REGULATORY ACTIVITIES

Contents

Overview

The Commission promotes competitive conduct in network industries and, if competition is not possible, seeks to restrain monopoly pricing and other abuses of market power. The principal barrier to competition in these industries and the source of their market power is their reliance on facilities with natural monopoly characteristics. These are the essential infrastructure facilities such as telecommunications networks, electricity and gas transmission, interstate rail networks and airports.

The Commission is responsible for the economic regulation of services provided by some of these facilities. Under Parts IIIA and XIC of the Trade Practices Act, and associated codes, the Commission regulates third party access to some essential facilities. This enables access seekers, such as telecommunications carriers and electricity generators and retailers, to gain access to the network services. Efficient regulation of these bottleneck facilities is necessary to promote competition in upstream and/or downstream markets.

The Commission also administers Part XIB of the Trade Practices Act, which deals with anti-competitive conduct in the telecommunications industry. It also assesses price notifications of declared services, and monitors costs, prices and profits, under the Prices Surveillance Act, and administers the Postal Corporation Act.

Major decisions

This year the Commission released several major decisions in the industries for which it has regulatory responsibility. A series of changes to the National Electricity Code were assessed, covering areas such as ancillary services arrangements, full retail competition, aspects of Tasmanian NEM entry, the participation of market network service providers in the NEM, and network planning and development. The Commission also released its revenue cap decision for the Queensland electricity transmission network.

In gas, final decisions for the Moomba to Adelaide pipeline system, Ballera to Mt Isa and Roma to Brisbane pipelines were released. The Commission also released final approvals for the Wallumbilla to Rockhampton and Ballera to Wallumbilla pipelines.

In rail the access undertaking submitted by the Australian Rail Track Corporation was accepted. Covering access to interstate rail track, this is the first rail access undertaking accepted by the Commission.

In airports the Commission released its Virgin Blue access determination, deciding not to apply access regulation to the domestic express terminal at Melbourne airport.

The Commission also considered Adsteam's harbour towage price notification, objecting to its proposal to increase prices for harbour towage services at Australia's six main container ports.

The Commission completed its report to the Treasurer into fuel price variability in December 2001.

In telecommunications the Commission released a range of draft, final and revised pricing papers, informing the telecommunications markets of the Commission's thinking on likely indicative prices and the methodologies and principles that it uses in making price decisions.

During the year 19 arbitrations were resolved—the Commission issued two final determinations, 16 matters were withdrawn and in one matter the Commission's jurisdiction was not established.

Other major developments

Throughout the year the Commission continued developing efficient regulation in network industries. It released the *Post-tax revenue model and handbook* in October 2001, which explains how the Commission applies the model in its regulation of various utilities. In June 2002 the Commission released the *Draft greenfields guideline for natural gas transmission pipelines*. This is a guide to the access regulation framework and contains options for new natural gas transmission pipeline developments in Australia. Several telecommunications pricing papers were also released during the year. They informed the market of the Commission's thinking on likely indicative prices and the methodologies and principles that it uses in making price decisions.

Work commenced during the year on setting revenue caps for the Victorian and South Australian electricity transmission networks. The Commission assumes regulatory responsibility for these transmission networks from 1 January 2003. Work also began on assessing the proposed increase in the price of assorted postal services, including the price of the basic postage stamp.

Reviews

Much of the framework governing the Commission's regulatory work has recently been reviewed, or is currently being reviewed. The Productivity Commission has reviewed the Prices Surveillance Act, Part IIIA of the Trade Practices Act, the telecommunications-specific competition regulation (including Parts XIB and XIC of the Act) and the airport price oversight arrangements. The Council of Australian Governments (COAG) has also established a review of future directions in the electricity and gas markets. As the declaration of the harbour towage service expires in September 2002, the Productivity Commission is reviewing the prices oversight arrangements.

While the Commission is largely responsible for telecommunications, airports, postal services and liner shipping conferences, the states and territories retain important roles in electricity,

gas, rail and waterfront regulation. Therefore, it is essential that the regulatory approaches by the Commission and state and territory regulators are consistent. The Utility Regulators Forum, a committee of all Commonwealth, state and territory regulatory agencies, was established to do just that and met several times during the year.

The Commission also participates in international regulatory policy forums of the OECD and IEA and monitors overseas developments in regulatory policy.

Reforming Australia's Energy Markets: ACCC submission to the Energy Market Review

Last year COAG initiated an independent review of Australia's energy markets—the Energy Market Review. The terms of reference are wide ranging, covering both gas and electricity. The Commission prepared a submission for the review, arguing that the energy reform process initiated by COAG in the 1990s is now stalling and that fundamental changes are required to capture the full potential of the NEM.

The reforms introduced by COAG are delivering benefits with a trend to more efficient electricity pricing, improved service standards and substantial new investment. However, electricity markets are not as competitive as they could be and in some circumstances generators continue to have significant market power.

The submission proposes various reforms to make the electricity market operate more effectively. They are:

- new entry and/or further structural reforms
- completion of the move to full retail contestability and the roll out of interval based meters
- further investment in transmission between the states (and supporting intra-state transmission).

These reforms are expected to increase competition between generators, both within states by increasing the number of competing generators, and between states through increased interconnection. The reforms will also facilitate demand-side participation (where users can respond to peak prices and other price signals).

The Commission made the following key observations about the Australian gas industry:

- There is a continuing role for regulation of non-contestable gas transmission pipelines to provide the necessary framework for an Australia-wide and integrated gas network.
- The Commission's role is to help develop the market by ensuring fair and open access to these pipelines.
- For regulated assets, the Commission seeks to balance the interests of service providers and users by providing a framework that will encourage efficient investment and provide long-term benefits to the economy.
- Reform of the upstream sector can be addressed by promoting new upstream entrants, further pipeline interconnections and the expiry of existing contractual arrangements.

The submission is available on the Commission's website.

Electricity

Significant events during 2001–02

During the year the Commission's regulatory work in the electricity sector increased. Additional resources, as part of the increased funding which the Commission received commencing in 2001–02, resulted in an improvement in the electricity group's outputs.

Much of the work during the reporting period concerned finalising a backlog of code changes and commencing assessments for new code change proposals. Details of this work are described on page 94. Work began on the assessment of revenue determinations for the transmission businesses of SPI Powernet, Electranet SA and VENcorp. Work was also undertaken for inclusion in the preparation of a submission to the COAG's Review of Energy Markets Directions.

Key work undertaken during 2001–02 included:

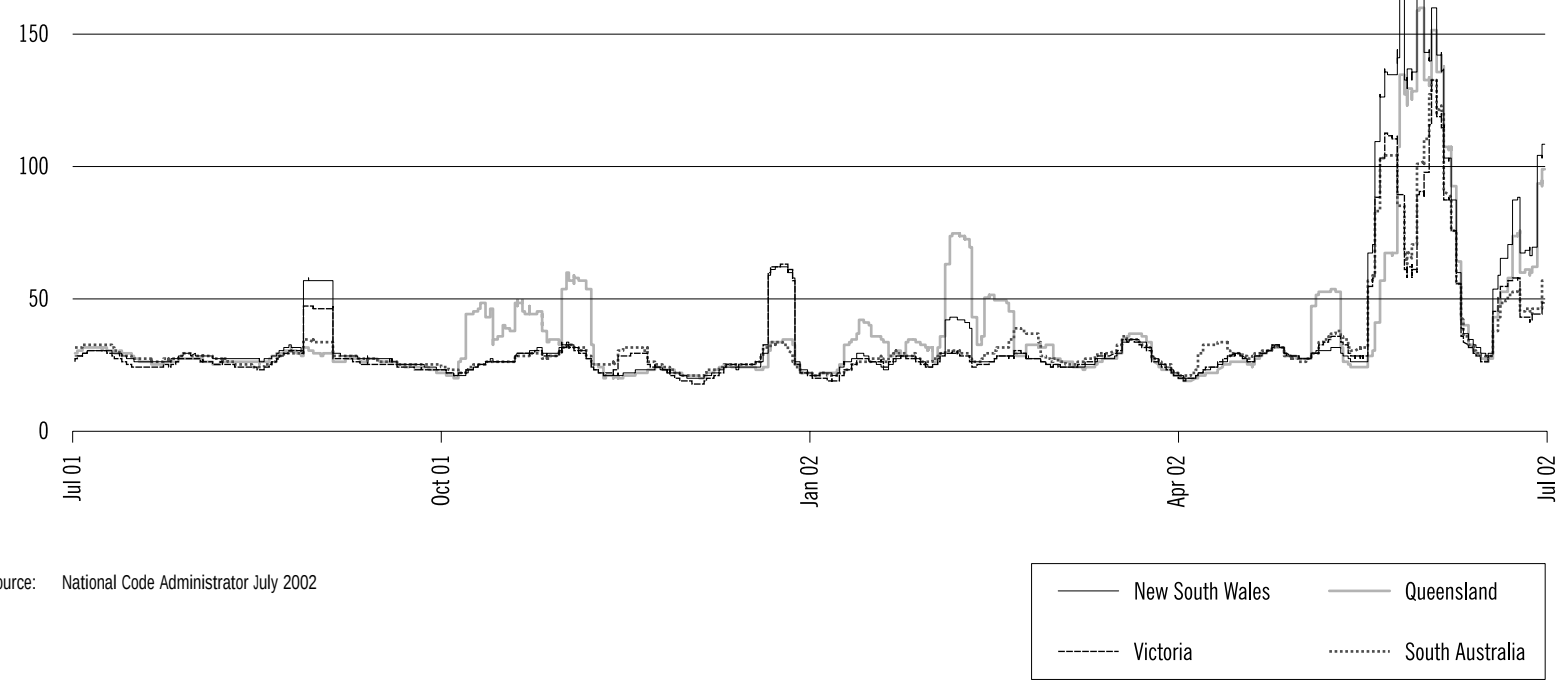
- finalisation of the network and distributive resources code changes that introduced significant realignment of network planning responsibilities and their regulatory oversight
- authorisation of the code changes introducing a spot market for ancillary services
- commencement of work on the *Principles for the Regulation of Transmission Revenues*
- commencement of work on the development of service standards and incentive mechanisms for transmission networks to better reward networks and make them more accountable for network performance
- commencement of the regulatory resets for the transmission businesses of SPI Powernet, (Victoria), VENcorp (Victoria) and Electranet (South Australia)
- assessment of revenue pass-through events for Electranet under the South Australian Electricity Pricing Order, SPI Powernet under the Victorian Tariff Order and the revenue determination for Powerlink Queensland
- development of a discounting guideline for prudent transmission price discounts and the subsequent assessment of several proposals
- submission to the Review of Energy Market Directions
- code changes dealing with dispute resolution, extension of technical derogations
- holding a forum on market power and rebidding in the national electricity market.

Review of the performance of the national electricity market

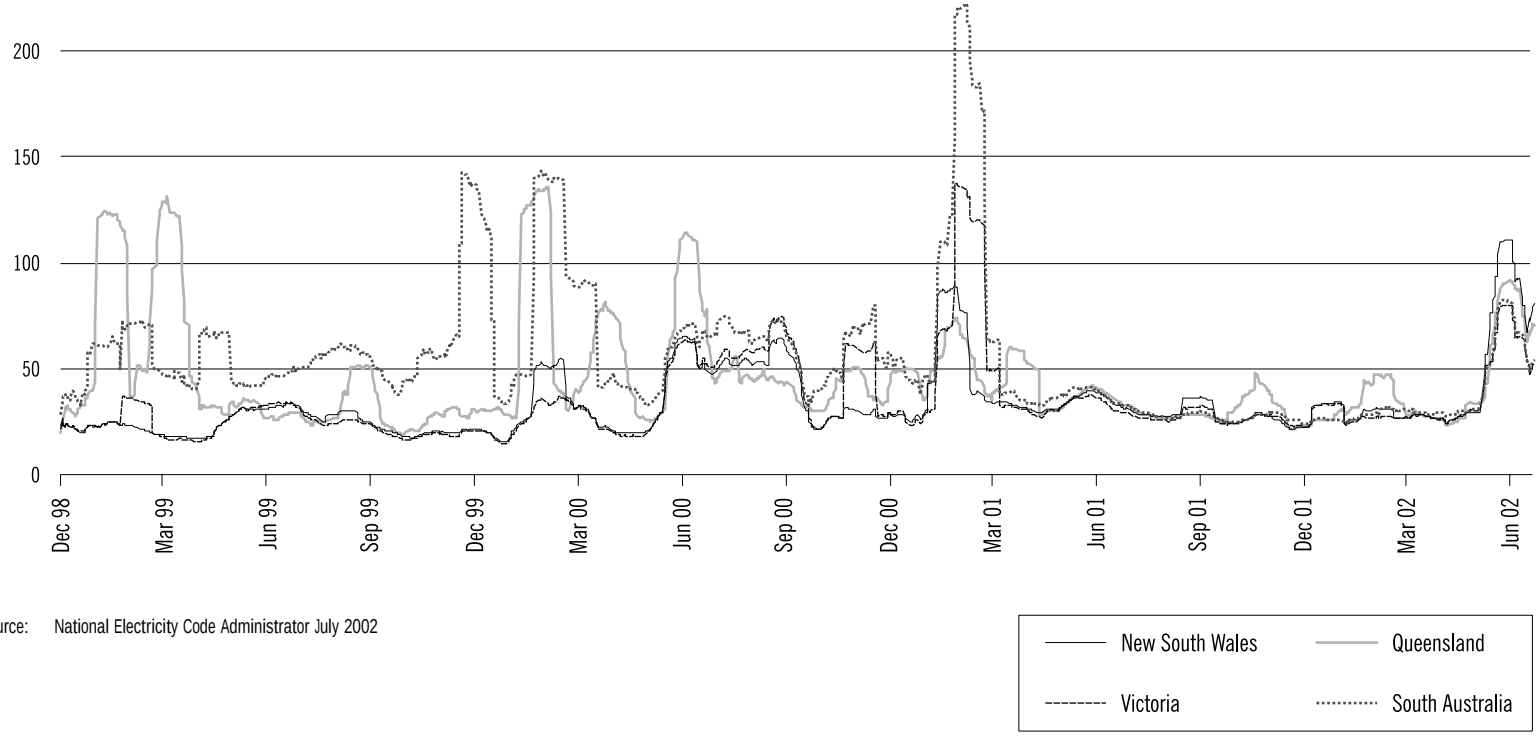
During 2001–02 debate continued about the operation of the electricity market. Concerns were raised about the performance of the market regarding the perceived high level of price volatility in the spot market associated with the introduction of the ancillary services market. Expected high prices over summer 2001–02 did not materialise, perhaps due to mild weather and changes in the contract positions of market participants. However, in May 2002 there was a marked increase in pool price volatility, resulting in an overall increase in the average price for the financial year. The following graphs indicate average spot market prices both over the financial year and since the commencement of the market in December 1998.

The graph for the financial year shows that prices were generally stable leading up to May 2002. Mild summer weather coupled with improved plant availability and the contracting positions of market participants militated against a recurrence of the pricing levels experienced in the summer of 2000–01. However since May, there has been a substantial increase in pool prices.

The Commission is closely watching the performance of the market to determine whether efficient outcomes are being achieved and the extent to which market power is being exercised.



Source: National Code Administrator July 2002



Source: National Electricity Code Administrator July 2002

As discussed elsewhere, the Commission believes that the electricity market is at a crossroad in its development. For further gains to be made there must be greater demand side participation. Consideration is needed for more efficient pricing of the use of the existing transmission system and to guide its future augmentation.

Authorisations

Amendments to the National Electricity Code

The Commission received a number of applications for authorisation from the National Electricity Code Administrator (NECA) proposing amendments to the National Electricity Code.

Ancillary services

On 23 August 2000 NECA lodged applications for authorisation to enable the introduction of new ancillary services arrangements in the NEM. The proposed arrangements introduce a market-based system for procuring ancillary services, and where possible, introduce a 'causer pays' regime for cost allocation among market participants.

The draft determination was released on 2 April 2001 and the Commission held a pre-determination conference in May before releasing the final determination approving the proposed code changes on 11 July 2001.

Full retail competition

On 11 August 2000 NECA applied to the Commission for authorisation of amendments to the code. These changes facilitated the introduction of full retail competition (FRC), and amended the procedures for registering code participants. NECA amended that application on 17 August 2000 to rectify typographical errors.

The FRC code changes introduced transitional arrangements for metering to recognise the existing domestic metering infrastructure. The changes also require jurisdictions to appoint a metrology coordinator responsible for developing procedures to help convert metering data into a format suitable for use in the current wholesale market settlements system.

The Commission granted conditional interim authorisation to the proposed arrangements on 20 September 2000. In response to concerns regarding the conditions, the Commission revoked and regranted the interim authorisation on 27 October 2000. The Commission released its draft determination on 11 April 2001 and a pre-determination conference was held in Canberra on 29 May 2001. The Commission then released its final determination on 1 August 2001 granting conditional authorisation to the proposed code changes.

Victorian FRC derogations

On 19 March 2001 the Commission received applications from NECA, on behalf of the Victorian Government, for authorisation of amendments to the derogations contained in chapter 9 of the code. The proposed derogations relate to the metering arrangements of chapter 7 of the code.

The Victorian Government applied to amend the derogations contained in chapter 9, in conjunction with the introduction of full retail competition in Victoria.

The Commission released its draft determination on 4 July 2001, and granted conditional interim authorisation to the derogations that related to their end date.

At a pre-determination conference held on 20 July 2001, the Commission considered the issues raised by interested parties before releasing its final determination on 8 August 2001 granting conditional authorisation to the proposed code changes.

Inter-regional TUOS, treatment of losses, PASA, demand-side participation, end user advocacy and pricing under extreme conditions

On 8 December 2000 the Commission received applications from NECA to authorise a package of code changes that included:

- extending the current moratorium on inter-regional transfer of transmission use of system (TUOS)
- minor changes to the treatment of losses
- improvements to PASA (projected assessment of systems adequacy) regarding the availability

of network and generator availability information

- making demand-side bidding more attractive to customers by removing perceived barriers to their participation
- clarifying pricing under extreme conditions
- changes in establishing an advocacy panel and the funding of end user advocacy.

The Commission released a draft determination on the proposed changes on 6 June 2001 and a pre-determination conference was held with interested parties on 19 July 2001, mainly to discuss the code changes relating to end user advocacy. It released its final determination on 19 September 2001 granting conditional authorisation.

Network pricing and market network service providers

On 21 September 2001 the Commission released its determination on NECA's application for authorisation of proposed changes to the code covering network pricing and market network service providers.

The changes aimed to accommodate the introduction of a new pricing methodology for the use of the transmission network and for the entry of market network service providers (MNSPs) to the NEM, by allowing the MNSPs to earn their revenue from participating in the wholesale spot market rather than levying network charges. The code changes set out safe harbour provisions that allow a market network service to be automatically approved if it meets specified criteria. This allows MNSPs to operate in the NEM without price regulation. The Commission authorised NECA's proposals.

Queensland technical derogations

On 24 October 2000 the Commission received applications from NECA to authorise amendments to the code to extend the end dates of eight derogations to 31 December 2002. The derogations originally terminated on the date of the commissioning of the Queensland–New South Wales interconnector (QNI). The proposed changes also clarified the definitions in the Queensland derogations.

NECA asked the Commission to consider these applications as soon as possible, to ensure that QNI could meet Queensland's increased energy demands over the 2000–01 summer period.

On 6 December 2000 the Commission granted conditional interim authorisation to the applications. The Commission released its draft determination on 12 September 2001 and granted conditional authorisation to the code changes on 3 October 2001. The condition ensured that NEMMCO would determine security risks to systems outside Queensland in the period after QNI was commissioned.

Averaging loss factors in distribution networks

On 20 March 2001 NECA applied to the Commission to authorise changes to the code to allow distribution network service providers to assign smaller contestable customers to non-physical transmission connection points using an averaged transmission loss factor. The proposal will replace the existing obligation on distribution networks to assign all such customers to physical connection points.

The Commission released its draft determination outlining its analysis and views on the proposed changes on 6 June 2001 and a pre-determination conference with interested parties was held on 19 July 2001.

The Commission released the final determination on 3 October 2001 providing conditional authorisation to the code changes.

Tasmanian NEM entry

The Tasmanian Government has developed an energy reform framework covering two major infrastructure projects and market reforms. An undersea electricity cable (Basslink) and a natural gas pipeline will link Tasmania to the mainland. Tasmania is anticipated to join the NEM in 2003, with a subsequent phased introduction of retail contestability for all electricity consumers. The Commission has been involved in several processes to facilitate Tasmania's energy reform framework.

As part of these arrangements, Hydro Tasmania has entered into an agreement with Basslink Pty Ltd regarding the operation of the Basslink

interconnector. After discussions with the Commission, the two parties advised the Commission that they would not be applying for authorisation of that agreement.

On 13 September 2000 the Commission received an application from NECA to authorise amendments to the code to facilitate the Inter-Regional Planning Committee's (IRPC) consideration of the technical network issues associated with the Basslink interconnector. The Commission released a draft determination on this matter on 6 December 2000 and, in the absence of a request for a pre-determination conference, released its final determination on 24 January 2001.

On 22 November 2000 the Commission received an application to authorise a vesting contract between Hydro Tasmania and Aurora Energy for the non-contestable load and derogations to the code. Following the release of draft determinations the Commission held a pre-determination conference with interested parties on 6 September 2001, issuing the final determination on 14 November 2001, which approved the code changes conditional on a number of amendments.

New South Wales derogations

On 5 October 2001 the Commission received applications from NECA to authorise amendments to the New South Wales derogations in the code. The amendments relate to the metering arrangements of chapter 7 of the code.

For the full benefits of full retail competition to be realised, it is important to operate in an environment that allows customers to choose their retailer. The Commission also considers that allowing LNSPs to have temporary exclusivity in meter provision would simplify the process for customers who choose to switch retailers, and would minimise disruption to the metering data systems.

The Commission released its draft determination on 12 December 2001, granting interim authorisation to facilitate the transition to full retail competition due to begin in January 2002. No pre-determination conference was called and on 23 January 2002 the Commission released its final determination. The implication of this decision is that all metering services, including meter ownership and installation, meter reading, and metering data agency will become contestable at the end of the derogation, unless the jurisdictional review determines otherwise for meter ownership.

Prudential arrangements: security deposits

On 22 October 2001 the Commission received applications from NECA to authorise amendments to the code affecting how market participants can respond to the code's prudential requirements.

To satisfy the prudential arrangements, market participants previously had to seek credit support, in the form of a bank guarantee, from an entity that satisfies the code's acceptable credit criteria.

The code changes formalise the existence of a security deposit fund for prudential requirements, and allow market participants to call on cash deposits rather than costly bank guarantees if they need extra funds to meet their prudential requirements. The code changes also spell out the rights and responsibilities of NEMMCO and market participants under the changes.

On 2 January 2002 the Commission released its draft determination of the proposed arrangements. No pre-determination conference was called and on 6 February 2002 it released its final determination approving the proposed arrangements.

Network and distributed resources

On 20 December 2000 the Commission received applications from NECA to authorise the network and distributed resources code changes concerning network planning and development.

The changes proposed that transmission network service providers (TNSPs) be allocated greater responsibility for justifying and bringing forward new network investments and that the inter/intra regional investment distinction be replaced with a large/small network asset distinction. The changes also proposed improvements to the transparency and information disclosure requirements relating to TNSP's investment programs and that TNSPs must consider non-

network investments as an alternative to regulated network solutions.

On 20 August 2001 the Commission issued its draft determination. A pre-determination conference was held on 13 September 2001 and on 13 February 2002 the Commission decided to grant authorisation, conditional on amendments being made to the proposed code changes. Overall the Commission considers that the changes are an improvement on the existing network planning and approval arrangements as they provide a clearer, more streamlined assessment framework within which new investment is able to occur.

Code dispute resolution arrangements

On 26 July 2001 the Commission received applications from NECA to authorise changes to the code's dispute resolution arrangements.

Under the code NECA is obliged to review these arrangements to assess how effective the old code provisions were.

The changes include clarifying the market participants' role, rights and responsibilities when involved in a dispute, time limits to ensure disputes are resolved quickly and a way of resolving disputes that involve more than two market participants.

The Commission issued its draft determination on 5 December 2001, holding a pre-determination conference on 17 January 2002 and releasing a final determination on 13 March 2002.

In its final determination the Commission granted authorisation on condition that the transition into the new dispute resolution arrangements is improved.

Full retail competition—Mark II

On 10 December 2001 the Commission received applications from NECA to authorise code changes to facilitate the introduction of full retail competition (FRC). The changes relate to NEMMCO's powers to determine a 'declared' project and the market fees required to cover costs associated with that project. In addition, the supplementary code changes relate to the processes for collection and transfer of data to facilitate FRC. The amendments also allow for the deferral until 1 July 2003 of the recovery of market fees relating to the introduction of FRC.

In the supporting submission, NECA sought an interim authorisation of the proposed changes before 13 January 2002 to allow a smooth transition to FRC in New South Wales and Victoria. The Commission granted conditional interim authorisation to the proposed code changes on 19 December 2001. On 3 April 2002 the Commission released its draft determination, and its final determination approving the proposed changes subject to one minor change on 8 May 2002.

Review of technical standards: interim extension of existing derogations

On 15 February 2002 NECA applied for authorisation to extend certain existing technical derogations to the code—existing chapter 8 derogations for South Australia, New South Wales and Victoria. In the cases of South Australia and Victoria, it also proposes amendments to extend their coverage.

Extending the derogations would allow a managed transition to NECA's new technical standards, proposed in its applications for authorisation of technical code changes lodged with the Commission on 3 June 2002.

The Commission released a draft determination on 10 May 2002 and its final determination on 5 June 2002, granting authorisation to the proposed code changes. The authorisation expires on the earlier of 31 December 2004, or 12 months after the revised technical standards are gazetted.

Other code changes currently being considered

Rebidding

On 13 September 2001 the Commission received applications from NECA to authorise code changes to the rebidding rules that would enable NECA to work with NEMMCO and the market to address issues such as inefficiencies contributing to short-term price spikes and generators' bids and rebids.

The changes proposed by NECA will address behaviour that is detrimental to market outcomes. The changes respond to concerns of market power being exercised in the national electricity market (NEM) to influence higher prices.

In the draft determination, released on 3 July 2002, the Commission accepted NECA's proposal that bids and rebids must be made in good faith. However, the Commission did not accept NECA's proposal of 'reverse onus of proof' for conduct prejudicial to the market. The Commission believed the following suggestions would deliver beneficial outcomes while minimising the legal uncertainty of interpretation:

- NECA to consider drafting a specific code change to prohibit economic withholding where it is used to deliberately tighten supply and raise prices
- NECA to consider specific restrictions on bidding of ramp rates if the ability to exercise market power through ramp rates remains a concern
- NECA to consider compulsory but confidential disclosure of contract volume and price information for all generators
- NECA to consider delaying the release of aggregate bidding information, currently released one day after dispatch, to a period of several weeks or months
- NECA to contribute to the Market Review Forum as a mechanism for NEM participants to contribute to debate on topical issues.

The South Australian Minister for Energy, the Hon. Patrick Conlon, called the pre-determination conference in Melbourne on 13 August 2002. Submissions close on 20 September 2002.

Review of directions in the NEM

On 18 February 2002 the Commission received applications from NECA to authorise code changes concerning the review of directions in the NEM.

The power to direct is part of the safety net arrangements in the market, which NEMMCO may use if one of the normal market mechanisms does not function adequately. The current provisions of the code allow for directions to ensure reliability, security and safety of the power system as separate categories of direction.

In accordance with the code, NECA and NEMMCO jointly review directions in the NEM and the code changes implement the conclusions and recommendations of the joint review report.

The Commission received three submissions relating to the code changes and anticipates releasing the draft determination in August 2002.

RIEMNS stage 1

On 27 March 2002 the Commission received applications from NECA to authorise code changes arising from NECA's stage 1 review of integrating the energy market and network services (RIEMNS).

NECA requested interim authorisation for those changes relating to the extension of the settlement residue auction and the development of methodology for forward-looking loss factors.

The Commission received six submissions relating to the code changes.

On 5 June 2002 the Commission granted conditional interim authorisation to the extension of the settlement residue auction arrangements until 31 December 2003, and the provisions requiring NEMMCO to develop a methodology for the calculation of forward looking loss factors. The Commission is in the process of completing the draft determination.

Review of technical standards

On 3 June 2002 the Commission received applications from NECA to authorise amendments to the code relating to the implementation of the recommendations of NECA's review of technical standards in the NEM.

The code changes are aimed at implementing the technical requirements to facilitate access to the power system while maintaining its security and integrity.

The Commission called for submissions addressing the proposed technical standards code changes on 26 July 2002.

The closing date for submissions was 23 August, and the Commission will consider the issues raised by interested parties in submissions as part of the draft determination.

The draft determination is expected to be released in December 2002.

Variations to the NEM access code

On 10 May 2002 the Commission received a request from NECA to vary the approved NEM access code in accordance with s. 44ZZAA(6) of the Trade Practices Act. The variations sought included all provisions of the authorised code not subject to the Commission's approval of the NEM access code granted on 20 January 1999 (including chapter 3 for the first time).

Each of the proposed changes has been the subject of industry and public consultation by the Commission through the code change process. Among the changes that will be included in the NEM access code are 'implementation of VOLL, capacity mechanisms and removal of zero price floor', 'ancillary services', 'full retail competition', 'network pricing and market network service providers' and 'network and distributed resources'.

The Commission expects to release a draft decision in September.

Regulatory work

Murraylink access undertaking

On 6 February 2002 the Commission received an access undertaking from Murraylink Transmission Company Pty Ltd (MTC), under Part IIIA of the TPA. MTC is a market network service provider (MNSP) that proposes to provide access to the Murraylink interconnector, which will be an unregulated link connecting the Victorian and South Australian electricity grids.

The Commission is currently considering the undertaking against the statutory criteria set out in s. 44ZZA (3) of the TPA.

The Commission received submissions from TransGrid and the New South Wales Treasury, as well as the applicant's response to the submissions and a presentation.

The Commission will take these into account in considering MTC's access undertaking, and anticipates releasing a draft decision in August 2002.

Basslink access undertaking

On 25 May 2001 the Commission received an access undertaking from Basslink submitted under Part IIIA of the TPA and the code. Basslink is an MNSP that proposes to build and provide access to the unregulated transmission cables that will connect the Tasmanian and Victorian electricity regions.

Basslink undertakes to make its networks available to code participants and at prices properly determined. While the code includes a specific undertaking for MNSPs (schedule 5.9), this is a recent amendment not yet included in the NEM industry access code that has been accepted by the Commission. Therefore the Commission will assess the undertaking in accordance with s. 44ZZA of the TPA.

At the time the undertaking was submitted, the Commission was also assessing the Tasmanian Government's authorisation application for a vesting contract and code changes to facilitate Tasmania entering the NEM and becoming a member jurisdiction. The Commission thought it was prudent to resolve issues in the Tasmanian authorisation process first so that the framework in which Basslink would operate would be set before its undertaking was assessed. Accordingly, it was decided that the Commission delay assessing Basslink's undertaking until after making a final determination on Tasmania's NEM entry. The Commission expects to release a decision in September 2002.

Regulation of Queensland transmission networks

Under the code, the Commission began regulation of the Queensland transmission network operated by Powerlink from 1 January 2002.

On 14 February 2001 the Commission received Powerlink's application outlining its proposed revenue cap. To help consider Powerlink's application, the Commission engaged PB Associates to review and analyse the assumptions, methodology and findings of a 1999 valuation of Powerlink's asset base and analysed and commented on Powerlink's proposed capital expenditure (capex), operating expenditure (opex) and service standards.

In July 2001 the Commission released its draft decision, which draws on Powerlink's application, PB Associates' reports, submissions from interested parties and other information.

The Commission's final decision was released on 1 November 2001.

The revenue cap was based on:

- an asset base of $2277 million
- a post-tax nominal return of equity of 11.85 per cent
- an X-factor of –6.67 per cent.

Based on these elements of the building block, the Commission derived a smoothed revenue allowance, which increases from $318.50 million in 2001–02 to $347.14 million, to $378.35 million by the next year, then $412.37 million, $449.45 million and $489.86 million by 2006–07. The increase in revenues is largely attributable to Powerlink's extensive proposed capex program.

The Commission recognised the consequential impacts of the 11 September US tragedy on the bond rates and the flow-on effects on the WACC calculations, noting that the Commission's current approach would place them at a considerable disadvantage than if the decision had been made before 11 September. Given the uncertainty, the Commission adopted a 40-day moving average ending on 11 September.

Regulation of South Australian transmission network

On 1 January 2001 the Commission began regulation of the South Australian transmission network, ElectraNet SA.

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 and therefore, until 1 January 2003, the Commission's role is limited to administering transmission-related functions under the EPO. The Commission will not become responsible for setting ElectraNet's revenue cap until 1 January 2003.

On 9 January 2002 ElectraNet applied to pass through discounts relating to its regulated transmission charges for 1 January 2002 to 30 June 2002 ($0.9 million). The Commission approved this application.

The Commission is currently considering ElectraNet's application to pass through discounts relating to its regulated transmission charges for 1 July 2002 to 31 December 2002 ($7.1 million).

ElectraNet also submitted an application on 3 May 2001 to the Commission relating to its transmission charge applying from 1 July 2001 to 30 June 2002. This tariff statement breeched the re-balancing requirements of the EPO and ElectraNet was forced to re-submit its annual tariff statement on 6 June 2002. The Commission approved the new charges as outlined in chapter 6.5 of the EPO.

On 1 January 2003 the Commission will begin full regulation of the South Australian transmission network. As required under the code, the Commission is currently conducting a review to determine the appropriate revenue cap for non-contestable transmission network services provided by ElectraNet for a period of 5 ½ years from 1 January 2003 to 30 June 2008.

On 16 April 2002 ElectraNet lodged an application with the Commission outlining its proposed revenue cap, to be applied to the non-contestable elements of its transmission network. The Commission engaged Meritec to analyse and comment on ElectraNet's opening asset base, the proposed capex and the proposed opex.

The Commission anticipates releasing its draft decision late August 2002 and the final in November 2002.

Regulation of Victorian transmission network

On 1 January 2001 the Commission began regulating the Victorian transmission network, SPI PowerNet and the Victorian Energy Network Corporation (VENCorp). The transmission arrangements are unique to Victoria in that PowerNet is the owner of the transmission assets, while VENCorp is responsible for the planning and augmentation of the transmission network.

The methodologies for determining the revenues and customer charges for PowerNet and

VENCorp are outlined in the Victorian Tariff Order (VTO). Until 1 January 2003 the Commission's role is limited to administering transmission-related functions under the VTO. The Commission will not become responsible for setting PowerNet and VENCorp's revenue requirements under the national electricity code until 1 January 2003.

PowerNet submitted an application on 3 May 2002 for maximum allowable revenue of $129.9 million for the six months from 1 July to 31 December 2002. This represents a decrease of 4.2 per cent from the previous year on a pro-rata basis.

VENCorp submitted an application on 21 May 2002 for a revenue requirement of $258.54 million, representing an increase of about 16 per cent on the previous year (the Commission can make a decision for the 12-month period 1 July 2002 to 30 June 2003 because of the particular interaction of the VTO and the code regarding VENCorp). The Commission approved both applications.

On 1 January 2003 the Commission will begin full regulation of the Victorian transmission network, bearing in mind the special arrangements under the code regarding VENCorp. The code outlines the general principles and objectives for the transmission revenue regulatory regime to be applied by the Commission.

On 11 April 2002 PowerNet lodged an application with the Commission outlining its proposed revenue cap for the period 1 January 2003 to 31 March 2008. The revenue cap is to be applied to the non-contestable elements of its transmission network. To assist in its considerations of PowerNet's application, the Commission engaged PB Associates to analyse and comment on PowerNet's opening asset base, proposed capex and proposed opex.

VENCorp lodged its revenue cap application with the Commission on 12 April 2002. Again, the Commission engaged PB Associates to analyse and comment on VENCorp's proposed opex.

The Commission anticipates releasing its draft decisions in early August 2002 and the final revenue cap decisions in October 2002.

Regulation of the Tasmanian transmission network

As part of its regulatory responsibilities, the Commission is responsible for determining the maximum allowable revenue of transmission businesses participating in the national electricity market. The Commission is now preparing for the commencement of regulation of the Tasmanian transmission business, Transend.

Tasmania is not currently part of the NEM, but will join once the Basslink interconnector between Victoria and Tasmania is commissioned. Commission staff are closely consulting with staff of the transmission business, the Office of the Tasmanian Energy Regulator (OTTER), and the Tasmanian Department of Treasury. The Commission is expected to begin the revenue cap process in the last quarter of 2002.

Draft regulatory principles

The Commission released its draft regulatory principles in May 1999. Since then there have been several developments in the approach to the regulation of network industries. Given the time since the release of the draft, the Commission proposes to finalise the regulatory principles by the second half of 2002.

Guidelines for the negotiation of discounted transmission charges

Clause 6.5.8 of the National Electricity Code refers to Commission guidelines for the negotiation of discounted transmission charges. The code permits a TNSP to recover the amount of a discount to a transmission customer's general and/or common service charges from other transmission customers provided it is satisfied that it can demonstrate that the discount complies with the guidelines. At the subsequent revenue reset, the Commission may 'claw back' the recovered revenue if it decides the discount did not meet the guidelines.

On 10 October 2001 the Commission released its draft *Guidelines for the negotiation of discounts on transmission charges* and sought submissions from interested parties. In light of the submissions received, a fourth guideline was added to deal with pre-existing discount arrangements and the wording of Guideline 1 was refined. A further clarification of the

procedures for assessing discount recovery applications from TNSPs was made. Under the code, such applications must be formally considered at a TNSP's revenue determination. However, there is also provision for a TNSP to apply for a letter of guidance from the Commission at the time the discount is being negotiated.

On 3 May 2002 the Commission released its final *Guidelines for the negotiation of discounted transmission charges.* These now constitute those referred to in the code.

The Commission intends to monitor the application of the guidelines and may revise them at some later date following due consultation with all relevant stakeholders.

Statement of principles for the regulation of transmission revenues—information requirements guidelines

On 1 July 1999, in accordance with its responsibilities under the code, the Commission began regulating the transmission revenues in the national electricity market.

Clauses 6.2.5 (a) and (c) of the code require transmission network owners to submit to the Commission certified annual financial statements (in a form to be determined by the Commission), and any other information the Commission reasonably requires to perform its regulatory functions. Chapter 6 of the code also envisages that the Commission will develop a set of guidelines outlining how it will exercise its power to regulate transmission revenues.

On 27 May 1999, in accordance with this provision of the code, the Commission released its draft *Statement of principles for the regulation of transmission revenues*. The draft regulatory principles included the Commission's initial views on the information disclosure requirements.

Following the release of the draft principles, the Commission received submissions from interested parties outlining their concerns with the proposed information requirements. These matters were taken into consideration in the development of the draft information requirement guidelines, which were released on 9 May 2001.

The Commission received several submissions regarding the draft information requirement guidelines and consulted widely with the transmission network service providers, before releasing its final decision on 5 June 2002.

As envisaged under the code, the Commission has developed the guidelines to limit the ability of the transmission network service providers (TNSPs) to extend their monopoly powers from the network business to the contestable parts of the industry. In particular, the Commission is keen to ensure that regulated activities do not cross-subsidise contestable activities.

The Commission has balanced its regulatory responsibilities with the costs of compliance. Information provided by the regulated TNSP will form the basis of the Commission's revenue cap decisions. The Commission will also use its information gathering powers to annually monitor the TNSP's compliance with its revenue cap.

Ring-fencing guidelines

On 15 August 2002 the Commission released its *Transmission ring-fencing guidelines*. Under the code, all TNSPs are required to comply with the guidelines. The guidelines, which separate the accounting and functional aspects of prescribed services from those of other services provided by TNSPs, take effect from 1 November 2002. In defining these guidelines, the Commission is reinforcing the effectiveness of regulation by limiting the ability of the TNSPs to extend their monopoly powers into the contestable parts of the industry.

In developing these guidelines the Commission took into account comments by interested parties and recommendations by various state regulators. Most of the interested parties supported the development of ring-fencing guidelines along the lines of the national gas access code.

The Commission has used the ring-fencing provisions of the gas code as a model for the NEM. It also selected a set of arrangements that give the Commission the flexibility to waive elements of the ring-fencing arrangements, where costs of compliance outweighed benefits. Ring-fencing guidelines ensure that TNSPs' decisions

and actions in competitive activities (such as retail supply) are based on access prices that are published and verifiable.

Proposals for national guidelines on service standards and network performance

The Commission has begun its review into transmission service standards, which will link the level or quality of service that a transmission network provides to its revenue. The Commission engaged Sinclair Knight Merz (SKM) in December 2001 to provide a detailed recommendation.

After extensive consultation, SKM will deliver its final recommendation in August 2002. The Commission will then call for submissions on parts of SKM's recommendation before releasing its draft decision. The Commission expects to release a final decision by November 2002.

Review of the regulatory test—issues paper

In June 2001 the Commission and NECA released a joint statement announcing their decision to review the current framework for essential new investment in the NEM. They noted that the existing arrangements for the planning and approval of regulated network investment have been widely criticised and recognised that there is a need to streamline the arrangements.

The Commission stated that it would review the regulatory test, a test that all transmission network investment must satisfy if it is to receive regulated status, to ensure that it does not result in a complex and lengthy process that delays regulated investment. As a result, the Commission released an issues paper on 10 May 2002 highlighting issues that had been raised with the operation of the regulatory test.

The Commission expects to release a draft discussion paper in early October.

Gas

Over the past year the Commission has assessed nine access arrangements under the National Third Party Access Code for Natural Gas Pipeline Systems (the code)—of these, two final approvals were issued for the Wallumbilla to Gladstone via Rockhampton and the Ballera to Wallumbilla pipelines. The Commission released final decisions for the Moomba to Adelaide, Ballera to Mount Isa and Wallumbilla to Brisbane proposed access arrangements and is considering the proposed access arrangements for the Moomba to Sydney and the Amadeus Basin to Darwin pipelines, with draft decisions being released in 2000 and 2001 respectively. Two applications to revise the access arrangements were received for the Victorian Principal Transmission System that were initially approved by the Commission in 1998.

The Australian Competition Tribunal is responsible for hearing appeals against decisions made by the Commission as the gas transmission regulator. At the tribunal in 2002, the Commission successfully defended its right to include trigger mechanisms, which are defined as specific major events that would trigger an early review, within an access arrangement. Trigger mechanisms are normally inserted into access arrangements that are longer than the standard duration of five years.

The Commission is continuing to consider minor proposed rule changes to the Victorian market system operation rules and is also assessing an application for the re-authorisation of these rules.

In the past year the Commission has released the *Draft greenfields guideline for natural gas transmission pipelines* to help interested parties understand their rights when proposing to build new pipelines. The Commission has also released its *Post-tax revenue model* and associated handbook which outlines the Commission's approach to determining regulated utility access prices.

Access arrangements

Moomba to Adelaide pipeline system: Epic Energy

The Commission released its final decision for Epic Energy South Australia Pty Limited's proposed access arrangement for the Moomba to Adelaide pipeline system on 12 September 2001. The access arrangement describes the terms and conditions on which Epic proposes to make transportation services available until 31 December 2006.

The final decision provided for a reduction in tariffs of 10 per cent and establishing a benchmark post-tax return on equity of 12.6 per cent. It also amends non-tariff aspects of the proposed access arrangement to provide a fair balance of the interests of users and the service provider.

In response to the Commission's final decision Epic was granted an extension of time to lodge a revised access arrangement which was received on 22 January 2002. Extra material supporting Epic's access arrangement was eventually submitted on 26 March and 2 July 2002 and related to self-insurance and the Commission's interpretation and application of the gas code.

The Commission intends to release its final approval shortly. The final approval is an assessment of Epic's revised access arrangement to determine whether it complies with the Commission's final decision.

Moomba to Sydney pipeline system: East Australian Pipeline Limited

On 5 June 2001 East Australian Pipeline Limited (EAPL) applied to the National Competition Council (NCC) to revoke coverage of certain sections of the Moomba to Sydney pipeline (MSP), specifically the Moomba to Sydney mainline and the Canberra lateral. This follows the Australian Competition Tribunal's decision of 4 May 2001 that the Eastern Gas pipeline (owned by Duke Energy International) is not to be a 'covered pipeline', that is a pipeline subject to regulation under the gas code.

In December 2001 the NCC made its draft recommendation to the responsible minister that the MSP (including the Moomba to Sydney mainline and the Canberra lateral) remain covered by the gas code. In accordance with the provisions of the gas code, the NCC extended the date of release of its final recommendation to 29 July 2002.

In its draft recommendation the NCC relied on material contained in the Commission's draft decision on EAPL's proposed access arrangement in which the Commission proposed tariffs significantly less than EAPL's current tariffs. The NCC concluded that this was evidence that EAPL was earning monopoly rents which in turn was distorting investment in upstream and downstream markets.

On 14 June 2001 EAPL requested that the Commission postpone releasing its final decision on the MSP pending resolution of its application to revoke gas code coverage that was lodged with the NCC. The Commission agreed, subject to a review in six months' time. After considering a further request for an extension in January 2002, the Commission decided to proceed with issuing a final decision. Given the reliance that the NCC placed on the Commission's draft decision, the Commission considered it was in the public interest to restart the assessment process. Subsequently, the Australian Pipeline Trust (APT) lodged a revised access arrangement dated 30 April 2002 on behalf of EAPL.

The Commission called for public submissions on the revised access arrangement in June 2002. After considering APT's revised access arrangement for the MSP and any submissions received from interested parties, the Commission will issue a final decision.

Amadeus Basin to Darwin pipeline: NT Gas

On 2 May 2001 the Commission issued a draft decision on the proposed access arrangement submitted by NT Gas Pty Ltd for the Amadeus Basin to Darwin pipeline (ABDP). The Australian Pipeline Trust holds a 96 per cent share in NT Gas, which is the operator of the ABDP.

The Commission's draft decision established a revenue stream with a post-tax return on equity of 12 per cent over the next five years. NT Gas could achieve a return on equity of over 12 per cent via lower than forecast operations and

maintenance costs and through the sale of non-reference services.

The Commission granted the NT Government and the Power and Water Authority a three-month extension (to 7 September 2001) to lodge a joint submission on the draft decision. Since receiving the submission, the Commission has been assessing the proposed access arrangement and anticipates the release of the final decision in 2002.

Queensland gas pipelines

As reported last year the National Competition Council (NCC) asked the Commission to advise whether the Queensland gas pipeline access regime, as it applies to four derogated pipelines, is consistent with the code. Specifically, the NCC asked the Commission to assess the relevant tender processes against those established in the code. If they were inconsistent, the Commission was then asked to determine whether the reference tariffs in the respective access principles were consistent with the pricing principles set out in section 8 of the code.

The Commission found that the tendering process conducted by the Queensland Government to determine access principles for the Wallumbilla to Gladstone via Rockhampton, Ballera to Mt Isa and Ballera to Wallumbilla pipelines were inconsistent with the code.

The Commission then estimated the return on equity (RoE) for the derogated pipelines. For the Ballera to Wallumbilla and Ballera to Mt Isa pipelines the RoEs were estimated to fall within a reasonable range. In the case of the Wallumbilla to Gladstone via Rockhampton pipeline, the estimated RoE was at the high end of a reasonable range. Finally, for the Wallumbilla to Brisbane pipeline the estimated RoE was higher than could reasonably be expected and may be inconsistent with the code.

The Commission also expressed concern at the lack of provision of access arrangement information and the significant length of most access arrangement periods.

In February 2001 the NCC made its recommendation to the Commonwealth minister regarding the certification application of the regime as an 'effective' regime. The NCC subsequently withdrew its recommendation after being notified by the minister that new material had been received from the Queensland Government and the owners of the pipelines. After considering the new material, the NCC made a draft recommendation to the minister (released in February 2002) that the regime is not an effective access regime. The NCC called for submissions on the draft recommendation by 7 June 2002. The NCC is considering the submissions it received and is yet to make its final recommendation to the minister.

In 2001–02 the Commission assessed proposed access arrangements for the four Queensland gas transmission pipelines. The Queensland Government derogated some elements from the code as it would have applied to the pipelines. For example, the derogation provides for reference tariffs to be set by the Queensland Minister for Mines and Energy. As a result, most of the typically contentious aspects of the access arrangements were not open to Commission consideration for any of the four pipelines.

Wallumbilla to Gladstone via Rockhampton pipeline: Duke Energy International

The Commission released its final decision on the Duke Energy International proposed access arrangement for the Wallumbilla to Gladstone via Rockhampton pipeline, also known as the Queensland gas pipeline (QGP), on 1 August 2001. As this pipeline is subject to the Queensland Government derogation, the Commission did not have the power to review reference tariffs or reference tariff policy issues.

One contentious aspect of this final decision was the inclusion of a review trigger. Duke argued that the review date was established in the derogation and that the Commission could not require an earlier review. The Commission was concerned that, given that the first review might not occur until the year 2016, the proposed access arrangement did not allow for review of the non-tariff elements of the access arrangement if a major change in the Queensland gas industry were to occur. The final decision required an amendment that Duke submit a list of specific major events that would trigger a review of the non-tariff elements under section 3.17 of the code.

The Commission issued and approved its own access arrangement for the QGP on 1 November 2001 after Duke failed to amend its access arrangement as set out in the Commission's final decision. Specifically, Duke failed to include a review trigger mechanism.

Duke appealed the Commission's final decision to the Australian Competition Tribunal asserting that the Commission did not have the authority to include a trigger mechanism. On 10 May 2002 the tribunal dismissed Duke's appeal and held that the Commission retained the authority to include a trigger mechanism and review the non-tariff elements of the access arrangement before the derogated review date if the trigger mechanism was activated.

Ballera to Wallumbilla pipeline: Epic Energy

During this year the Commission considered the proposed access arrangement lodged by Epic Energy (Queensland) for the Ballera to Wallumbilla pipeline, also known as the south-west Queensland pipeline. The Queensland Government determined the reference tariffs for this pipeline and set the review date at 30 June 2016. Consequently, the Queensland derogations specifically precluded the Commission from reviewing the tariff elements of the proposed access arrangement.

The Commission released its final approval for the Ballera to Wallumbilla pipeline on 4 June 2002 after Epic failed to submit a revised access arrangement to the Commission required in its final decision. Epic did not appeal the Commission's final decision to the tribunal.

The Commission's final approval shortened the minimum term for a gas transportation contract from five years to two to ensure consistency with the length of haulage contracts offered by other pipelines. It also included a trigger mechanism that will be activated if a specified event such as the interconnection of the Ballera to Wallumbilla pipeline with another pipeline should occur.

Ballera to Mt Isa Pipeline: Carpentaria Gas Pipeline Joint Venture

The proposed access arrangement for the Ballera to Mount Isa pipeline, which is also known as the Carpentaria gas pipeline (CGP) and is owned by the Carpentaria Gas Pipeline Joint Venture (CGPJV), was considered by the Commission during this year. The Commission was precluded by Queensland legislation from assessing the reference tariff elements of the proposed access arrangement. Additionally, the Queensland Government has determined the reference tariff and set the review date at 1 May 2023.

The Commission released its draft decision on 15 August 2001 and its final decision on 16 January 2002. The final decision rejected the proposed access arrangement submitted by the CGPJV and required several changes. These included removing the scope for amendments to access terms and conditions without the Commission's approval and allowing prospective third party users to supply commercially confidential information to an independent person rather than the CGPJV. The Commission also required the inclusion of a review trigger for the access arrangement should prescribed circumstances occur. Final approval is expected to be issued during 2002.

Wallumbilla to Brisbane pipeline: Australian Pipeline Trust

A draft decision for the Wallumbilla to Brisbane pipeline (also known as the Roma to Brisbane pipeline) was issued on 15 August 2001. This decision required amendments to the proposed access arrangement to more effectively balance the interests of the service provider and existing and potential third parties. As with the other Queensland pipelines, reference tariffs for this pipeline have been determined by the Queensland Government and a specified review date has been set at 29 July 2006.

The final decision was released on 16 January 2002 and required revisions to the non-tariff aspects of the proposed access arrangement. The Commission's amendments sought to ensure the access arrangements consistency with the Queensland legislation that granted tariff

derogations and removed the potential for the service provider to amend the terms and conditions of the access arrangement without the approval of the Commission. The final decision also required that all expansions to the pipeline be considered as part of the 'covered pipeline' unless the Commission agrees otherwise. Final approval is expected to be issued in 2002.

Victorian Principal Transmission System Review: GasNet and Victoria Energy Networks Corporation (VENCorp)

Background

On 16 December 1998 the Commission gave final approval for access arrangements for Victoria's principal transmission system (PTS), the western transmission system (both submitted by Transmission Pipelines Australia Pty Ltd and Transmission Pipelines (Assets) Pty Ltd, but now owned by GasNet) and VENCorp for the PTS. VENCorp remains the independent system operator of the PTS. The initial access arrangement periods for GasNet and VENCorp are due to finish at the end of 2002.

GasNet and VENcorp access arrangement revisions

On 28 March 2002 GasNet and VENCorp lodged proposed revisions to their existing access arrangements. The Commission released an issues paper on the proposed access arrangements on 19 April 2002 with submissions sought by 13 May 2002. The Commission identified key issues for comment including GasNet's proposal to increase the initial capital base value by $35.8 million and the proposed real increase in tariff prices of over 10 per cent during the access arrangement period. As part of its proposed revisions, GasNet also sought to include the cost of the south-west pipeline under the code's economic feasibility test and merge access arrangements for the PTS and the WTS.

In relation to VENCorp's proposed revisions to its access arrangement, key issues included the proposed real tariff reductions for metering and commodity charges and the introduction of five-yearly rather than an annual budget approval process for registration and commodity tariffs.

Sixteen submissions were received in response to the issues paper. The Commission is considering these and intends to release draft and subsequently final decisions for both the GasNet and VENCorp access arrangements shortly.

Riverland and Mildura pipelines: Envestra

Envestra Limited submitted proposed access arrangements for the Riverland and Mildura pipelines on 22 November 1999. A 1997 competitive tender for the Mildura pipeline established a rate of return and a price path to deliver an appropriate internal rate of return over a 30-year period. In April 1999 the Commission accepted that the tender process was carried out according to the gas code, binding the Commission to accept the outcome. Elements of the access arrangement that were not addressed by the tender were included in the proposed access arrangement for assessment by the Commission. The Commission released an issue paper on the proposed access arrangements for both pipelines in February 2000, but no submissions were received.

In May 2001 the NCC received applications for revocation of coverage for the Riverlands and Mildura gas pipelines. The NCC conducted a public consultation process as required under the gas code to determine if coverage of the two pipelines should be revoked. The NCC forwarded its final recommendation to the relevant responsible ministers on 20 August 2001. They decided to revoke coverage for the Riverlands pipeline on 12 September 2001 and the Mildura pipeline on 17 September 2001. Revocation became effective on 30 September 2001. Consequently, these pipelines are no longer regulated under the gas code and the matter before the Commission is closed.

Victorian market and system operations rules

Authorisation: Victorian MSOR

On 19 August 1998 the Commission granted authorisation until 1 January 2003 to those aspects of the Victorian market and system operations rules (MSOR) that it considered could potentially breach the TPA.

On 17 May 2002 VENCorp lodged an application to the Commission for the renewal of its authorisation and requested that it take effect from 1 January 2003, for ten years, until 31 December 2012. In response to this application the Commission released an issues paper on 7 June 2002 and sought comment by early July.

Among the issues under consideration are the length of the proposed authorisation and the public benefits and detriments of the MSOR. The Commission intends to release a draft determination in September 2002 and interested parties will then be given a further opportunity to make submissions in relation to the draft determination.

Authorisation: Victorian MSOR—minor variation

On 20 June 2002 VENCorp applied under s. 91A of the Act for minor variation to existing authorisations in respect of the MSOR. It relates to proposed amendments to the MSOR. The proposed rule changes are designed to establish a clear mechanism and process under which VENCorp may recover its costs incurred in the implementation and operation of full retail contestability (FRC) in the Victorian gas market, which is due to begin on 1 October 2002.

VenCorp annual statement

Under the Victorian Gas Industry Tariff Order, VENCorp must seek Commission approval of an annual statement that sets out its total annual costs and market fees for the forthcoming financial year. The Commission approved the annual statement for 2002–03 on 22 May 2002.

Ring fencing

Ring fencing helps introduce effective competition into markets traditionally supplied by integrated monopolies. It involves putting structures in place to prevent flows of information and personnel within an integrated utility and between related businesses. While the objective of effective ring fencing is to limit the potential for anti-competitive behaviour, the code does allow flexibility—in certain circumstances the regulator may waive or increase a service provider's obligations.

NT Gas

On 10 December 2001 NT Gas submitted an application to waive ring-fencing obligations that prohibit a service provider's (NT Gas) marketing and other staff from working for a related business (NT Gas Distribution Pty Ltd). A public consultation process conducted by the Commission determined that interested parties were not opposed to the waiver.

On 13 March 2002 the Commission released its final decision to approve NT Gas' application. It was approved because the cost of NT Gas complying with the ring-fencing obligations would outweigh the public benefits from the company doing so. In reaching its decision the Commission noted that certain developments in the Northern Territory gas industry may change the outcome of such an assessment in the future. If so, under the Gas Pipeline Access Law the waiver can be rescinded should the Commission no longer be satisfied that the grounds on which the waiver was granted are met.

South-west Queensland producers

In early March 2002 Santos, Origin Energy and Delhi Petroleum, collectively known as the South-west Queensland producers (SWQP), applied for the waiver of certain ring-fencing obligations. The SWQPs are also part owners of the Ballera to Mount Isa pipeline and as service providers they sought a waiver to allow marketing staff in their related business of gas production to continue to work for their gas transmission business.

The SWQP also sought a waiver to enable them to continue to operate their related businesses of gas production. Compliance with the ring-fencing provisions of the code would have required the divesture of SWQP's pipeline interests in south-west Queensland.

On 26 April 2002 the Commission released its draft decision proposing not to waive certain aspects of the applications. On 1 May 2002 the SWQP withdrew that part of their applications that related to the sharing of marketing (and other staff) between the gas transmission business and the gas production interest. Therefore the Commission was no longer required to assess this aspect of the initial applications.

Table 6.1 Service provider compliance with ring-fencing obligations

Service provider	Pipeline	Compliance with ring-fencing obligations
Australian Pipeline Trust	Moomba to Sydney pipeline Central West pipeline	Compliant Compliant
GPU GasNet	principal transmission system and western transmission system pipelines	Compliant
VenCorp	principal transmission system	Compliant
Duke Energy	Queensland gas pipeline	Compliant
Epic Energy	Moomba to Adelaide pipeline system	Compliant

On 30 May 2002 the Commission released its final decision granting a waiver to the SWQP to continue to operate their related businesses of producing natural gas. The waiver was granted once the Commission was satisfied that the producers had set up adequate internal procedures to prevent the transfer of commercial information between the related business interests. The Commission will continue to monitor the new arrangements through SWQP's annual reporting requirements under the gas code.

Ring-fencing compliance reports

Under section four of the code, the Commission is responsible for monitoring compliance with ring-fencing obligations and starting enforcement action if provisions are breached. The code obliges service providers to report to the Commission at reasonable intervals as required. The year ending 30 June 2001 was the first of the annual reports required by the Commission.

The 2001 compliance reports did not provide much detail on the measures taken to ensure compliance but because the reporting requirement was new the Commission decided that the responses were adequate. The table below summarises the responses.

The Commission has developed a pro forma compliance report, requiring board sign-off, to be used as the basis for future reports by service providers. This should minimise the regulatory burden and increase transparency and accountability of the process. The next ring-fencing reports are due by 31 July 2002.

Gas pipeline competitive tender processes

On 30 August 2001 the Loddon Murray Gas Supply Group (LMGSG) comprising the Swan Hill Rural City, Gannawarra Shire and the Loddon Shire councils submitted a proposal to the Commission to conduct a tender under the code to supply natural gas to the Loddon Murray area in north-west Victoria. The tender would determine the tariff-related aspects of the pipeline's initial access arrangement, and allow the successful bidder to construct both a transmission and distribution pipeline to the region.

On 1 November 2001 the Commission approved the proposed tender procedures and rules that would be used to select the preferred supplier of the transmission aspects of the project. At the same time, the Victorian Office of the Regulator General (now the Essential Services Commission) also approved the equivalent for the distribution components of the tender. The LMGSG then conducted the tender and bidding closed on the 15 March 2002.

On 9 April 2002 LMGSG advised the Commission that no formal bids had been received. Despite this, several companies expressed an interest in the project and LMGSG indicated its intention to approach those parties for further discussion.

Publications

Draft greenfields guideline

On 25 June 2002 the Commission released its *Draft greenfields guideline for natural gas transmission pipelines* (the Greenfields guide). The Greenfields guide provides an overview of the access regulatory framework and options available for new natural gas transmission pipelines. During its preparation, the Commission consulted with all sections of the gas industry and sought many expert views.[1]

The Greenfields guide addresses perceptions of regulatory uncertainty about how the regulatory framework applies and the Commission's approach to greenfields projects. It will also help service providers evaluate the likely regulatory outcome of potential projects and provide ideas on the different regulatory options available for a greenfields pipeline.

The Commission will hold a public consultative forum before finalising the Greenfields guide.

Post-tax revenue handbook

The Commission released its *Post-tax revenue model* (PTRM) on 25 October 2001, and its associated handbook. The PTRM handbook sets out the process that the Commission uses when determining revenue requirements as part of its regulatory decisions for utilities. The release of the PTRM allows service providers and interested parties to better understand how regulatory decisions are made and provides greater insights into future decisions. A copy of the handbook is available from the Commission's website.

[1] Macquarie Bank Limited, Kevin Davis (Chair of Finance, University of Melbourne) and John Handley, (Senior Lecturer, University of Melbourne) and National Economic Research Associates (NERA).

Liaison activity

Retail contestability

Full retail contestability (FRC) for residential and small business consumers was introduced in New South Wales on 1 January 2002 and it is intended to be introduced in Victoria later this year. As they approach their own FRC implementation dates, other jurisdictions are taking a great interest in NSW and Victoria's approaches.

During the past year the Commission has liaised with the Department of Natural Resources and Environment as part of Victoria's move toward FRC. The Commission continues to monitor the progress of other jurisdictions as they remove barriers to competition.

All jurisdictions have developed slightly different contestability and FRC timetables; however, the table below outlines the general evolution of FRC.

Because it has a market carriage system of operation, Victoria's implementation will differ from other states that have a contract carriage system.

NSW has established an industry-driven body called the Gas Market Company to administer the FRC market rules. In contrast, Victoria is planning to establish a Victorian Gas Retail Rules Committee composed of gas industry participants and stakeholders to provide recommendations to the VENCorp Board.

Regarding national consistency, each jurisdiction is trying to meet their contestability timetable commitments; some local variations may arise between jurisdictions in elements of the FRC arrangements. It is important that jurisdictions maintain consistency so that a national energy market can evolve.

Natural Gas Pipelines Advisory Committee (NGPAC)

CoAG established the NGPAC on 7 November 1997 to administer the gas code. Membership includes an independent chair and representatives of the Commonwealth, states and territories, together with industry and regulator representatives, including the Commission. Meetings are held every quarter.

Table 6.2 The introduction of contestability and full retail contestability across jurisdictions

	NSW	QLD	SA	VIC	WA
> 500 TJ	Aug. 1996	—	—	Oct. 1999	Jan. 1997
>100 TJ	July 1997	Dec. 2000	April 1998	March 2000	Jan. 2000
>10 TJ	July 1998	—	July 1999	Sept. 2000	(1)
Original FRC(2)	July 1999	—	July 2001	Sept. 2001	July 2002
Revised FRC	1 Jan. 2002(3)	1 Jan. 2003(4)	2003(5)	1 Oct. 2002(6)	1 Jul. 2002(7)

Source:

(1) WA: > 1TJ on 1 January 2002

(2) Source: *Natural Gas Pipelines Access Agreement 1997*, Annexure H.

(3) www.energy.nsw.gov.au

(4) www.energy.qld.gov.au

(5) www.energy.sa.gov.au

(6) www.dnre.vic.gov.au

(7) www.energy.wa.gov.au (legal contestability only, mechanisms to support residential FRC yet to be implemented)

The code may be amended by agreement between the relevant ministers after a recommendation from NGPAC.

Changes to the code came into effect during the year to explicitly allow for incentive mechanisms to apply across regulatory periods and make it clear that costs incurred by distribution businesses associated with generic marketing activities could be recognised.

On 20 March 2002 NGPAC agreed to a public consultation process for a code change that would allow one access arrangement to apply to two covered pipelines. NGPAC is currently considering the proposal.

Telecommunications

During the year the Commission received approximately 210 complaints that raised issues under Part XIB of the Trade Practices Act. Of these, 13 progressed to substantive investigation, five were ongoing at the end of the financial year and the remainder did not require action under Part XIB.

The Commission also enforced the consumer protection provisions of the Act as they apply to the telecommunications industry.

During the year the Commission released various draft, final and revised pricing papers, informing the telecommunications markets of both the methodologies and principles that the Commission uses in making price decisions and likely indicative prices.

By the end of 2001–02 the Commission had two current arbitrations, both relating to analogue subscription broadcasting—interim determinations had been issued for both. During the year 19 arbitrations were resolved—the Commission issued two final determinations, 16 matters were withdrawn and in one matter the Commission's jurisdiction was not established.

Telecommunications competitive safeguards—Part XIB

The Commission is responsible for administering an industry specific regime established by Part XIB of the Act, which empowers the Commission to deal with anti-competitive conduct in telecommunications markets and obtain information to help monitor competition in the industry.

Tariff filings

Under Part XIB the Commission can obtain information on charges, terms and conditions for telecommunications services from carriers and carriage service providers.

The Commission's tariff powers can be divided into two distinct parts:

- general tariff filing directions (Division 4 of Part XIB)
- Telstra-specific tariff filing (Division 5 of Part XIB).

Tariff filing directions under Division 4

Section 151BK allows the Commission to issue a tariff filing direction for specified carriage services, ancillary goods and services, if it is satisfied the carrier or carriage service provider had a substantial degree of market power in a telecommunications market. Under such a direction the Commission can obtain information:

- about charges for the supply of the goods or services, including any discounts, allowances, rebates, commission or similar benefits
- about intentions, to be provided at least seven days before it imposes a new charge, varies a charge or ceases imposing a charge.

In 2001–02 the Commission did not find it necessary to use the powers defined under Division 4.

Tariff filing by Telstra under Division 5

Division 5 of Part XIB requires Telstra to file information for all of its basic carriage services (BCS) with the Commission. While a strict interpretation would necessitate Telstra providing complete detail of all offerings (standard and non-standard and all variations) both the Commission and Telstra consider that this would be administratively burdensome. Accordingly, a streamlined process was developed that meets the objectives of Division 5, but only requires Telstra to file BCS and charging information that has been identified as relevant to help the Commission detect potential anti-competitive behaviour.

This regime, in place since June 1998, requires Telstra to provide weekly reports about changes to the standard form of agreement offerings. The Commission also receives monthly summaries of major non-standard tariff offerings.

During 2001–02 Telstra complied with the requirements to provide tariff filing information to the Commission.

Record keeping rules

Under s. 151BU of the Trade Practices Act, the Commission has the power to make record keeping rules (RKRs) and to require some carriers and carriage service providers to comply with them. The rules may specify what records are kept, how reports are prepared and when they are to be provided to the Commission.

The most prominent example of RKRs is the Telecommunications Industry Regulatory Accounting Framework (RAF) which was released in May 2001, replacing the Chart of Accounts and Cost Allocation Manual. The primary objective of the RAF is to provide for accounting separation for major vertically integrated carriers—requiring them to report separately on the retail and wholesale businesses.

Every six months the carriers that report under the RAF (Telstra, Optus, Vodafone, AAPT and Primus) give the Commission information on revenues, costs, capital and usage across a broad range of services and across the retail, internal wholesale and external wholesale businesses.

As well as the RAF, other RKRs are in operation. For example, Telstra has an ongoing commitment to provide a weekly report on the conditioning of the network to provide unconditioned local loop service (ULLS) and the number of exchanges that are activated for asymmetric digital subscriber line services.

In December 2001 a new RKR was issued requiring Telstra to report on the commercial agreements it has with access seekers for the local carriage service and the ULLS.

The Commission released a discussion paper on the public disclosure of information collected under the RKRs in January 2002. This included, but was not limited to, the disclosure of data collected under the RAF. The Act provides for disclosure of information by the Commission

when it considers that disclosure will promote competition or the operation of Parts XIB or XIC—with consideration of the legitimate commercial interests of disclosing firms. The discussion paper provided some preliminary views on the broad principles of disclosure to be followed, and on the specific types of information that might be disclosed. The Commission will consider the views expressed in submissions and finalise disclosure arrangements in the 2002–03 reporting period.

Major investigations raising competition issues

During the year the Commission received approximately 210 complaints that raised issues under Part XIB of the Act. Of these, 13 progressed to substantive investigation, five were ongoing at the end of the financial year and the remainder did not raise issues requiring action under Part XIB.

ADSL competition notice

In September 2001 the Commission issued a Competition Notice regarding Telstra's conduct over the pricing and architecture of its wholesale ADSL (asymmetric digital subscriber line) service. The notice was due to come into effect in late November 2001 but the Commission delayed this process to allow Telstra time to amend its conduct.

In March 2002 the Commission determined that although Telstra had reduced the wholesale price for ADSL services by up to 25 per cent, it had not adequately addressed the architecture issues outlined in the notice. Hence, the competition notice came into effect.

The notice was revoked in May 2002 after Telstra made changes to the architecture of its offering to wholesale customers.

PSTN data terminating access

In mid-2001 the Commission began a Part XIB investigation into PSTN (public switched telephone network) data terminating access. This issue had previously arisen as an access price dispute under Part XIC—Telstra notified disputes regarding the costs of terminating data calls on other carriers networks. During the course of the arbitration Telstra chose to withdraw from the arbitration process, as it assessed that it was under no legal obligation to seek access on another carrier's network, only to provide access. In effect, Telstra was refusing to hand over non-voice calls to the networks operated by its competitors.

The Commission subsequently received complaints from numerous network owners alleging that unless Telstra agreed to pass calls from Telstra retail customers to Internet service providers (ISPs) connected to the complainants' networks, then these non-dominant network owners would be unable to compete for ISP business. Following extensive discussions between the parties and the Commission, commercial agreements were struck and the various complaints withdrawn. The Commission will continue to monitor these interconnection arrangements closely.

Axxess Australia Pty Ltd and Benchmark Sales

In May 2001, following complaints from consumers that they had been transferred to other telecommunications networks without their consent (known as slamming), the Commission instituted proceedings against door-to-door sales agent Axxess Australia Pty Ltd. The Commission alleged that Axxess and its employees had engaged in unconscionable conduct, misleading and deceptive conduct and had made false and misleading representations. Telemarketing sales company Benchmark Sales Pty Ltd was joined to the proceeding in November 2001.

In March 2002 the Federal Court found that Axxess and Benchmark Sales breached the Trade Practices Act when trying to obtain customers for telephone companies and in many instances the conduct complained of resulted in slamming. The court ordered that Axxess and Benchmark Sales contribute $60 000 to a fund established by the Commission to raise awareness of consumer rights when obtaining phone services and issued injunctions restraining Benchmark and Axxess from engaging in a range of misleading and deceptive conduct. The Commission had previously obtained orders against Primus and One.Tel, two of Axxess's former customers, in

relation to slamming.

The Commission also accepted undertakings from the directors of each company acknowledging that they had breached the Act. They agreed to an independent review of their company's trade practices compliance procedures; adopt a number of telecommunication industry codes of practice; and to pay the Commission's costs.

Access to mobile retail outlets

In mid-2001 the Commission began receiving complaints from mobile carriers alleging that they were having difficulty securing large retail outlets as sales agents for mobile phone products and services. Around this time the Commission also received allegations from mobile phone dealers of anti-competitive conduct on the part of certain mobile phone carriers in terminating agency arrangements.

During the course of the Commission's investigations, the retail mobile market underwent significant restructuring—the result, among other things, of the introduction of mobile number portability and a move away from fixed-term contracts. Furthermore, a number of the larger mobile dealerships moved away from exclusive sales relationships to multi-service provider arrangements that allowed them to retail services for more than one mobile phone carrier. Consequently the Commission decided to suspend its investigation pending further monitoring and analysis of the effect of the market restructure, which is ongoing.

Transfer of One.Tel customers

In June 2001 the Commission became aware that Telstra was making incorrect representations to customers of the now defunct One.Tel regarding the transfer of its mobile services to Telstra. This included representations that customers would be liable for early termination fees if they did not move their service to Telstra before 9 June 2001. Following Telstra's failure to respond to the Commission's requests to cease this conduct, the Commission instituted proceedings on 5 July 2001 against Telstra in the Federal Court for misleading and deceptive conduct and false and misleading representations in breach of the Trade Practices Act.

On 6 July 2001 the Federal Court granted an interim injunction to the effect that Telstra make no further representations to One.Tel Next Generation customers that if they transferred their business to Telstra's competitors, or failed to transfer to Telstra, or failed to transfer to Telstra by a specified date, they may be liable to pay termination fees to One.Tel.

In December 2001 the Federal Court issued consent orders declaring that Telstra had breached the Act. The court issued injunctions affirming the interim injunctions. Telstra was ordered to develop and implement, for a period of two years, a compliance program for Part V of the Act for all staff of its retail mobile telephone business. Telstra was also required to partially repay the minimum monthly access fees for some customers and ordered to pay the Commission's agreed legal costs.

Inquiry into Telstra's charges for local number portability (LNP)

From September 2001 several carriers, carriage service providers and business consumers lodged complaints with the Commission alleging Telstra was imposing excessive charges for providing complex LNP. The porting of complex numbers—typically business applications involving blocks of numbers or a smaller range of numbers—requires project management and many manual steps that add substantial costs to the process. The complainants claimed these charges acted as a disincentive for Telstra's customers to change carriers and thereby inhibited competition. They also claimed that Telstra's charges breached the Commission's pricing principles for LNP.

Preliminary investigations indicated there were grounds for concern. The Commission raised the matter with Telstra in October 2001. In May 2002, following lengthy negotiations, Telstra agreed to reduce its complex LNP charges by almost 50 per cent (effective from July 2002) bringing them into line with those levied by other carriers and carriage service providers.

Telecommunications access—Part XIC

Part XIC of the Act establishes a telecommunications-specific regime for facilitating access to the networks of competing carriers. It is based on the general access provisions found in Part IIIA of the Act, but with certain refinements to take into account the specific characteristics of telecommunications networks. It provides the Commission with the power to: declare services; enforce standard access obligations; grant exemptions and variations to declarations; accept or reject an access undertaking from an access provider; and, if negotiations between parties fail, arbitrate access disputes.

Declaration of services

There is no general right of access to telecommunications services—the Commission must first declare the relevant service. As outlined in Division 2, before declaring a service, the Commission must conduct a public inquiry (under Part 25 of the *Telecommunications Act 1997*) and be satisfied that declaration is in the long-term interests of end-users (LTIE), as defined in the Act.

Line sharing declaration inquiry

In September 2001 the Commission announced an inquiry into whether line sharing services should be declared. Line sharing refers to a situation where two separate carriers provide separate services over a single metallic pair (or line). Traditionally, only a relatively small part of the useable spectrum of the line has been used to provide voice services. However, with the development of xDSL (variations of digital subscriber line technology), the remaining part of the spectrum can now be used for a variety of broadband services, enabling a combination of low and high-speed services to be provided on a single line at the same time.

The Commission released a discussion paper in October 2001 and received 11 submissions from interested parties. It also conducted market inquiries.

In April 2002 the Commission issued a draft decision indicating it considered, at that stage, that declaration of a LSS would be in the long-term interests of end-users.

Subsequent to releasing the draft decision, the Commission received five submissions from interested parties and conducted a range of market inquiries. The Commission released a final decision to declare the service on 30 August 2002.

Access to cable networks

In 1998 Television and Radio Broadcasting Services (TARBS) requested access to Telstra Multimedia's broadband cable television network, pursuant to the Commission's declaration of broadcasting services (including pay TV). Telstra and Foxtel objected on the grounds that the initial service declaration was invalid because:

- the Commission incorrectly specified more than one service or the Commission specified a service that 'did not exist' on 13 September 1996
- imposing an obligation on Telstra would deprive Foxtel of a protected contractual right.

The Commission announced on 30 August 1999 that, partly because of these doubts, it had decided to declare an analogue subscription television broadcast carriage service over cable links. It also decided not to declare a technology-neutral broadcast carriage service. However, the Commission stated that it was monitoring developments in digital services, including broadcasting, to see whether declaration was appropriate in the future.

TARBS and Seven Cable Pty Ltd made access requests relying on both the 1997 deemed service and the 1999 declared service. Telstra and Foxtel used similar arguments to those made to TARBS to deny access to the cable.

In September 1999 TARBS sought Commission arbitration for access to this service following Telstra's refusal to permit it, citing its protected contractual right with Foxtel. In October 1999 Seven Cable Pty Ltd sought a declaration from the Federal Court that Foxtel and Telstra did not have a protected contractual right. Foxtel sought declarations that both the 1997 and 1999 services were invalid.

The Federal Court rejected claims by Telstra and Foxtel that they had a protected contractual right preventing anyone else accessing the Telstra network, and also upheld the validity of the Commission's pay TV declarations. Both decisions were appealed and the Full Court decided that the 1999 service declaration was valid and neither Foxtel nor Telstra had a protected contractual right. A special leave application by Telstra to the High Court was refused on 10 August 2001.

Variation of declarations

Under s. 152AO of the Act the Commission has the power to vary or revoke declarations. As with declaring a service, this must be preceeded by a public inquiry (under Part 25 of the Telecommunications Act) unless the variation is of a minor nature.

Variation to make the GSM service declaration technology-neutral

In September 2001 the Commission commenced a public inquiry into whether the domestic GSM (global system for mobile) originating and terminating access service declaration (the GSM declaration) should be varied to become mobile technology-neutral with respect to technologies currently deployed or in use in Australia.

The domestic GSM services are wholesale inputs used by carriers and service providers to supply mobile and fixed-to-mobile retail services to end-users. They were deemed to be declared under s. 39 of the *Telecommunications (Transitional and Consequential Amendments) Act 1997*.

The Commission initiated this inquiry following its decision that a form of retail benchmarking is the most appropriate pricing methodology for the domestic GSM terminating access service. In reaching this view, the Commission noted that many of the issues relevant to the GSM terminating service may equally apply to other mobile technologies that are currently deployed or in use in Australia, such as CDMA (code-division multiple access). These mobile services, despite being considered close substitutes for GSM services, were not currently regulated.

The Commission understands that as GSM and CDMA are the principal mobile technologies currently deployed and in use, the proposed variation would result in service declarations that only encompass GSM and CDMA services.

The Commission released its final report in March 2002. Considering the submissions received, the Commission's view was that varying the GSM service declarations to include other mobile technologies currently deployed or in use would be in the long-term interests of end-users. In particular, competition in the fixed-to-mobile services market will likely be improved under the variation. There will be less opportunity for integrated mobile carriers to price in an anti-competitive manner and benefits for end-users making fixed-to-mobile calls (lower prices). The variation would also ensure competitive neutrality in the mobile services market.

Exemption from declaration

Section 152AT of the Act provides that a carrier or service provider may apply to the Commission for a written order exempting it from any or all of the standard access obligations that apply to a declared service. If the Commission believes that an order for an individual exemption is likely to have a material effect on the interests of a person, it must publish the applications and invite submissions on whether the applications should be accepted.

Local carriage service exemption applications

In June 2000 Telstra applied to the Commission for an exemption from its obligations to supply the local carriage service (LCS) to its competitors in the CBD areas of Melbourne, Sydney, Brisbane, Adelaide and Perth. The application noted that it was to be one of several designed to phase out Telstra's standard access obligations for the LCS over a 12-month period.

Telstra lodged a second application in November 2000 for an exemption from its obligation to supply the local carriage service to its competitors in the CBD areas of Hobart, Canberra and Darwin, metropolitan areas of all capital cities, and three regional centres, Newcastle, Wollongong and Geelong, but has not

pursued this application.

The Commission decided to consider concurrently class exemptions (under s. 152AS) in the areas covered by both of Telstra's applications and sought public comment.

The Commission issued a draft decision in September 2001, indicating that it intended to grant a class exemption to Telstra and other carriers and carriage service providers in the areas specified in Telstra's first exemption application, to take effect one year after issuing any final decision. The one year delay was specified to provide access seekers with time to alter their business plans to accommodate the exemption.

Submissions from interested parties were received on this draft decision and the Commission made its final decision in July 2002. This was to grant Telstra an individual exemption (under s. 152AT) to take effect on 17 July 2003 and subject to the provision of market information to the Commission for a period of two years from this date. The final decision also provided a class exemption (under s. 152AS) for all carriers and carriage service providers other than Telstra in the same areas as Telstra's individual exemption. This took effect on 31 July 2002 and is not subject to any conditions.

Transmission monitoring

The Commission committed itself to implement an expanded monitoring program in 2001–02 as part of its decision in May 2001 to remove all intercapital transmission capacity services from access regulation. Under the monitoring program, all operators must provide revenue, pricing and capacity utilisation information every six months. Two reports, covering the six months ending 30 June 2001 and 31 December 2001, have been provided to date. The Commission will consider public disclosure of transmission data in 2002–03, in consultation with the operators.

Enforcement of standard access obligations

Telecommunications carriers or providers must give access to declared telecommunications services as requested by a service provider. The access provider must also take reasonable steps to ensure the technical and operational quality of the service, including fault handling services that are of similar quality to those that it provides to itself.

Investigation into Telstra's provisioning and fault management processes

In August and September 2001 the Commission received several complaints alleging discriminatory behaviour by Telstra towards other service providers regarding provisioning practices between Telstra's wholesale and retail network operations, and possible non-compliance by Telstra with its standard access obligations (SAOs) in providing fault detection, handling and rectification services to other service providers. Following an investigation, the Commission concluded that there was no substantive evidence of discriminatory behaviour by Telstra in how it delivered these services to other service providers, although it found that the process for some complex provisioning orders could be improved and made more transparent.

Regarding Telstra's fault management system, the Commission concluded that there was cause to believe that many customers of other service providers were not receiving the same standard of service as Telstra's own retail customers, which could be interpreted as a breach of the SAOs. This was based on the apparent longer time taken to service wholesale customers' end-users compared to Telstra's servicing of its retail customers.

Negotiations were then initiated with Telstra in June 2002 to implement monitoring programs focusing on the outcomes of Telstra's management of complex provisioning orders and fault rectification processes. The Commission is also closely monitoring the implementation of Telstra's new faults management system (due to begin operation in 2003) to ensure wholesale customers receive equivalent service with Telstra retail customers. The Commission will be exploring the options with Telstra to improve outcomes in its faults and provisioning processes by developing an industry-led education and training program to better inform service providers of Telstra's relevant systems.

Arbitrations

By the end of 2001–02 the Commission had two current arbitrations, both relating to analogue subscription broadcasting. Interim determinations have been issued for both. During the year 19 arbitrations were resolved—the Commission issued 2 final determinations, 16 matters were withdrawn and in one matter the Commission's jurisdiction was not established.

Most of the arbitrations before the Commission during the past year were withdrawn by the access seeker over a 4-month period—15 were resolved between August and December 2001 and one in April 2002. The relevant parties have entered into commercial arrangements regarding the terms and conditions of access to the relevant services.

It is difficult to anticipate the level of access disputes likely to be notified to the Commission in the future. Many of the access disputes before the Commission were resolved between the parties after protracted submissions and rulings by the Commission that significantly narrowed the issues of disputation. In some cases settlement was achieved after the Commission had issued a draft determination. The Commission has consistently warned about the regulatory distortions that are raised as a consequence of full re-arbitration by the Australian Competition Tribunal. The Commission considers it likely that smaller carriers resolved ongoing arbitrations to gain regulatory certainty and eliminate the possibility of costly appeals.

The Commission's experience as a consequence of arbitrating a substantial number of access disputes is that information asymmetries continue to pervade telecommunications markets. The Commission has undertaken significant pricing work on a range of declared services in these access disputes. To give guidance to the market and encourage the commercial resolution of future disputes the Commission released indicative pricing for the ULLS and the LCS in March and April 2002 respectively.

Withdrawal of PSTN access price determinations appeal

Under s. 152DO of the Act, parties to an access dispute can seek review of final determinations issued by the Commission to the Australian Competition Tribunal. Such a review is assessed on the merits and is a full re-arbitration of the matter.

In October 2000 Telstra lodged applications with the tribunal to review the Commission's determinations (issued in September and November 2000) on disputes between Telstra with AAPT and Primus regarding PSTN originating and terminating access. These determinations set a price for the service for the 1999–00 and 2000–01 financial years.

The Commission was involved in substantial work on the case during financial year 2001–02. For example, there were nine directions and other preliminary hearings and submissions of detailed contentions and responses by the parties, including some 81 witness statements. Much of this information was new and had not previously been presented to the Commission for consideration.[2]

Telstra withdrew the case in April 2002, approximately one month before the formal hearing was due to begin, after the last of the disputing parties, AAPT, signed an agreement with Telstra. Earlier, Telstra had settled with each of the other parties individually: Optus (which had been granted leave to join the case in January 2001) in October 2001 and Primus in February 2002.

The tribunal review process put the Commission's approach under scrutiny, including its cost modelling methodology and application, for determining the price of PSTN access. The Commission considers its approach would have been endorsed by the tribunal had the case continued to a conclusion.

[2] As a result of amendments to Part XIC of the Act in June 2001 parties are now restricted from placing fresh evidence before the Tribunal or changing the submissions that they made to the Commission in its consideration of the matter.

Current arbitrations

Access seeker	Access provider	Service/s	Date notified	Interim decisions
TARBS	Telstra	Broadcasting Access Service	23 September 1999	24 April 2001
C7	Telstra, Foxtel & related providers	Broadcasting Access Service	31 August 1999 & 1 September 2000	5 April 2001

Matters finalised in 2001–02

Access seeker	Access provider	Service	Date resolved
One.Tel	Telstra	Unconditioned local loop	10 August 2001—withdrawn
WorldxChange	Telstra	Domestic GSM terminating access	7 September 2001—jurisdiction not established
Dingo Blue	Telstra	Local carriage service	4 October 2001—withdrawn
Primus	Telstra	Local carriage service	5 October 2001—withdrawn
Optus	Telstra	Local carriage service	5 October 2001—withdrawn
AAPT	Telstra	Domestic GSM terminating access	5 October 2001—withdrawn
Optus	Telstra	PSTN originating and terminating access	5 October 2001—withdrawn
Optus	Telstra	Freephone and local number portability	5 October 2001—withdrawn
Optus	Telstra	Local number portability	5 October 2001—withdrawn
Telstra	Primus	Domestic PSTN terminating access—for data calls to ISPs	21 November 2001—final determination
Telstra	PowerTel	Domestic PSTN terminating access—for data calls to ISPs	13 November 2001—final determination
People Telecom	Telstra	Local carriage service	12 November 2001—withdrawn
MCT	Telstra	Local carriage service	12 November 2001—withdrawn
WorldxChange	Telstra	Local carriage service	12 November 2001—withdrawn
AAPT	Vodafone	Domestic GSM originating and terminating access	14 November 2001—withdrawn
Primus	Telstra	Unconditioned local loop	23 November 2001—withdrawn
AAPT	Telstra	Unconditioned local loop	28 November 2001—withdrawn
CWO & XYZed P/L	Telstra	Unconditioned local loop	3 December 2001—withdrawn
Telstra	AAPT	Domestic PSTN terminating access—for data calls to ISPs	11 April 2002—withdrawn
Total matters finalised in 2001–02 = 19			

Responsibilities under other legislation

The Commission has a number of monitoring and reporting responsibilities under acts other than the Trade Practice Act.

Telstra's retail price control arrangements

Price control arrangements with Telstra were first introduced in 1989. Since then the government has conducted periodic reviews, the most recent changes scheduled for introduction in July 2002. Under the arrangements, the Commission is responsible for assessing the accuracy and completeness of Telstra's annual audited price control report.

For the 2000–01 financial year, a broad range of telecommunications services, including connections, local call, line rental, mobile, domestic and international leased lines, STD and IDD services were subject to the price control arrangements. In addition, the price control arrangements included a 22 cent price cap on local calls; a CPI–0 per cent price cap on a basket of local calls and line rentals (with a similar cap for connections); and a requirement for local call charges to be broadly the same for both metropolitan and non-metropolitan consumers. There were also further sub-caps relating to 'low-spend' consumers.

The Commission was satisfied that Telstra had complied with the price control requirements for 2000–01 for both the overall CPI–5.5 per cent price cap and the individual CPI–0 per cent and CPI–1 per cent price caps on the sub-baskets. Telstra has also complied with the metropolitan/non-metropolitan pricing parity requirement for residential and business customers.

Other activities

A large number of arbitrations were withdrawn this year as the Commission was preparing to issue final determinations. Thus, while the Commission had developed its thinking about pricing for various services, the last minute withdrawal of the arbitrations meant that the Commission could not publish final determinations. To help reduce information asymmetries, and to provide greater regulatory certainty, the Commission released a range of indicative prices and pricing methodologies during the year.

Pricing principles and indicative prices

The Commission released a range of draft, final and revised pricing papers, informing the telecommunications markets of the Commission's thinking on likely indicative prices and the methodologies and principles that it uses in making price decisions. Some of the key issues are discussed below.

GSM/CDMA draft pricing principles

With the variation of the GSM declaration, the Trade Practices Act required the Commission to determine appropriate pricing principles as soon as possible after the Commission varied the declared service. In June 2002 the Commission released its draft pricing principles for GSM and CDMA termination services for public comment. These are the principles the Commission will generally apply if it has to arbitrate a dispute over the terms and conditions of these services between the service providers involved.

The Commission expects to finalise its GSM and CDMA pricing principles by the end of August 2002.

Mobile telephony pricing principles

In July 2001 following a public inquiry, the Commission released its final *Pricing Methodology for the GSM Termination Service* report. The report concluded that certain characteristics of the GSM terminating service require regulation, and that the preferred approach is retail benchmarking, which links termination access prices to retail price movements reflecting the competitive elements of the retail mobile services market.

The three GSM mobile carriers, Telstra, Singtel Optus and Vodafone, will be required to report every six months on retail price movements. For administrative efficiency, the retail benchmarking data will be submitted in conjunction with each carrier's financial reporting obligations under the RAF.

After the release of the report, the three remaining GSM access disputes were withdrawn. The Commission held additional consultation with the industry to provide further guidance on

implementing the retail benchmarking approach in access disputes and to monitor retail and wholesale price movements.

Methodology for determining revenue-weighted price movements

Under Telstra Carrier Charges—Price Control Arrangements, Notification and Disallowance Determination No.1 of 2001 (the determination), price movements must be calculated according to a methodology the Commission establishes in consultation with Telstra.

In the course of evaluation of Telstra's price compliance report 2000–01, the Commission raised various concerns with Telstra, especially the methodology for calculating price movements, the yield approach and the interpretation of the term end of the financial year in section 9 of the determination. However, considering the time constraint, it was agreed that the compliance report for 2000–01 should proceed with the existing methodology, while that for 2001–02 should be reviewed.

The Commission also raised concerns about the standard of reporting and advice in the independent auditor's assessment of Telstra's price compliance report. These were also to be reviewed by the Commission.

The Commission's review of the methodology for Telstra's 2001–02 compliance report was to ensure consistency and transparency for future compliance purposes. The revision particularly focused on the method used to measure price movements; method for revenue weightings for price movements; definition of cumulative approach for measuring price and CPI movements; and the methodology to measure price movement for product packaging and bundling. The Commission also introduced new methods to measure changes in net yield and a new measure for the GST effect on local call prices.

The new methodology requires that, in general, the price movement calculation will be based on actual data. In circumstances where actual data is not available, the calculations may be based on sample surveys. However, the size and structure of the sample must represent demand patterns and conform to the statistical principles.

The new methodology also requires that the Commission appoint an independent auditor in consultation with Telstra. Costs incurred will be borne by Telstra.

The Commission approved the new methodology in May 2002 that will be applied to the 2001–02 price compliance report.

PC Inquiry

The Commission made submissions to government responding to the findings of the Productivity Commission's telecommunications inquiry. The government announced its response to the report in April 2002. The Commission continues to liaise with the government on implementing the response.

ADR

During the year the Commission has been refining and testing an ADR (alternative dispute resolution) process. The process, developed by consultants Phillips Fox, has now been adopted by the Commission and has been used in progressing the pay TV dispute. It involves a case-management approach to disputes, using mediation, experts in conflict resolution, and arbitration.

Australian Communications Industry Forum (ACIF)

During 2001–02 Commission staff participated as observers on several code committees organised by the ACIF, the industry body for telecommunications companies.

ACIF committees comprise representatives of the telecommunications industry, consumer groups and government regulators (such as the ACCC, the ACA and the Telecommunications Industry Ombudsman). Several codes are currently being developed within the ACIF to cover issues such as:

- ordering, provisioning and customer transfer processes for ULLS
- rights of use of numbers
- mobile number portability (revision)
- local number portability (revision)

- pre-selection (revision)
- customer and network fault management (revision).

The Commission's involvement in ACIF committees includes consumer protection issues, as well as operational and network issues.

The ACIF's Code Administration and Compliance Scheme will continue to monitor compliance by industry participants who are signatories to these codes. If codes are registered with the ACA, it can take enforcement action for failure to comply.

Mobile number portability (MNP)

Commission staff contributed to meetings to review the MNP industry code. As a result of experiences gained after the implementation of MNP in September 2001, the ACIF decided that it was necessary to review the industry code on MNP, IT specifications and operations manual. A draft of the revised industry code is due to be released for public comment by the end of July 2002 and the code is to be finalised by September 2002. ACIF intends to submit the code for registration by the ACA, thus making it enforceable.

Local number portability (LNP)

Commission staff participated in meetings convened by the ACIF to review its industry code on LNP, including the IT specifications and operations manual. The revised industry code sets out the procedures that carriers and carriage service providers must follow to support the various requirements associated with porting telephone numbers. A draft of the revised industry code will be released for public comment by the end of July 2002 and the revised LNP code and associated documents should be completed by September 2002. ACIF intends to submit the code for registration by the ACA, thus making it enforceable.

Aviation

Air transport

Until October 2001 the Commission was responsible for the economic regulation of Sydney airport and 11 privatised airports: Adelaide, Alice Springs, Brisbane, Canberra, Coolangatta, Darwin, Hobart, Launceston, Melbourne, Perth and Townsville. These airports were previously declared under the *Prices Surveillance Act 1983* (PS Act) and, except for Sydney airport, were subject to CPI–X price caps.

In October however, following the Productivity Commission's draft recommendation to government, the declaration applying to Adelaide, Alice Springs, Canberra, Coolangatta, Darwin, Hobart, Launceston and Townsville airports was revoked. This means the airports are no longer required to notify the Commission of proposed increases in charges for aeronautical services. For these airports, the Commission's role from that time has been limited to monitoring the prices, costs and profits related to aeronautical and aeronautical-related services at Adelaide, Canberra and Darwin airports.

Prices surveillance for Sydney, Melbourne, Brisbane and Perth airports remained in place over the full year to 30 June 2002.

Over the past year, the Commission's focus in administering the airport arrangements has been to:

- provide input into the Productivity Commission's inquiry into price regulation of airport services
- assess Virgin Blue's request for an access determination over the Domestic Express Terminal at Melbourne airport
- assess proposals for new or increased charges to fund new investment, security requirements, and a one-off increase allowable under the price cap to core-regulated airports following the collapse of Ansett

- assess price cap compliance and monitor quality of service.

The Commission is also responsible for assessing proposals by Airservices Australia to increase charges for terminal and en route navigation services and rescue and fire fighting services.

Changes in airport regulation—the Productivity Commission's inquiry into price regulation of airports

In May 2002 the federal government released the Productivity Commission's inquiry report on price regulation of airport services, recommending that Sydney, Melbourne, Brisbane, Perth, Adelaide, Canberra and Darwin airports be subject to price monitoring for five years. The government decided to adopt the recommendations, which take effect from 1 July 2002. An independent review will be carried out towards the end of the five-year period to assess the need for future airport price regulation.

The Commission broadly agreed with the Productivity Commission's findings on the market power of airports. The Productivity Commission provided two options for dealing with this market power, the first being prices monitoring and the second being stricter regulation in the form of price caps. The government subsequently adopted the prices monitoring approach.

From 1 July 2002 the Commission's main responsibilities are:

- monitoring of prices for aeronautical and aeronautical-related services at Sydney, Melbourne, Brisbane, Perth, Adelaide, Canberra and Darwin airports
- monitoring service quality at these airports
- collecting and publishing information on the airports' financial performance.

Virgin Blue access determination

Because it is a core-regulated airport, airport services at Melbourne airport are declared services under the access provisions of the Trade Practices Act. Access regulation gives businesses the right to negotiate to use certain facilities. It also gives the Commission the power to arbitrate if the parties cannot agree on terms and conditions.

In March 2001 Virgin Blue Airlines Pty Ltd asked the Commission to determine that certain domestic terminal services at Melbourne airport are airport services under s. 192 of the Airports Act.

After much consultation and the release of a draft determination in October 2001, the Commission made its final determination in February 2002, deciding not to apply access regulation to the Domestic Express Terminal at Melbourne airport because airlines were already protected by other arrangements. In particular, the terminal was already subject to price control under the Prices Surveillance Act. These statutory price controls limit Melbourne airport's ability to exercise its market power over the terminal. In August 2000 the Commission had approved a price of $1.65 per passenger for use of the new terminal.

The Commission also noted that Virgin Blue was already using the terminal under a commercially negotiated agreement that applies until 2007. By asking the Commission for formal right to use the terminal, this would enable Virgin Blue to seek Commission arbitration if Melbourne airport did not agree to lower its price. In deciding not to apply the access regulation to the terminal, the Commission was mindful that it had already determined a fair price for the use of the terminal and that Melbourne airport had not denied Virgin Blue access to the terminal.

Sydney airport—apron charges

In January 2002 Sydney Airports Corporation Limited (SACL) sought approval to levy a charge for apron parking during curfew hours by certain freighter aircraft.

SACL proposed a charge of $38.50 (GST-inclusive) per 15-minute period for freighter aircraft operating during curfew hours and which use the designated aprons for operational purposes. SACL sought approval to retrospectively apply the charge from 1 October 2001.

After wide consultation the Commission decided not to object to SACL's proposal, although it did not agree to it being retrospective. The Commission had some concerns, however, that this charge could allow Sydney airport to generate revenues in excess of its costs.

Regulatory reports

Each year the Commission releases regulatory reports for Sydney airport and 11 privatised airports: Adelaide, Alice Springs, Brisbane, Canberra, Coolangatta, Darwin, Hobart, Launceston, Melbourne, Perth and Townsville. The reports provide information on quality of service, financial accounts, price cap compliance and prices, costs and profits of monitored aeronautically related services.

The Commission released the 2000–01 report for Sydney airport in November 2001, followed by regulatory reports for Phase I airports in early February 2002 and Phase II airports in April 2002.

Price cap compliance

The compliance results for 2000–01 were as follows.

- Brisbane airport over-recovered for the past three years, and had a carry forward over-recovery of over $2 million as at 30 June 2001. This largely related to taxi fee revenue.
- Melbourne airport marginally over-recovered in 1999–00 and 2000–01 and had a carry forward over-recovery of over $100 000 as at 30 June 2001.
- Perth airport lowered its charges to meet its CPI–X for the year, but still had an over-recovery from previous years, and therefore failed to comply with the cap. It had a carry forward over-recovery of just under $1 million at 30 June 2001—largely taxi fee revenue.

While the declaration providing for prices surveillance at Phase II airports was revoked in October 2001, price caps were in place over the year 2000–01 and compliance for these airports was reported.

With the exception of Adelaide and Launceston airports, all Phase II airports had an under-recovery balance at 30 June 2001. In these cases, the over-recoveries arose when reductions in charges arising from savings under the New Tax System (NTS) were excluded from the calculation of compliance.

Quality of service

Under the *Airports Act 1996*, the Commission monitors airport quality of service, collecting information from airport operators, Australian Customs Service and Airservices Australia. The information includes data from customer perception surveys. The Commission also conducts airline surveys.

Over the year, the quality of service for the three Phase I and Sydney airports was generally rated as satisfactory. Brisbane airport again achieved high quality of service ratings from airline operators and passengers. Perth and Sydney airports achieved generally satisfactory results although some facilities and services at Perth airport continue to have low ratings. Melbourne airport received improved ratings compared to the previous year.

The results indicated that of the Phase II airports, users at Alice Springs, Canberra, Darwin and Launceston airports were reasonably satisfied. Users were moderately satisfied at Adelaide, Coolangatta and Hobart airports and quite satisfied at Townsville.

Financial accounts

The regulatory reports show that the three Phase I airports reported positive earnings before the deduction of interest and taxation. The results are an improvement on the previous year's results across all three airports, although once taxation and interest were taken into account, losses were recorded. Sydney airport recorded a profit in 2000–01, although less than the year before, because of higher borrowing costs and income tax.

All Phase II airports reported positive earnings before interest and taxation, but once these items were deducted, losses were recorded.

Prices monitoring outcomes

The PS Act requires the Commission to monitor prices, costs and profits of aeronautical-related services such as aircraft refuelling, car parks and airline check-in services.

For Phase I and Phase II airports, as well as Sydney airport, revenues tended to be well in excess of costs, although it is important to note that the costs did not include amortisation of intangible assets or interest.

Necessary new investment

The price cap arrangements include provisions to pass on the costs of necessary new investment. They allow airport operators to increase charges to fund new investment provided they have the Commission's approval.

In assessing new investment proposals, the Commission must consider criteria such as user support for the proposals and the relationship between the proposed price increases and the costs of the new investments. In 2001–02 the Commission assessed two new investment proposals.

Melbourne airport

Melbourne airport notified the Commission in October 2001 of its intention to increase general and international landing fees to fund projects including land acquisition for future runway capacity, and aerobridge safety. The Commission did not object to an increase in the international terminal charge to $0.18 per tonne MTOW (GST-inclusive) and the general landing charge to $0.03 (GST-inclusive). Following a final review, Melbourne airport advised the Commission that because of the reduced capital requirement and a revision of the aeronautical tonnage forecasts, the increase would only be $0.16 on the international terminal charge.

Brisbane airport

On 26 November 2001 Brisbane airport presented the Commission with a proposal to revise aeronautical charges for two new investment projects—a ground facilities project undertaken in 1998, as well as a small project relating to the domestic terminal building taxi queuing area. Brisbane airport also proposed an additional increase in landing charges of $0.10 to compensate for past under-recoveries under the price cap but withdrew the proposal after discussions with the Commission.

Brisbane airport proposed that the following cumulative amounts (GST-exclusive) be approved as a pass through of the price cap:

- $0.21 for the general landing charge
- $1.16 for the international terminal charge
- $20.10 for the domestic terminal charge.

The Commission did not object to the pass-through amounts for the international and domestic terminal charges, but only agreed to $0.19 for the landing charge.

One-off increases to aeronautical charges following the collapse of Ansett

Following the collapse of Ansett Airlines, the Commonwealth Government decided to allow regulated airports, including Melbourne, Perth and Brisbane airports, a once only price increase for aeronautical charges, based on starting point prices (1 January 1997).

The increases were for the following amounts:

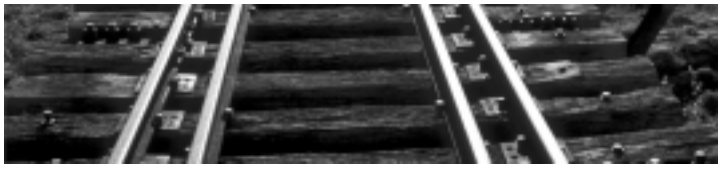
- 6.7% of starting point prices for Brisbane airport
- 6.2% of starting point prices for Melbourne airport
- 7.2% of starting point prices for Perth airport.

The Commission did not object to any of these one-off increases.

Security charges

The price caps allow direct costs of providing compulsory airport security such as passenger screening, baggage screening and counter terrorist security to be passed on.

During 2001–02 the Commission assessed six such proposals, four of which were in response to the federal government's direction to apply additional security measures following the events of September 11 (see below). Of the two



remaining notifications, one related to checked baggage and passenger screening charges at Perth airport, and the other to the counter terrorist charge at Melbourne airport.

Additional security measures

Following the events of September 11 the Department of Transport and Regional Services directed all core-regulated airports as well as Sydney airport to apply additional security measures. The Commission was advised that these measures were over and above those in place during the normal course of airport operations. Perth, Melbourne, Sydney and Brisbane airports subsequently lodged notifications for new or increased charges to recover the costs of these measures. The Commission did not object to any of these proposals.

Airservices Australia

On 13 May 2002 Airservices Australia submitted a proposal to change the pricing of its terminal navigation, en route navigation and rescue and fire fighting services because of a sharp downturn in aviation activity since September 2001. After obtaining comments and considering the issues, the Commission decided that there was some justification for an increase in charges but that there was not sufficient evidence, in the form of long-term traffic forecasts, to justify an increase beyond the financial year ending 30 June 2003. However, it was possible that a permanent increase in en route charges may be justified because Airservices Australia had specifically identified a previous reduction in that charge as temporary.

The Commission invited Airservices and interested parties to respond by 1 July and anticipated making a final decision in late July.

Rail

Australian Rail Track Corporation

The Commission accepted its first rail track access undertaking on 1 May 2002 in accordance with Part IIIA of the Trade Practices Act, lodged by the Australian Rail Track Corporation (ARTC).

ARTC is a public company owned by the Commonwealth of Australia, set up in 1998 to manage the infrastructure and access to the standard gauge rail network connecting the mainland capital cities between Brisbane and Perth. The part of the network subject to the undertaking links Kalgoorlie in Western Australia; Adelaide, Wolseley and Crystal Brook in South Australia; Broken Hill in New South Wales; and Melbourne and Wodonga in Victoria.

The access undertaking sets out a framework for how negotiations should be conducted between ARTC and train service operators who wish to obtain access to the network. ARTC's objectives included stimulating customer confidence and market growth in the rail industry. Equity and transparency are key elements in the undertaking for determining access, prices and terms and conditions of agreements. Specifically, the undertaking covers the process of negotiation for access, pricing principles, quality of service and performance indicators and issues relating to management of the network. It also includes an indicative access agreement that forms a basis for an agreement between ARTC and an operator.

The Commission's decision to accept the undertaking followed extensive public consultation, negotiations with ARTC, revisions to the proposal and assessment on the basis of the statutory criteria set out in subsection 44ZZA(3). The Commission released an issues paper, conducted two public forums, released a draft decision and considered two rounds of submissions from interested parties.

The criteria in subsection 44ZZA(3) oblige the Commission to ensure that the undertaking, among other things, strikes an appropriate balance between the interests of the infrastructure owner and access seekers and the public interest. The Commission formulated some principles to help assess three broad issues:

- pricing for access to ARTC's rail track that focuses on efficient outcomes
- processes for gaining access including negotiation and dispute resolution provisions that provide for timely, commercially negotiated outcomes
- providing clear conditions that allow enforceability of the undertaking.

It is the first time this process was followed and resulted in ARTC adopting some significant changes to its original proposal.

The Commission also recognised that ARTC's interstate rail network has many characteristics common to natural monopolies: investment in specialised assets which is, to a large extent, irreversible; correspondingly high sunk fixed costs leading to economies of scale; and network effects.[3] Some of ARTC's customers have significant sunk investments in infrastructure, which could potentially provide ARTC with leverage in commercial negotiations.

There may, however, be some limits to ARTC being able to take advantage of any consequent market power when the nature of the markets in which its customers operate is considered. Most of ARTC's revenues are earned from the interstate transport of freight in markets that are subject to a substantial degree of competition from non-rail sectors, mainly road and sea. Similarly, prices set by ARTC result in revenues significantly below that necessary for an adequate long-term economic rate of return. These factors, together with the fact that ARTC is not vertically integrated, provide an incentive to drive greater productivity from the asset and ensure that the physical asset is maintained to increase rail's relative competitiveness.

Several provisions in the undertaking also act as constraints to the misuse of market power. These include ARTC's intention to commit to ongoing reductions in real prices charged to users and limit price discrimination. It depends on lifting the amount of traffic on the network and on greater operating and cost efficiency to ensure future profitability.

However, constraints on ARTC's non-price conduct may be less effective. Some clauses in an earlier version of the undertaking, particularly those dealing with negotiation processes, capacity management, network extensions and capacity additions, gave ARTC broad scope in its dealings with access seekers. The Commission considered that these clauses did not satisfy the legislative criteria in Part IIIA and made recommendations on them.

Subsequently ARTC amended certain provisions to impose more stringent obligations on itself and/or greater safeguards for access seekers. The undertaking thus achieves a more appropriate balance between the interests of the infrastructure owner and access seekers and reflects the Commission's consultative assessment process.

The undertaking is an important step towards improving interstate rail access for train operators and, with the Commission's detailed analysis, can be used as a guide for further access undertakings covering other parts of the interstate rail network. The final decision is now available from the Commission's website.

[3] A network effect occurs when users of an infrastructure service benefit from other users deciding to use that infrastructure. In ARTC's case this may include, for example, the ability to connect with other users, the availability of complementary products or reduced network access costs.

Waterfront and shipping

Container stevedore monitoring

On 20 January 1999 the Federal Treasurer directed the Commission under s. 27A of the *Prices Surveillance Act 1983* to monitor prices, costs and profits of container stevedoring operators in the ports of Adelaide, Brisbane, Burnie, Fremantle, Melbourne and Sydney. The aim is to inform the community about the progress of some aspects of waterfront reform at the major container terminals, as well as the absorption of the stevedoring levy.

The Commission released its third container stevedoring monitoring report in October 2001. It examined trends in prices, costs and profits of the three major stevedoring companies, P&O Ports Pty Ltd, Patrick Stevedores Operations Pty Ltd, and CSX World Terminals Pty Ltd for the two half year periods—July to December 2000 and January to June 2001. The average industry wide cost per TEU for the six months July to December 2000 was $140, which increased to $149 for the second six months to June 2000. Average unit revenue also increased from $172 per TEU in the six months to December 2000 to $174 in the first six months of 2001.

The Commission monitoring has also highlighted major productivity improvements in the container stevedoring industry. In terms of long-run trends, industry wide average revenue (prices) and average costs are much lower than in 1995 when the previous stevedoring monitoring program by the Prices Surveillance Authority (PSA) ended.

It appears the stevedore levy was not passed on as higher charges but seems to have been offset against other cost reductions made by P&O Ports and Patrick.

The next monitoring report is due in October 2002.

Part X

Australia's approach to regulation of liner shipping services is similar to that adopted in many other developed countries. Under Part X of the Trade Practices Act shipping companies and their exporting and importing customers can negotiate the terms and conditions for providing liner shipping services. Essentially, Part X gives concessions to providers of liner shipping services to behave in ways that would not otherwise be permissible under the TPA—that is, to enter into cooperative arrangements in providing shipping services to Australian importers and exporters.

The Commission's role under Part X is limited to investigating specific agreements before recommending to the minister whether or not there may be grounds for deregistering the agreement and subjecting the lines to the provisions of the TPA.

Until recently, the Commission could only investigate an agreement following a request from either the minister or a complaint from shippers. However amendments in 2000 to Part X mean the Commission can initiate investigations. It has started an informal monitoring program to develop an awareness of factors that are likely to contribute to increased rate rises for sea cargo freight either in the form of rises in blue water freight rates or in general tariff levels.

Harbour towage

Under the PS Act, the Commission regulates price setting by harbour towage operators in the 'declared' ports of Sydney (Port Botany and Port Jackson), Melbourne, Brisbane, Adelaide, Fremantle and Newcastle. With recent trends of industry rationalisation, the declaration now applies solely to the towage subsidiary companies of Adsteam Marine.

The Commission can object to, but cannot prevent price increases of declared services, and

in February 2002 made a decision to object under the PS Act to price rises sought by Adsteam for harbour towage services. Despite the Commission's decision Adsteam subsequently implemented all its proposed increases.

The Commission also has a responsibility to assess whether a declared company may be using its monopoly position set monopoly prices.

On this occasion, the Commission decided that the price increases proposed by Adsteam, which ranged between 11 per cent (in Brisbane) and 27 per cent (in Port Jackson), would have generated excessive rates of return.

On 20 February 2002 the federal government announced that the Productivity Commission (PC) would undertake an inquiry into the economic regulation of harbour towage and related services.

The Commission considers that this inquiry is timely. The declaration needs to be reviewed in a public and transparent manner before it expires in September 2002. The harbour towage industry structure and performance also needs to be thoroughly investigated.

The Commission argued to the PC that the regulation of prices set by towage operators in the seven declared ports should continue on the grounds that the Australian towage market is a natural monopoly, with single providers in all declared ports (until the recent entry of Australian Maritime Services into the Port of Melbourne). There is very little scope for inter-port competition, weak contestability, and little opportunity for users to substitute away from towage usage.

There is little evidence to suggest that the single towage operator, Adsteam Marine, which operates in 32 ports around Australia, is subject to any competitive discipline on pricing—either from existing competitors or from potential entrants.

This is a market therefore where the incumbent wields considerable power.

Because of this, the Commission submitted to the PC that if there is a demonstrated case for economic regulation of towage, then the regulator should be able to effectively implement decisions.

The PC finalised its report on the economic regulation of harbour towage and related services and it is now being considered by the government.

Post

The Commission assesses price notifications relating to proposed increases in charges for postal services 'reserved' to Australia Post.

Over the past year, the Commission has:

- assessed Australia Post's proposal to remove the AdPost discount
- begun assessing Australia Post's proposal to increase the price of the basic stamp as well as assorted other reserved services.

AdPost

In December 2001 Australia Post lodged a notification with the Commission proposing to phase out the current content-based AdPost discount for all customers except charities.

This is not the first such proposal. In March 1999 Australia Post proposed reducing Ad Post discounts from 26.5 to 21 per cent. The reduced discount was introduced in April 2000.

The current notification proposes to phase out the AdPost discount in two stages:

- a 10 per cent increase in AdPost prices from 1 July 2002
- terminating the AdPost service in 1 January 2003, resulting in a further 9 per cent price increase as customers migrate to the equivalent barcode pre-sort service.

The Commission made no objection to the proposed price changes.

Proposal to increase the price of the stamp and assorted reserved services

In April 2002 Australia Post advised the Commission of its intention to lodge a pricing notification under s. 22 of the Prices Surveillance Act to increase the price of various postal services, including the basic postage stamp, pre-sorted mail, greeting cards and large letters, from January 2003. Australia Post also proposes to introduce a new bulk mail category, 'Clean Mail', priced at a discount to the basic postage rate.

Australia Post argues that the profitability of providing letter services is declining and will continue to decrease because of falling volume and fewer opportunities for improving efficiency.

The Commission released an issues paper on 10 May 2002, requesting submissions by mid-June and ran public forums across the country in late June.

The Commission expects to release a decision in the second half of 2002.

Petrol monitoring

Outline of price monitoring program

Following the deregulation of petrol and diesel prices on 1 August 1998 the Commission's main role was to monitor petrol prices in the capital cities and a number of country towns. The Commission examined retail prices and determined notional retail margins by comparing them with an indicator of import parity prices. The Commission also monitored the city–country retail price differential and the wholesale list and terminal gate prices of the oil majors.

In 2000–01 the Commission's price monitoring program was expanded to more effectively assess prices under the New Tax System. Average retail prices for unleaded petrol, diesel and auto LPG from around 150 country towns across all states and territories were collected weekly, as well as in the five largest capital cities and Darwin, Canberra and Hobart. Monitoring in 2001–02 continued on the same basis.

With the end of the New Tax System transition period on 30 June 2002, the Commission will be scaling back its country price monitoring to around 100 towns.

Monitoring outcome

The Commission's monitoring of unleaded petrol prices from July 2001 to June 2002 showed that average retail prices in metropolitan and country areas were quite volatile. Movements in the international product price (the spot price for Singapore Mogas 95 unleaded) and the Australian/US dollar exchange rate principally drove this volatility.

International product prices showed large fluctuations during the year. However, the average price in 2001–02 ($US25. 7 per barrel) was $US6.7 per barrel lower than the average price in 2000–01 ($US32.4 per barrel). Between July 2001 and June 2002 the monthly average Australian/US dollar exchange rate rose by about six cents.

Consistent with these movements in international product prices and the exchange rate, the average monthly five capital cities unleaded petrol price remained stable in July and August and rose sharply in September—to the year's monthly high of 89.1 cents per litre (cpl). It declined in the following months to the year's monthly low in January 2002 of 78.5 cpl. The price increased substantially over the next three months and then declined marginally. These movements in price are shown in figure 6.3. The average price in 2001–02 (83.4 cpl) was 7.3 cpl lower than the average price in 2000–01 (90.8 cpl).

The average price in the country towns monitored by the Commission remained fairly stable for the first half of 2001–02, before falling sharply in February and increasing in March. There was a steady increase in the last three months of the year. In general, country prices do not respond as quickly to changes in international prices as metropolitan areas because of lower volume turnover rates.

The average differential in 2001–02 between average retail petrol prices in the five major metropolitan cities and country areas was 6.7 cpl. This was 0.5 cpl lower than in the previous year (7.2 cpl). However, the monthly differential fluctuated from a high of 9.9 cpl in July 2001 to a low of 3.6 cpl in March 2002.

In 2001–02 the Commission received over 2395 inquiries and complaints relating to fuel pricing issues (including the Fuel Sales Grant Scheme). They were examined and follow-up action taken where appropriate.

Inquiry into reducing fuel price variability

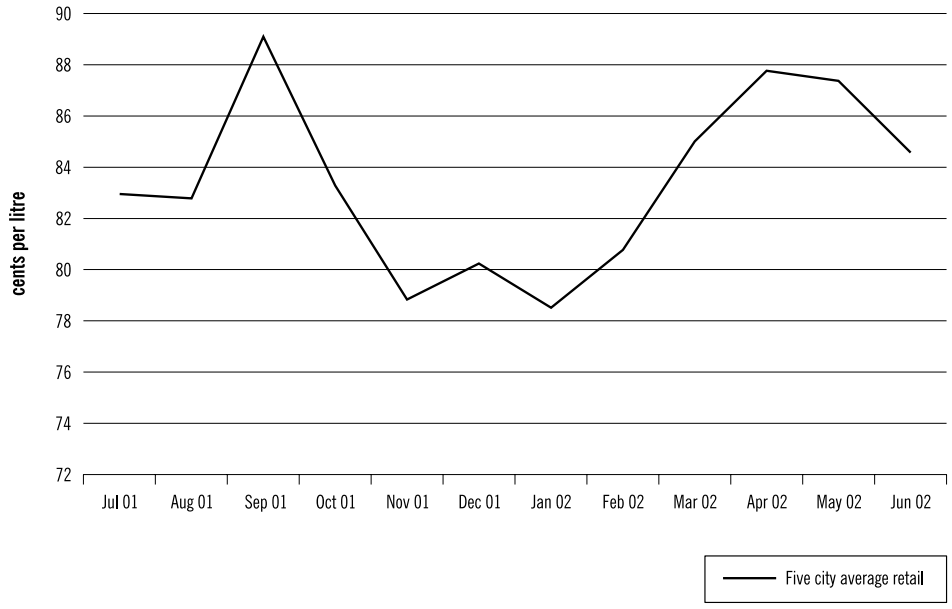
In early March 2001 the federal government asked the Commission 'to examine the feasibility of placing limitations on petrol and diesel retail price fluctuations throughout Australia'. A discussion paper was released in June 2001 and the final report was provided to the Treasurer in December 2001. The report was publicly released on 14 May 2002.

The report noted that volatility in retail petrol prices is generally confined to the major metropolitan cities and some rural towns on major highways. The price cycles in these areas are fairly regular and frequent. Diesel prices do not exhibit similar price cycles.

Some consumers are concerned about price cycles and others take advantage of them by buying petrol at the bottom of the cycle when prices are lower. The report concluded that overall consumers benefit from price cycles for two reasons:

- In general, consumers are better off with variable prices than they are with a fixed (simple average) price, because they have the opportunity to buy at the low point of the price cycle.
- Data obtained by the Commission indicates that on average, around 60 per cent of the total volume of petrol sold over the petrol price cycle is sold below the average price of the price cycle and around 40 per cent is sold above.

Figure 6.3 Average monthly unleaded petrol prices— five major capital cities—July 2001 to June 2002





While consumers as a whole may benefit from price cycles, there are individual consumers who do not. Some may be price sensitive and it may be possible to help them change their buying behaviour by raising their awareness of price cycles.

The Commission examined options for limiting petrol price cycles, including terminal gate pricing (TGP) with a number of conditions, limiting price changes to only once in 24 hours, limiting price increases to a certain amount each day, and price regulation at the retail and wholesale levels. The Commission concluded that they would have either no effect on price cycles or, if they did, they could lead to higher average retail prices.

The Commission's report had five recommendations:

- There should be a consumer awareness initiative to raise consumers' understanding of price cycles and help them time their purchases so that they buy petrol when prices are relatively low.
- The government should consider holding discussions with all industry participants to further reform the petroleum industry.
- The current TGP arrangements in Western Australia and Victoria should be monitored closely before a final conclusion is made about TGP.
- Other options to limit price cycles should not be implemented.
- The fuel pricing arrangements in Western Australia should continue to be monitored closely.

The government agreed to all of these recommendations and asked the Commission to:

- collect and make available the information it considers helpful to consumers
- continue monitoring and report back to the government by the end of 2002 on the TGP arrangements of Victoria and Western Australia and the fuel pricing arrangements in Western Australia.

Utility Regulators' Forum

The Commission, in conjunction with other state-based regulators, established the Utility Regulators' Forum—a committee of regulatory agencies—to promote information sharing and consistent approaches to the development of regulation. Industry and user representatives are able to attend and address the forum.

During the year the forum released a discussion paper on *National regulatory reporting for electricity distribution and retailing business,* which was published in March 2002. Copies are available from the Commission's Melbourne office or on the ACCC web page.

The forum also started a working group on promoting best practice regulation. It includes the ACCC, Independent Pricing and Regulatory Tribunal and the Essential Services Commission and is undertaking work on comparing building blocks and index-based approaches to regulation. A paper is expected during the year.

Several meetings have been held over the past 12 months and regular issues of the newsletter, *Network*, have been published. *Network* is posted on the Commission's Internet website and is distributed to industry and the general public.

The member agencies of the forum are:

The Australian Competition and Consumer Commission (ACCC)

NSW Independent Pricing and Regulatory Tribunal (IPART)

Victorian Essential Services Commission (ESC)

Tasmanian Government Prices Oversight Commission (GPOC)

Office of the Tasmanian Electricity Regulator (OTTER)

Queensland Competition Authority (QCA)

WA Office of Gas Regulation (OffGAR)

Office of Water Regulation—WA

SA Independent Pricing and Access Regulator (SAIPAR)

SA Independent Industry Regulator (SAIIR)

ACT Independent Competition and Regulatory Commission (ICRC)

Northern Territory Utilities Commission (NTUC)

National Competition Council (NCC)

Government response to the Intellectual Property and Competition Review Committee

In June 1999 the federal government established the Intellectual Property and Competition Review Committee to review the competition aspects of intellectual property legislation.

The committee issued its final report in September 2000, and made a series of recommendations to change Australia's intellectual property laws and the Trade Practices Act, improving the balance between those laws and competition policy.

The government announced its response to the final report in August 2001.

Two areas of the government's decision are of particular interest and relevance to the Commission—first, the decision to amend s. 51(3) of the Trade Practices Act, and second, the decision to give the Commission a role in the activities of copyright collecting societies.

Section 51(3) of the Trade Practices Act

Section 51(3) of the Act exempts certain licences and assignments relating to patents, copyrights, trade marks or designs from prohibition under ss. 45 (agreements that substantially lessen competition), 47 (exclusive dealing) and 50 (mergers that substantially lessen competition).

The government decided to amend s. 51(3) so that intellectual property licensing would be subject to Part IV, but a contravention of the *per se* prohibitions of ss. 45, 45A and 47 or s. 4D would instead be subject to a substantial lessening of competition test.

This decision will expose intellectual property licensing and assignment to Part IV of the Trade Practices Act to a greater extent than is currently the case.

To reduce business uncertainty about how the Commission will enforce Part IV in relation to intellectual property licensing, the government has decided that the Commission would issue guidelines.

The guidelines would define:

- when intellectual property licensing and assignment conditions might be exempted under s. 51(3)
- when intellectual property licences and assignments might breach Part IV
- when conduct that is likely to breach the Act might be authorised.

The government expects the Commission to consult with interested parties in preparing these intellectual property guidelines.

Copyright collecting societies

Copyright collecting societies are an administratively efficient way for copyright owners to enforce their intellectual property rights and to collect and distribute copyright licence fees. However, as monopolies, their existence gives rise to potential competition concerns including the potential abuse of market power to extract high licence fees from users.

The Committee recommended that the existing powers of the Copyright Tribunal to review output arrangements of declared collecting societies be extended to cover those of voluntary collecting societies not administered under a statutory licence.

The government accepted this recommendation and outlined the involvement of the Commission.

The Commission will be required by statute to issue guidelines on which matters it considers to be relevant in determining reasonable remuneration for copyright holders in negotiations between societies and users of copyright material.

The main purpose of the guidelines would be to facilitate licence negotiations and minimise recourse to the Copyright Tribunal for a determination. If negotiations failed and one or other party applied to the tribunal for a determination, recourse to the tribunal would not be restricted in any way. The Commission's guidelines would be advisory, not determinative.

The Copyright Act will be amended so that the Copyright Tribunal has the discretion to take account of the guidelines and to admit the Commission as a party to tribunal proceedings.

International forums

The Commission is increasingly cooperating with its international counterpart agencies on competition, consumer protection and regulatory matters to effectively enforce laws in Australia and overseas (see also chapter 3, p. 68).

APEC

The Commission also continued its support of the joint APEC/OECD Cooperative Initiative on Regulatory Reform, implemented in 2001, which contributes to deepening the dialogue and technical assistance between regulatory agencies of economies inside and outside APEC. Mr Michael Cosgrave, General Manager of the Commission's Telecommunications Group, participated in a workshop in Beijing in September 2001. This work, in the form of a series of workshops and seminars, will continue into 2003.