

Finding the Balance – The Rules, Prices and Network Investment

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For many years Australia enjoyed relatively stable energy prices in real terms. However, in the last three years this situation has changed markedly, as increased network costs have contributed significantly to substantial retail price increases.

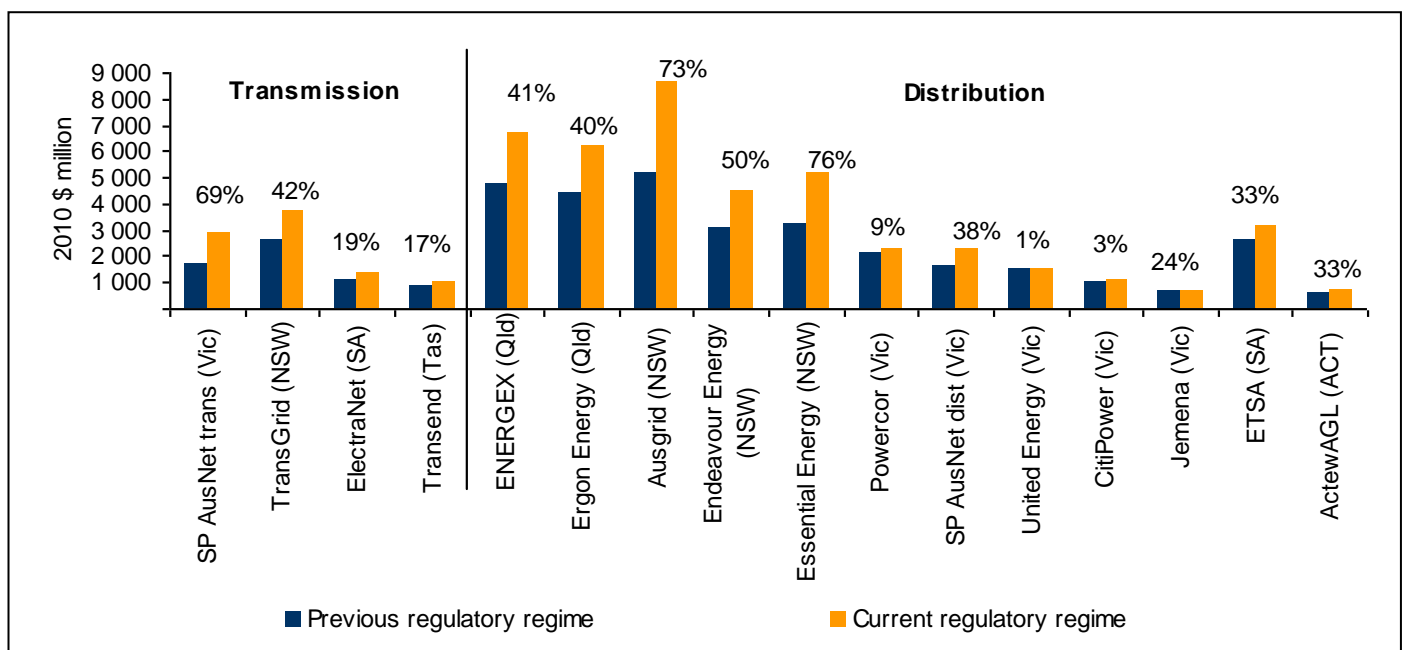
There are a number of reasons for this, including the need to spend money on the networks to meet growth in peak demand, to provide services to new connections and to replace ageing equipment to maintain reliability. In addition, tighter financial markets led to higher allowances for the costs of capital. However, having approved the revenues of almost all of the electricity network businesses under the current regulatory framework, the Australian Energy Regulatory (AER) is concerned that the National Electricity Rules (the rules) do not strike an appropriate balance between the interests of network businesses and those of consumers.

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Under the current regime, the AER approved network and operating expenditure of \$56 billion compared to a total of \$36 billion approved by previous regulators. The following graph illustrates the expenditure outcomes from the current rules framework.

Network spending under current and previous regulatory regimes



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While recognising the underlying cost pressures, the AER considers that these increases are likely to be greater than necessary to meet the efficient needs of the network businesses. This is because the rules provide opportunities and incentives to the businesses to overestimate their required revenues while limiting the ability of the regulator to test these estimates to ensure they represent efficient costs.

The current regulatory regime was designed to 'lock-in' much of the process of economic regulation. When the relevant rules were written in 2006, network businesses argued that the former arrangements did not give the assurance of returns needed to guarantee investment and support strong growth. However, the current rules not only lock-in the process of making a determination, but also codify critical methodologies and procedures of economic regulation. This has led to a bias in outcomes in favour of the network businesses, leading to customers paying more than necessary. While certainty for investment remains a key consideration, it is equally important that only necessary and efficient investment be paid for by customers.

For this reason, the AER has proposed a rule change to the Australian Energy Market Commission (AEMC) that will protect consumers from paying more than necessary for a safe and reliable energy supply.

Existing Protections in the National Electricity Law

The National Electricity Law (the law) includes an objective 'to promote efficient investment in and efficient operation of electrical services in the long term interests of consumers with respect to price, quality, safety, reliability and security of supply.' Sitting under this objective are a set of revenue and pricing principles that further guide regulatory decision making. Importantly, the first of these principles is that networks should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in providing services and complying with regulatory obligations. The language 'at least efficient cost' reflects the accepted principle in regulatory economics that, given the consequences of a supply failure, a small under-investment in infrastructure has a greater economic cost than a small over-investment.

This is a critical consideration and one that has been at the heart of the development of the AER's rule change proposal. Under the AER's proposal, revenue determinations would be bound by the clear and consistent set of principles in the law and the existing expenditure objectives in the rules.

Networks would still have a reasonable opportunity to recover at least the efficient cost incurred in providing services and complying with regulatory obligations,

but the provisions which attempt to prescribe the AER's decision making process would be removed.

Setting Forecasts of Required Expenditure

The current rules require the AER to accept proposals from network businesses if it is satisfied the proposal 'reasonably reflects' efficient, prudent and realistic expenditure. Accordingly, the first step in the determination process is for the AER to determine whether it is satisfied that the forecast expenditure put forward by the business 'reasonably reflects' the expenditure criteria, taking certain factors into account. In the event that the AER is not satisfied, then the total expenditure must be rejected and a substitute forecast of expenditure be formed.

In distribution decisions, the AER is explicitly restricted to only amending amounts and values, including forecasts of capital and operating expenditure on the basis of the regulatory proposal and to the minimum extent necessary to enable it to be approved under the rules. The same restrictions apply for substituting the proposed maximum allowed revenue and total revenue cap in transmission decisions, however, separate processes apply for substituting forecast expenditure in draft and final decisions.

For transmission draft decisions, the rules require that the AER include details of the changes required or matters to be addressed before the AER will approve those amounts or values. This means that even if the AER is not satisfied the proposed total forecast reasonably reflects the required expenditure, in developing a substitute the AER must always begin with the business's proposal and set out the changes to that proposal in the draft decision. In practice, this unduly ties the regulator to the network business's proposal in the determination of the total forecast that 'reasonably reflects' the required expenditure. While seemingly more freedom is allowed in the substitution in a transmission final decision, the AER must again consider the revenue proposal in determining a substitute forecast.

A proper consideration of the proposal from the business should always form part of the regulator's consideration of the required expenditure. However, the current rules limit the ability for the regulator to balance this with its own analysis before coming to a view on an impartial forecast of required expenditure.

This issue is compounded when considered alongside procedural fairness considerations that must be afforded to stakeholders throughout the process of moving from a draft to final decision. Were the AER to fundamentally change its approach between draft and final decisions, no other stakeholders—including network businesses—would have the opportunity to comment on the changed methodology. Given the time constraints of the

process required for the AER to make decisions, often the only practical option for the AER is to stay within the bounds of the draft decision and the revised proposal.

The AER considers that changes to the rules are required to enable a balanced assessment of a broad range of information, leading to a forecast being determined that delivers on both the National Electricity Objective and the principles. The current rules impose additional limits on regulatory discretion, rather than relying on the protections already set out in the law. Adding further constraint on the AER through the Rules has led to unintended consequences, with consumers ultimately paying more than is required for a safe and reliable electricity supply.

Overview of the AER's Rule Change Proposal

The two key changes to the rules proposed by the AER allow a more balanced approach to setting forecasts, while ensuring that networks are funded to provide a safe and reliable electricity supply. The first aspect of the AER's proposal seeks to amend the process for estimating how much network businesses need to spend in order to provide a safe and reliable electricity supply. Second, the AER proposes reforms to the way in which the returns that electricity and gas network businesses may earn on their assets are determined. The proposal also includes improvements to the process for making decisions, making it easier for interested parties to participate in the process.

The AER's proposal retains the fundamentals of the current regime. It does not seek to alter the certainty that is provided to all stakeholders from having the process of regulation codified in the rules. This proposal is not radical, but would place the regulation of the electricity sector back in line with normal regulatory practice in other countries and across other industries.

Ensuring Investment is Efficient

The AER proposes to increase the incentive on network businesses to invest efficiently to ensure a safe and reliable supply by amending the rules to ensure that only capital expenditure within the approved forecast is automatically added to the asset base. Currently the value of all investment (capital expenditure) undertaken by the electricity networks is added to their 'regulatory asset base'. The networks then earn a rate of return on this asset base. This occurs even if the cost of this capital expenditure is in excess of the forecast expenditure determined by the regulator at the start of the period. In certain circumstances, the current rules create incentives for networks to over-invest, even if such investment is inefficient.

The AER proposes if a network spends more than was forecast, it would only be allowed to add 60 per cent of the value of the overspend to the asset base. The cost of the remaining 40 per cent would be borne by the owners of the network. This greatly strengthens the discipline on the networks to properly manage their capital expenditure.

Dealing with Uncertainty

The AER also proposes additional measures for managing uncertainty, by introducing new mechanisms which permit electricity distribution networks to re-open their forecasts if a significant unforeseen event occurs. The current rules address the risk that the regulator may incorrectly set forecast expenditure by tightly prescribing the regulator's decision making functions, but this may lead to consumers paying for systemically inflated forecasts. The AER recognises the need for mechanisms to allow networks to adjust their expenditure in the event of significant unforeseen circumstances.

It is also proposed that the 'contingent project' framework currently available to transmission networks also be introduced for distribution. This approach ensures that network businesses are able to recover at least the efficient costs of their operation, while advancing the long term interests of electricity consumers by removing the systemic upward bias in forecasts.

Setting the Rate of Return on the Asset Base

The AER proposes to change the process for determining the rate of return that energy networks earn on their asset bases, known as the weighted average cost of capital (WACC). The AER's proposed changes to the WACC methodology apply to gas pipelines as well as electricity networks.

The AER currently uses three separate methodologies for setting the WACC, depending on whether the relevant network is an electricity transmission network, an electricity distribution network or a gas pipeline. In electricity transmission, the AER must review the WACC every five years and the results of this review must apply in each transmission determination. In electricity distribution and gas, each network business has the opportunity to seek a unique outcome. The AER believes that all energy networks should be treated consistently.

The AER proposes to undertake WACC reviews at intervals of no more than five years, and the outcomes of each review would apply to each subsequent energy network revenue determination. The WACC review would cover a range of parameters used to calculate the WACC, including the methodology for setting the debt risk premium.

The AER would be required to have regard to previously adopted values in tandem with all other

relevant legal requirements. The AER also proposes to remove certain rules which prescribe how certain WACC parameters must be calculated. This will help to ensure that the regulatory framework keeps pace with the actual debt financing practices of the sector. Currently, the AER must calculate an allowance for debt using benchmarks that are not reflective of how the sector is actually managing its debt, resulting in significantly higher prices for consumers.

Improving the Regulatory Process

The AER's proposal also improves the effectiveness of the regulatory process by addressing procedural problems that have arisen during the course of its reviews. In particular, the AER considers that changes to the rules are necessary to discourage network businesses from strategically withholding key information until the final stages of the review process and from seeking confidential treatment for information which is not genuinely confidential.

Currently, electricity networks make submissions on their own revenue proposals. These submissions are due at the same time as submissions from other stakeholders. Often submissions from the network businesses contain substantial detail that should have been contained in either the initial or revised regulatory proposal. This denies stakeholders the opportunity to consider and respond to this information and compresses the time for the AER to analyse the information.

The AER proposes that networks be precluded from making submissions on their own proposals. This will ensure that all stakeholders will have the opportunity to contribute meaningfully to the revenue determination process.

Conclusion

Taken as a whole, the proposed changes are aimed at giving better effect to the National Electricity Objective and principles, set out in the law. The AEMC is currently consulting on the AER's rule change proposal. Details of the consultation process are available via the AEMC's website, www.aemc.gov.au. The AER intends that the rules changes would be in place in time for the revenue determinations in NSW and the ACT, with the first determinations under the new rules to take effect from 1 July 2014.

The AER is confident that the changes that it has proposed will not only protect the incentives for efficient investment, but will also protect energy users from paying more than necessary for a safe and reliable energy supply.

Critical Issues in Regulation – From the Journals

‘Competition Innovation and Productivity in Australian Businesses’, Leo Soames, Donald Bruncker and Tala Talgaswatta, Research Paper, Australian Bureau of Statistics, September, 2011.

This paper uses econometric methods to investigate two important relationships relating to firm behaviour and performance: first, the relationship between product market competition and innovation; and, second, the association between innovation and productivity. The authors suggest that, possibly because of data limitations, there has been little empirical research into the relationships between competition, innovation and productivity at the firm level in Australia. Using cross-sectional data from the newly developed Australian Bureau of Statistics’ Business Longitudinal Database (BLD), the relationship between competition and innovation is examined. The model is then extended to explore the link between innovation and productivity.

In examining the relationship between competition and innovation, a number of innovation measures are considered: the status of innovation, the type of innovation, the diversity of innovation, the degree of innovation, and the method of protecting intellectual property. A variety of competition indicators are used: market share, the number of competitors, the price-cost margin, the export status, the export intensity, and a measure, based on survey evidence, of the downward pressure on profits arising from competition. Other explanatory variables include firm size, firm age, and industry. A variety of discrete choice models – binary probit, multivariate probit and ordered probit models – are employed in the econometric modelling. Overall, the empirical results support an anti-Schumpeterian relationship between competition and innovation – that is, firms are more likely to innovate if they face stronger competition. However, a higher market share, all else equal, is found to be associated with greater propensity to innovate.

Two productivity measures are used to analyse the relationship between productivity and innovation: a survey measure of the change in firm productivity; and a proxy for multifactor productivity that is based on taxation data. The results suggest that innovation is associated with better productivity outcomes, but the relationship is weaker than that between competition and innovation.

The authors acknowledge that, given data limitations, there are two important caveats to their conclusions: first, the one-year information precludes the study of causality; and second, the survey-based data include many subjective and categorical measures (rather than continuous and objective indicators).

Nevertheless, the paper contributes to the literature by adopting broader industry coverage and considering a variety of competition, innovation and productivity measures. [Paper](#)

‘The Changing Politics of Competition Reform’, Frederick Hilmer, *Australian Journal of Competition and Consumer Law*, 19(3), September 2011, pp. 217-220.

Between 1985 and 1990, the average growth in multifactor productivity was 0.2 per cent. The average between 1991 and 2001, however, rose to 1.9 per cent, before falling back to 0.4 per cent between 2002 and 2007. In this article, Hilmer argues that the high productivity growth in the 1990s reflected the robust and comprehensive policy of competition reform in the 1990s. The subsequent fall in productivity growth, Hilmer suggests, is a consequence of a weakening in competition policy over the past decade. This article provides a diagnosis of the weaknesses of recent competition policy, and offers suggestions about ways in which policy might be improved.

In the late 1980s and early 1990s, Australian governments embarked on a process of policy reform that focused on market forces and competition rather than regulation. Reform was backed by both political parties – in particular, by Hawke and Keating from Labor and (at state level) by Kennett and Greiner from the Liberals. There was both an awareness of the need for competition reform, and a vision for the direction of reform. Processes for reform were well-resourced – for instance, funds were made available to the states for the purpose of implementing reforms. Since 2000, however, the factors that encouraged reform in the 1990s – bi-partisanship, the perceived need for reform, the vision for reform, and the resources – have all weakened.

In his analysis of the problems with competition policy over the past decade, Hilmer suggests that the blame does not lie with either the *Competition and Consumer Act 2010* or the Australian Competition and Consumer Commission. Instead, he proposes that the following four changes need to be made. First, competition responsibilities should be moved back to the Treasury. In the early 1990s, competition policy was driven by the Prime Minister, Paul Keating, and then subsequently (under the Howard government) it was the remit of the Treasurer. Recently, however, responsibility for competition issues shifted from Bowen (Minister Assisting the Treasurer) to Emerson, who is not in the Cabinet. Second, Hilmer recommends that the responsibilities of the National Competition Council (NCC) should be strengthened. This would reverse the trend over the

past decade or so, during which time the mandate of the NCC has narrowed significantly. Third, key areas for competition reform should be identified and targeted. Hilmer suggests, in particular, a focus on the areas of telecommunications, energy and transport. Fourth, Hilmer proposes a renewed emphasis on competition as a source of productivity growth. He contrasts policies which are 'enablers' of productivity growth, such as the 'education revolution' from those which provide 'incentives' for productivity growth, such as competition. He calls for a shift of policy towards 'incentives' away from 'enablers' of productivity growth.

'Narrative in Managers' Corporate Finance Decisions', Les Coleman, Krishnan Maheswaran and Sean Pinder, *Accounting and Finance*, 50, 2010, pp. 605-633.

This paper investigates how executives make major finance decisions regarding capital budgets and investments, sources of finance, returns to shareholders, risk management and social responsibility. The authors rely on survey and interview evidence to criticise a body of literature which purports to show that the decisions of financial executives are frequently irrational. The paper also examines anecdotal evidence that firms are increasingly incorporating non-financial considerations, such as ethics and sustainability, into financing decisions.

The study is conducted in two stages. Stage one is a survey of finance executives that uses questions similar to those in a previous study. Stage two is a series of interviews with finance executives. The interviews explore in more detail the reasons behind the finance executives' decisions.

The paper concludes that finance executives are logical and rational in their decisions, but they employ a wider range of criteria than those assumed in conventional finance theory. The interview data support the conclusion that finance executives are conversant with modern financial techniques, but incorporate many non-financial factors in their decisions. These non-financial factors include constraints from labour shortages and competitor activity, and the need to send favourable signals, to meet the needs of their clientele, and to satisfy rating agencies. These factors are often qualitative and unobservable, at least from outside the firm. Thus it should not be a surprise to find that variables based on finance theory have limited ability to explain financial decisions.

Most executives reported that their investment decisions relied on strategic benefits and rules-of-thumb rather than detailed calculations of rates of return. Finance executives suggest that cash-flow calculations are merely a formality, as finance

executives form a view on whether a project is viable on the basis of their experience and strategic objectives. The constraints felt by executives are a direct reflection of the state of the markets at the time. Furthermore, finance executives are generally sceptical about the role of complex funding mechanisms in creating value for the firm. In addition, executives are aware of the growing focus on sustainability and social responsibility, and are almost unanimous in concluding that these concepts coincide with the effective economic management of the firm.

'Equity Risk Premiums (ERP): Determinants, Estimation and Implications', Aswath Damodaran, Stern School of Business, February 2011.

In this article, the author outlines and evaluates a variety of approaches to estimating the ERP. The article divides these approaches into three broad kinds: first, estimates based on survey evidence; second, estimates derived from historical data; and third, forward-looking, implied estimates.

Damodaran considers survey evidence from three groups – investors, managers (especially Chief Financial Officers) and academics. He is particularly critical of surveys of investors and academics: the premiums suggested by investors are overly responsive to recent price movements and are poor predictors of market returns; and the premiums proposed by academics are implausibly high.

The 'most widely used approach' to estimating the ERP, Damodaran suggests, is the historical average. He warns against excessively short and long averaging periods: periods of 10 or 20 years are too short to be representative and produce standard errors in excess of the ERP; but periods longer than 100 years may place too much weight on data that may no longer be relevant in today's markets. The method of averaging is significant: the arithmetic mean 'is likely to over state the premium', Damodaran concludes, citing a 1997 study by Indro and Lee which argues for an ERP estimate that is a weighted average of arithmetic and geometric means. The two principal problems with the historical approach are, first, that it makes the implausible assumption that the ERP is constant over time, and second, that it ignores survivor bias.

The article explores three implied, forward-looking estimates of the ERP: estimates based on discounted cash flows (DCF), on bond spreads, and on option prices. Damodaran presents a DCF model in which two assumptions of the constant-growth dividend discount model are relaxed. The first is the assumption that growth is constant: whereas long-run growth is assumed to be constant, short-run growth is estimated using analysts' earnings estimates. The

second is the assumption that investors only care about actual dividends, as opposed to excess cash flows more generally. Damodaran uses his DCF model to assess the effect of the Global Financial Crisis on the ERP. Immediately prior to the crisis, the implied premium was 4 per cent, but it jumped to 6-7 per cent in late 2008. Subsequently it dropped from its post-crisis peak, and settled in the 4.5-5 per cent range for most of 2010. The article also explores the possibility of expressing the ERP as a function of bond spreads and of volatility. Damodaran finds that, while there is no reliable rule of thumb relating the ERP to bond spreads, nevertheless the positive correlation between bond spreads and the ERP can be used to assess whether calculations of the ERP 'make sense'. Volatility is also positively correlated to both the survey estimates of ERP and also the DCF estimates.

The article concludes with some observations of the relationships between the various approaches to estimating the ERP. When the historical ERP increases, the implied ERP tends to fall, because (all else equal) stock prices will be driven up by a lower ERP. Moreover, whereas ERP estimates based on survey data are generally presented as forward looking, in fact, they 'reflect historical data more than expectations' because respondents tend to give excessive weight to recent history.

'Measuring the Benefits of Greater Spatial Granularity in Short-Term Pricing in Wholesale Electricity Markets', Frank Wolak, *American Economic Review: Papers and Proceedings*, 101(3), 2011, pp. 247-252.

One of the most important and controversial issues in the design of wholesale electricity markets is the extent to which congestion on the wholesale electricity transmission network should be reflected in differences in the wholesale price for electricity across different locations. Economists have often argued that the simplest approach is to reflect all of the network congestion in wholesale prices – even if that results in a different price at each 'node' on the network. This approach is known as nodal pricing. In practice, however, several markets, including the Australian National Energy Market (NEM), have opted for a 'zonal' or 'regional' pricing structure which glosses over network congestion within a zone or region. This can give rise to undesirable market outcomes which are known in the NEM as 'mis-pricing' and 'disorderly bidding'. A few of the US wholesale electricity markets have also adopted a zonal/regional market design. However, as problems have emerged with the zonal/regional design, there has been a switch towards nodal pricing. As Wolak notes:

Less granular spatial-pricing markets existed during the early stages of electricity industry

restructuring in the United States. All US markets have now adopted nodal-pricing designs with Texas being the last to do so in 2010.

California switched to nodal pricing in April 2009. This switch gives rise to an opportunity for an interesting economic experiment: how much did the change from zonal to nodal pricing improve market outcomes? This question is the focus of Wolak's paper. He uses econometrics to estimate three functions (corresponding to hourly energy, total hourly generator starts, and the hourly variable cost) using data for the period 1 January 2008 to 30 June 2010. He draws on market data, showing the actual output of each generator for each hour, combined with information on the supply curve for each generator. One feature of a wholesale electricity market is that certain types of generators incur material costs to start up before they can produce any power at all. In the NEM such start-up decisions are decentralised to the generators. The switch to nodal pricing in the California market was accompanied by the introduction of a day-ahead forward market. One of the potential advantages of a day-ahead market is that it allows the start-up decision to be centralised, potentially improving the quality of both the price signals and the start-up decision.

The study estimates that the total amount of energy consumed each hour is 2.5 per cent lower following the switch to nodal pricing. This is mainly due to a 2.1 per cent fall in the variable cost. This cost saving amounts to about US\$105 million in annual cost reductions. Wolak concludes:

these empirical results argue in favor of existing zonal short-term markets adopting nodal pricing, because the switch to nodal pricing in California appears to have resulted in net economic benefits in the form of less energy and variable costs being required to produce the same level of total hourly output from all natural gas-fired generation units in the California ISO control area.

'Superfast Broadband: Is it Really Worth a Subsidy?', Robert Kenny and Charles Kenny, *Journal of Policy, Regulation and Strategy for Telecommunications, Information and Media*, 13(4), 2011, pp. 3-29.

This article analyses the evidence behind arguments in support of government funding of superfast broadband through investment in 'fibre-to the home' (FTTH) infrastructure. The authors conclude that there is inadequate evidence to sustain the conclusion that the expected benefits of superfast broadband, when compared with basic broadband, are sufficient to justify the sizable costs.

Compared with the previous two upgrades to telecommunications networks, which were undertaken to support the internet, the marginal cost of FTTH is substantial. The cost of upgrading the network to facilitate dial-up internet was less than US\$200 per user, and it provided email, e-commerce, user-generated content, online news and other media networking services. The cost of digital subscriber line (DSL) services was approximately US\$150 per user. DSL allowed the provision of reliable, 'always on' internet services. According to the authors, the benefits of these previous upgrades outweighed the costs. In contrast, the installation of fibre is estimated to cost approximately US\$2,750 per home. Furthermore, there may be additional hidden costs: users might need to upgrade wireless routers to preserve speed; and, moreover, upgrades to other parts of the network may be required to address congestion. To justify the investment in FTTH, the incremental benefits of superfast broadband must be significantly greater than basic broadband.

The authors argue that the evidence in support of the benefits of FTTH is exaggerated. They offer three reasons to be sceptical about the alleged benefits in relation to the remote delivery of health-care services. First, the evidence relies on the benefits of connecting businesses to the network, whereas FTTH only connects homes. Second, the evidence also relies on the benefits of videophone services which, in fact, are already being delivered by basic broadband. Third, the major beneficiaries have relatively poor internet skills, and are likely to require significant training and support.

While basic broadband is claimed to create positive educational outcomes, some studies have identified negative effects. Moreover, even if broadband does, in fact, have educational benefits, the authors observe that the vast majority of educational materials, including video-streaming, are already provided over copper. Similarly, the ability to work from home has been increasing rapidly without FTTH. and the research into barriers to 'teleworking' does not identify bandwidth issues.

The need for FTTH as a TV platform is exaggerated, the authors argue, because other technologies – including DSL+2 and copper-based broadband – can deliver these services. The demand for time-shifting, simultaneous-streaming and on-demand TV, to date, has not been as strong as expected. Furthermore, studies examining consumers' willingness-to-pay for superfast broadband have had disappointing results. In some countries, measures such as price discounting or free installation were used to entice customers into purchasing what is supposed to be a premium product.

'Benchmarking Telecoms Regulation – The Telecommunications Regulatory Governance Index (TRGI)', Leonard Waverman and Pantelis Koutroumpis, *Telecommunications Policy*, 35(5), June 2011, pp. 450-468.

This paper is about institutional design for the economic regulation of telecommunications, involving the construction of a Telecommunications Regulatory Governance Index (TRGI) for 142 countries in the International Telecommunications Union (ITU). The authors – distinguished economist Leonard Waverman and Pantelis Koutroumpis – stress that the TRGI 'measures governance not outcomes' (p. 453), setting the theme for the paper. The authors also consider a measure of general political governance for these countries. This is based on two variables – the rule of law and corruption. This measure is compared with the TRGI.

The TRGI is constructed on the basis of attributes leading to good governance, reflecting five sets of variables. First, there is transparency that is essentially identified in terms of what is made public on things like interconnection and spectrum policy. Second, 'independence' considers the role of government or minister versus a separate regulator; and aspects of the appointment of members or commissioners to the regulatory body. Third, 'resource availability' covers resourcing-related attributes such as years of operation; the source of funding and the ownership of the fixed-line incumbent (government or private). Fourth, 'enforcement on licensees' includes elements such as 'can licensees be fined?'; 'can licences be modified?' and 'can licences be revoked?'. Fifth, GDP per capita is the final factor used in the construction of the TRGI for reasons discussed in the paragraph starting near the bottom of page 455. All five components have equal weighting, and the maximum score is one.

The TRGI is computed for the 142 ITU countries. The maximum score attained is 0.74 (Norway) followed by Germany, the United States, Denmark, Sweden, Belgium, the United Kingdom, Canada and Ireland. Australia is tenth overall at 0.63; equal with Singapore. Countries in the OECD broadly score highly (in most cases at or above 0.58) and hold most of the top positions. However, some richer countries (including Japan, New Zealand and Mexico) are not very high on the list (all near 0.3). The lowest score attained is zero (Sierra Leone).

Countries that are high on TRGI tend also to be high on general political governance, and this is true of nearly all of the OECD countries. However, of more developed countries, Greece and Italy are cases of reasonably high TRGI and relatively low ranking for general political governance. On the other hand, a few countries (including Japan, New Zealand and Luxembourg) have a low TRGI, but a high score on

general political governance. Waverman and Koutroumpis (p. 465) have a positive specific prescription for these latter countries:

those countries whose [telecommunications] regulatory governance lags general governance should be able to quickly improve telecoms specific regulation as general economy-wide institutions are in place.

The prognosis for those countries that are low on both measures is not as promising.

The scores are not explicitly related to measures of telecommunications performance such as broadband penetration, mobile penetration and pricing level for key services – it is explicitly not about outcomes. This could be an interesting area of research.

‘Confusing Policy and Catastrophe: Buybacks and Drought in the Murray-Darling Basin’, Glyn Wittwer, *Economic Papers*, 30(3), 2011, pp. 289–295.

In 2007, the government introduced initiatives to address problems arising from the over-allocation of water in the Murray-Darling Basin (MDB). One such initiative was the water-buyback scheme: the government purchased water from farmers at a market price so as to realise the ‘sustainable diversion limits’ for usage under the Basin Plan. In 2010, public meetings were held to discuss the Basin Plan, and at these meetings the Murray-Darling Basin Authority received a hostile reception from local communities. This could be attributable to a number of factors, including the communities’ misunderstanding of the impact of buybacks.

This paper aims to examine the impact of buybacks separately from the impact of drought, so as to put the water-buyback policy into perspective. Under the assumption that there is no factor mobility, the estimated basin-wide economic impacts show that drought would have a larger negative impact than buybacks. Drought would reduce irrigation water availability by 37 per cent in 2007-08, together with a dry-land productivity loss of 20 per cent and rainfall loss of 37 per cent. In comparison, if 3,500 GL were removed from water entitlements, which are estimated to be 10,900 GL across the basin, the water available for irrigation would fall by 32 per cent. As participating farmers are compensated for buyback waters, the communities might not be worse off.

Furthermore, empirical evidence from the MDB indicates that, when water availability changes, farm factors are relatively mobile between different activities and between irrigation and dry-land technologies. Using TERM-H20, a dynamic multi-regional computable general equilibrium model which allows factors to be mobile, the author estimated that

the three years of drought (2006-07 to 2008-09) brought about a loss of about 6,000 jobs. Moreover, the drought can be expected to have a long-term negative impact on employment, causing about 1,500 job losses, because of the fall in investment during the prolonged drought. This contrasts with estimated losses of about 500 jobs across the basin due to compensated water buybacks and 800 due to uncompensated buybacks.

The author considers that it important for policy-makers to model the impacts of both the drought and the buyback scheme, and also to capture mobility of farm factors in the modelling. Of equal importance is the effective communication of water policy to the public. This paper concludes that assertions from interest groups that buybacks will result in a rural catastrophe have, in general, under-estimated the adaptability of farmers to buybacks, and, moreover, such assertions typically fail to distinguish between the impacts of drought and buybacks.

‘Retrospectives: X-Efficiency’, Michael Perelman, *Journal of Economic Perspectives*, 25(4), 2011, pp. 211-222.

The concept of X-efficiency was introduced by Harvey Leibenstein in 1966: he argued that competitive pressures created greater incentives to minimise costs, and he referred to the gains from such cost minimisation as X-efficiency. In this article, Michael Perelman outlines the debate about X-efficiency and defends Leibenstein’s views, attacking the arguments of one of Leibenstein’s most ardent critics, George Stigler.

Leibenstein’s work on X-efficiency was a response to Harberger’s 1954 article ‘Monopoly and Resource Allocation’. Harberger used a ‘deadweight loss triangle’ framework to estimate the inefficiencies created by market power. He calculated that allocative inefficiency in US monopolies was very small, that the improvement in national income from eliminating market power was only about one-thirteenth of one per cent. In reply, Leibenstein argued that the introduction of competition would not only eliminate allocative inefficiency but would also encourage firms to minimise costs. In the absence of competitive pressures, firms are unlikely to use resources efficiently. Leibenstein, in effect, was applying the principal-agent problem to monopoly industries, arguing that both management and labour lack the incentive to maximise efficiency if there is no competitive pressure.

Leibenstein offered a variety of evidence in support of X-inefficiency. For example, he relied on studies showing that similar factories had significantly different levels of productivity. Moreover, a number of empirical studies show that management is able to increase efficiency rapidly in response to competitive

pressure. Thus in the wake of the 1986 oil price crash, firms were able to cut costs substantially.

George Stigler attacked Leibenstein on both empirical and theoretical grounds. He suggested that the evidence for X-inefficiency was anecdotal and illusory. For example, Leibenstein's claims about productivity differentials failed to take into account product differentiation. Apparent productivity differences might, for instance, reflect differences in the quality of the goods. Moreover, Stigler emphasised the dangers of moving away from the neoclassical model of profit maximisation. The profit maximisation hypothesis should not be abandoned, Stigler argued, until 'we are given a better theory'.

In his retrospective on the debate, Perelman suggests, that for the most part, economists sided with Stigler over Leibenstein. Perelman puts this down, at least in part, to Stigler's 'rhetorical success', his 'combination of brilliance and bluster'. While Leibenstein's response to Stigler was well reasoned, Perelman judges, it was underappreciated, and Leibenstein's challenge to the profit maximisation hypothesis is still relevant today.

'The Restoration of Welfare Economics', Anthony Atkinson, *American Economic Review: Papers and Proceedings*, 101(3), 2011, pp. 157-161.

In this paper, Oxford economist Sir Tony Atkinson argues that 'welfare economics should be restored to a prominent place on the agenda of economists'; that it should have centrality in teaching of economics; and that economists need to work harder on providing an ethical basis for welfare statements. In making these points, Atkinson refers to the work of a number of prominent economists and philosophers including Adam Smith (*The Theory of Moral Sentiments*, 1759); Lionel Robbins; Paul Samuelson* (*Foundations of Economic Analysis*, 1947); Amartya Sen* (*On Economic Inequality*, 1973); Robert Lucas*; Kenneth Arrow* and John Rawls (*A Theory of Justice*, 1971) (names with an asterisk are Nobel Prize winners). In a little over four pages, Atkinson makes four strong points about the restoration of welfare economics.

First, economists should devote more time and attention to welfare economics. In making this case Atkinson invokes the power of economists including John Maynard Keynes ('economics is essentially a moral science'), Samuelson ('a central concern of the discipline'), Arrow and the prolific writer, Edward J Mishan (author of scores of articles on welfare economics and a seminal text on cost-benefit analysis). Atkinson is dismayed that:

[w]hile welfare economics, as such, was a subject of importance half a century ago, now it has largely disappeared from the mainstream

...

Clearly he wants it back.

Second, Atkinson argues that economists should recognise the 'plurality and diversity in the welfare criteria that could be applied'. The point is made in a number of ways. For example, the macroeconomist Robert Lucas is not supported in his adding up of individual welfare gains and losses 'to obtain the welfare gain for the group'. (Lucas would appear to be suggesting the standard approach known variously as the 'Kaldor-Hicks criterion', 'potential Pareto criterion' or 'dollar-is-a-dollar' approach.) John Rawls's theory of justice and Amartya Sen's concept of capabilities are presented as alternative or additional considerations.

Third, Atkinson wants to remove the 'division of labour' between economists (identifying the efficiency frontier) and others (choosing where to be on the frontier). He explicitly argues that economists should pay more attention to 'fairness', which he observes often comes up in 'popular debates about taxation'.

Fourth, Atkinson argues that 'economists are ... insufficiently reflective about their professional role' and 'the study of professional ethics [should be added] to the training of professional economists'. He cites the ethical code used by the American Statistical Association as an example of an approach that should be considered by economists.

Regulatory Decisions in Australia and New Zealand

Australia

Australian Competition and Consumer Commission (ACCC)

ACCC Invites Comment on Telstra's Revised Structural Separation Undertaking

On 16 December 2011 the ACCC issued a discussion paper in relation to the revised structural separation undertaking submitted by Telstra on 9 December 2011. The ACCC is seeking comment, by 13 January 2012, on the appropriateness of the interim equivalence and transparency measures, and the monitoring of compliance measures in Telstra's revised undertaking. The ACCC does not propose to issue a draft decision prior to making a final decision on the undertaking, which it intends to make in February 2012. [Read more](#)

ACCC Revokes Geographic Exemptions for Declared Fixed Line Services

On 16 December 2011 the ACCC announced completion of its public inquiry into the geographic exemption provisions of the Wholesale Line Rental (WLR), Local Carriage Service (LCS), and PSTN Originating Access (PSTN OA) services. The decision will vary the final access determinations (FADs) for these services to remove the exemption provisions. [Read more](#)

ACCC Commences Inquiry into Declaration of Wholesale ADSL

On 16 December 2011 the ACCC issued a discussion paper inviting comment on whether to declare a wholesale ADSL service. Submissions are required as soon as possible, but no later than 19 January 2012. [Read more](#)

ACCC Receives Revised Structural Separation Undertaking from Telstra

On 9 December 2011 the ACCC received a revised structural separation undertaking from Telstra. A discussion paper relating to the undertaking was imminent and comments invited from interested parties by mid-January 2012. A final decision on Telstra's undertaking is anticipated in February 2012. [Read more](#)

ACCC Issues Draft Guidelines on Non-Discrimination for NBN and Superfast Telecommunications Networks

On 13 December 2011 the ACCC released draft guidelines on the non-discrimination provisions contained in Part XIC of the *Competition and Consumer Act 2010*. As part of the National Broadband Network reforms, NBN Co and other providers of superfast telecommunications services are prohibited from discriminating between their customers, except in limited circumstances. Comments from interested parties on the draft guidelines are sought by Friday 3 February 2012. [Read more](#)

[Read more](#)

ACCC Issues Draft Final Access Determination for Regulated Transmission Services

On 9 December 2011 the ACCC issued a draft final access determination (FAD) for the declared domestic transmission capacity service (DTCS). It is the first time the ACCC has determined price terms for the domestic transmission capacity service using an advanced statistical model. Submissions on the draft DTCS FAD are required by 27 January 2012, for finalising by the end of February 2012. [Read more](#)

[Read more](#)

ACCC Issues MTAS Final Access Determination

On 8 December 2011 the ACCC released a final access determination (FAD) for the domestic mobile terminating access service (MTAS) following consultation with stakeholders. The MTAS is a technology-neutral wholesale input, used by providers of voice calls from fixed line, mobile and IP networks, in order to complete voice calls to end users directly connected to digital mobile networks. The calling party's network pays the MTAS price to the receiving party's network. This price is generally passed on to the consumer in the form of retail charges. The ACCC's previous pricing principles reduced the rate for the MTAS from 21 cents per minute in 2004 to 9 cents per minute from 1 July 2007. The rate has remained at 9 cents per minute since that time and the current pricing principles expire on 31 December 2011. The FAD implements a reduction in the regulated MTAS rate, from 6 cents per minute on 1 January 2012 to 3.6 cents per minute on 1 January 2014. While parties will still be able to negotiate their own commercial agreements, the FAD establishes benchmark prices and non-price terms and conditions for access seekers to fall back on in negotiations. [Read more](#)

ACCC Petrol Report Shows Higher Prices Reflect Global Trends

On 8 December 2011 the ACCC released its 2011 report on the prices, costs and profits of unleaded petrol in Australia. It shows that over 2010-11 prices were around 8 cents per litre higher than in 2009-10. Across the five largest cities, retail petrol prices at the bowser increased to an average of 132 cpl, in line with the relevant international benchmark price (Singapore Mogas 95) and the exchange rate. Despite this, petrol prices in Australia remain among the lowest in the OECD. [Read more](#)

ACCC Issues Revised Guide on Water Termination Fee Rates

On 5 December 2011 the ACCC issued a revised guide aiming to better inform irrigators and irrigation infrastructure operators about their termination fee rights and obligations. As a result of feedback from industry, the revised guide includes more information about the requirement for a written notice of termination and also provides more details on how to calculate the total network access charge, being a key concept in determining the maximum permissible termination fee.

The *Water Act 2007* provides the ACCC with powers to enforce compliance with the *Water Charge (Termination Fees) Rules 2009* and other water rules. As part of this role the ACCC provides guidance to operators and irrigators to assist them to understand when operators are permitted to charge termination fees and how to calculate the maximum permissible termination fee. The ACCC also monitors termination fees imposed by operators and reports on industry trends in its annual monitoring report. The 2010-11 monitoring report is due out in April 2012. [Read more](#)

ACCC Issues Draft Final Report on Local Bitstream Access Service

On 24 November 2011 the ACCC issued a draft final report and draft service description for local bitstream access, which will be the basis for the declared service when amendments to the Competition and Consumer Act 2010 and Telecommunications Act 1997 commence in 2012. The local bitstream access services will be used to carry digital data on superfast telecommunications networks. The amendments require that the ACCC declare a Layer 2 bitstream service (local bitstream access service), which will enable wholesale providers of Layer 2 bitstream services with the opportunity to provide access to those services to retailers under the standard access obligations in the Competition and Consumer Act. However, it will not apply to the National Broadband Network (NBN) or to wireless or satellite networks. The ACCC aims to publish the final service

description before the end of 2011. The deadline for submissions was 8 December 2011. [Read more](#)

ACCC Issues Carbon Price Claims Guide For Businesses

On 15 November 2011, ACCC chairman Rod Sims launched a guide for businesses on carbon price claims. This guide is intended to assist business in understanding their rights and obligations when making claims about the impact of a carbon price. [Read more](#)

ACCC Publishes Container Stevedoring Annual Report

On 2 November 2011 the ACCC released its annual report on stevedoring operations at Australia's largest container ports. The ACCC has monitored the industry since 1999, under a direction from the Australian government. This involves monitoring prices, costs and profits of container stevedores at the major Australian container ports. DP World and Patrick operate at the four largest ports – Brisbane, Fremantle, Melbourne and Sydney. [Read more](#)

ACCC Provides Submission to the PC's Airport Regulation Draft Report

On 10 October 2011 the ACCC made a further submission to the Productivity Commission 2010 inquiry into economic regulation of airport services. In the submission it proposes that the existing monitoring regime be replaced by regulations that encourage true commercial negotiations without the ability of the airports to exercise their market power. The proposal is to encourage true commercial negotiations by having ACCC arbitration as a fallback for services provided to airlines. The ACCC is concerned that some airports may have used their market power to achieve monopoly profits in services provided to airlines and in car parking, and that more monitoring and inquiries will not constrain the airports' monopoly behaviour. [Read more](#)

ACCC Does Not Oppose Revised Price Increases by Airservices Australia

On 9 September 2011 the ACCC decided not to object to a revised proposal from Airservices Australia to increase its prices for services, such as air traffic control. In its view on Airservices' previous proposal, released on 8 September 2011, the ACCC was concerned that proposed price increases would see Airservices over-recover its costs. Airservices has now proposed lower prices than were in its previous proposal, which the ACCC believes will not lead it to over-recover its costs. Airservices implemented these revised prices on 1 October 2011. [Read more](#)

ACCC Publishes Telecommunications Reports 2009-10

On 23 September 2011 the ACCC published its Telecommunications Reports 2009-10. The report states that there was a significant expansion in the scope of services supplied in response to consumer demands in 2009-10. This included the greater availability of service bundles, including the provision of television over the internet. The report also analysed price changes in 2009-10. It found that prices for: fixed-voice services fell by 5.8 per cent, internet services fell by 4.9 per cent, mobile voice services were up slightly by 1.8 per cent (largely due to increased prices for GSM services, which are gradually being replaced by 3G technologies), 3G services fell by 3.6 per cent. [Read more](#)

ACCC Approves Wheat Export Access Arrangements for Melbourne Port Terminal

On 28 September 2011 the ACCC announced it had accepted an undertaking from Australian Bulk Alliance (ABA), which sets out arrangements for wheat exporters using Melbourne Port Terminal. The ACCC considers that the arrangements will provide bulk wheat exporters with fair and transparent access to the Melbourne Port Terminal. This follows ABA making amendments to its original proposal, to ensure consistency with industry-wide standards and increased transparency for exporters on the details of port-terminal operations. The access arrangements require: ABA not to discriminate or hinder access to port-terminal services, clear and transparent port loading protocols for managing demand for port-terminal services, for ABA to negotiate in good faith with eligible wheat exporters for access to port-terminal services, and for wheat exporters to have access to dispute mediation or arbitration on terms of access. The accepted undertaking applies from October 2011 to September 2013. [Read more](#)

ACCC Approves Wheat Export Access Arrangements for South Australia

On 29 September 2011 the ACCC announced its acceptance of an undertaking from Viterra, allowing wheat exporters to access Viterra's six ports in South Australia. Viterra's revised undertaking introduces an auction system for allocating capacity by May 2012. This follows the ACCC rejecting the continuation of the 'first come, first served' (FCFS) capacity allocation arrangements previously operated by Viterra. The accepted undertaking applies from October 2011 to September 2014. [Read more](#)

ACCC Approves Wheat Export Access Arrangements for Western Australia

On 28 September 2011 the ACCC announced it had accepted an undertaking from Co-operative Bulk Handling (CBH) allowing Western Australian wheat

exporters access to CBH's ports at Kwinana, Geraldton, Albany and Esperance. The ACCC considers that CBH's current access arrangements have successfully allowed access to CBH's port-terminal services by wheat exporters and that it is appropriate for those existing arrangements to continue. CBH agreed to continue with its existing auction arrangements after the ACCC raised concerns about a two-tiered capacity allocation scheme that CBH had previously proposed. [Read more](#)

Australian Energy Regulator (AER)

Distribution Ring-Fencing Guidelines Review - Release of Discussion Paper

In December 2011 the AER announced it was undertaking a review of the Distribution Ring-Fencing Guidelines under clause 6.17.2 of the National Electricity Rules. Nationally consistent ring-fencing guidelines that apply to Distribution Network Service Providers in all participating jurisdictions do not currently exist. Submissions are sought by 24 February 2012 on whether the AER should develop a nationally consistent set of Distribution Ring-Fencing Guidelines. [Read more](#)

AER Issues Final Decision on Smart Meters

On 31 October 2011 the AER issued its final determination on applications from the Victorian electricity distribution businesses for 'smart meter' budgets and forecast charges for 2012-15. The businesses are able to recover expenditure associated with the smart meter program from consumers through metering service charges incorporated into customers' electricity bills. The smart meter deployment requires significant investment in metering infrastructure and new technology. This follows the Victorian Government mandating the implementation of smart meters for residential customers in 2006, where the AER must determine the approved budget for each Victorian distribution business according to an 'Order in Council' made by the Victorian Government. [Read more](#)

AER Releases ACT and NSW Electricity Distribution Businesses Comparative Performance Report 2009-10

In November 2011 the AER released the 2009-10 [performance report](#) for the ACT and NSW electricity Distribution Network Service Providers (DNSPs). The DNSPs reviewed in the report are ActewAGL, Ausgrid, Endeavour Energy and Essential Energy. The report is the first of its type to be issued by the AER under the national electricity regime. The intention of the AER's performance report is to

provide comprehensive, accurate and reliable information for all DNSPs to better inform stakeholders of DNSPs' performance and encourage considered analysis of the sector. The report shows that in relation to their basic network services, all DNSPs over-recovered revenues by approximately 3-5 per cent, compared to the forecasts which were published in the AER's 2009 determination. The AER intends that from 2012-13, the annual performance report will include all NEM DNSPs. [Read more](#)

National Competition Council (NCC)

Third Party Access to Pilbara Railways

On 25 October 2011 the High Court granted Fortescue Metals Group special leave to appeal the Full Federal Court's 4 May 2011 decisions upon various appeals relating to access to Pilbara iron ore railways. Similar applications by the NCC were referred to an enlarged bench for consideration. The NCC expects these proceedings to be heard by the High Court in the first part of 2012. [Read more](#)

Access to Monopoly Infrastructure in Australia

In October 2011 the NCC published an introduction to the National Third Party Access Regime. [Read more](#)

Applications for Declaration of Jet Fuel Supply Infrastructure Services at Sydney Airport

On 27 September 2011 the Board of Airline Representatives of Australia Inc (BARA) made two applications for the declaration of services provided by jet fuel supply infrastructure at Sydney airport. Specifically, the applications are for declaration of:

1. Caltex pipeline - the service provided by the Caltex pipeline facility, which transports jet fuel from interconnection points with off-site jet fuel storage facilities at Port Botany to the Sydney airport Joint User Hydrant Facility (JUHI); and
2. Jet fuel storage and pipeline network / JUHI facility - the services provided by the jet fuel storage facility (including facilities for refuelling trucks) and jet fuel hydrant pipeline network facility provided by the JUHI at Sydney airport.

Declaration of both services is sought for the purpose of providing jet fuel to international passenger and freight aircraft operating to or from Sydney airport. The NCC invited written submissions on the applications by 21 November 2011 and received 14 submissions. The NCC will consider the submissions

before releasing a draft recommendation(s) on the applications. The NCC will provide a further opportunity for public comment before providing its final recommendation(s) to the designated Minister. [Read more](#)

Australian Energy Market Commission (AEMC)

AEMC Assessment of the Impact of the Enhanced Renewable Energy Target on Energy Markets

On 9 December 2011 the AEMC reported that it had published the updated Interim Report and a Final Report provided to the MCE on 25 November 2011. On 16 September 2010, the Ministerial Council on Energy (MCE) requested advice from the AEMC on the impact of the enhanced Renewable Energy Target (RET) on energy markets. Advice was requested on the impact of the enhanced RET on:

- The price of electricity for retail customers;
- The level of emissions; and
- The security and reliability of the electricity supply.

The Interim Report and Final Report include modelled outcomes out to 2020 for both components of the enhanced RET - the Large Scale Renewable Energy Target and the Small Scale Renewable Energy Scheme. [Read more](#)

Transmission Frameworks Review – Publication of Interim Report

On 17 November 2011 the AEMC published the First Interim Report for the Transmission Frameworks Review. This report sets out five alternate paths for reforming the role and provision of transmission networks. The AEMC is seeking stakeholder views on these proposals, by 27 January 2012. Combined with further analysis, this will inform the next stage of this review. A public forum was held on 12 December 2011 in Melbourne. [Read more](#)

Reliability Panel Publishes Draft Report on its Annual Market Performance Review

On 10 November 2011 the Reliability Panel (Panel) published the draft report of its latest annual review which examines the performance of the National Electricity Market (NEM) in the 2010-2011 financial year. Feedback is required by 13 January 2012. [Read more](#)

AEMC Commences Consultation on Consolidated Rule Change Request Relating to the Economic Regulation of Electricity Network Businesses

On 3 November 2011, the AEMC gave notice under section 93(1)(a) of the NEL to consolidate the process for a rule change received from an Energy Users Committee representing Amcor, Australian Paper, Rio Tinto, Simplot, Wesfarmers, Westfield and Woolworths (the Energy Users Committee) with the Economic Regulation of Network Service Providers Rule request proposed by the Australian Energy Regulator (AER). The Energy Users' Committee's rule change request related to the calculation of the cost of debt for electricity network businesses. Part of the AER rule change request also deals with similar subject matter. The AEMC has initiated and commenced assessment of the consolidated rule change request. Submissions on the consolidated rule change request were due 8 December 2011. The AEMC held a public forum in Brisbane on 23 November 2011 to facilitate discussion on the proposals. Due to the complex nature of the consolidated rule proposed, the AEMC has also extended the period of time for the making of the draft rule determination on this rule change request to 26 July 2012. [Read more](#)

AEMC Publishes Strategic Priorities for Energy Market Development

On 20 October 2011 the AEMC published a paper outlining the 2011 strategic priorities for energy market development. The paper focusses on how consumers, industry and governments can best work together to effectively manage structural change in the national energy sector. The AEMC intends to continue developing them periodically, and will seek further advice and feedback from interested parties in doing so. [Read more](#)

AEMC Commences Consultation on Efficiency Benefit Sharing Scheme and Demand Management Expenditure by Transmission Businesses

On 29 September 2011, the AEMC gave notice under section 99 of the National Electricity Law of the making of the 'Efficiency Benefit Sharing Scheme and Demand Management Expenditure by Transmission Businesses' draft Rule and draft Rule determination. The AEMC considered the rule change proposal from the Ministerial Council on Energy regarding the exclusion of non-network alternative expenditure from the operating expenditure that is subject to the Efficiency Benefit Sharing Scheme applicable to Transmission Network Service Providers, and decided to make a draft Rule in response to the Rule change request. Submissions on the draft Rule determination and the

draft Rule were required by 10 November 2011. [Read more](#)

Australian Capital Territory

Independent Competition and Regulatory Commission (ICRC)

Inquiry into Secondary Water Use

On 23 November 2011 the ICRC released an Issues Paper *Secondary Water Use in the ACT*, as a first step in conducting the inquiry referred to the ICRC on 9 September 2011, by the Treasurer, Andrew Barr MLA. The closing date for submissions is 20 December 2011.

Among other things, the review is required to:

- Report on opportunities for a commercial market in grey water and the ACT Government's urban waterways and stormwater harvesting programs
- Consider the economic, environmental and social costs and benefits of these projects and any other conservation initiatives.

The ICRC must report to the Treasurer by the end of 2012. [Read more](#)

Price Direction for the Supply of Water and Sewerage Services

On 13 October 2011, the Treasurer Andrew Barr MLA referred a price direction for the supply of regulated water and sewerage services within the ACT for the period 1 July 2013 to 30 June 2018. The review is required to:

- recommend a level of prices for regulated water and sewerage services provided by ACTEW Corporation Limited between 1 July 2013 and 30 June 2018
- assess the impact on water and sewerage costs of ACT and Commonwealth government policies, a price on carbon, the balance between revenue recovery and consumer benefits and any other relevant matters.

The ICRC must report to the Treasurer by 1 May 2013. [Read more](#)

ACT Greenhouse Gas Inventory Report for 2008-09, Report 7 of 2011

On 25 October 2011, the ICRC tabled in the Legislative Assembly its ACT Greenhouse Gas Inventory Report for 2008-09. On 27 May 2011, the Minister for the Environment and Sustainable Development, Simon Corbell MLA, wrote to the

Commission requesting it to provide advice on an appropriate methodology for measuring Greenhouse Gas emissions in the ACT, as required by the *Climate Change and Greenhouse Gas Reduction Act 2010*. Following advice from the Commission (Measuring Greenhouse Gas Emissions in the ACT, Report 6 of 2011) the Minister determined a methodology for measuring emissions. [Read more](#)

Price Direction for the Supply of Electricity to Franchise Customers

On 21 September 2011, the Treasurer Andrew Barr MLA referred a price direction for the supply of electricity to franchise customers for the period 1 July 2012 to 30 June 2014. The review is required to:

- recommend a level of prices for electricity services to franchise customers in the ACT between 1 July 2012 and 30 June 2014
- assess the impact on direct electricity costs of changes in government policies, the efficient and prudent cost of managing risk in purchasing electricity and any other relevant matters.

The ICRC must produce its final report in time sufficient to allow ActewAGL Retail to make any necessary changes to its billing system and to provide information on the new tariff to customers. [Read more](#)

New South Wales

Independent Pricing and Regulatory Tribunal (IPART)

IPART's Decisions on Desalination Pricing

See Notes on Interesting Decisions.

Release of Draft Report for Solar Feed-In Tariffs

On 24 November 2011 the IPART released its Draft Report for Solar Feed-In Tariffs.

In an environment of already increasing electricity prices, the NSW Government closed the Solar Bonus Scheme to new participants on 1 July 2011. It then asked IPART to recommend a 'fair and reasonable' value for a feed-in tariff for customers who export electricity to the grid but are not eligible for the Solar Bonus Scheme, and a mechanism to implement this value in New South Wales. [Read more](#)

Access Pricing on NSW Grain Line Network

On 31 October 2011 the IPART released the Draft Report of its Review of Access Pricing on the NSW Grain Line Network, recommending that a single, variable access price of \$5.22 per thousand gross

tonne kilometres should be phased in over two years. The IPART further recommends that the access price should be published and should apply to all grain and non-grain freight on the network.

Historically, low cost recovery has resulted in ongoing uncertainty about the future sustainability of many lines and this has discouraged industry investment in the rail supply chain. Currently, the NSW Government recovers only three per cent of maintenance costs and provides an annual subsidy of around \$26 million each year, compared to access revenue of less than \$1 million. Submissions on the Draft Report were invited by 9 December 2011. The final report will be provided to the New South Wales Government in February 2012. [Read more](#)

Northern Territory

Utilities Commission

Draft Guaranteed Service Level Code

On 28 November 2011, the Commission released a Draft Guaranteed Service Level Code (GSL Code), setting out the arrangements for payments by a network service provider to small customers who have received a very poor level of service. Feedback was required by 9 December 2011. [Read more](#)

New Utilities Commissioner

On 16 November 2011 the Treasurer announced the appointment of Dr Patrick (Pat) Walsh as the Northern Territory's new Utilities Commissioner. Dr Walsh is also currently Chairman of the ESCOSA. [Read more](#)

Queensland

Queensland Competition Authority (QCA)

Notified Electricity Prices 2012-13

On 11 November 2011, the QCA released a Draft Methodology Paper on regulated retail electricity prices for 2012-13, as directed by the Minister for Energy and Water Utilities on 22 September 2011. On 13 September 2011, *the Electricity Act 1994* was amended to replace the previous Benchmark Retail Cost Index approach to adjusting regulated retail electricity prices with a new price determination process. This process builds on the QCA's *Review of Regulated Retail Electricity Tariffs and Prices*. The Ministerial Delegation requires that the QCA publish:

- a Draft Methodology Paper no later than December 2011;

- a Draft Price Determination on 30 March 2012; and
- a Final Price Determination by 31 May 2012. [Read more](#)

Irrigation Prices for SunWater Review

On 10 November 2011 the QCA released its Draft Report and draft prices as part of the Review of SunWater Irrigation Prices for 2012-17. A Final Report is due 30 April 2012. [Read more](#)

South Australia

Essential Services Commission of South Australia (ESCOSA)

Economic Regulation of the South Australian Water Industry

On 14 December 2011 the ESCOSA extended to 30 January 2012, the period for providing submissions to its Draft Advice to the Treasurer. On 11 November 2011 the ESCOSA released a Draft Advice to provide greater certainty as to the proposed scope and operation of regulation under the Water Industry Bill 2011 (Bill), introduced into the South Australian Parliament on 27 July 2011, having been previously released as a consultation draft during 2010. Amongst other things, the Bill proposes that the ESCOSA will be the independent economic regulator of the water industry in South Australia. In September 2010 the Treasurer sought the advice of the ESCOSA as to the nature and form of the regulatory regime that the ESCOSA would implement if the Bill were enacted. Stakeholders were asked to provide comment by 19 December 2011 on the Draft Advice. The ESCOSA will provide its Final Advice to the Treasurer soon after the Bill has been enacted. [Read more](#)

2010-11 Potable Water and Sewerage Pricing Processes Inquiry

On 7 December 2011 the ESCOSA finalised its Inquiry into the process that led to Cabinet's 25 November 2011 decision on SA Water's potable water and sewerage charges to apply in 2010-11. The Cabinet decision led to an average increase in potable water charges of 21.7 per cent in real terms, with the major driver of the announced increases being the costs associated with the Government's projects and initiatives. [Read more](#)

2011 Determination of Solar Feed-in Tariff Premium

On 7 November 2011 the ESCOSA released its Draft Price Determination to apply from 27 January 2012 to 30 June 2014. Recent changes to the feed-in tariff

scheme have amended the amount that can be earned by future customers that install eligible solar photo-voltaic (PV) generators. Customers with eligible PV generators will be entitled to receive an additional premium, which is to be determined by the ESCOSA. The amount to be determined is to reflect the fair and reasonable value to a retailer of electricity fed into the network, and all retailers selling electricity to eligible customers would be required to pay the amount. A Final Report is expected late January 2012. [Read more](#)

Tasmania

Office of the Tasmanian Energy Regulator (OTTER)

Water and Sewerage Price and Service Plan Guideline

In October 2011 the OTTER released a Price and Service Plan Guideline setting out the proposed approach to the first water and sewerage price determination investigation. Independent regulation of water and sewerage prices in Tasmania is scheduled to commence on 1 July 2012. As determined by the Treasurer, the first price determination will cover a period of three years from 2012-13 to 2014-15 inclusive. The price determination investigation will be conducted in response to proposals put forward by each water and sewerage corporation in their proposed Price and Service Plans. Each water and sewerage corporation was required to submit proposed Price and Service Plans by 31 October 2011. [Read more](#)

Victoria

Essential Services Commission (ESC)

Information Notice for Port of Melbourne Corporation 2011

On 4 December 2011 the ESC released a final decision paper outlining its reasoning behind the Information Notice 2011 issued to Port of Melbourne Corporation for the current regulatory period. The *Port Management Act 1995* (Vic) (the PMA), previously the *Port Services Act 1995* (Vic), establishes the regulatory framework that applies to Victoria's commercial sea ports. The PMA identifies certain port infrastructure services as prescribed services. Under the *Essential Services Commission Act 2001* (Vic) (ESC Act), the ESC has regulatory powers in respect of the prices charged for the provision of, or in connection with, prescribed

services. Following a review of Victorian port regulation by the ESC (completed in June 2009), it was determined by the Government that from 1 July 2010 the prescribed services subject to price monitoring would be limited. The effect of these changes is that the Port of Melbourne Corporation (PoMC) is the only port operator to be monitored with respect to its shipping channels and the wharves that serve containerised and motor vehicle cargoes. To give effect to the new regulatory regime, the ESC issued a Price Monitoring Determination 2010 (PMD 2010) to apply for the five-year period 1 July 2010 to 30 June 2015. The PMD 2010 requires the ESC to issue an information notice to port operators detailing the information to be submitted annually to the ESC.

[Read more](#)

Proposed Amendments to Guideline 19 - Energy Price and Product Disclosure

On 10 October 2011, the ESC published an issues paper to propose and seek comment on possible amendments to Guideline 19 Energy Price and Product Disclosure (the Guideline). The Guideline implements the obligations created by sections 35C and 36A of the Electricity Industry Act 2000 (Vic) and sections 42C and 43A of the Gas Industry Act 2001 (Vic). Those obligations require retailers to publish tariffs and terms and conditions of sale.

[Read more](#)

Western Australia

Economic Regulation Authority (ERA)

Revised Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline

On 31 October 2011 the ERA issued its final decision on DBNGP (WA) Transmission Pty Limited's (DBP) revised access arrangement proposal for the Dampier to Bunbury Natural Gas Pipeline (DBNGP). The ERA's final decision is not to approve the revised access arrangement proposal. Under the new National Gas Law (rule 64 of the National Gas Rules) where the ERA decides not to approve a revised access arrangement of a service provider then the ERA must, within two months of making a final decision, deliver a revised access arrangement for the pipeline. Accordingly, the ERA will publish an approved revised access arrangement for the DBNGP on or before the end of December 2011.

[Read more](#)

Release of Final Report into Costs and Benefits of the State Underground Power Program

On 20 October 2011 the Treasurer, the Hon. Christian Porter, released the ERA's final report on its Inquiry into the State Underground Power Program Cost Benefit Study. The inquiry, requested by the Treasurer on 23 April 2010, considers the costs and benefits of the Government's State Underground Power Program (SUPP) and what the appropriate funding shares should be for the parties that contribute funding to the current SUPP. The ERA's final report concludes that there has been an overall positive value of the SUPP to Western Australians. A large proportion of the benefits of the program have accrued to the owners of properties in suburbs where underground power has been installed, as reflected in increased property values. Overall, the study concludes that property owners have benefited more from the SUPP than they have paid for it. In preparing the final report, the ERA conducted two rounds of public consultation and received 22 public submissions.

[Read more](#)

New Zealand

Commerce Commission (NZCC)

NZCC Publishes Three Decisions That Implement Telecommunications Act Amendments

See Notes on Interesting Decisions.

NZCC Progresses Default Price-quality Paths for Gas Pipeline Services

On 21 November 2011 the NZCC announced it was seeking feedback on its draft decisions on the first default price-quality paths for gas pipeline services regulated under Part 4 of the Commerce Act 1986. The NZCC proposed the initial gas price-quality paths should apply from 1 July 2012, and be set by 'rolling over' existing prices. Once the NZCC has determined a starting price input methodology as required by a recent High Court judgment, it will consider whether the price-quality paths should be reset based on the profitability of each gas supplier. Submissions were due by 19 December 2011 and cross-submissions by 20 January 2012.

[Read more](#)

NZCC Sets Revenues for Transpower for the Three Years from mid-2012

On 1 November 2011 the NZCC announced the forecast maximum revenues that Transpower is able to earn for the three-year period from April 2012. Transpower is the sole owner and operator of the New Zealand national electricity transmission grid.

The revenues determine the total amount Transpower can charge its customers, namely power companies and large electricity users. Overall, the figures announced on 1 November 2011 are significantly higher than previous years with the 2012/13 revenue allowance being 21.7 per cent higher than the current revenue allowance. This increase reflects the amount of investment in critical infrastructure planned by Transpower.

Since April 2011, Transpower has been regulated under Part 4 of the Commerce Act by way of individual price-quality regulation. The individual price-quality path governs Transpower's maximum revenues for each pricing year, with the paths being reset either every four or five years. [Read more](#)

NZCC Review Shows Improvement in Electricity Asset Management Planning

On 21 October 2011 the NZCC released a review of asset management plans disclosed by electricity distribution businesses (EDBs) for the period beginning 1 April 2011. There are 29 EDBs currently providing distribution services between Transpower and end users in New Zealand. This year the NZCC's review assessed the three disclosure areas identified in the 2009 review as having relatively weak compliance: service levels, network development planning, and expenditure forecasts, reconciliations and assumptions. [Read more](#)

NZCC to Appeal Input Methodology Decision

On 21 October 2011 the NZCC announced its appeal against the High Court decision that it should have determined further input methodologies before seeking to reset starting prices for certain electricity distribution businesses (EDBs).

The High Court decision has resulted in a delay to the proposed mid-period price reset of the Default Price-quality Path for EDBs that would have been effective from 1 April 2012. [Read more](#)

Telecom Pays \$31.6 million in Compensation in Settlement of Sub-loop Extension Discrimination Claim

On 14 October 2011, the NZCC reached a \$31.6 million settlement with Telecom over alleged discrimination under the Telecom Separation Undertakings. The settlement follows a decision by the NZCC in May 2011 to issue legal proceedings alleging that Telecom had discriminated against other telecommunications companies in breach of the Undertakings by failing to provide them with unbundled bitstream access (UBA) in conjunction with the sub-loop extension service (SLES) when Telecom was providing an equivalent service to its own retail business. [Read more](#)

NZCC Issues Consultation Paper on UFB Information Disclosure Requirements

On 3 October 2011 the NZCC issued a consultation paper on Information Disclosure requirements for companies who will be building fibre networks as part of the Government's ultra-fast broadband (UFB) initiative. Recent amendments to the Telecommunications Act 2001 require the NZCC to collect information on the costs and characteristics of the UFB fibre networks for regulatory purposes. Companies are also required to provide information to support the NZCC's assessment of compliance with open access undertakings that the companies are required to give as part of the UFB initiative. Under the NZCC's proposal the companies must supply the NZCC with quarterly and annual financial information and performance indicators. The NZCC will publish summaries on its website. The first summary will be published in 2014. Submissions on the consultation paper were due by 11 November 2011. [Read more](#)

Notes on Interesting Decisions

IPART's Decisions on Desalination Pricing

On 9 December 2011 IPART released its decisions on the prices that Sydney Desalination Plant Pty Ltd (SDP) can charge Sydney Water and any future customers.

SDP owns a 250 megalitre a day desalination plant at Kurnell, which is capable of supplying about 15 per cent of Sydney's water needs. The plant's capacity can be scaled up to 500 megalitres per day if required in the future.

Under the NSW Government's Metropolitan Water Plan operating rules, SDP is required to operate at maximum capacity when total available storages fall below 70 per cent and continue to do so until storages reach 80 per cent. When storages are above these levels the plant may be shutdown. This variable operating regime means that the plant has five distinct modes of operation. These range from full operation through to a shutdown period of more than two years.

Terms of reference for the price review were issued by the Minister for Finance and Services. The terms of reference included principles for the structure of prices and a requirement that prices should encourage SDP to be financially indifferent as to whether or not it supplies water.

IPART used a standard building-block approach to calculate SDP's revenue requirement and prices. SDP's costs vary between the five different modes of plant operation. To provide certainty and cost reflective pricing, IPART set daily revenue requirements and prices for each mode.

The key features of IPART's decisions are that:

- it recognises the plant's variable operating regime by establishing daily notional revenue requirements for each of the five modes of plant operation
- it allows SDP to recover its efficient costs and to earn a real pre-tax return on its assets of 6.7 per cent
- it doesn't result in upward pressure on Sydney Water's customers' water and sewerage bills for the next five years, in real terms
- it creates incentives for the plant to operate in accordance with the Government's Metropolitan Water Plan.

This review was IPART's first price determination under the Water Industry Competition Act 2006 (WICA). SDP is the first WICA licensee to have been

declared a monopoly and hence subject to IPART's pricing powers.

The NSW Government announced its intention to refinance the SDP through a long-term lease as part of its 2011 election commitments. This price determination will apply to SDP whether or not it is refinanced.

Further information is available at www.ipart.nsw.gov.au

IPART's Final Report on the Productivity of State Owned Corporations (SOC)

On 14 December 2011 the IPART released its final report of SOC productivity, comprising two main parts. The first part is a quantitative analysis of the change in the SOCs' productivity performance over time (to 2008-09) and a comparison of their efficiency against peer organisations. The second part is a review of the factors that may have affected the SOCs' productivity performance over this time, drawing on the quantitative analysis and findings of other studies on the factors that affect performance. IPART's recommendations on improving the SOCs' efficiency focus on ensuring that the mechanisms that the Government has established (to ensure that the SOCs make prudent and efficient production decisions and to encourage them to make continual improvements in efficiency) are effectively applied and continue to be so over time. [Read more](#)

NZCC Publishes Three Decisions That Implement Telecommunications Act amendments

On 24 November 2011 the NZCC released three decisions which follow recent amendments to the Telecommunications Act. The amendments require the NZCC to review some of the current standard terms determinations (STDs) ahead of the structural separation of Telecom into Chorus and Telecom Retail.

The first decision makes more than 400 substantive amendments to six STDs which are necessary as a consequence of the structural separation of Telecom and the legislative amendments.

The second decision sets the price and non-price terms for a new service, the Unbundled Copper Low Frequency Voice Service (UCLFS), created by the Amendment Act and which is available from separation day. The UCLFS enables telecommunications companies to provide a voice service to their customers using the low frequency band in Telecom's copper local loop network.

The third decision is a review of the unbundled copper local loop (UCLL), unbundled bitstream access (UBA) and sub-loop (SLU) services STDs to set geographically averaged prices for these services. The NZCC has set these geographically averaged prices by undertaking a simple averaging of the existing different urban and non-urban UCLL prices, and flowing that averaged price through to UBA and SLU prices.

On 9 September 2011 the NZCC released a corrected version of its draft review of prices for the Unbundled Copper Local Loop Service (UCLL). Under changes made to the Telecommunications Act the NZCC is required to calculate an average price for the UCLL service, to be implemented three years after separation day. The NZCC has also updated the prices of the current urban and non-urban UCLL prices, and UCLL connection charges. The UCLL service allows Telecom's competitors to use Telecom's copper network between the exchange and the end-user's premises to provide their own services to their customers. The NZCC had undertaken an international benchmarking exercise to determine the movement of UCLL prices since 2007 when the UCLL STD was put in place. [Read more](#)

Regulatory News

Fifth ACCC/AER Working Paper

The latest working paper in the ACCC/AER Working Paper series was released, at the beginning of December. It is titled ***Evaluation of Australian Infrastructure Reforms: An Assessment of Research Possibilities*** and is available on the ACCC website:

<http://www.accc.gov.au/content/index.phtml/itemId/1020304>

This paper is, in part, a reference document to provide background material to researchers from the public and private sectors. Each chapter provides context about regulatory frameworks, the literature and available data. It is the companion piece to the working paper released in August 2010 ***Evaluating Infrastructure Reforms and Regulation – Working Paper no. 2***.

2012 ACCC Regulatory Conference

The 2012 ACCC Regulatory Conference will be held at the Sofitel in Brisbane on 26 and 27 July 2012. The conference will feature eminent professionals from Australia and abroad, including speakers that have addressed previous conferences, and some that are new to the conference. Further details of speakers and topics will be released in late January 2012.

IPART/ACCC Workshop on Customer Engagement

On 24 October 2011 a number of URF members attended the joint ACCC/IPART workshop in Sydney on pursuing customer engagement for better regulation. A range of thoughtful papers were presented which are available on the IPART website at the following link: [***Pursuing More Effective Customer Engagement***](#)

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