation Authority (ERA) of Western Australia

Large investments in water procurement are currently underway in most Australian capital cities. For example:

- In South-East Queensland, a restructure of the industry is underway as well as various significant capital investments. This includes a changed ownership structure of the network, the creation of a 'water grid' with associated investment in piping allowing transfer of water, investment in the construction of a recycling plant capable of treating sewage to potable standards and investment in a desalination plant.
- In Sydney, a desalination plant is being constructed at Kurnell.
- In Canberra, a project has been completed allowing for increased transfer of water between storages to better manage existing supply. In addition, a further piping project aimed at augmenting supply is underway as well as investment in increasing the capacity of an existing dam.
- In Melbourne, plans exist to pipe water from the Goulburn River to one of the existing storages (Sugarloaf) as well as for the construction of a desalination plant to the South-East of the city.
- In Adelaide, the Government has committed to building a desalination plant.
- In Perth, a second desalination plant has been proposed. Tenders for construction of the plant were due late August 2008 with the winning consortium likely to be announced in November 2008.

Given the cost of these investments (for example the second desalination plant in Perth is expected to cost approximately \$1 billion while the Melbourne plant is expected to cost in excess of \$3 billion), there is a clear need to ensure that the *most appropriate options* are being developed. In addition, it is necessary to ensure that options are developed at the *most appropriate time*. The main challenge faced by the water industry is how to undertake these procurement processes at least cost. This challenge is exacerbated by uncertainty surrounding the degree to which climate change is contributing to the current drought. The uncertainty regarding future rainfall and climate conditions implies that flexibility must be a key consideration. The options likely to be offered through creating a competitive procurement process is the most effective way to provide this flexibility.

It is necessary to recognise that security of supply differs from simply having sufficient sources. Security can be maintained by having options available which could be brought on-line quickly if need be. For example, by gaining all necessary approvals, finalising plans and identifying construction teams, a desalination plant can provide security without actually being constructed. The actual decision to commit to construction can then be left until it is required. In addition, relatively small options which appear costly on a per-kilolitre basis, compared to the levelised cost of a major source, may in fact be more cost effective. This is due to the flexibility such options can provide as well as their ability to avoid large capital investments, which may prove unwarranted and lay idle should conditions improve.

'Real options' modelling has been suggested as a framework which allows both security of supply as well as actual supply to be taken into account.<sup>1</sup> Furthermore, maintaining security of supply is more than just seeking additional sources. Security of supply can be achieved through both supply and demand options. For example, additional sources include dams, groundwater, desalination, recycling and water sourced via water trading from rural to urban areas (for example, in Western Australia a 17GL permanent trade has taken place between a rural irrigation cooperative and the Water Corporation). Demand management includes water restrictions, scarcity pricing and rebates.

The recent reforms in the electricity industry provide an interesting case study of how to introduce competition into a network industry. While the gas industry is also similar in nature, it has generally evolved as a substitute to electricity and has been developed privately. As such, parallels between the gas and water industries regarding the introduction of competition are more limited.

Reforms in the electricity industry in recent years have typically seen the separation of natural monopoly segments of the supply chain from non-natural monopoly segments. This has typically seen the establishment of competitive generation and retail markets, with regulation of natural monopoly transmission and distribution networks continued.

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<sup>1</sup> See Water Services Association of Australia, *Real Options and Urban Water Resource Planning in Australia*, WSAA Occasional Paper No. 20, April 2008. Also see ACIL Tasman, *Frameworks for Water Source Procurement in W*, discussion paper prepared for the ERA inquiry into competition in the water and wastewater services sector, October 2007.

It is generally accepted that these reforms have been successful, especially with respect to the introduction of new sources of generation. The successful introduction of new generation capacity has been due in a large part to the creation of a competitive environment for the introduction of additional capacity. Under this decentralised approach, individual businesses have been responsible for assessing investment risks and commit to new generation only when it is considered profitable. Competition between potential competing suppliers ensures that capacity is developed at least cost. In addition, this decentralised approach reduces the need for government involvement in these investment decisions, recognising the role of government in putting in place appropriate environmental and quality controls.

For example, in the case of the Wholesale Electricity Market in Western Australia, a backup arrangement exists whereby, if insufficient generation is being developed, the Independent Market Operator (IMO) can go to the market and directly procure what it considers to be the least cost additional generation capacity. To date, the IMO has yet to do this as sufficient generation capacity has been developed in time.

Given the success of the electricity reforms in developing alternative generation, it is logical to ask the question: 'Can the electricity model be adopted for water and wastewater?'

There is no 'off the shelf' model of how to introduce competition into a network industry. Rather, it is necessary to tailor the introduction of competitive arrangements to specific industries, jurisdictions and points in time. It is necessary to be confident that any reforms implemented will result in overall benefits. There is a range of specific differences between water and electricity which mean that it is not as simple as transferring the electricity model to the water industry. A major difference is the extent to which a competitive market for water supply and security could be established. It would require significant time to develop, as well as significant costs associated with the establishment of retail contestability and an access regime.

In addition, the development of a competitive market would require substantial sophistication to deal effectively with the joint needs of water, wastewater and water security services. For example, electricity markets have evolved sophisticated ways of meeting both supply security requirements as well as delivering actual supply. This is often witnessed through the development of higher unit cost power from a peak or intermediate load station as opposed to the development of additional base-load capacity. The combination of options represents the least expected cost way of ensuring both supply security and delivery of supply. With climate change and drought uncertainties, there would be the need for analogous development in water markets before a decentralised approach (like that adopted in electricity) could be successfully implemented in the water industry.

Competition between potential suppliers could assist in ensuring security of supply is maintained at least cost. Such benefits have been demonstrated in the electricity industry. However, it is neither feasible nor desirable to simply transfer the competitive electricity model to the water industry. Rather, a model must be developed which allows for competitive pressures to be taken advantage of, especially those that exist in electricity generation, while recognising the characteristics of the water industry.

### **Analysis of Existing Arrangements in Western Australia**

In Western Australia, the Water Corporation (Corporation) is a vertically integrated monopoly water and wastewater service provider. It provides water and wastewater services for the majority of the State.<sup>2</sup> The Authority focussed on the procurement processes of the major operation of the Corporation, the Integrated Water Supply Scheme (IWSS) in the South West. The IWSS provides potable water to approximately three quarters of the Western Australian population. The IWSS supplies water to towns in the South-West from Mandurah to North of Perth. The IWSS also provides water inland around the Perth hills and to towns along the Goldfields pipeline to Kalgoorlie, 600 km inland. The IWSS water sources for 2006-07 are shown in Table 1.

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<sup>2</sup> There are other smaller providers in some regional towns (Bunbury and Busselton). Also, local shires provide some services in regional and remote areas.

Table 1 IWSS Supply Sources 2006-07

Source	Gigalitres	Operating (\$/kL)	Costs <sup>3</sup>
Surface Water	111	0.14	
Ground Water	168	0.19	
Desalination	18	0.51 <sup>4</sup>	
Water Reclamation <sup>5</sup>	4	0.42	
<b>Total</b>	<b>301</b>	<b>0.19<sup>6</sup></b>	

Source: Water Corporation

The approach adopted currently by the Corporation to maintaining security of supply is to determine the need for an augmentation on the basis of assumptions about dam inflows, groundwater abstractions and demand. Once the timing and volume of a major source is identified, the Corporation investigates alternative options and commences the regulatory approval processes. The competing sources are then identified and costed, and the Government then selects its preferred project. The Corporation then goes out to tender within a 'Design, Build, Operate' framework that establishes an alliance between the Corporation and a private sector business. The private sector also has the ability to suggest an alternative option to that developed by the Corporation, however, this opportunity is limited.

The Authority assessed the current arrangements in detail. The main findings are summarised below.

**Security requirement:** There is no clear security requirement or process regarding the establishment of the level of security. At present, the Corporation is primarily responsible for determining the security requirement. The requirement is based on judgements by the Corporation regarding the risk its consumers are willing to bear in relation to possible sprinkler bans. The Authority concluded that a process should be developed whereby the Government specifies a system security requirement. Following completion of the Authority's inquiry, the National Water Commission has called for the development of a national minimum security requirement.<sup>7</sup> Importantly, when considering the development of a security requirement, there is a need for government to be made aware of the potential cost implications of the level it chooses.

**Supply and Demand factors:** Under the current arrangements, responsibility for factors that influence the supply/demand balance are dispersed amongst the Corporation, the Department of Water and the Government. For example:

- The Corporation sources additional supply options and undertakes some demand management work.
- The Department of Water oversees rebates and other demand management programs.
- The Government decides on sources to be developed and determines prices and water restrictions.

The Authority concluded that to ensure coordination all levers for achieving security of supply are likely to be best held by a single entity. Without a coordinated approach to managing all supply and demand options, it is likely that options will not be implemented in the most efficient manner. In addition, it is necessary that the institutional and regulatory arrangements ensure the single entity has the incentive to minimise costs.

<sup>3</sup> Operating costs are those costs incurred in producing the given volume of water excluding capital costs.

<sup>4</sup> It should be noted that the desalination plant was only operational for part of the year. It has an annual capacity of 45 GL. The average operating cost when operating at full capacity is expected to be \$0.51/kL.

<sup>5</sup> Reclaimed water is not used in the IWSS. Rather it is used for fit-for-purpose requirements and therefore offsets the use of additional scheme water.

<sup>6</sup> Weighted average of operating costs.

<sup>7</sup> National Water Commission, *Urban Water Pricing: National Water Commission position*. Downloaded from NWC webpage 07-08-08: [http://www.nwc.gov.au/resources/documents/UrbanWaterPricing\\_PS-0708.pdf](http://www.nwc.gov.au/resources/documents/UrbanWaterPricing_PS-0708.pdf)

**Institutional and regulatory arrangements:** The Authority considered the institutional and regulatory arrangements in place in Western Australia and concluded that the current regime does not drive the Corporation to minimise costs. It reached this conclusion for three reasons. First, much of the Corporation's operations are a natural monopoly and there is little competition in other segments of the supply chain. As such, it has a reduced incentive relative to a business operating in a rivalrous market to seek productive and dynamic efficiencies.<sup>8</sup> Second, the Corporation is not subject to an effective regulatory regime. Under the current arrangements, expenditures of the Corporation are not subject to a technical prudence and efficiency review by an independent auditor. Rather, the Corporation's costs are approved by the Government's Cabinet Expenditure Review Committee. Third, all expenditure approved by the Government is recovered entirely from customers via tariffs as an 'unders/overs' account is maintained. The Authority concluded that the Corporation has little incentive to minimise costs.

**Delineation of roles and responsibilities:** The Authority considered the roles and responsibilities of the various participants in the water industry. These include Government, the government department responsible for water resource management, the environmental regulator, the government department responsible for planning, the economic regulator, the water utility and the private sector. The Authority concluded that there was a lack of clearly defined roles between each of these interests, and in particular, the Government, Department of Water and the Corporation, and this potentially leads to a lack of coordination and uncertainty.

**Opportunities for alternative proposals:** Under the current arrangements, the Corporation identifies its preferred major source and then goes out to tender. The private sector also has the ability to suggest an alternative option to that developed by the Corporation. However, while there is an opportunity for the private sector to suggest an alternative option, the Authority concluded that in reality there was little opportunity or incentive for the private sector to do so as a result of:

- uncertainty regarding how the Corporation would assess alternative proposals;
- a perception that the Corporation may have a conflict of interest in assessing alternative proposals; and
- a competitive disadvantage associated with proposing an alternative option relative to bidding on the Corporation's preferred source for which identification and development costs have been paid for by the Corporation.

**Political risk:** The potential for political intervention in the development of one option over another has the ability to significantly reduce the incentive for the private sector to identify and develop alternative options. The Authority concluded that there is potential for political risk in the development of options in the IWSS.

Based on these (and other) shortcomings, the Authority concluded that the current approach to maintaining security of supply was not resulting in the identification of the widest possible range of options. As such, the Authority considers that the least cost combination of options is not necessarily being achieved. In response, the Authority proposed that an Independent Procurement Entity be established.

### **An Independent Procurement Entity**

The Authority proposed the establishment of an Independent Procurement Entity (IPE). The IPE would be responsible for managing all supply source and demand management options such that security of supply is maintained at least expected cost. A broad overview of the functions of the IPE and other major participants is set out below:

- The IPE would be an independent statutory authority funded by customers via water tariffs. The role of the IPE would be to ensure security of supply was maintained at least expected cost.
- The IPE would adopt a 'real options' approach. Under this approach, it would continually assess all existing (and potential) supply source and demand management options to ensure security of supply was maintained at least expected cost.

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<sup>8</sup> Noting the degree to which the Corporation takes advantage of competitive tendering processes.

- The Minister would determine the security requirement based on advice from the IPE, the Department of Water and the Corporation. The IPE's advice would include analysis of the marginal costs of additional supply and demand options relative to altering the security requirement.
- The IPE would identify future possible supply shortfalls. This decision would be based on a detailed source timing model. The model would be made available freely allowing the private sector to make judgements regarding the likely need for future options.
- Once the IPE had concluded that a future shortfall was possible, it would seek proposals from the Corporation and the private sector. The IPE would enter into contracts with the most appropriate proponents to ensure security of supply. The Corporation has stated that, with the introduction of an IPE, it would continue to identify potential source options. As such, there is no risk of the IPE procurement process being unable to identify a possible source. Rather, as the Corporation would continue to identify what it considered the most appropriate option, any decision by the IPE to adopt an alternative would represent a lower cost outcome to that which would be gained under the *status quo*.
- The Corporation would continue to operate the existing sources and network. If an alternative provider was successful in winning a contract, the IPE would oversee any negotiations between the alternative provider and the Corporation regarding integration and operational matters.
- The IPE would assume responsibility for funding and approving existing demand management programs such as restrictions and rebates. The IPE would also oversee the use of price as a demand management tool.
- The IPE would be responsible for developing annual source operating plans, subject to pre-existing contracts, to ensure all sources were treated impartially.

Competition, where feasible, is generally the most effective way of ensuring the efficient production of goods and/or provision of services as it compels businesses continually to look for new and improved ways of doing things. However, in the water industry, competition between potential water source and demand management suppliers is largely non-existent. The establishment of an IPE with the express function of creating a market for the provision of water security could increase competition and competitive pressures and therefore potentially lead to lower cost service provision.

As noted previously, the adoption of a fully decentralised market model like that adopted in electricity is not currently feasible or desirable. Rather, centralised coordination is required in the short to medium term. In addition to centralised coordination, there are clear advantages from having all elements that influence supply and demand reside within a single entity. By having a single entity, with appropriate incentives to minimise costs, responsible for matters such as source procurement and demand management (including water restrictions, rebates and pricing) the least-cost combination of options is encouraged.

In addition, the establishment of an IPE would ensure a clear delineation of roles and responsibilities. Government would set the security requirement; the IPE would ensure it was met at least expected cost; the Department of Water and EPA would ensure water resources were used sustainably; the Corporation would continue to manage and operate existing sources, the water and wastewater network as well as propose future sources; and the private sector would offer proposals and be free to build, own and operate water sources in competition with the Corporation.

The creation of the IPE would create neutrality for all prospective participants and would therefore ensure that the widest variety of possible options were identified and considered. A further advantage of the IPE model is that it places water source development at greater arm's length from politics. The role of government would be to set the security requirement. While it has been argued that water is different to other goods and that therefore there is an ongoing role for government in decisions regarding future sources, similar arguments were made prior to the electricity reforms. Through the establishment of rigorous institutional arrangements, matters related to environmental and social considerations can and may be better addressed without direct political intervention.

### **Possible Future Developments**

The IPE model is not the only way in which competition can be introduced into the water and wastewater industry. A State-based third party access regime, as is being introduced in New South Wales and proposed in Victoria and Western Australia (as part of this inquiry), offers opportunities for increased competition, especially with respect to wastewater recycling. The UK and Wales have focussed on 'inset appointments' where a competitor can challenge an incumbent for the right to serve a particular area as well as contestability for large customers. Scotland has focussed on introducing competition at the retail level. The success of these arrangements will take time to assess.

However, the introduction of an IPE with responsibility for ensuring security of supply offers a practical, immediate opportunity to increase competition and competitive pressures into a segment of the supply chain where large investments are currently taking place. The IPE should be viewed as a first step in the process of reform.



## Critical Issues in Regulation – From the Journals

**‘Separability and Subadditivity in Australian Railways’** Nick Wills-Johnson, *The Economic Record*, Vol. 84, No. 264, pp. 95-108, March 2008

This paper examines the reform to railway infrastructure in Australia in the mid-1990s which split above-rail (trains) and below-rail (track and signalling) services into separate businesses. This reform was based on the premise that below-rail services are natural monopolies, while above-rail services are potentially competitive.

The potential for competition in above-rail services is investigated by testing for subadditivity in the cost function of above-rail services. If there is subadditivity, then there may be limited potential for competition. This paper also tests for whether railways are econometrically separable into above-rail and below-rail parts, and hence whether efficiency losses might result from vertical separation.

The transcendental (translog) cost function of Australian railways is estimated using data on the tonnes of grain, minerals and general and intermodal freight hauled per annum; indexes of the costs of various inputs; and the total above-rail costs (for subadditivity analysis) or total cost (for separability analysis). The resultant model is tested for subadditivity and separability.

The author finds limited evidence for superadditivity and hence limited evidence for sustainable above-rail competition. He also finds evidence (albeit limited) that vertical separation of railways caused efficiency losses.

**‘Unbundling the Local Loop’**, M. Bourreau & P. Doğan, *European Economic Review*, 49, pp. 173-199, 2005 and **“Build-or-Buy” Strategies in the Local Loop’**, M. Bourreau & P. Doğan, *American Economic Review*, 96(2), pp. 72-76, 2006.

This pair of papers addresses the well-known tension in the regulation of many network industries between service/access-based and facilities-based competition. In access-based competition, entrants to a market gain access to an incumbent’s network in order to be active in the final market, so that competing services are provided over the one network to which all providers have access (typically under the auspices of some form of access regulatory regime).

By contrast, in facilities-based competition, an entrant typically decides to invest and build its own network, so that competing services are delivered over competing networks. For example, the competing fibre networks for CBD customers in Australian telecommunications.

A central issue is the trade-off faced by the incumbent in setting an access price – how does access pricing affect the entrant’s incentive to invest and build its own network, rather than using the incumbent’s network? Specifically, a high access charge may permit an incumbent to maintain supra-competitive profit in the short-run, but this may in turn trigger more rapid investment by an entrant, likely resulting in lower incumbent profits in the long-run. Given this trade-off, how will an incumbent set its optimal access price over time? And more broadly, how does access pricing thereby affect the structure of the regulated industry, by affecting the movement (or not) from access-based competition to facilities-based competition?

Bourreau and Dogan more formally modelled the dynamic interplay between the date at which an entrant decides to invest in its own network, and its alternative of renting the incumbent’s network and paying the access charge. The key operating assumptions are that:

- (1) investing in its own network enables the entrant to increase its retail profit – therefore there is a positive stand-alone incentive (all else being equal) for the entrant to build its own network
- (2) the fixed cost of investment decreases over time – therefore the entrant will choose to invest at some time.

The incumbent’s and entrant’s private decision-making are compared to those which otherwise achieve the social welfare ‘optimum’.

A key stylised result of both models is that the incumbent typically has an incentive to delay the entrant’s own investment, relative to the socially optimal timing of investment. To achieve this, the incumbent’s (privately) optimal strategies are:

- (1) Where the access price is not time-dependent, the incumbent sets the access price too low (relative to the social optimum).
- (2) Where the access-price is time-dependent: the incumbent optimally sets a decreasing access price path, thereby keeping the entrant indifferent between renting (paying an access charge) and investing, for as long as possible.

**‘Gasoline Prices Jump up on Mondays: An Outcome of Aggressive Competition?’**, O. Foros and F. Steen, *Centre for Competition Policy*, Working Paper 08–20, University of East Anglia, 2008.

Petrol retail price cycles, where sharp price increases are followed by gradual price decreases, are found in a number of local markets in the United States, Canada, and Australia. Empirical studies have generally found these asymmetric cycles are consistent with the so-called ‘Edgeworth Price Cycles’ theory (Maskin and Tirole, 1988). The theory suggests that the cycles arise from aggressive competition among petrol retailers who have incentives to undercut each other in order to gain market share.

In contrast to the general findings in the literature, Foros and Steen’s analysis of daily station-specific gasoline pump prices in Norway from March 2003 to March 2006, finds that the Norwegian gasoline price cycles arise from both strong local competition and central coordination in pricing.

Foros and Steen show that Norwegian gasoline prices exhibit a fixed weekly pattern, with prices increasing significantly every Monday afternoon since April 2004. Prior to that time, gasoline prices jumped on Thursdays. The price–cost margin increased significantly as a result of this weekly pattern change, indicating it is more profitable for petrol companies to coordinate price increases on Mondays.

According to the authors, whilst the observed gradual price reductions are consistent with the undercutting phase in the Edgeworth cycles, the persistent and exclusive price increases on Mondays show the price increases are initiated on the basis of the day of the week, rather than the level of prices as predicted under the Edgeworth model. Foros and Steen also find that gasoline retailers appear to use oil majors’ publicly posted recommended prices as the reference price for setting their respective prices.

The authors call for policy-makers to be cautious in drawing the conclusion that petrol retail price cycles are the result of highly competitive market. It is worth noting that the ACCC’s petrol inquiry in 2007 has explored a number of economic explanations for the causes of Australian retail petrol price cycles. The ACCC concluded that:

- the existence of price cycles alone does not appear to provide evidence of a lack of retail competition, and
- there are certain institutional arrangements that may facilitate price cycles.

To download paper click here: [Gasoline prices jump up on Mondays](#)

**‘Promoting Renewable Electricity Generation in Imperfect Markets: Price vs. Quantity Policies’**, R. Madlener, W. Gao and P. Zweifel, *Socioeconomic Institute Working Paper* No.0809, University of Zurich, 2008.

This paper investigates the economic efficiency of different policy instruments designed to promote renewable energy technologies in a liberalised energy market. The two broad approaches considered are a quota-based system of tradable green certificates versus a system based on taxation and subsidies. This paper contrasts the two alternative policies in terms of cost-effectiveness and social welfare, using the modelling assumption that electricity markets are not perfectly competitive. Criticism of the Australian Government’s proposed quota-based emissions trading scheme is reflective of this debate between the two policy approaches.

Madlener *et al.* examine the conventional wisdom that a subsidy/taxation policy or a quota-based scheme are equivalent in terms of static efficiency. Under imperfect competition, the authors find that the two schemes are equivalent in terms of social welfare as long as both are implemented in a socially optimal manner. The reason is that subsidy and tradeable permit schemes contain the same price information which determines each generator’s strategies (under Cournot competition).

The paper concludes that it is important for certificates to be tradeable, because of the technological heterogeneity of green power generation. Therefore, because both policy alternatives (tax/subsidy and quota system) have their advantages and disadvantages, a mix of the two might prove to be efficiency-enhancing. The paper proposes that this issue be investigated further. To download click here: [Promoting renewable electricity generation in imperfect markets](#)

**‘Comparing Price and Non-price Approaches to Urban Water Conservation’**, S.M. Olmstead, and R. N. Stavins, *NBER Working Paper Series*, Working Paper 14147, June 2008.

In times of water shortages, should water be rationed using one-size-fits-all water restrictions (such as a ban on outdoor watering), or should water be rationed by raising the price? Economists, naturally, favour rationing through the price mechanism. This paper is not so much an academic piece as a polemic essay, assessing price and non-price approaches to water conservation along five dimensions: the ability of policies to achieve water conservation goals, cost-effectiveness, distributional equity, monitoring and enforcement, and political feasibility.

If price-based mechanisms can be judged to be effective at reducing pollution, the authors ask why the same mechanisms could not be used for rationing scarce water. They argue that (a) due to low rates of compliance with water restriction programmes, it is not clear that non-price rationing mechanisms have an advantage over price-based rationing; (b) price-based rationing schemes do result in larger water savings by lower-income households, but this effect could be offset by rebating the additional profits in a manner that favours lower-income households; (c) monitoring and enforcement requirements of price-based rationing is far lower than for non-price rationing; (d) the economic costs of non-price rationing should be made transparent so that voters can make informed decisions. The authors argue that a shift in attitudes towards the use of price rationing mechanisms for urban water is long overdue. To download click here: [Comparing price and non-price approaches to urban water conservation](#)

**‘Consistent Regulation of Infrastructure Businesses: Some Economic Issues’**, F. M. Menezes, *School of Economics Discussion Paper Series*, No. 372, University of Queensland, June 2008.

This paper examines some important economic aspects of the notion that consistency in the regulation of infrastructure businesses is desirable. Recent empirical findings on the consistency of Australian regulators are reviewed, along with theoretical work suggesting consistency might not always be a good sign.

Menezes notes that one possibility for regulatory consistency has come about in the Australian context due to the merger of existing regulators, such as the AER. However, measuring regulatory consistency is a difficult exercise. The author notes that different regulatory parameters are not evidence of inconsistent regulatory policy. For example, differences in WACC parameters between industries regulated by the ACCC are not evidence of inconsistency.

For consistency among different regulators, other theoretical work is considered which proposes that consistency can be the result of career concerns of regulators, which may or may not coincide with the socially optimum regulatory decisions. This theoretical research suggests regulatory decisions might converge if regulators are sufficiently concerned about the adverse effect of inconsistency on their future career opportunities. The paper concludes by cautioning against ‘consistency for consistency’s sake’ and suggests there might be a need to develop analytical tools to distinguish ‘good’ from ‘bad’ consistency. To download click here: [Consistent regulation of infrastructure businesses](#)

## International Round-Up of Regulatory Decisions

*This section contains a sample of recent regulatory decisions in leading OECD countries and the European Union, with emphasis on the energy, telecommunications, postal, water, rail, airports and ports sectors.*

### **Telecommunications**

#### **Netherlands: Independent Post and Telecommunications Regulator (OPTA) Releases 'Context and Perspectives' Document**

OPTA released a document examining the context and perspective of the preliminary draft decisions for fixed telephony, broadband and leased lines which were released on 15 July 2008. Under the terms of Chapter 6a of the Dutch Telecommunications Act, the OPTA is required to analyse specific relevant markets in the electronic telecommunications sector in order to determine whether there is effective competition in those markets or whether any party holds significant market power (SMP). The OPTA may impose appropriate remedies on any party that holds SMP. The decisions will cover the period 1 January 2009 to 31 December 2011. [Report](#)

#### **Netherlands: KPN to Open Fibre-optic Network to Rivals**

On 15 July 2008 the Dutch communications regulator OPTA announced it was relaxing regulations on KPN in the retail market. The dominant Dutch telecommunications company KPN has announced its intent to open up its fibre-optic infrastructure to other market participants. KPN says this will help to increase network usage rates. KPN has stated its support for a 'tiered model,' where one operator owns the infrastructure and others are able to use it to provide services. [OPTA](#) and [KPN](#)

#### **United States of America: FCC Announces New Standards for Showings of Effective Competition for Cable Service**

The Communications Act (US) permits the FCC to rescind the local franchise authority to regulate cable service rates if it can be shown that the cable operator is subject to 'effective competition'. One way that a cable operator can demonstrate effective competition is to show that the number of households in a franchise area that subscribe to competing video services is more than 15 per cent of all the households in that franchise area. This is known as the 'competing provider' test for effective competition. The FCC has clarified the data that must be submitted to support a finding that a competing provider provides effective competition in the franchise area. [Link](#)

#### **Canada: CRTC Issues First Annual Report on Communications Industry**

On 31 July 2008 the Canadian Radio-television and Telecommunications Commission (CRTC) issued the inaugural Communications Monitoring Report. Previously, the CRTC had published separate annual monitoring reports for the broadcasting and telecommunications industries. The report provides information on different sectors of the broadcasting and telecommunications industries. It also includes sections on new media trends and international perspectives. [CRTC Communications Monitoring Report](#)

#### **United Kingdom: Ofcom Releases Report on Communications Market 2008**

This report captures developments in the communications landscape through a blend of converged and sector analysis. The report is arranged into six sections which provide a summary of the key points, a broad context for the changes which are taking place in the market, and an examination of convergence based on content, distribution and consumption, followed by a look at each of the television, radio and telecommunications sectors. [Link to report](#)

#### **UK: Ofcom Releases Report on Theoretical Limitations of Copper in the Last Mile**

The report seeks to address the question of when the current copper network would be unlikely to meet the expectations of the majority of UK consumers.

The study suggests a theoretical upper limit, given all technical progress possible, of 50Mbit/s, with fibre to the cabinet. Ofcom is publishing the report to gain views from interested parties on the possibility that future technologies could exploit, in practice, the theoretical potential described in this report. [Link](#)

#### **Europe: ERG Publishes Second Report on International Roaming Data**

On 12 August 2008, the European Regulators Group (ERG) published a benchmark data report on international roaming. The report covers the period from October 2007 until March 2008. According to the ERG, the data show that the wholesale and retail price caps on voice roaming have been successfully implemented in accordance with the requirements of the Roaming Regulation. It is, however, too early to assess fully the impact of the Regulation since factors such as seasonality cannot yet be measured in their entirety. [Link to presentation](#) and [Link to report](#)

**Telecommunications (continued)****Ireland: Eircom Publishes Access Reference Offer for LLU Ancillary Charges**

The Irish communications regulator ComReg has reported that Eircom has published the revised Access Reference Offer (ARO) price list relating to local loop unbundling (LLU) ancillary charges. The charges, which are the result of a review of Eircom's pricing by ComReg, are expected to result in reductions of up to 65% in the main current ARO charges. ComReg believes the price reductions will result in additional competition in Ireland's LLU market. [Link](#)

**United States of America: FCC Puts Revised Roaming Rules on Hold**

Reuters has reported that Federal Communications Commission (FCC) chairman Kevin Martin has put on hold a plan to revise the rules that regulate roaming agreements between carriers in the USA. The rules ensure that smaller carriers have the right to have their customers roam onto the networks of larger carriers. Chairman Martin had proposed adopting new rules that would require carriers that own spectrum in an area to build out their networks to use the spectrum within four years of purchase or lose their guaranteed access rights for roaming in that area. The goal was to ensure the country's wireless spectrum is utilised rather than merely held in reserve for a future need. According to reports, Martin withdrew the proposed changes because the five members of the FCC commission could not come to a consensus on the subject.

**USA: Wilmington, North Carolina, Becomes First Place in USA to Switch from Analog to Digital Television**

On 8 September 2008, Wilmington in North Carolina became the first place in the US to switch from analog to digital television. The DTV transition for the rest of the US will not take place until 17 February 2009. At that time, all television stations must turn off their analog signals and broadcast only in digital. [Link](#)

**Energy****United Kingdom: Ofgem's Transmission Access Review – Final Report**

Ofgem, with the Department for Business Enterprise & Regulatory Reform (BERR), published their joint Transmission Access Review Final Report to the Secretary of State on 26 June 2008. Grid access is currently considered to be a major barrier to the deployment of new renewable (and other low carbon) generation. The measures set out in this report, if implemented fully, would remove, or significantly reduce, grid-related access barriers.

The March 2008 Regulatory Policy Institute Issues Paper, issued as part of the review, provides a brief description of approaches that have been adopted to address the common challenge facing those who own, operate, use and regulate electricity transmission networks in many jurisdictions around the world: reconciling the actual and anticipated increase in renewable energy generation with the risks, high costs and system management issues associated with the expansion and adaptation of transmission infrastructure to accommodate this form of generation. [Ofgem-BERR Transmission Access Review - Final Report](#)

**UK: Ofgem Electricity Distribution Charges, Methodology and Governance**

On 22 July 2008, Ofgem announced its decision on a common methodology for use of system charges from April 2010, consultation on the methodology to be applied across DNOs and consultation on governance arrangements.

**[22 July 2008 Ofgem decision](#)****UK: House of Commons Business and Enterprise Committee Releases Report on Energy Prices, Fuel Poverty and Ofgem**

The inquiry was commenced on 21 February 2008 after the majority of the 'Big 6' UK energy companies raised their prices in early 2008. As Ofgem is also conducting a review of energy markets, the House of Commons review has been structured to feed into Ofgem's work. The report raises concerns that UK energy markets are not as efficient as they should be and that UK prices are higher than in other countries. Its overall conclusion on the functioning of both gas and electricity wholesale markets is that there are significant questions that need to be addressed in the interests of both business and retail customers. The report has also identified important issues in the retail market and recommended consideration of the merits of referring two of those issues to the Competition Commission (the forward gas market and the supply of electricity to the SME sector) if Ofgem is unable to take 'sufficiently robust' steps itself. Although the inquiry did not find evidence of collusion in wholesale or retail markets, it noted that 'in a retail market dominated by six major players, it is easy for those players to make informed judgements about the behaviour of their competitors. This alone can distort competition. The regulator therefore needs to remain very watchful.' The Committee considers that the best ways to address the problems it has identified are to improve market design, take specific regulatory steps and continue to work for liberalisation of European markets. Such an approach will need Ofgem to 'demonstrate a rather greater sense of urgency than has been apparent so far.' [Report](#)

**Energy (continued)****Germany: Regulator Publishes Draft Decision on the Future Return on Equity**

The German regulator, Bundesnetzagentur, has published a draft decision on the Return on Equity (ROE) for electricity and gas grid operators in Germany. From the start of incentive regulation on 1 January 2009, all gas and electricity grid operators would receive a 7.82 per cent return on their equity in new assets during the first regulatory period. Previously, the ROE has been set by government decrees. In determining the ROE, the Bundesnetzagentur used current yields on fixed-interest securities of domestic issuers in addition to a risk premium established using the Capital Asset Pricing Model. The Bundesnetzagentur also considered the returns on equity allowed in other European countries. Source: NERA, Global Energy Regulation, Issue 108, May 2008

**Netherlands: NMa Publishes Draft X-factor Method Decision for Electricity Transmission**

The Dutch competition authority, NMa, has published a draft method decision that sets out the regulation of electricity transmission tariffs for Tennet, the Transmission System Operator (TSO) in the Netherlands, between 1 January 2008 and 31 December 2010. The draft decision method will form the basis for NMa to determine annual X-factors for Tennet. The methodology is the same in principle as the methodology set out in the 2007 method decision, but takes account of new regulatory developments and information. Source: NERA, Global Energy Regulation, Issue 108, May 2008

**United Kingdom: Operator Says Gas Transport Service is Delayed by Ofgem's Failure to Approve Tariff**

BBL Company, which operates the Balgzand-Bacton gas interconnector between the Netherlands and Britain, plans to postpone introducing an 'interruptible reverse flow' service that would allow users to transport gas from the UK to continental Europe. BBL says the delay arose because it has not been able to agree on a tariff methodology with Ofgem. According to the company's website, apart from regulatory approval, BBL Company has everything it needs to introduce the service. [Link](#)

**Germany: Federal Network Agency Sends Reminders for Implementation of Determination on Change of Electricity Suppliers**

The German Federal Network Agency has threatened nearly 40 grid operators with administrative fines amounting to a total of around €1.7 millions. The reason for this action is the still incomplete or incorrect implementation of the authority's requirements for business processes and data formats for the supply of end customers in the electricity sector. This so-called GPKE determination (Business processes for supplying customers with electricity) of 11 July 2006 provides, inter alia, the basic principles which enable consumers to change electricity suppliers in a quick and uncomplicated manner. [Link](#)

**Germany: Gas Grid Operators Investigated**

Germany's network regulator, the Bundesnetzagentur, has launched an investigation into five operators of natural gas grids over suspected market abuse. The investigation is related to plans to reduce the number of market areas for low-calorific gas, or L-gas, in an effort to boost competition and improve network access to third parties. [Link](#)

**Germany: Court Largely Confirms Cutting of Electricity Tariffs by Regulator**

The German federal court, the Bundesgerichtshof, has confirmed many decisions that the federal and state regulators had taken in the context of the approval of electricity tariffs. According to the law, tariffs have to be cost oriented and their derivation is spelled out in the decree known as the StromNEV. The interpretation of various provisions in the StromNEV has, however, led to disagreements, which have now been clarified by the federal court. The Bundesgerichtshof has largely approved the regulators' calculations, particularly the so-called residual value, the double capping of the return on equity, and the allowance for trade tax. The federal court ruled in favour of the grid operators only in a few instances, including allowing interest during construction and taking account of assured facts during the planning year with regard to network losses.

**Netherlands: NMa Publishes Regulatory Method Decision for Gas Flexibility Services**

The NMa has recently determined that Gastransportservices (GTS), operator of the gas transmission network in the Netherlands, has to continue offering flexibility services from 2009 to 2011 inclusive, to allow gas supply companies to adjust for unpredictable swings in the gas off-take from the grid. The Method Decision finalises the methodology and forms the basis on which GTS must submit a tariff proposal to the NMa by 1 September 2008. By the end of this year, the NMa will determine the definitive tariffs to apply from 1 January 2009. Energiekamer website, 25/08/08

**Energy (continued)****Netherlands: NMa Publishes Draft Amendment Tariff Codes for Electricity and Gas**

On 20 August, the NMa published for consultation a draft amendment of the electricity and gas tariff codes for small users. The proposed amendment involves a change in the tariff structure to replace variable distribution charges for small users with a capacity charge, to eliminate distributors' need to obtain metering data for small users, so that the data can then be handled by the relevant supply company. Interested parties were invited to respond to the NMa up to six weeks after the publication date of the draft amendment, and attend a hearing at the NMa on 22 September 2008. Energiekamer website 20/08/08; case number 102490

**Water****United Kingdom: 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. For more information, click [here](#).

**UK: Ofwat Publishes its New Strategy for Regulation**

Ofwat today published its new strategy which sets out how it plans to develop economic regulation of the water and sewerage sectors in England and Wales. To view, click [here](#).

**United Kingdom: Ofwat Issues International Comparisons Report**

Ofwat's International Comparisons 8 August 2008 report compares data on bills, service levels, quality compliance, leakage, operating costs, capital expenditure, relative efficiency, network activity and financial performance of water and sewerage companies in Scotland, Portugal, Northern Ireland, Netherlands, Canada, Australia and the US. These comparisons are used to put the performance of regulated companies in the UK and Wales into a wider context, support regulatory decisions and explore differences that allow Ofwat to challenge the performance of those regulated companies. [Link](#)

**UK: Ofwat Releases Guidance for Completing the Principal Statement Information Capture System 2009-10**

The purpose of the principal statement information capture system (PSICS) is to enable Ofwat to check that regulated firms' proposed charges for the coming charging year comply with statutory and Ofwat requirements. All the sections of the PSICS are presented in Excel spreadsheet format. [Link to Guidance](#)

**Post****UK: Postcomm Statement on Zonal Access Price Structures**

On 14 August 2008, Postcomm announced that it welcomes the fact that Royal Mail has launched an industry consultation on a revised zonal access price structure. Postcomm is currently conducting a general review of zonal access pricing (under which Royal Mail charges a zonal price for delivering mail to the 'final mile' for large customers and other postal operators). In addition, TNT Post UK Limited (TNT) has applied to Postcomm for a direction under Condition 9 of Royal Mail's licence in relation to two access products, both of which it has requested be zonally priced, but with a two zone pricing structure. Condition 9 requires Royal Mail to negotiate access, access prices and the terms of access agreements and gives Postcomm the power to make directions to resolve disputes about access. [Link](#)

**Ireland: ComReg Reports on AnPost Quality of Service Performance Between April and June 2008**

The Commission for Communications Regulation (ComReg), the regulator for the postal industry in Ireland, has published the results of its quarterly independent report on the Quality of Service performance of An Post during the period April to June 2008. [Link](#)

**Airports****UK: Civil Aviation Authority's Response to the Call for Evidence by Government's Review of Regulation of UK Airports**

On 22 April 2008, the UK Secretary of State launched a review of the regulatory framework for UK airports. When launching the review, the Secretary of State set out three objectives for the future development of the UK airport regulatory framework. These were:

- Improving the passenger experience.
- Encouraging appropriate and timely investment in additional capacity to help deliver economic growth in line with wider Government policy.
- Addressing the wider environmental impacts of aviation on airport development.

An important issue is whether regulation of UK airports is required over and above general competition law. If regulation is appropriate what forms of intervention or regulation are appropriate? The CAA's submission focuses on the overall objectives and approach to the review. The CAA has, however, published a number of documents that are relevant to this review which include extensive analysis of the UK airports markets. These are referenced in this submission. The submission includes a number of strategic recommendations.

The CAA stressed that the case for 'best practice' regulation should not be interpreted as meaning that airports should be regulated as if they were network utility businesses, such as water or energy networks. This is because, according to the CAA, airports are not inherently natural monopoly businesses but can and do compete for airlines and passengers. Economic regulation should reflect this fact. [Submission](#)



## Regulatory Decisions in Australia and New Zealand

### New Zealand

#### New Zealand Parliament Passes Commerce Amendment Bill

Parliament has passed legislation which Commerce Minister Lianne Dalziel says is 'excellent news' for the growth and improvement of infrastructure businesses that are natural monopolies. The Commerce Amendment Bill, which passed its remaining stages under urgency, is a major rewrite of the price control provisions of the Commerce Act 1986. (See longer note under 'Notes on Interesting Decisions'.) [News Release](#)

#### Commerce Commission Release June Quarterly Report on Telecommunications Markets

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

#### Commission Notifies Telecom of Breach of the Separation Undertakings (MR 11 July 2008)

Telecommunications Commissioner Dr Ross Patterson has written to Telecom advising that the first *prima facie* breach of the Separation Undertakings has occurred. The Separation Undertakings are a deed between the Crown and Telecom that require Telecom business units to treat the other Telecom business units and external wholesale customers in an equal and transparent manner. The breach relates to Telecom's failure to consult and provide information to the Minister of Communications, David Cunliffe, and the Commerce Commission before 30 June 2008 about the method by which Telecom classifies customer service addresses. [Media Release](#)

#### Commerce Commission Issues Draft Terms Determination for Sub-Loop Services

The Commerce Commission released on 5 September 2008 its draft standard terms determination on the price and non-price terms on which Telecom must make the regulated sub-loop services available to other telecommunications providers. These are the services required to allow companies to provide services to their customers from Telecom's roadside cabinets. After consultation on the draft determination, a final determination will be made by the Commission. It is anticipated that the final determination will be issued in January 2009. [Link](#)

#### Telecommunications Act: Commerce Commission Releases Final Telecom TSO Cost Calculation for 2004/05

The Commerce Commission has released its telecommunication service obligations (TSO) determination covering the 2004/05 year. The final TSO cost is \$52.0 million for 2004/05. The determination specifies how the TSO cost is shared between Telecom and other operators whose networks are interconnected with Telecom's fixed network. [Link](#)

#### Commission Issues Draft Standard Terms Determination for the Mobile Co-Location Service

The Commerce Commission released on 25 July 2008 its draft standard terms determination on the non-price terms for co-location on cellular mobile transmission sites (the Mobile Co-location Service). The Mobile Co-location Service allows the equipment of a mobile network operator to be installed on another operator's cell masts. Co-location helps reduce network infrastructure costs for existing and potential mobile service providers by providing for the sharing of network infrastructure. It is anticipated that the final determination will be issued in November 2008. [Link](#)

#### Court of Appeal Confirms Decision to Control Powerco's and Vector's Gas Pipeline Services (MR 12 August 2008)

The Court of Appeal has dismissed a challenge by Powerco Limited to the Commerce Commission's 2004 recommendation to control gas pipeline services supplied by Powerco Limited and Vector Limited. The Court also dismissed Powerco's challenge to the Minister of Energy's subsequent decision to impose control. The Court found that, in recommending price control, the Commission's interpretation of the relevant regulatory provisions in the Commerce Act was 'the correct approach'. [Media Release](#)

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

##### ACCC Proposes to Reject Telstra's Optus HFC Exemption but Accept Transmission Exemption

The ACCC issued a draft decision on 22 September 2008 proposing to reject Telstra's application for exemption from its obligations to supply regulated fixed line services to Optus within Optus's Hybrid Fibre Coaxial cable network footprint. The ACCC also issued a draft decision that proposes to allow certain exemptions relating to the Domestic Transmission Capacity Service. The ACCC is not satisfied that granting the 'HFC exemption' would promote the long-term interests of end users. [Link](#)

(...ACCC continued)

### **ACCC Proposes Fair Access Terms for Core Telecommunications Access Services**

On 18 September 2008 the ACCC issued a draft determination specifying model non-price terms and conditions for core telecommunications access services. These core services are the main access services which competitors need in order to compete with Telstra for a variety of retail services. Consequently, the terms of access to these services can act to the long-term benefit of Australian consumers of various telecommunications services, including high-speed broadband services. Although non-binding, they provide guidance as to the ACCC's views regarding fair terms and conditions of access. [Link](#)

### **ACCC Proposes to Grant Telstra PSTN OA Exemptions**

On 5 September 2008 the ACCC issued a draft decision proposing to grant Telstra exemptions from its obligations to supply public switched telephone network originating access (PSTN OA) services in five central business district areas (CBD) and parts of metropolitan Australia. The proposed exemptions, which cover 15 CBD and 248 metropolitan exchange service areas (ESAs), are not as broad as those requested by Telstra. Further, the draft decision relates only to wholesale voice services, not broadband services which are not subject to open access regulation. [Link](#)

### **ACCC Grants Authorisation to IATA Tariff Coordination System (MR 29 August 2008)**

The ACCC has issued a determination granting authorisation to the International Air Transport Association for its new passenger tariff coordination system. The ACCC also extended authorisation to the current system to allow a transition period. On balance, the ACCC considers that the public benefits of the new system are likely to outweigh the public detriments. [Link](#)

### **ACCC Grants Telstra Local Carriage Service and Wholesale Line Rental Exemptions**

The ACCC has decided to grant Telstra exemptions from its obligations to supply two 'declared' services in parts of metropolitan Australia, subject to a number of conditions. The decision relates only to wholesale voice services, not broadband services - which are not subject to open access regulation. The exemptions, which cover 248 exchange service areas, are not as broad as those requested by Telstra. [Link](#)

### **ACCC Issues Position Paper on Water Termination Fees**

The ACCC issued on 14 August 2008 its position paper seeking submissions on the development of water charge rules for termination fees. [Link](#)

### **ACCC Issues Final Decision on Australia Post's Proposed Price Increases**

The ACCC issued on 31 July 2008 its final decision not to object to Australia Post's proposal to increase the price of the basic postage rate from 50 to 55 cents. Australia Post must now give written notice of this change to the basic postage rate to the Minister for Broadband, Communications and the Digital Economy. The ACCC has also decided not to object to Australia Post's proposal to increase other letter prices, including large ordinary letters, and small and large Pre-Sort Bulk Mail. [Link](#)

### **ACCC Accepts Undertaking for Interstate Rail Access**

On 30 July 2008 the ACCC accepted an undertaking from the Australian Rail Track Corporation that provides for train services to access much of Australia's interstate rail track. The ACCC's decision on ARTC's Access Undertaking was issued today. ARTC's undertaking sets out the principles and processes under which ARTC, as an infrastructure provider of rail, will be obliged to provide access to businesses wishing to run trains on ARTC's interstate rail network. [Link](#)

### **ACCC Publishes Data on Take-up of Broadband Access Services**

On 21 July 2008 the ACCC published details of the take up of broadband access services on Telstra's copper network. The data provides, for the first time, details of the take up of these broadband access services between metropolitan, regional and rural areas. [Media Release](#)

### **ACCC to Oversee Access to Telstra Exchange Facilities**

The ACCC has made a record keeping rule which requires Telstra to keep and retain records and give reports to the ACCC relating to access to Telstra exchange facilities. [Link](#)

(...ACCC continued)

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

The ACCC released on 7 July 2008 its position paper seeking submissions 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. [Media Release](#)

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

On 7 July 2008 the ACCC released its issues paper seeking submissions on the development of water charge rules for bulk water suppliers. The water charge rules are an important component of the new *Water Act 2007*. The development of water charge rules will contribute to the sustainable and efficient management of water resources and infrastructure in the Murray-Darling Basin. [Media Release](#)

#### **ACCC Issues Position Paper on Water Charge Rules**

The ACCC issued on 30 September 2008 its position paper seeking submissions on the development of water charge rules for irrigation infrastructure operators and bulk water operators. The water charge 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. [Link](#)

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

##### **Call for Submissions on Draft Access Arrangement Guideline**

The AER has developed the draft access arrangement guideline (dated September 2008) to assist service providers and other interested parties in the context of the AER's assessment of the access arrangement proposals for gas pipelines under the National Gas Law and National Gas Rules. Interested parties are invited to make submissions on the draft access arrangement guideline by 12 December 2008. [Link](#)

##### **Framework and Approach for Energex and Ergon Energy Distribution Determinations 2010–2015**

The AER has released a paper setting out its proposed approach to the classification of Energex's and Ergon Energy's distribution services and the control mechanisms to apply in the 1 July 2010 to 30 June 2015 regulatory control period. The AER has also released a preliminary positions paper relating to the application of a service target performance incentive scheme, an efficiency benefit sharing scheme and a demand management incentive scheme to Energex and Ergon Energy for the same period. [Media Release](#)

##### **AER Review of Electricity Transmission and Distribution WACC**

On 6 August 2008 the AER released an issues paper for its review of the weighted average cost of capital for electricity distribution and transmission businesses. Submissions on the issues paper were due on 17 September 2008. [Link](#)

##### **AER Appoints National Electricity Market Dispute Resolution Adviser**

The AER announced on 30 July 2008 the re-appointment of Ms Shirli Kirschner as the National Electricity Market Dispute Resolution Adviser. The Dispute Resolution Adviser's role is to ensure that the NEM dispute resolution processes operate effectively. The process is designed to encourage market participants to resolve disputes without formal legal representation or the use of legal procedures. Ms Kirschner, of Resolve Advisors, has performed the role of NEM Dispute Resolution Adviser since 2001 and has recently also been appointed the dispute resolution adviser for the Victorian gas market. The AER has re-appointed Ms Kirschner as the NEM Dispute Resolution Adviser for a period of three years. [Media Release](#)

##### **Strong Transmission Investment Continues: Fifth Electricity Regulatory Report**

The fifth electricity regulatory report covering transmission network service providers in the National Electricity Market was issued on 11 August 2008. AER Chairman, Mr Steve Edwell, said the AER report aims to provide transparency about the financial and operational performance of the transmission businesses. The report provides revenue, profit, expenditure and service standards information on each transmission business for the 2006/07 reporting year. The businesses covered are Directlink, ElectraNet, EnergyAustralia, Murraylink, Powerlink, SP AusNet, Transend, TransGrid and VENCORP. [Link](#)

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

### **AEMC Publishes the First Final Report of its Review of the Effectiveness of Energy Retail Competition in South Australia**

The Australian Energy Market Commission (AEMC) on 19 September published the First Final Report of its Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia – confirming its preliminary finding that retail competition for both electricity and gas is effective. AEMC Chairman, Dr John Tamblyn, said the Commission's Final Report was prepared following extensive consultation with a wide range of stakeholders. Dr Tamblyn noted that market entry and expansion by new energy retailers has strengthened competition and customer choice in the energy retail market. [Link](#)

### **AEMC Starts Review of Implications for Energy Markets in Light of Climate Change**

AEMC Chairman, Dr John Tamblyn, announced on 25 August 2008 the Review of electricity and gas market frameworks in the light of new climate change policies. The Ministerial Council on Energy has provided the Terms of Reference to the AEMC. The Review is to focus on assessing how the introduction of the Carbon Pollution Reduction Scheme (CPRS) and the expanded Renewable Energy Target may affect Australia's energy market frameworks and determine what, if any, amendments are needed to those frameworks as a result. [Link](#)

## **National Competition Council (NCC)**

### **Final Decisions on Pilbara Rail Access**

The NCC received three applications for declaration under Part IIA of the Trade Practices Act (TPA) in late 2007 and early 2008. These were all made by The Pilbara Infrastructure Pty Ltd in relation to the Hamersley Railway; the Goldsworthy Railway and the Robe Railway. The NCC provided its final recommendation on these applications to the Minister Hon Wayne Swan MP on 29 August 2008. If the Treasurer does not make a decision within 60 days, the TPA provides that he is deemed to have decided not to declare the service.

## **Australian Capital Territory**

### **Independent Competition and Regulatory Commission**

#### **Retail Prices for Non-contestable Electricity Customers – Price Direction 2008-09**

On 20 June 2008, the Commission released the Final Report and Price Direction on Retail Prices for Non-contestable Electricity Customers in the ACT for the period from 1 July 2008 to 30 June 2009. The 'transitional franchise tariff' (TFT) is a regulated retail tariff for customers who choose not to move to a negotiated contract offered by the incumbent retailer, ActewAGL Retail, or by a competing retailer. The Commission approved a 7.11 per cent increase in the annual average transitional franchise tariff price cap. [Link](#)

## **New South Wales**

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

#### **The New Water Industry Act 206 (WICA) Has Been Introduced**

#### **Draft Determination and Report – Review of Developer Charges for Metropolitan Water Agencies**

The Independent Price and Regulatory Tribunal of NSW (IPART) released on 18 July 2008 a draft report which recommends a simpler and clearer system for calculating developer charges. Developer charges recover from developers some of the costs of providing water-related infrastructure to new projects. The final determination by the Tribunal will take effect from 1 January 2009. [Media Release](#)

## **Northern Territory**

### **Utilities Commission**

#### **2009 Regulatory Reset**

As required by the Commission's 2009 Regulatory Reset: Final Price Control Mechanism Decision (published in May 2008), Power and Water submitted its Initial Regulatory Proposal for the third regulatory period in August 2008. The Commission will publish its Initial Draft Determination, based on whether or not it proposes to approve the initial regulatory proposal and, if not, what revisions it proposes to require before a revised regulatory proposal could be approved by the Commission in early October, at which time the view of interested parties will be sought.

[Link](#)

### **Electricity Market Information**

The Commission has released its annual report on the composition of the Northern Territory Electricity Market for 2007-08. [Link](#)

**(...Northern Territory cont.)****2009 Regulatory Reset**

As required by the Commission's 2009 Regulatory Reset: Final Price Control Mechanism Decision (published in May 2008), the Commission has approved the network services classification proposed by Power and Water for the third regulatory period. This is an interim approval - the final network services classification for the third regulatory period will form part of the Commission's 2009 Regulatory Reset: Final Determination to be released in November 2008. [Link](#)

**Queensland****Queensland Competition Authority (QCA)****Notified Electricity Prices 2009-10**

In August 2008 the Queensland Competition Authority released the draft first report by its consultant, CRA International, on the Benchmark Retail Cost Index, for Notified Electricity Prices 2009-10. [Link](#)

**Review of Minimum Service Standards and Guaranteed Service Levels to Apply in Queensland from 1 July 2010**

The Authority has released a Discussion Paper on the Review of Minimum Service Standards and Guaranteed Service Levels to Apply in Queensland from 1 July 2010. The Queensland Electricity Industry Code (the Code) sets the minimum service standards and guaranteed service levels and payments that are to be met by Energex and Ergon Energy during the current regulatory period. [Link](#)

**South Australia****Essential Services Commission of South Australia****Administration of Residential Energy Efficiency Scheme**

On 21 August 2008, Regulations were made under the *Electricity Act 1996* and *Gas Act 1997* giving effect to the Residential Energy Efficiency Scheme (REES) announced by the South Australian Government in February 2008 for commencement from January 2009. The Regulations establish the Essential Services Commission of South Australia (the Commission) as the administrator of the REES, a new energy efficiency scheme providing incentives for South Australian households to achieve greenhouse gas reductions and potentially lower their energy bills through reduced energy consumption. [Link](#)

**Regulatory Arrangements for Reticulated LPG Networks – Issues Paper (MR 29 August 2008)**

The Essential Services Commission of South Australia is the licensing authority for the purposes of the Gas Act (the Act), a role which it assumed in July 2003. There is an increasing interest in the establishment of reticulated LPG networks, particularly in new housing and small industrial developments in areas beyond the reticulated natural gas network operated by Envestra Ltd. A paper has been developed seeking feedback from interested parties on the Commission's initial thinking on such matters. [Media Release](#)

**Inquiry into 2008-2009 Metropolitan and Regional Water and Wastewater Pricing Processes – Final Report**

In February 2008, the Treasurer referred to the Essential Services Commission of South Australia (the Commission), pursuant to Part 7 of the *Essential Services Commission Act 2002*, a public Inquiry into the processes leading to the Cabinet decision in late 2007 on the level and structure of SA Water's water and wastewater prices in metropolitan and regional South Australia for 2008-09. The Final Report was released by the Government on Wednesday 6 August 2008.

**Victoria****Essential Services Commission****Energy Regulatory Instruments Review**

The Commission is reviewing its energy retail and non-economic distribution regulatory instruments, including codes and guidelines. The review will examine the administrative and regulatory obligations on energy businesses to identify opportunities to improve and streamline the framework for consumers and the industry. The ESC released its Draft Decision in August 2008. [Link](#)

**Victorian Energy Efficiency Target Scheme Guidelines**

The Commission is responsible for administering the Victorian Energy Efficiency Target (VEET) scheme, due to commence on 1 January 2009. The scheme sets a target for energy savings to be achieved through the uptake of energy efficient technology, initially in the residential sector. Energy retailers are required to meet these targets by purchasing energy efficiency certificates. The VEET scheme guidelines were released on 20 August 2008. [Link](#)

**Tasmania*****Office of the Tasmanian Energy Regulator*****Comparison of 2008 Australian Electricity Distribution Use of System Charge Report**

The Comparison of 2008 Australian Standard Offer Energy Prices Report released by the Regulator provides an overview of the pricing environment in both the electricity and gas retail markets for 2008, as an update to information presented in Chapter 13 of the 2006-07 Energy Supply Industry Performance Report. Pricing information has been updated as a result of approved increases in tariffs in Victoria and South Australia, and the Tasmanian tariffs approved by the Regulator for 2008. [Link](#)

**Western Australia*****Economic Regulation Authority (ERA)*****Inquiry on Competition in the Water and Wastewater Services Sector**

On 25 July 2008 the Treasurer released the Economic Regulation Authority's Final Report on its inquiry into competition in Western Australia's water and wastewater services sector. The inquiry's major recommendation was for the State to establish a new body to identify and procure new water sources that could be developed, owned and operated by the private sector. [Media Release](#)

**Inquiry into Pricing of Recycled Water in Western Australia**

On 1 August 2008 the Treasurer requested the Economic Regulation Authority to undertake an inquiry into the pricing of recycled water in Western Australia. The Terms of Reference require the Authority to consider issues including if and when recycled water prices should be regulated and the pricing recommendations of the State Water Recycling Strategy. [Media Release](#)

## Notes On Interesting Decisions

### New Zealand Parliament Passes Commerce Amendment Bill

New Zealand Parliament has passed legislation recommended unanimously by the Commerce Select Committee which Commerce Minister Lianne Dalziel says is 'excellent news' for the growth and improvement of infrastructure businesses that are natural monopolies. The Commerce Amendment Bill, which passed its remaining stages under urgency, is a major rewrite of the price control provisions of the Commerce Act 1986, specifically amending the price control provisions applying to sectors not faced with competition, such as electricity lines, gas pipelines and airports. The Commerce Minister said the overall aim was to provide protection for consumers against excessive prices and poor quality for basic infrastructure in these natural monopoly sectors.

The Amendment includes a new test for when regulation may be introduced, including requirements on the level of competition and the scope for the exercise of substantial market power. Further amendments include changes to input methodologies, where the Commission is required to set input methodologies for electricity lines, gas pipelines and airports by 30 June 2010, and a new arbitration regime.

A significant change is the provision for appeals to the High Court on final implementation decisions by the Commerce Commission. The Bill as introduced only provided for appeals on the detailed rules, such as input methodologies, relating to the various forms of control. Decisions of the Commission will take effect pending the outcome of any appeals.

The Energy Minister David Parker welcomed other changes to the Bill which improve the transitional arrangements to the new regulatory regime for electricity lines businesses and gas pipelines, and the proposed new arrangements for consumer-owned electricity lines businesses, which limits regulation to information disclosure.

[Link](#)

### Opposition to Single EU-wide Telecommunications Regulator

The Industry, Research and Energy Committee (ITRE) and the Internal Market and Consumer Protection Committee (IMCO) of the European Parliament voted on the European Commission's proposals to reform the EU Telecommunications rules. These votes are important steps towards shaping the final legislative texts to be adopted by the European Parliament and the Council. The ITRE Committee accepted a number of the Commission's key proposals, including the addition of functional separation to the toolbox of national regulators to ensure competition. However, the ITRE Committee did not accept the Commission's proposal to set up an independent European Electronic Communications Market Authority (EECMA). Instead it proposed setting up a Body of European Regulators in Telecommunications (BERT) which would consist of the 27 national regulators. BERT will have substantially weaker powers than those envisaged for the EECMA.

Members of the European Parliament proposed a new 'co-regulation' procedure which would require national regulatory authorities to consult the Commission and BERT before taking regulatory decisions. The Commission may require the national regulatory authority to amend the draft measure if BERT considers the measure inappropriate or ineffective. A national regulator may, as 'an exceptional measure', require telecommunications operators to separate their network access products from other services. However, the national regulator may apply this remedy only if both the Commission and BERT confirm that no other measure has achieved effective competition and that, without the remedy, there is little prospect of future infrastructure-based competition. The European Parliament planned to vote on the EU's Telecommunications regulatory framework on 8 September 2008. [European Commission Press Release](#) and [Greens Press Release](#)

### Agreement on European Union Energy Legislative Package

In September 2007, the European Commission adopted a package of legislative proposals for an EU-wide energy market. The package proposed a number of measures to complement the existing rules. Importantly, it proposed the separation, or 'unbundling' of production and supply from transmission networks, including ownership unbundling. In addition, the Commission proposed a second option, the 'independent system operator' which would make it possible for existing vertically integrated companies to retain network ownership, if its assets are actually operated by a company or body that is completely independent from it.

On 6 June 2008, Member States accepted a so-called 'third way' proposal, endorsing two alternatives to ownership unbundling: the 'independent system operator' (ISO) and 'independent transmission operator' (ITO) models. Both of these would allow European energy companies to retain their network assets, provided they met strict conditions to ensure separation of interests between supply and transmission.

In a contested vote, however, the European Parliament adopted provisions in support of full 'ownership unbundling' in the electricity market. In doing so (and in endorsing a stronger role for the Energy Regulators Agency) it went even further than the original Commission proposal.

In relation to the gas market, however, the European Parliament accepted the ITO as an alternative to ownership unbundling. However, the EP will require that, no later than five years after the directive comes into force, an inquiry will be held to determine whether the ITO model has ensured the independence of transmission systems operators. If not, the EC will submit proposals to ensure the full and effective independence of network systems operators.

Members of the European Parliament also preserved the Commission's proposal to prevent control of transmission systems or transmission system operators 'by a person or persons from third countries'. The European Parliament supported the liberalisation of the gas market by adopting reports that – though reaching out to countries opposed to 'full ownership unbundling' (the separation of gas suppliers from gas transmission networks) – place strict conditions on companies that do not unbundle. [Gas market decision](#) and [Electricity market decision](#)

### **Water Industry Competition Act 2006 (WICA)**

The Water Industry Competition Act 2006 and its associated regulations came into force on 8 August 2008. The Act is a central component of the NSW Government's strategy for a sustainable water future and aims to encourage competition by enabling private sector entry to the industry. The intention is to harness innovation and the associated investment potential of the private sector while protecting public health and providing safeguards for water industry customers and the environment. It grants private sector entrants similar rights to those enjoyed by the current public authority incumbents.

The three key areas of the Act and IPART's associated roles are:

1. To establish a licensing regime to provide for private sector involvement in the supply of water and provision of sewerage services. The aim of the licensing regime is to ensure the continued protection of public health, consumers and the environment. IPART is responsible, on behalf of the Minister, for receiving and assessing licence applications and for the ongoing administration and enforcement of licences.
2. To establish a third party access regime to ensure that certain monopoly infrastructure services are available to persons seeking access to them. The provisions relating to third party access currently apply to the area of operations of Sydney Water Corporation and Hunter Water Corporation. The NSW Government has applied to the National Competition Council for the certification of the state based access regime. Under the Act, IPART may arbitrate an access dispute.
3. Binding arbitration of sewer mining disputes. The Act provides for IPART to act as the arbitrator in the event of a dispute between a sewer miner and a service provider.

IPART is conducting seminars for potential industry participants. Details are available from IPART's website at [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)

### **Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia**

On 19 September 2008, the Australian Energy Market Commission (AEMC) published the First Final Report of its Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia, following the request by the Ministerial Council on Energy (MCE) on 13 December 2007. The First Final Report confirms the AEMC's preliminary finding that competition in both electricity and gas retailing in South Australia is effective.

Full retail competition (FRC) was introduced for electricity customers in South Australia in January 2003 and, in practical terms, for gas customers in July 2004. In the short time since the introduction of FCR, the supply of retail energy services to small customers in South Australia by two single fuel host retailers has been replaced by competition between four large dual fuel retailers and several smaller, mostly electricity-only, retailers.

The Commission's finding is that competition is effective for small electricity and small natural gas customers in South Australia, although competition is relatively more intense in electricity than in gas. However, in making this finding, the commission has identified some structural limitations that are affecting the ability of small gas customers in regional areas to access the full benefits of competition. The Commission's finding is supported by evidence of consumer behaviour (approximately 66 per cent of electricity customers and 59 per cent of gas customers are now supplied under a market contract), evidence of strong retailer rivalry and the history of entry and expansion within the energy sector to date.

The publication of the First Final Report completes the first stage of the South Australian Review. Given its finding that competition is effective, the AEMC will now consider ways to phase out the current retail price regulation arrangements in the second stage of the South Australian Review. The AEMC's draft advice will be the subject of the Second Draft Report. If competition was found to be effective, the Commission is required to provide advice to the South Australian Government and the MCE on ways to phase out retail price regulation. [Link](#)



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