NETWORK

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Valuing land for regulatory purposes

The ACCC's draft decision

On 9 February 2001 the Australian Competition and Consumer Commission issued a draft decision on proposals by Sydney Airports Corporation Limited (SACL) to increase aeronautical charges at Kingsford Smith Airport.

The draft decision relates to aeronautical charges that cover the main services required for aircraft take-off and landing, taxiing and parking as well as services for processing passengers. SACL wanted to increase annual revenues by $116 million per annum, from $89 million to $205 million, an increase of around 130 per cent.

The ACCC's draft decision objects to the proposal, but approves lower price increases. The prices accepted would increase SACL's annual revenue to $160 million, an increase of $71 million or 79 per cent — approximately 60 per cent of the increase proposed by SACL.

The higher charges will be levied on airlines. If passed on to airline passengers, the increases will add around $2 to a domestic return flight from Sydney Airport and around $10 to an international return flight from Sydney Airport.

Kingsford Smith Airport in Sydney. Photographed by Arthur Mostead.

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SACL proposed large price increases. The draft decision approves a substantial part of those increases. The ACCC considers that the increases are required to give SACL a reasonable return on its investments and to compensate it for major new investments undertaken in the lead up to the Olympics.

Nevertheless the draft decision has not approved all of the increases. One reason being that the ACCC considers the land valuation too high.

There were three other reasons for not approving the price increases.

- The ACCC has concerns about the way in which SACL **applied** the 'dual till' approach to pricing, even though the ACCC has accepted the principle of dual till.
- The ACCC considers the proposed operating and maintenance costs too high.
- The ACCC considers that SACL's proposals do not take into account the impact of future traffic growth and likely cost reductions.

The draft decision addresses these issues by making three main changes to SACL's proposals. The first is to use an inflation-adjusted historic cost valuation of land as recommended by independent consultants. The second is to modify the dual till approach proposed by SACL. The third is to model costs and revenues over a five-year period instead of the one-year period used by SACL, factoring in growth in traffic volumes and reductions in operating and maintenance costs.

The resulting prices are specified in the table below.

Assessment process

Aeronautical services at Sydney Airport are declared under s. 21 of the Prices Surveillance Act. As a result, SACL must notify the ACCC if it wants to increase prices for these services. The ACCC may object to the proposal, but has the option of not objecting to a lower price than proposed.

In reaching its draft decision on SACL's proposal the ACCC carried out an extensive public consultation process. In October it released an issues paper seeking submissions by 30 November 2000. The ACCC received 15 submissions from airlines, airport operators and other interested parties.

The submissions are available on the ACCC's website.

In mid-December the ACCC held public discussion forums in Melbourne and Sydney.

The ACCC sought submissions in response to its draft decision by close of business on 5 March 2001.

Given the complexity of the issues the ACCC sought consultancy advice on a number of matters from:

- Professor Kevin Davis on the rate of return proposed;
- Network Economics Consulting Group (NECG) on land valuation and the dual till approach;
- Dr Rohan Pitchford on land valuation; and
- Opus International Consultants Ltd, who reviewed the asset valuation methodology used by SACL.

Alan Robertson SC also provided assistance to the ACCC in its interpretation of the regulatory framework. The ACCC has made consultancy reports publicly available. The reports are on the ACCC's website.

Approved prices

Charge	Unit	Price levels	
		SACL proposal	ACCC draft decision
Runway	per 1000kg MTOW per movement	$4.00	$3.07
International terminal	per passenger	$9.50	$7.28
Apron parking	per 15 minute block	$35.00	$35.00
(Bussing/stand-off discount)	Per use of bus	($200.00)	($200.00)
Helicopter movements	per movement	$25.00	$25.00
General aviation parking	per GA movement	$60.00	$60.00

The draft decision is available on the ACCC's website.

Land valuation

SACL's proposal is derived using the 'building block' methodology, where charges are in effect determined through a bottom-up build up of costs to arrive at the required aeronautical revenue. It involves estimating total maximum allowable revenue based on projected costs.

The maximum allowable revenue is the sum of the return on capital, return of capital (i.e. depreciation allowance) and operating and maintenance expenditure. SACL's proposal uses projected 2000–01 costs as the basis for estimating allowable revenue.

Given the capital-intensive nature of airport operations, the asset base is a major determinant of prices when using the building block approach. SACL's proposed land valuation represents a significant part of the asset base. At $705 million it comprises over one-third of the $1.7 billion asset valuation proposed.

SACL values aeronautical land by estimating the site's market value in its best alternative use. The valuation adopted is based on use of the site in mixed residential, commercial and industrial uses. The resulting valuation is $705 million.[1]

SACL supports this approach by arguing that the market value captures the opportunity cost of the land and sends the right signals for using the land and investing in land.

Airport users, by contrast, argue that the opportunity cost of the land is zero since legislation prevents SACL from selling the land or using it for other purposes.

The approach adopted in the draft decision supports the principle of using opportunity cost, but questions SACL's application of the concept. The draft decision raises two main concerns about SACL's approach.

The first is that SACL has not taken into account the costs of converting the site to alternative uses, for example, the costs of demolishing facilities on the site.

The second is that SACL has only considered the private costs and benefits of selling the site.

In practice the Commonwealth is the owner of the airport and would make the decision to close or relocate the airport — their considerations would likely be broader than those of SACL. It could include the cost to the Commonwealth of additional transport infrastructure to service a relocated airport, and broader social issues such as aircraft noise.

The draft decision concludes that the ACCC is not persuaded that SACL has arrived at a reasonable measure of opportunity cost. In light of difficulties in identifying and quantifying opportunity cost, the decision goes on to consider the historic cost of the land as an alternative basis for valuing the site.

Historic cost has three main advantages. The first is that the historic cost of land is readily identifiable and less subjective than opportunity cost. The second is that it provides compensation to the owner of Sydney Airport for investments into land already providing a rate of return on the investments. The third is that it provides appropriate incentives for the airport operator to acquire additional land.

In general though, the ACCC has not adopted an historic cost approach in valuing assets, instead favouring valuations based on depreciated optimised replacement cost (DORC). The main reasons for this are explained in the ACCC's *Draft Statement of Principles for the Regulation of Transmission Revenues* (DRP):

While historic cost, if available, offers (or appears to offer) a firmer base than DORC, there are many aspects which make it unsuitable as a method of establishing a cost base consistent between different network owners. Some issues are the following:

- *inconsistent past accounting practices with respect to how much of an asset was capitalised e.g. in the past network assets had a high day labour content which was not treated in a common way between the transmission network service providers;*
- *the industry has been subjected to structural change which has often been done without sufficient attention to asset valuation;*
- *very similar assets in different networks can have different historic values due to different purchasing practices; and*
- *attempts to inflate historic costs to current costs are fraught with problems and will frequently result in a much higher value than a depreciated current replacement cost based on modern equipment of equivalent capacity. Because of technological improvements and economies of scale the cost in real terms of most electricity assets has fallen consistently over time.*[2]

However, these problems tend not to arise in relation to land. While technological change is important in considering the cost of purchasing plant and equipment it is not relevant in considering land.

The ACCC weighed up the advantages and disadvantages of historic cost valuation in considering the valuation of land easements for

1 Includes landfill costs.

2 Australian Competition and Consumer Commission, *Draft Statement of Principles for the Regulation of Transmission Revenues*, May 1999, (DRP). Available on the ACCC's website by following the 'electricity' link.

electricity transmission in NSW and the ACT, concluding in favour of historic cost.[3]

In comparing the merits of historic cost and SACL's proposed approach, the draft decision also considers the efficiency signals generated by the land valuation proposed in terms of use of the land, signals for relocation of the airport and signals for new investment. It concludes that there is no evidence to suggest that SACL's proposals would send better signals. In particular, historic cost valuation of land provides appropriate signals for land purchases. The land is added to the asset base at purchase price and the airport operator is compensated by a rate of return on the additional assets.

The draft decision is to use the historic purchase cost of land for purposes of setting aeronautical prices at Sydney Airport.

Adoption of an historic cost valuation raises the question of whether to index the land valuation and if so at what rate. Under a real rate of return on capital approach, the historic cost should be indexed forward.

Alternatively, a nominal approach would apply a nominal rate of return to the unindexed historic purchase cost of land. Given that SACL's building block approach is based on a real rate of return the ACCC considers the former method appropriate in this case.

The base for indexation adopted for the purposes of this decision, is the consumer price index (CPI). The attraction of the CPI is that it is well documented and easy to apply. The CPI has been used to index land values overseas and was used by the ACCC to index electricity transmission land easement valuations.[4]

An alternative to the CPI would be to adopt a land value index. A practical limitation of this approach is the absence of no published land value indexes. More fundamentally, a land value index would inflate the historic cost of land to its current market value, raising the same concerns as discussed above.

The ACCC's draft decision is to use the CPI indexed historic purchase cost of land for the purposes of setting aeronautical prices at Sydney Airport. This gives a land valuation of $488 million, compared to $705 million proposed by SACL.[5]

Dual till

SACL's proposal for a dual till approach to pricing conceptually separates aeronautical services from other services provided at the airport. The proposal then sets aeronautical charges on the basis of the cost (including a rate of return on assets) of providing the aeronautical services.

The approach differs from the single till adopted in the past by the previous operator of the airport, the Federal Airports Corporation. The FAC adopted a rate-of-return target for the airport as a whole, and set aeronautical charges at a level required to meet the rate-of-return target.

Since profitability on non-aeronautical services was high, and typically well above the target rate of return for the airport as a whole, this meant that returns on the aeronautical side of the business were low.

The ACCC's draft decision proposes an alternative application of the dual till approach that takes into account SACL's financial performance in the provision of aeronautical related services. The ACCC considers that the approach adopted will yield better economic efficiency outcomes and constrain market power more effectively than SACL's proposals.

The services taken into account in the ACCC's alternative application of the dual till approach are already subject to regulatory scrutiny under the existing regulatory framework. They include car parking and aircraft refuelling services.

Operating and maintenance costs

Operating and maintenance (O&M) expenditure covers labour costs, utilities and services, property maintenance and general administration. O&M costs for the airport were estimated and allocated between aeronautical and non-aeronautical services using SACL's activity based costing (ABC) model.

SACL's proposal acknowledges that its costs are higher than major privatised airports in Australia, but argues that this is because of factors specific to Sydney Airport. By contrast airport users argue that costs are too high and reflect inefficiency at the airport. Short of a detailed independent review of O&M costs, the ACCC is not well placed to accurately gauge the reasonableness of the level of costs proposed by SACL. However, based on the experience of the privatised airports it seems reasonable to assume that substantial savings would be possible over time.

The ACCC's draft decision factors in real reductions of 5 per cent per annum into its draft decision. The savings reflect the average saving achieved by Melbourne, Brisbane and Perth airports since privatisation in 1997.

3 Australian Competition and Consumer Commission, *NSW and ACT Transmission Network Revenue Caps, 1999/00–2003/04*, January 2000. Available on the ACCC's website by following the 'electricity' link.

4 id.

5 Land values include landfill.

Financial modelling

The draft decision uses the components of the building block approach discussed above to derive an allowable revenue. In applying the building block approach, SACL bases its estimate of allowable revenue on a one-period financial model.

By contrast, the ACCC has used a financial model to calculate allowable revenues over a five-year period.

There are two reasons for modelling SACL's costs and revenues using a multi-period financial model. The first reason relates to the regulatory framework. Applying the building block methodology over time would result in falling prices because of traffic growth and reductions in operating and maintenance expenses.

Under the current arrangements there is no mechanism for the ACCC to ensure SACL will lower future prices as traffic volume grows and costs fall.

The second reason for using a multi-period financial model is to mitigate the immediate price shock to airport users.

The financial modelling 'smooths' prices, translating the cost and revenue data into a constant nominal price over the forecast period, providing an equivalent net present value of cash flows to SACL. This smoothed price generates steadily increasing revenues for SACL over the five-year period.

An alternative scenario might be for larger price increases now with prices subsequently driven down in the future. In the case of privatised airports, for example, this was achieved through a CPI–X price cap.

The draft decision is to model SACL's costs and revenues over a five-year period factoring in growth in traffic volume and the operating and maintenance cost reductions discussed in the draft decision.

The draft decision also recommends that aeronautical prices at Sydney Airport should be reviewed after five years from the introduction of the new prices.

Incentive regulation, benchmarking and utility performance

The Utility Regulators Forum recently issued the discussion paper, *Incentive regulation, benchmarking and utility performance*, which is intended to help policy-makers sort through the inherently interrelated issues of economic regulation, utility performance measurement, and appropriate benchmarking methods.

The recent and continuing Californian energy crisis has reminded everyone of the critical and essential role that reliable and cost-effective electricity plays in our society.

The manner in which economic regulation of networks is implemented in Australia will have an important effect on the ability of the electricity supply industry to respond, in time and innovatively, to society's expectation of a secure and reliable end-to-end electricity service.

CitiPower's response to the Regulators Forum discussion paper strongly urges regulators and policy-makers to look beyond the 'natural monopoly' paradigm and promote regulatory approaches that facilitate competition and provide maximum incentive for business to pursue efficient diversification and investment in new technology.

While CitiPower welcomes this contribution to the debate, it believes that the Regulators Forum discussion paper has some major shortcomings:

- it does not address the many important issues that have been discussed extensively in Australia;
- it pays scant attention to the relationship between regulatory arrangements and the promotion of efficiency and effective competition in contestable markets;
- it exaggerates the problems associated with measuring total factor productivity (TFP); and
- it is too reminiscent of rate-of-return regulation, which makes it an unlikely springboard for positive regulatory reform.

The paper begins by discussing problems using partial factor productivity as a performance measure.

A main concern is that partial measures can be influenced by other inputs that are not part of the analysis.

CitiPower agrees with this criticism, but notes that partial productivity measures remain common in Australia. One reason is that partial measures are inherently tied to the building block approach to regulation.

The natural link between building block regulation and unreliable performance measures supports the move to external regulation that uses comprehensive performance measures outside of the regulated utility.

One such measure is the industry trend in total factor productivity (TFP). The discussion paper says that TFP has conceptual appeal but believes that it is 'fraught with practical difficulties'. CitiPower believes that these difficulties are overstated. In

practice, there are well-established methods for estimating TFP.

TFP has been used in a large number of regulatory proceedings overseas, and this would almost certainly not be the case if TFP measures were inherently flawed or problematic.

The paper provides only a cursory examination of 'frontier' methods such as stochastic frontier analysis (SFA) and data envelopment analysis (DEA). There is effectively no discussion of problems associated with these techniques. CitiPower believes that, compared with TFP, this treatment is unbalanced and presents a misleading impression of the relative merits of different performance measures.

In discussing other performance measures, such as financial returns, the discussion paper is reminiscent of rate-of-return regulation. For example, the paper states unequivocally:

> *... where the regulated utility had been able to increase its profitability …there is prima facie evidence that X was too low.*

CitiPower strongly disagrees. It is appropriate to have an initial cost of service review before incentive regulation takes effect. However, the treatment of initial tariffs is and should be separable from setting the ongoing parameters of price control formulas.

It is important to keep these issues separate, because whenever the CPI–X formula is set to achieve target returns, there is a blending of rate-of-return and CPI–X regulation.

CitiPower believes that regulation should allow returns to be commensurate with company performance. The X-factor should not distribute excess profits to customers. Indeed, if regulation is to create the correct incentives, it must allow companies to benefit through higher earnings when efficiency improves.

Ultimately, this goal is only achieved through the use of external performance measures, which create the strongest possible incentives, maximise long-term customer benefit, and enable returns to be commensurate with company performance.

External regulation is also most compatible with deregulation and the 'energy only' based wholesale electricity market in Australia. Any attempts to tie network prices to company-specific performance measures will prove unwieldy in dynamic environments.

External regulation allows many problems associated with company-specific regulatory approaches to be mitigated. For example, companies have no incentive to allocate costs in ways that raise their revenues, since network prices are completely decoupled from a company's reported costs. This eliminates controversy associated with ongoing cost allocations.

Rigorous empirical methods can establish objective performance measures that serve as the foundation for external regulation. Yardstick regulation is one approach that can be used to develop objective external targets.

CitiPower also believes that the information and incentives project (IIP) in the United Kingdom is consistent with a greater reliance on external benchmarks and yardstick measures. Although still preliminary, we believe that IIP developments merit attention.

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National developments

Telecommunications

Regulation review

The Productivity Commission released the draft report of its review of the telecommunications-specific competition provisions at the end of March. The provisions are contained in the Trade Practices Act and other legislation.

Under its terms of reference the Productivity Commission is to report on the operation of the provisions and whether repeal or amendment is required.

The ACCC has made several submissions to the review.

Telstra retail price controls

Late last year the Minister for Communications, Information Technology and the Arts directed the ACCC to undertake a review of the price control arrangements on Telstra.

The ACCC sought submissions and conducted public hearings in the course of the review. Its draft report was published in December and recommended retention of the controls, but on a more limited basis. The final report was forwarded to the Minister in February.

ADSL roll-out

Close monitoring of the roll-out of Telstra's retail asynchronous digital subscriber line (ADSL) service is continuing. Following earlier directions to Telstra, the ACCC made further directions to Telstra in November concerning the provision of information on the scope and timeframes of service delivery to itself and its competitors.

Pricing principles for declared services

The ACCC confirmed in November that it would use retail-minus pricing for local call resale (LCR). The retail-minus methodology involves determination of the wholesale LCR price by subtracting the retail costs of supplying local calls from the retail price of a local call.

In December the ACCC announced its draft view on pricing for wholesale GSM mobile termination services. The draft approach favours less extensive regulation of mobile termination charges than fixed line services, and suggests a pricing rule which ensures the price decrease of wholesale GSM mobile termination services at the same rate as GSM retail prices.

In March the ACCC issued its pricing principles for access to network services supplied by non-dominant networks. The ACCC announced that, where it is conducting an arbitration or reviewing an undertaking, it is unlikely to set or accept a charge for a service that was higher than the efficient cost incurred by Telstra for the supply of an analogous service. This approach in effect imposes a price ceiling in negotiations for the supply of PSTN originating and terminating services by a smaller or non-dominant fixed network equal to the efficient costs incurred by Telstra.

The ACCC has previously issued a discussion paper on the pricing of the unconditioned local loop service, which was declared in 1999.

Revocations and exemptions from service declarations

The ACCC has revoked the declaration of two AMPS services following the closure of the AMPS network.

Telstra lodged a further application with the ACCC in November for an exemption from its obligations to supply local calls to its competitors for resale in certain CBD, metropolitan and rural areas of Australia. An earlier application was lodged in June 2000. The ACCC is considering submissions in relation to both applications.

Intercapital transmission capacity

The ACCC announced in March its draft decision to remove the current access regulation on the intercapital transmission capacity service. This service is used for the transmission of voice, data and other communi-cations between mainland capital cities.

The ACCC's decision to remove the regulation was based on evidence that the structure and conduct of the currently declared intercapital routes has changed. New entry has occurred on the eastern seaboard by carriers such as PowerTel and Macrocom. Other carriers are in the process of building new networks, such as Amcom Communications.

C&W Optus sale

The ACCC is considering proposals from a number of parties in relation to the acquisition of C&W Optus.

Conduct of telecommunications and Internet service providers

The ACCC has investigated acceptable use policies (AUPs) relating to Internet service and warned Internet service providers to be up-front about the products they offer. In November it required the cable Internet service provider Optus@Home to cease promoting services subject to download limits as 'unlimited download' services and to compensate customers terminated

from the service under its earlier AUP.

The ACCC also investigated the selling practices of several telecommunications companies following complaints concerning unauthorised customer transfers (slamming). One.Tel and Primus, whose door-to-door selling practices were the subject of ACCC action in the Federal Court, agreed to pay $500 000 towards a public awareness campaign aimed at eliminating slamming.

Telecommunications access disputes (arbitrations)

Since October 2000 the ACCC has made a further two final and seven interim determinations in its arbitration of various disputes over access to Telstra's fixed line telephone network. Two final determinations on interconnection to Telstra's Public Switched Telephone Network service were made in September 2000, and were subsequently appealed by Telstra to the Australian Competition Tribunal.

Three further telecommunications access disputes under part XIC of the Trade Practices Act have been notified to the ACCC since October 2000.

- The Internet Group Limited notified a dispute with Telstra on 1 November 2000 concerning the terms and conditions on which the Internet Group Ltd proposes to supply Telstra with PSTN termination services. Chime Communications notified a similar dispute on 22 December 2000.
- Telstra notified a dispute with PowerTel Limited on 5 December 2000 concerning the terms and conditions on which PowerTel proposes to supply Telstra with PSTN termination services.
- WorldxChange Pty Ltd notified a dispute with Telstra on 28 December 2000 concerning the terms and conditions on which Telstra supplies access to the local carriage service. WorldxChange also notified a dispute with Telstra on 22 December 2000 concerning the terms on which Telstra supplies GSM terminating access.

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Electricity

ACCC issues network draft determination

On 12 December 2000 the ACCC issued its draft determination of changes to the network pricing arrangements in the National Electricity Code. The decision followed a review of the code's network pricing arrangements, which was conducted by the National Electricity Code Administrator (NECA).

The code's network pricing arrangements are a key component of the National Electricity Market (NEM) design and affect the ability of the code to deliver public benefits through efficient use of and investment in network assets, as well as optimal electricity production and consumption decisions.

In assessing the changes put forward by NECA the ACCC considered several issues that would detract from the public benefits the changes would provide. Two of these issues were the beneficiary pays system for funding new network investments and the transmission usage charge, which was based on three methods and was to be payable by customers only.

The ACCC's draft determination requires that the beneficiaries pays system be deleted and that transmission usage pricing be applied to all network users, depending on whether they add to or relieve congestion. The ACCC considered that such a significant change to the original set of code changes was required to ensure the code's network pricing arrangements delivered the required public benefits.

Other important changes to the code include improved information disclosure requirements for network businesses, the ability for transmission network service providers to recover the cost of discounts from other customers and the introduction of rules which will allow market network service providers to participate in the NEM.

The ACCC held a pre-determination conference about the draft determination on 15 March 2001. The minutes from the conference are available on its website. Interested parties had until 27 April to lodge submissions with the ACCC. The ACCC's final determination will take into account the issues raised at the pre-determination conference together with those raised in the additional submissions.

Copies of the ACCC's draft determination are available from its website or from Ms Maxine Helmling on (02) 6243 1246.

ACCC issues determination on VoLL code changes

On 20 December 2000 the ACCC released its final determination authorising code changes which increase the price cap for spot prices in the market from $5000 to $10 000. The determination also approved the introduction of a negative price floor for spot prices, changes to the cumulative price threshold and the introduction of new capacity mechanisms.

VoLL (value of lost load) is a cap on regional reference prices in the NEM. Currently, in situations where determination of dispatch prices would otherwise result in a dispatch price greater than VoLL at any regional reference node, the dispatch price at that regional reference node must be reduced to VoLL. The level

of VoLL therefore represents the maximum spot price for wholesale electricity in the NEM and is currently set at $5000/MWh. The price of electricity most often sits between $20/MWh and $60/MWh.

NECA proposed to increase VoLL in two steps — to $10 000/MWh in September 2001 and to $20 000/MWh in April 2002. NECA also proposed to impose a cap on the market price if the cumulative effect of high spot prices exceeds a threshold level of $300 000.

The ACCC acknowledged that the proposed increase in VoLL would provide public benefit, as it would encourage investment in peaking capacity in circumstances where demand peaks occur for only a few hours a year (such as is currently the case in Victoria). However, the ACCC did not consider that the other major public benefit argued by the NECA has been demonstrated — that VoLL provides the incentive for reliability of supply through improved demand-side response. As such, the ACCC did not believe that an increase in VoLL to $20 000/MWh delivers sufficient public benefit to outweigh the anti-competitive detriments noted above.

The ACCC therefore proposed to limit the increase in VoLL in the short term to $10 000/MWh. This would provide an additional incentive to promote investment in peaking plant while capping risk in the market at a level lower than that proposed. Additionally, the ACCC proposed to delay increasing VoLL to $10 000/MWh until April 2002 to allow market participants sufficient lead-time to make the necessary arrangements to accommodate the increase in risk.

The ACCC further proposed to reduce the cumulative price threshold to $150 000 rather than $300 000 as proposed by NECA, which would reduce the risk of exposing market participants to prolonged periods at high prices.

Copies of the ACCC's determination are available from its website or from Ms Maxine Helmling on (02) 6243 1246.

Regulation of Queensland transmission networks

From 1 January 2002, the ACCC, in accordance with its responsibilities under the code, will commence regulation of the Queensland transmission network, Powerlink.

On 14 February the ACCC received Powerlink's application outlining its proposed revenue cap. To assist in its considerations of Powerlink's application, the ACCC engaged PB Associates to undertake a review which analyses and comments on the assumptions, methodology and findings contained in a 1999 report on Powerlink's asset base and analyses and comments on Powerlink's proposed capital expenditure, operating expenditure and service standards. The ACCC has also invited interested parties to lodge submissions on issues raised in the application by Friday, 30 March 2001.

The ACCC anticipates releasing a draft decision in June 2001. It will then invite interested parties to comment on the draft decision before making a final decision.

On 15 March 2001 the ACCC extended the closing date for submissions to 12 April 2001 to provide interested parties sufficient time to comment on PB Associates' asset valuation, capex, opex and service standards consultancies. PB Associates' consultancies and a copy of Powerlink's application are available on the ACCC's website.

Regulation of Snowy Mountains Hydro-Electric Authority

On 6 February 2001 the ACCC, at the request of the members of the Snowy Mountains Council and in accordance with its responsibilities under the code, released a revenue cap decision for the Snowy Mountains Hydro-Electric Authority's transmission assets.

The decision outlines the maximum revenue that may be earned by the SMHEA for the five-year period ending 30 June 2004.

The ACCC set a revenue cap that trends down slightly from $10.79 million to $10.66 million over the regulatory period. The decision is based on an opening asset base of $62.45 million and a post-tax nominal return on equity of 11.20 per cent. The post-tax nominal return on equity is lower than in other recent ACCC decisions due to the prevailing market conditions.

A copy of the final decision is available on the ACCC's website.

Regulation of South Australian transmission network

On 1 January 2001 the ACCC commenced regulation of the South Australian transmission network, ElectraNet SA.

Currently, the revenue cap and transmission network prices for ElectraNet are outlined in the South Australian electricity pricing order (EPO). The EPO was established before the privatisation of the electricity assets. Until 1 January 2003 the ACCC's role is therefore limited to administering transmission-related functions under the EPO. The ACCC will not become responsible for setting ElectraNet's revenue cap until 1 January 2003.

The ACCC has three broad responsibilities under the EPO. These are to:

- ensure that ElectraNet complies with the initial tariffs specified in the EPO;
- assess any application by ElectraNet for altering tariffs or proposing new tariffs; and
- assess any applications by ElectraNet to pass through additional charges or rebates.

On 12 January 2001 ElectraNet submitted an application for a net negative pass through (discount) of approximately $18.1 million relating to its regulated transmission charges for the six-month period commencing 1 January 2001 to 30 June 2001. The pass-through amount relates to a settlements residue event and network event, as outlined in chapter 6 of the EPO.

On 6 February 2001 the ACCC approved ElectraNet's pass-through application.

A copy of ElectraNet's application is available on the ACCC's website.

Rail

ARTC rail access undertaking

The ACCC has received an access undertaking under part IIIA of the Trade Practices Act from Australian Rail Track Corporation (ARTC). The undertaking covers terms and conditions of access to rail tracks owned or leased by ARTC.

The tracks are part of the interstate mainline standard gauge track linking Kalgoorlie in Western Australia, Adelaide and Wolseley in South Australia and Melbourne and Albury in Victoria.

ARTC was established under an inter-governmental agreement signed by all governments in 1997. One of the key elements of the IGA was to facilitate a coordinated approach to rail reform. ARTC's primary objective is to promote use of Australia's national rail network linking all capital cities by providing a single point of access to providers of rail freight services whose operations cover state jurisdictions. ARTC owns the line in SA (including the track to Kalgoorlie in WA) and has control over the track in Victoria where it has a lease agreement in place.

Under s. 44ZZA(4) of the Trade Practices Act, the ACCC must go through a public consultation process before accepting the undertaking. As part of that process, the ACCC has distributed an issues paper to interested parties inviting comments and submissions on the ARTC access undertaking.

The ACCC will take these comments into consideration in its assessment of the undertaking. It intends to publish a final decision by the end of July 2001.

If the ACCC accepts the undertaking then the services covered by the undertaking cannot be declared. This removes the opportunity for access seekers to have the ACCC arbitrate access disputes in relation to services covered by the ARTC undertaking as a first option. Acceptance of the ARTC undertaking means that the undertaking forms the basis for access.

Access to parts of the interstate network owned by Qld, NSW and WA are subject to access regimes in those States. Presently, no rail access regime is certified 'effective' under part IIIA of the Trade Practices Act.

Airports

Aeronautical charges at Canberra Airport

Taxi fees

In March 2001 the Federal Court found that taxi fees at Canberra Airport are covered by the price cap on aeronautical services.

In April 2000 Canberra Airport introduced a fee of $2 on taxis proceeding from the taxi queuing area to the taxi rank adjacent to the terminal building. The ACCC took the view that the charge was within the price cap on aeronautical services. Canberra Airport sought review of the ACCC's decision in the Federal Court.

Justice Gyles ruled that the charge is within the price cap because it relates to the use of landside roads at the airport. Charges for landside roads are covered by the price cap.

Justice Gyles found that the taxi queuing area at the airport is used by vehicles waiting for the opportunity to move to the rank. He regarded the area as an alternative to having taxis queuing along the main road. Justice Gyles did not consider that the presence of boom gates at the head of the queuing area detracted from the charactarisation of the area as a landside road.

Justice Gyles' findings meant that the ACCC had to take the proceeds of the taxi charge into account when assessing Canberra Airport's compliance with the price cap.

New investment proposals

Canberra Airport is redeveloping the central terminal area into a facility known as the common user commuter terminal. The ACCC is considering a proposal from the airport to increase aeronautical charges to fund certain aspects of the redevelopment.

The project has been submitted in two stages. The first stage includes the construction of a main entrance and covered walkways leading to the carpark and hire car areas. The second phase involves some more extensive remodelling of the central terminal.

The terminal redevelopment is the most recent in several new investment proposals at the airport. In March the ACCC approved a small increase in aeronautical charges to fund the construction and maintenance of an overhead walkway linking the airport's common user apron with the central terminal area.

The new walkway will maximise the flexibility of the new apron. It will allow passengers of any airline access to the new apron. The ACCC has approved a charge on the airlines of 10.5 cents per arriving and departing passenger.

National Competition Council (NCC)

Publications

In January 2001 the NCC forwarded a submission to a review by the Productivity Commission of part IIIA of the Trade Practices Act and clause 6 of the competition principles agreement (CPA).

The submission includes a summary of declaration and certification applications since 1996, and outlines the NCC's current approach to part IIIA matters.

The NCC's submission to the inquiry argues that major changes to the part IIIA/CPA framework would be inappropriate, given that:

- it has been in place for a relatively short period of time;
- there has been significant progress to date in its application;
- it appears to be capturing (and only capturing) the sort of infrastructure intended; and
- it should be applied with a long-term view of appropriate outcomes.

The NCC argues nonetheless that a number of refinements would strengthen the effectiveness of the regime. The submission is available on the NCC's website at <http://www.ncc.gov.au>.

Declaration applications

Western Power

On 9 January 2001 the NCC accepted an application for declaration of certain electrical transmission and distribution services provided by Western Power Corporation. The application was made by Normandy Power Pty Ltd, NP Kalgoorlie Pty Ltd and Normandy Golden Grove Operations Pty Ltd.

The application covers electrical transmission and distribution systems situated in the south-west of Western Australia (known as the 'South West Interconnected System'), servicing the area bounded by Kalbarri in the north, Kalgoorlie in the east, Albany in the south and the western coast of Western Australia.

The applicants seek access to the services to allow the transmission of electricity from electricity generators, particularly the Parkeston power station, to consumers in the south-west of Western Australia.

In February 2001 the NCC released a discussion paper outlining its preliminary assessment of the application against the declaration criteria. The NCC's preliminary view is that the application meets each of the declaration criteria.

The NCC called for submissions on the application by 26 March 2001. It will then make a recommendation to the Western Australian Premier on whether the service should, or should not, be declared.

Certification of State and Territory access regimes

NT gas

The NCC received an application from the Northern Territory Government for certification of its gas access regime on 13 March 2001. It will shortly release an issues paper and seek comments from interested parties.

NSW gas

The NCC conveyed its recommendation on certification of the NSW gas access regime to the Commonwealth Minister for Financial Services and Regulation in March 1999.

The Minister's decision has been delayed pending resolution of cross-vesting issues arising from the High Court decision in *Re Wakim: ex parte McNally*.

Victorian gas

The Victorian Government applied for certification of its gas access regime in July 1999. The NCC released an issues paper and conducted a public process to assist in its consideration of the regime.

Most issues raised in the application have been examined by the NCC in other contexts. A major difference between the Victorian regime and other regimes, however, is the application of a market carriage framework to provide access to pipelines. The Victorian application also contains a number of transitional arrangements, including a delay in its contestability timetable.

The NCC forwarded its recommendation to the Minister for Financial Services and Regulation in April 2000.

Qld gas

The NCC received Queensland's application for certification of its gas access regime in September 1998. While the Queensland regime was submitted to the NCC as an application of the national gas regime, it incorporates a number of significant derogations from the national regime.

The derogations affect several major transmission pipelines and cover

matters such as access prices and information flows to access seekers.

The NCC initially considered whether the Queensland regime remained broadly consistent with the national gas regime. If it did, the NCC could draw upon its earlier assessment that the national gas regime was effective. The NCC sought the advice of the ACCC on whether the regulatory processes, including tariff outcomes, for the derogated pipelines were broadly consistent with the national code and the extent to which differences are significant.

The ACCC completed a substantial report in April 2000. It reported that the derogations significantly alter a number of regulatory processes, tariff and other outcomes from those in the national code. The NCC considers the variations to be sufficiently material not to regard the Queensland regime as a consistent application of the national code.

As such, the NCC has been obliged to consider the Queensland regime on a stand-alone basis against the certification principles (set out in clause 6 of the CPA).

The NCC forwarded its recommendation on the regime to the Commonwealth Minister for Financial Services and Regulation in February 2001.

The NCC notes that the Queensland regime was enacted in May 2000. While not certified, the provisions of the regime — including obligations on pipeline owners — now operate.

Western Australian rail

The Western Australian Government applied for certification of the WA rail access regime in February 1999 and withdrew it in November 2000 after failing to resolve issues the NCC had relating to interstate operators. (See *Network*, issue 6 for more detail.)

NSW rail

In November 1999 the Minister certified the NSW rail access regime as effective until 31 December 2000. The relatively short certification period reflected concerns as to whether the NSW regime could harmonise with national reform arrangements in rail.

The certification has now expired.

Northern Territory electricity

In December 1999 the Northern Territory (NT) Government applied for certification of an access regime covering its electricity network. After the NCC called for public comment on the regime it released a draft recommendation in September 2000 that the regime not be certified.

Unresolved issues relate primarily to the introduction of retail contestability and the pricing of out-of-balance energy.

The NCC has now received a number of submissions on its draft recommendation and will continue discussions with the NT Government. (See *Network*, issue 6 for more detail.)

National gas code

Eastern gas pipeline and Moomba to Sydney pipeline system final decisions

On 16 October 2000 the Commonwealth Minister for Industry, Science and Resources, Senator the Hon. Nick Minchin, decided to cover the eastern gas pipeline under the National Gas Pipelines Access Code. An application for a review of the decision was subsequently lodged.

On the same day the Minister decided against revocation of coverage under the code of parts of the Moomba to Sydney pipeline system.

The Minister's decisions in the case of both pipelines were in accordance with recommendations by the NCC.

Queensland gas pipelines — revocation applications

In August 2000 the NCC received applications to revoke coverage of four Queensland gas pipelines.

On 3 November 2000 the NCC recommended that coverage of each pipeline be revoked. On 23 November the Federal Minister for Industry, Science and Resources revoked coverage of the Peabody–Mitsui, Kincora–Wallumbilla and Dawson Valley to Duke Queensland pipelines. On 28 November the Qld Minister for Mines and Energy revoked coverage of the Dalby network.

All decisions were in accordance with the NCC's recommendations.

Matters before the Australian Competition Tribunal

On 27 October 2000 Duke Energy made an application to the Australian Competition Tribunal for a review of the decision to cover the eastern gas pipeline under the code.

The tribunal conducted hearings on the matter from 29 January until 8 February 2001. As provided for under the Gas Pipelines Access Law, the tribunal extended the time period for finalising its decision to 26 March 2001.

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State developments

Victoria

The Office of the Regulator-General (ORG)

Essential Services Commission

The Victorian Government intends to establish the Essential Services Commission (ESC) with responsibility for the regulation of electricity, gas, water, rail, ports and the handling of export grain. The Government's stated objective is to ensure high quality, reliable, equitable and safe provision of essential utility services in Victoria.

The Victorian Government is currently in the process of developing draft legislation to formally establish the ESC. This legislation is expected to be introduced into the Victorian Parliament in the Spring 2001 session.

Electricity

Distribution

From 1 January 2001 electricity distributors were required to comply with the price controls and associated arrangements set out in the '2001 Electricity distribution price determination' (and as amended in ORG's re-determination released in December 2000).

ORG has approved distribution and transmission tariffs for each of the five electricity distributors in Victoria. The distribution tariffs provide for reductions in the average price of electricity services of between 9.1 and 18.4 per cent.

TXU Australia has launched proceedings in the Supreme Court of Victoria in relation to ORG's determination. In particular, TXU has argued that ORG has adopted a rate-of-return regulatory approach rather than a 'price-based CPI–X' form of regulation required by the Victorian Electricity Industry Tariff Order. The court proceedings commenced on 9 March 2001 and are continuing.

Full retail competition (FRC)

ORG anticipates that full competition will commence in Victoria from January 2002 with the implementation of national systems. The regulatory framework for FRC in electricity is nearing completion and key current activities of ORG are summarised below. It also continues to contribute to the national FRC activities through various decision-making committees.

Metrology

The Victorian Government is expected to publish its draft metrology procedure in early April. The procedure will allow wholesale settlement through a net system load profile for small customers who retain their basic meter.

ORG has contributed to the development of the procedure and expects to ultimately assume the role of metrology coordinator. It will commence a study to assess the viability of a regulated roll-out of interval meters. This study was foreshadowed in the recent price determination.

Transfer

ORG has now published its draft decision on transfer rules for Victorian customers under FRC and intends to develop a transfer code to implement these rules.

Ring fencing

ORG's ring fencing position paper, *Ring-fencing in the electricity and gas industries*, following consultation on an issues paper, will be published in April 2001.

Industry readiness

ORG will monitor industry readiness for FRC. Industry participants will be required to have certain systems and processes in place to ensure customers can choose their retailer when FRC commences.

Access to supply

The retail code, which sets retail service standards in the competitive market, has been in operation since 1 January 2001 and the host retailers' standing and deemed contracts, which are not to be inconsistent with the code, were published with effect from 1 January 2001. During March to May 2001 ORG will be undertaking a review of the code to incorporate clauses that provide for limitations of liability, exclusion of statutory implied terms, indemnification and coercion.

ORG released its draft decision on 'Confidentiality and explicit informed consent' for public comment and submissions were due by the end of March.

Market conduct and information

The steering committee, which comprises representatives from industry, customers and Consumer and Business Affairs, continues to meet to finalise the Market Code of Conduct and established code governance arrangements. The Victorian Government is considering options for addressing code compliance by brokers, and the industry is preparing options for ORG's consideration on code compliance by licensed retailers.

Customer education

ORG is currently undertaking research on awareness of competition by customers in the 40–160MWh tranche. The outcome of this research will inform the broad communications' strategy for this

tranche. Tracking awareness of customers who consume less than 40MWh will start in April, in the lead-up to the public information campaign scheduled for July to November 2001.

Gas

Gas distribution price review

ORG is required to undertake a review of gas distribution pricing by the end of 2002.

It is expected that an initial consultation paper on the proposed approach and framework for the review will be issued for public comment during April.

Full retail competition (FRC)

ORG is seeking to facilitate contestability and at the same time protect consumers.

In November 2000 a new decision-making body was established — the Victorian Gas Retail Rules Committee (VGRRC). This body will develop and maintain retail rules for the fully contestable market.

The body comprises the following representatives (each has a single vote) — an independent chair, one Vencorp representative, three incumbent retailer representatives, two non-franchise retailers, one distribution business representative and one customer representative (+ one observer).

The VGRRC is responsible for developing retail market rules encompassing customer transfer, trading arrangements and Meter Identification Register Number (MIRN) discovery. The new body sits within the Vencorp legal entity and hence the Vencorp Board will be required to endorse any decisions made by it. ORG and Government are observers on this body.

ORG is represented on a number of working groups currently considering and developing the market structures for full retail competition (FRC), including trading arrangements, legal and regulatory and transfer protocol. The core activities at the moment are:

- finalisation of the legal and regulatory environment; and
- developing process flows detailing key operational processes for the trading arrangements.

The Government is yet to make its final decision regarding the recommendations on 'Profiling for gas FRC and trading arrangement' received from the VGRRC. The consultation period on each of these issues concluded in early February.

As has been the case in electricity FRC, the Government has legislated a safety net for consumers during the transitionary period of gas FRC for three years from 1 September 2001. This safety net comprises deemed and default contracts together with standing offers to consumers, all of which will require ORG approval of terms and conditions.

Government has a reserve retail pricing power.

The terms and conditions will flow largely from the new Gas Retail Code. In light of the very real likelihood that multi-utilities/dual fuel businesses will offer dual fuel products to consumers, ORG is keen to allow for as much commonality as possible in the retail codes to make this a more efficient process for all concerned.

ORG formed a working group of consumer and business representatives in 2000 (Gas Minimum Standards Working Group) to assist with the development of the retail code. It was generally agreed that the convergence between gas and electricity retail codes was desirable.

The public consultation on the draft Gas Retail Code concluded on 30 March 2001, ORG will now finalise the code. Retailers will then submit their contract terms and conditions for ORG approval. Government will at the same time consider the proposed retail prices.

As has been the case for earlier tranches of contestability, ORG continues to coordinate education campaigns for newly contestable customers.

Rail

On 1 February 2001 the Ministers for Ports and Transport jointly announced that open access to the services of the State's rail freight network infrastructure would be declared from 1 July 2001 onwards. This included access to the rail freight services of:

- the country rail networks;
- the part of the metropolitan network, leased to Bayside Trains, which would be declared for freight purposes;
- the South Dynon Terminal; and
- the Dynon Terminal.

The rail access regime is based on a negotiate–arbitrate model that encourages access seekers and access providers to reach a commercial agreement on the terms of access to declared rail transport services. From 1 July 2001 ORG's role under the Victorian access regime will be to resolve any disputes between parties about the terms of access to the declared services.

Grain

ORG regulates grain-handling services operated by GrainCorp within the ports of Geelong and Portland.

In July 2000 ORG made a price determination requiring GrainCorp to comply with certain grain-handling pricing principles in setting prices for the services of its grain-handling facilities at the ports of Geelong and Portland.

In July 2000 GrainCorp submitted its 'Prescribed services handling charge schedule' for the 2000–01 season. After extensive public consultation ORG was unable to conclude whether GrainCorp's proposed charges did comply with certain principles as GrainCorp had not provided sufficient information. In the absence of compliant prices, ORG established a set of default prices to operate for the 2000–01 season harvest.

Western Australia

Office of Gas Access Regulation

The Western Australian Independent Gas Pipelines Access Regulator is responsible for the administration of the National Gas Pipelines Access Code for Natural Gas Pipeline Systems for both gas transmission and distribution pipelines in the State.

Currently six pipelines or pipeline systems in the State are covered under the code.

Access arrangements for the mid-west and south-west gas distribution systems and Parmelia pipeline were approved on 18 July 2000 and 15 December 2000 respectively.

The proposed access arrangements of three other pipelines are at various stages of the approval process. In addition, the requirement to lodge a proposed access arrangement for the remaining pipeline (Kambalda lateral) has been deferred until 1 December 2002.

Associate contract

A proposed haulage contract between AlintaGas Networks Pty Ltd and AlintaGas Sales Pty Ltd was received on 28 February 2001 for approval under s. 7.1 of the National Third Party Access Code for Natural Gas Pipeline Systems. The regulator is currently conducting public consultation in accordance with s. 7.3. The public consultation period closes on 6 April 2001 and a decision is required by 19 April 2001.

Details on all developments are available on the Office of Gas Access Regulation website.

South Australia

South Australian Independent Industry Regulator (SAIIR)

Electricity

Grace period customers

A key issue of concern in SA is the inability of contestable customers on a 'grace period' tariff to obtain contracts for the supply of electricity.

The grace period tariff ends on 30 June 2001 and it is believed that only 400 of the 3000 contestable customers have contracts. It appears that the tight demand/supply situation in SA and the lack of competition in the retail market (AGL is the dominant retailer with only three other retailers active) have contributed to this situation. It may be that some grace period customers find themselves on market-related contracts as of 1 July 2001.

Augmentations and extensions of electricity distribution network

The SAIIR has prepared a bulletin, outlining the procedures for establishing new and upgraded connections to a distribution network, where a network extension or augmentation is required. Advisory Bulletin No. 3, 'Augmentations, extensions and connections to the electricity distribution network in SA' is intended to provide consumers with an explanation of how the augmentation and extension procedures contained in part A, chapter 3 of the distribution code operate. The bulletin is now available on the SAIIR website.

Augmentation costs continue to be a contentious issue in South Australia. The SAIIR will commence a project in mid-2001, which will compare the SA scheme with interstate schemes and if necessary suggest changes to the scheme.

Public street lighting

The SAIIR initiated a public consultation process to revise the minimum service standards set out in clause 5.3 (c) of part B of the distribution code. This clause sets out the service standards for the repair of street lights, in particular:

- the rebate available to those members of the public who report a street light outage which is not repaired within the specified service time (currently five business days in the Adelaide metropolitan area and 10 business days elsewhere); and
- the specified repair time for street light outages for country metropolitan areas.

The SAIIR has subsequently amended the distribution code to reflect:

- an increase in the rebate available from $10 to $20; and
- a reduction in the specified repair time for street light outages for country metropolitan areas from 10 days to five days.

These amendments will take effect from 15 March 2001.

Consumer Advisory Committee

The Consumer Advisory Committee (CAC) has established a work program consisting of projects to be actioned in the next six months. The committee's work program includes work on:

- electricity demand management;
- small generator connections;
- metering issues;
- access to land by electricity entities; and
- information for consumers.

Compliance reporting

The first and second reports from electricity licensees are being received in accordance with Guideline 4 'Compliance systems and reporting'.

All licensees were required to submit compliance reports by 30 November for the period ending 30 September and by 28 February 2001 for the period ending 30 December 2000.

AGL demand management — media campaign

The SAIIR endorsed a campaign on demand management launched by AGL to be run over the summer period. The campaign is designed to encourage consumers to monitor their electricity usage, but in particular to reduce the demand for electricity at peak times on hot days.

AGL has developed a range of print, radio and TV advertisements to support the campaign.

ACCC electricity transmission role

From 1 January 2001 the ACCC has assumed an increased role in regulation of the electricity transmission system in South Australia. Before that date the SAIIR administered the electricity pricing order (EPO) in its entirety, within the framework of SA derogations to the National Electricity Code. However, the ACCC will now administer the EPO as it relates to transmission services. The EPO applies to transmission services until 30 December 2002, so it will be administered by the ACCC for a period of two years when a new price determination issued by the ACCC will take effect.

Electricity reselling

The SAIIR has released an advisory bulletin on electricity reselling which addresses changes to regulations designed to allow inset network (embedded network) customers the opportunity to access their retailer of choice.

Licence applications

The previous issue of *Network* reported on a licence application from Transgrid to operate the proposed SA/NSW interconnector (SNI). The SAIIR will not finalise its consideration of this matter before the NEMMCO review of the SNI project. In late 2000 the SAIIR made a submission to the Inter-regional Planning Committee on this matter stressing that the SAIIR would need to consider the impacts of SNI on SA consumers.

The SAIIR is liaising with a number of proponents of wind farms in SA concerning electricity licencing issues associated with such projects.

Rail

The role of the SAIIR as regulator for the Australasia rail access regime for the Darwin to Tarcoola line is being determined in anticipation of an information brochure to be released in mid-2001.

Ports

The SA Government has started the sale process for PortsCorp. The SAIIR is currently determining the nature of its responsibilities under the *Maritime Services (Access) Act 2000*.

ACT

Independent Competition and Regulatory Commission (ICRC)

New regulatory regime for ACT utilities

The *Utilities Act 2000* establishes a new framework for regulating the provision of electricity, gas and water and sewerage utilities in the ACT. Specifically, the Act establishes:

- the broad objectives for the regulation of utilities;
- specific legal rights for each utility including rights of access to, and ownership of, existing assets and rights to acquire land;
- the right of supply for customers;
- processes for developing and implementing codes of practice governing specific areas of operation such as consumer protection, safety and technical standards, emergency planning; and
- a process for costing, imposing and enforcing consumer service obligations on utilities.

The Act commenced on 1 January 2001 and replaces the *Electricity Supply Act 1997* and the *Gas Supply Act 1998* and their respective licensing regimes.

Licenses

Underpinning the new framework is the licensing regime. The Act requires all relevant utilities to have operating licences for the specific utility services they provide, for example, gas transmission, electricity and gas distribution, electricity and gas retail, water supply and sewerage. This requirement is not new for electricity and gas utilities, but is for water and sewerage utilities, which were not previously required to be licensed.

Licences are subject to a range of conditions with which utilities are required to comply, some are statutory and others will be imposed by the ICRC. It will be a mandatory condition of all licences, for example, that utilities comply with any relevant codes of practice and that, if applicable, they supply franchise customers in accordance with their standard customer contracts.

Compliance with licence conditions is mandatory and utilities may incur heavy penalties for failing to do so. In extreme cases a utility's licence may be revoked for failing to comply.

Regulation

The Utilities Act establishes two regulators. The principal regulator, the ICRC, has responsibility for issuing, varying and revoking licences and for monitoring licence compliance. It also has responsibility for managing industry codes of

practice and for approving standard customer contracts for franchise customers. Technical and safety matters will be regulated by the Department of Urban Services.

Importantly, the Act also establishes the Essential Services Consumer Council, which assumes and builds on the functions currently performed by the Essential Services Review Committee. The new body will have the power to investigate and determine customer disputes; prevent disconnections for customers experiencing financial hardship; order rebates and waive debts. The council can make determinations with a value of up to $10 000.

Codes of practice

As noted earlier, the Act makes provision for the development of industry and technical codes of practice. These codes set out detailed operating procedures and service levels for the different utility types and place some additional responsibilities on utilities, for example, the requirement for distributors to enter into network use of system agreements with retailers.

Codes currently in place deal with such matters as consumer protection, network boundaries, service and supply standards, metering, network use of system arrangements, supplier of last resort arrangements, network design, maintenance and operation, customer connections, emergency planning and dam safety. A capital contributions code is also being prepared. The consultation period of the draft code closed on 30 May. A code is expected to be agreed before the end of June, to coincide with the commencement of the provisions of the Act.

Standard customer contracts

Utilities are required to adopt standard customer contracts for franchise customers that incorporate the minimum requirements specified in the codes. Utilities may, however, include more advantageous or additional provisions in their standard contracts as long as they are not inconsistent with the Act or any of the codes. The ICRC must approve standard customer contracts and any subsequent changes to them.

Transitional arrangements

Licences issued under the Electricity Supply Act and the Gas Supply Act will continue to apply until 1 July 2001. In the meantime utilities licensed under those Acts and the Territory's water and sewerage utility have been given a temporary exemption from the requirement to hold a licence under the Utilities Act. The exemptions will remain in force until 1 July 2001 by which time the new licences will have been issued.

Gas retail prices

A reference to determine gas retail prices was issued on 22 March. The draft determination was released in April and the consultation phase finished on 21 May. The final report is expected on 30 May. The draft determination provides for residential rates to fall by up to 8 per cent in real terms and business rates to fall by up to 11 per cent in 2001–02. Pensioners will benefit by an additional $5 rebate, taking the total rebate to $19 in 2001–02. In the following two years the rate will be CPI–1.

ACTION prices

The final report on ACTION bus prices was released on 18 May. The draft determination argued for a real price increase of 2 per cent over the first of a possible three-year price path. The determination recognised that significant progress had been made in delivering efficiencies but considered that more could be achieved by clarifying the Government's demands of ACTION, with consequential clarification of the funding arrangements for ACTION and operational adjustments such as achieving a higher level of fare box recovery.

Taxi fares

The final report of the inquiry into taxi fares is due by 30 May. The draft determination argued for no real movement in fares for 2001–02. The draft determination also outlined a new approach to the method of setting taxi fares and recognised that the taxi industry was subject to significant change over the next year, which argued against a longer than one year price path at this time. The ICRC anticipates returning to taxi prices during 2001–02 to set a longer term price path from 1 July 2002.

Further information is available either on the ICRC website or from Ian Primrose on ian.primrose@act.gov.au or (02) 6205 0779.

New South Wales

Independent Pricing and Regulatory Tribunal (IPART)

Energy licensing

Amendments to licence conditions

The *Electricity Supply Amendment Act 2000* amended electricity retail and distribution licences to facilitate the introduction of full retail contestability. The new licence conditions cover:

- compliance with IPART's determination of electricity retail prices;
- compliance with IPART determinations on capital contributions;
- payments to the Electricity Tariff Equalisation Fund;
- compliance with the market operation rules;
- compliance with the Marketing Code of Conduct;
- membership of an approved electricity industry ombudsman scheme; and

- minimum contractual provisions for negotiated contracts offered to small retail customers.

The Gas Supply Amendment (Retail Competition) Bill 2001 is currently before Parliament.

The Bill provides for:

- a guaranteed right of supply under a standard customer supply contract to certain classes of customers, and access to an ombudsman scheme; and
- adoption of market operations rules and a marketing code of conduct.

Annual compliance report

IPART has released its report on compliance by electricity businesses with their licence conditions during 1999–2000. IPART will shortly confirm licence compliance reporting requirements for 2000–01.

Review of energy licence operation and administration

IPART has commenced a review of the operation and administration of energy licences in NSW. Under the terms of reference from the Minister of Energy the review will advise on changes to administrative arrangements or licence conditions required to ensure improved compliance with Government policy. The review is to be completed by May 2002.

Electricity

Retail price review

In December 2000 IPART released its determination on regulated retail prices from 1 January 2001 to 30 June 2004 for customers consuming less than 160 MWh per year. This determination sets regulated retail prices for customers who cannot choose their electricity retailer. It also sets a regulated price that small customers may remain on, or return to, when they are eligible to enter the competitive market.

Electricity prices for most small businesses will remain unchanged or rise only slightly until the middle of 2004. The regulated price for domestic customers will not increase in real terms over this period.

Ring fencing

IPART released a discussion paper and draft guidelines in September 2000. It proposed legal separation (with separate directors), physical separation of offices and information systems, and a rigorous compliance program. Submissions are on IPART's website and a roundtable was held in December. IPART hopes to release a second draft report and guidelines in May 2001, before finalising this review.

Pricing principles

The final pricing principles and methodologies were released on 28 March 2001. Concurrently IPART notified its intention to reinstate part E of chapter 6 of the code, effective from 1 July 2001. IPART's pricing principles and methodologies will immediately replace part E of chapter 6.

IPART intends to publish its first price and service report before June 2001, providing comparative indicators of price and service across the NSW distribution network service providers.

Capital contributions

The *Electricity Supply Amendment Act 2000* gave IPART the powers to issue a capital contributions determination. IPART will issue a draft determination around July and will call for public submissions.

Demand management and network investment

IPART has started an inquiry into 'Demand management and the provision of electricity network services'. The draft terms of reference published on 20 March 2001 require IPART to examine the feasibility of a wide range of demand management and distributed generation options and the institutional, regulatory and market barriers which may reduce the take-up of these options. Following receipt of comments by 9 April 2001 the terms of reference will be finalised with the Premier.

Gas

AGLGN's proposed associate contract

On 7 March 2001 IPART released its decision and a statement of reasons on AGL gas network (AGLGN) application for approval of associate contract with AGL Energy Sales and Marketing Limited (AGL ES&M). The application was submitted on 5 October 2000 in the form of a deed between AGLGN and AGL ES&M. IPART approved the proposed associate contract, revised to reflect AGLGN's withdrawal of its application for approval in so far as it related to 36 sites no longer relevant.

The deed documented several contracts that deal with price and non-price variations to various delivery points that had not been submitted to IPART for approval before entering into contracts. IPART views breaches of this kind most seriously. They accordingly sought and received formal undertakings from AGLGN to strengthen future compliance with code provisions dealing with associated contracts.

IPART is also preparing guidelines to assist parties in submitting associate contracts for approval. A discussion paper incorporating draft guidelines will shortly be released for comment.

Tariff review — AGL

On 19 February 2001 IPART released its final decision on retail prices for residential and small business gas consumers supplied by AGL Retail Energy (AGLRE). In the three-year transition to a fully competitive retail gas market IPART and AGLRE have agreed on a set of voluntary pricing principles and a tariff plan up to 2003–04.

Under the agreement the maximum increase in the annual bill for residential gas customers will be $15 or 3 per cent above the CPI. Customers will also pay for approved costs associated with introducing retail competition. As for electricity, customers who do not want to enter the competitive market can stay on the prices established under these voluntary pricing principles during the next three years.

Water

Urban water

In December 2000 the NSW Minister for Energy requested that IPART conduct a review of system performance standards and customer contract for Sydney Water Corporation. The review has been completed and a report provided to the Minister. As part of this review IPART commissioned an independent study of system performance standards from Halcrow Management Sciences Ltd.

The review of customer contract conditions is to be completed by 25 October 2001. An issues paper for the review will be released in late May.

Bulk water

IPART has started a review of bulk water prices. The first step was the receipt of a submission from the Department of Land and Water Conservation (DLWC). In their submission DLWC has requested maximum price increases of 20 per cent per year over the period to 2003–04. Submissions were due on 11 May and hearings will be held in June/July.

Transport

Annual transport determination

IPART is conducting an investigation into the determination of maximum fares for government-owned urban passenger transport. The two service providers, the State Rail Authority (SRA) and the State Transit Authority (STA) have submitted proposals for average fare increases of 3.3 per cent and 9.3–11.2 per cent respectively for 2001–02. STA has also proposed a medium-term price path under which average fares would increase by 35 per cent (in real terms) over four years. Public hearings will be held on 20 April.

Social costs and benefits of public transport

A report by the Centre for International Economics (CIE) reviewing the social costs and benefits of public transport was released in March. This followed the release of the consultant's draft report to stakeholders and a forum on the draft report with stakeholders. The report is part of IPART's longer term work program in transport but it has invited comments on the report as part of both its annual determination of public transport fares and the future directions review.

Cross industry

Quality of service

In March IPART released a cross-industry discussion paper on quality of service prepared by the Allen Consulting Group. Comments are due by 18 May. The paper examined the issues in the linkage of quality of service and the economic regulation of utilities through minimum performance requirements and/or performance-based regulation.

The paper highlights that information on consumer preferences on quality of service and the cost of achieving various levels of quality are important inputs. CIE has been commissioned to review various approaches to assessing customer preferences. The CIE discussion paper is expected to provide guidance on the merits of the various approaches to assessing customer preferences and an appreciation of the uncertainties surrounding such studies.

Transfer pricing

Linking into the ring fencing work under way in the electricity industry, a cross-industry project was initiated to look at transfer pricing for inter-entity and intra-entity (regulated and non-regulated activities) transactions. A range of options for transfer pricing methodologies will be assessed, including those prescribed by overseas regulators of monopoly businesses and used in inter-jurisdictional tax transactions. A discussion paper will be produced by IPART in the first half of 2001.

All reports and documents mentioned can be downloaded from IPART's website.

Tasmania

Tasmanian Electricity Regulator (OTTER)

The regulatory structure for Tasmania's electricity supply industry is largely modelled on the NEM institutional arrangements. The regulator has code administration and enforcement responsibilities as well as the responsibilities of a jurisdictional regulator for distribution and pricing for tariff customers.

The Tasmanian Electricity Code has institutional arrangements to support the regulator through a code change panel, a reliability and network planning panel and the customer consultative committee.

Pricing

The distribution network service provider, Aurora Energy, is continuing to work on the development of distribution tariffs in consultation with the regulator. The objective of this project is to ensure that Aurora is well placed before the introduction of retail competition to assess the viability of its products.

The regulator received the first set of regulatory accounts from the network service providers in December 2000.

The current determination of maximum prices for regulated electricity services will expire on 31 December 2002. The regulator intends to issue a discussion paper on the declaration of regulated electricity services in April 2001 as the first step in the 2002 price investigation.

Code Change Panel (CPP)

Alignment of the Tasmanian Electricity Code (TEC) and the National Electricity Code (NEC)

The CCP has considered a code change proposal from the regulator proposing changes to align the TEC with changes made to chapters 4 and 5 of the NEC. The CCP has recommended to the regulator in favour of the proposed TEC changes.

Vegetation clearance code

The regulator submitted to the CCP, as a code change proposal, a draft code of practice for clearance of vegetation around distribution powerlines. The CCP determined that the proposal should proceed to consultation.

The CCP has decided to establish a consultative committee with the role of advising the CCP as to the consultative process for the draft code of practice. Widespread public interest in the code of practice is anticipated.

Customer Consultative Committee (CCC)

The committee's working group on proposed amendments to the Electricity Supply Industry (Tariff Customers) Regulations 1998 convened to consider a proposed amendment to the regulations dealing with customer privacy.

Licences

The regulator has determined that he will issue a generation licence to Energy Equipment Pty Ltd for a 20 MW generating plant in northern Tasmania to be fuelled by green waste.

Industry structure and ongoing reform

Basslink and the Tasmanian natural gas project

Energy reform continues to be a major priority for the Tasmanian Government, with both Basslink and the Tasmanian natural gas projects continuing through the commercial development process.

- The final route for Basslink has been identified and Basslink Pty Ltd is completing environmental studies and preparing to lodge its environmental impact statement to the joint advisory panel for consideration. Basslink is expected to be completed and operational by mid to late 2003 (see <http://www.basslink.com.au>).
- Duke Energy International (DEI) has confirmed Duke Energy Board approval for, and identified the customer base to support, the $380 million Tasmania natural gas project. Construction will commence during 2001, pending finalisation of environmental, licensing and regulatory approvals (see <http://www.duke-energy.com>).

The development of regulatory regimes for these projects has also been a significant priority.

- The Energy Markets Branch of the Department of Treasury and Finance coordinated the finalisation of Tasmania's NEM entry framework (Tasmania's participation in the NEM is dependent on Basslink and the approval of transition arrangements) and submitted aspects of the framework to the ACCC for authorisation under part VII of the Trade Practices Act. The authorisation package, including an information paper that explains the reform framework, is available on the ACCC's website.
- The legislative framework for the development of a natural gas industry in Tasmania has also progressed, with the passage of the *Gas Pipelines Act 2000* and associated legislation. Work is continuing on the development of regulations under the principal Acts.

Government Prices Oversight Commission (GPOC)

Bulk water pricing investigations

Preliminary work has commenced for the 2001 investigation of the pricing policies of the State's three bulk water suppliers, Hobart Regional Water Authority, Esk Water Authority and North West Water Authority. The GPOC intends to release for comment a draft report early in May 2001 and submit a final report to the Treasurer, the Minister and the three water supply authorities by the end of June 2001.

Fuel price monitoring

In 1999 the Treasurer requested GPOC to monitor the average retail prices of certain petroleum products in Tasmania. Monthly reports have been published since October 1999.

There was very aggressive discounting in retail petrol price soon after Liberty commenced operations in Glenorchy in August 2000. The heavy discounting appeared to have eased between December 2000 and February 2001. Competitive pricing was again observed in the south of the State following the reduction in excise on 1 March 2001.

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Queensland

Queensland Competition Authority (QCA)

Water

The major focus of the QCA in respect of the water sector is still the investigation into the pricing practices of the Gladstone Area Water Board (GAWB). The QCA has prepared an initial report on the

progress of the investigation and the following papers for public consultation:

- a draft paper outlining the projected demand for the GAWB's water over a 20-year period;
- an issues paper addressing the proposed pricing framework for monopoly pricing oversight of the GAWB (GAWB: framework for the pricing of monopoly business activities);
- an issues paper outlining the proposed building blocks for the price determination (GAWB: elements of the pricing framework).

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Local government

The QCA has completed its third review of Queensland local governments' implementation of competition policy reforms to recommend the levels of payments to councils under the Local Government Financial Payments Scheme. Recommendations for payment have been submitted to the relevant Ministers.

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Competitive neutrality

The QCA has completed investigations of three complaints against ENERGEX. In two matters it has concluded that the complaints did not breach the principle of competitive neutrality as defined under the *Queensland Competition Authority Act 1997*. In a third matter, it has concluded that certain regulatory arrangements, related to public and employee safety, breached the principle of competitive neutrality and has submitted recommendations to the relevant Ministers to remedy those.

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Rail

The QCA scheduled a meeting of interested parties on 22 March 2001 to discuss issues associated with the development of its final decision on QR's draft undertaking, the finalisation of an undertaking by QR in a form that is acceptable to the QCA and the approach that should be taken to develop QR's standard access agreement.

Further meetings of interested parties may be convened in May 2001 following the QCA's analysis of submissions in response to its draft decision. The closing date for submissions was 31 March.

Copies of the draft decision, all papers released by the QCA on its consideration of QR's draft undertaking, as well as public submissions received in response to the papers, are available on its website at <http://www.qca.org.au>.

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Gas

The *Gas Pipelines Access (Queensland) Act 1998* gives effect to the National Third Party Access Code for Natural Gas Pipeline Systems. The code and the legislation provide that the QCA is the relevant regulator for approval of access arrangements for natural gas distribution systems in Queensland.

In accordance with the requirements of the code, the two major distribution network owners, Allgas Energy Limited and Envestra Limited, have submitted proposed access arrangements and access arrangement information to the QCA for approval. (For more detailed information see *Network*, issue 6.) After calling for public submissions on 17 November 2000, the QCA's draft decision was released by the end of March 2001. Non-confidential submissions are available on the QCA's website at <http://www.qca.org.au>.

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Electricity

The QCA's final determination on the regulation of electricity distribution was released in May 2001. It established an incentive regulation regime for Queensland's distribution network service providers (DNSPs) based on a four-year regulatory period with revenue caps incorporating a CPI–X roll-forward mechanism. This approach is the same as that proposed in the draft determination released in December 2000.

An annual aggregate revenue requirement (AARR) for each of Queensland's DNSPs (ENERGEX and Ergon Energy) was calculated using a traditional building block approach.

The depreciated optimised replacement cost (DORC) method was used to value the DNSPs' prescribed assets (those assets and services subject to regulation), other than for easements which were valued at historic cost. An allowance for working capital was also included in the regulated asset base.

A post-tax nominal weighted average cost of capital (WACC) of 8.05 per cent was used to determine an appropriate return on the DNSPs asset base. This includes an expected inflation rate of 2.08 per cent and the use of a 20-day trading average of the 10-year Commonwealth bond rate to derive the risk free rate of 5.36 per cent.

A straight-line method of depreciation was used to depreciate assets.

The DNSPs' operating costs include an allowance for demand growth and inflation as well as for efficiency improvements. A relatively conservative efficiency factor has been applied in recognition that ENERGEX is already at the forefront of Australian best practice and Ergon is in a state of considerable change and that the true efficiency of the combined entity is difficult to estimate at this time.

The unadjusted AARR's that were calculated for the two DNSPs were significantly higher in 2001–02 (the first year of the regulatory period) than 2000–01. The magnitude of this increase reflected decisions made under previous regulatory regimes which held down prices and therefore revenues for both DNSPs.

The QCA considered that the implied price changes that would accompany this increase in revenue, if implemented in a single step, would not be in the interests of the community. Consequently, it determined to share the burden of adjustment between the distributors (and their owners) and consumers by spreading the adjustment over the regulatory period.

The final determination, non-confidential submissions, and relevant reports are available on the ACA's website.

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Northern Territory

Utilities Commission

Regulated electricity networks

In determining the revenue caps for 2000–01 and the 'X' factors to apply in 2001–02 and 2002–03, the Commission indicated that it would permit adjustments for the purpose of setting the 2001–02 and 2002–03 caps in specific circumstances, notably any substantial change in either planned capital expenditure or trend energy sales growth. The Commission is currently evaluating data provided by the Power and Water Authority networks for this purpose. The revenue caps for the coming financial year will be endorsed by 1 April 2001, with approval of the network tariffs to apply in the 2001–02 financial year expected by end-May.

Darwin–Katherine transmission line

The Commission is continuing its consultative processes on matters arising from PAWA's purchase of the Darwin–Katherine transmission line (DKTL). Submissions in response to the issues paper issued on 1 February 2001 have been received. The Commission is evaluating these submissions and will shortly publish its response and proposed methodology for incorporating the DKTL into PAWA's network prices from 1 July 2001, including the DKTL's value for regulatory purposes.

CSO payments

The Commission is in the process of finalising its valuation of the CSOs provided by PAWA, (especially those resulting from the Government's policies of uniform (franchise) retail tariffs across the Territory and a below-cost (franchise) retail price cap in Darwin).

Out-of-balance (OOB) energy pricing

Revised arrangements to improve the efficiency of supply and pricing of OOB energy are to be put in place. The revised code will allow for final detailed arrangements to be negotiated and agreed up till 1 July 2002.

Load forecasting

The Electricity Reform Act requires the Commission to monitor and report on system capacity, including an annual review of trends in system capacity and reliability relative to forecast growth. The Commission is currently meeting with electricity businesses and other interested parties for initial discussions on the issues involved and the availability of data. It is anticipated that the report will be finalised by 30 June 2001.

Ring fencing

Submissions to the Commission's draft replacement ring fencing code have been received. The Commission is currently considering the issues raised in these submissions and is on target to finalise the replacement code by 1 April 2001, for commencement from 1 July 2001.

Water and sewerage

The Water Supply and Sewerage Services Act which took effect on 1 January 2001 provides for a transitional period whereby licensing is not required until 12 months after the commencement of the Act. The Commission has agreed to defer consideration of licence applications until the various technical and management codes required under the legislation are nearing completion. A timetable has been put in place, with a view to finalisation by the end of 2001.

Contributing to *Network*

If you are interested in providing an article to be published in *Network*, please contact Katrina Huntington on (03) 9290 1915 or email to: katrina.huntington@accc.gov.au.

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