

## The Regulatory Dilemma with Smart Grid Investments: Some Lessons Learned from Europe

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Increasing energy demand, dwindling fossil energy resources and climate change have led to political objectives to reduce CO<sub>2</sub> emissions and to increase the share of renewable energy sources (RES). The long-term target of the European Union is to become carbon neutral by 2050 and the medium-term targets imposed by the 20-20-20 agenda (Lisbon Treaty) stipulate: (i) a reduction of CO<sub>2</sub>-emissions by 20 per cent; (ii) an increase of energy efficiency by 20 per cent; and (iii) that 20 per cent of energy demand is to be met from RES by 2020. Hence, underlying environmental policy targets will considerably affect the energy sector and change its structure substantially.

As a consequence of these policy changes, physical principles of the energy system change and its conventional value-chain breaks up. For example, distributed generation units closer to end users emerge (e.g., photovoltaic (PV) and combined heat and power (micro-CHP)) and generation arises remote from the load centre (e.g., offshore wind). Moreover, renewable energy plants depend on the fluctuating availability of RES. Notably, the electricity distribution sub-sector plays a key role in integrating intermittent, decentralised low-carbon technologies, enabling new forms of demand-side management and managing electric vehicles. This requires networks to respond to intermittent generation schedules, to enable bi-directional energy flows and to implement new forms of communication and network control. The key will be a technological upgrade towards an ICT-based infrastructure, namely smart grids. Their development, however, will require a significant amount of investment and innovation in distribution networks. Being natural monopolies, network operators invest in a regulatory environment.

The crucial question, therefore, is whether incentive regulation, as the prevailing regulatory regime in Europe, provides the right investment incentives to enable the paradigm shift towards smart grids; or is there a need for a realignment of the regulatory framework, including reconfigured investment incentives?

In addressing this issue, this paper builds on a review of the relevant economic literature, surveying the incentives from conventional cost-based regulation methods (rate-of-return and cost-plus regulation) and from incentive regulation. These regulatory methods are considered in the context of the three facets of economic efficiency – allocative, productive (or cost) and dynamic efficiency. Promotion of dynamically efficient investments is particularly relevant to the paradigm shift. This paper enlarges the academic views on this issue. To complement the insights from regulatory economics, the paper presents case studies of regulatory regimes implementing or discussing increased regulatory measures towards investments in a smart-grid context. Germany, the United Kingdom (UK) and Italy are reviewed.

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## Investment and Innovation and their Regulatory Treatment

In order to underline the focal issue of Innovative Regulation for Intelligent Networks (IRIN) theoretically, Müller, Growitsch and Wissner (2010) scrutinise cost- and incentive-based regulatory regimes with regard to their different incentives. Furthermore, they evaluate the different regulatory methods with respect to their efficiency goals – allocative, productive (cost) and dynamic efficiencies. Special attention is paid to how far network innovations can be stimulated by certain regulatory regimes, and whether these measures lead to dynamic efficiency.

The authors find that conventional cost-based regulation methods (rate-of-return and cost-plus regulation) lead to overcapitalisation (Averch-Johnson effect) and provide incentives for allocative efficiency only. However, this type of regulation does not stimulate productive or dynamic efficiency (technological progress). This, from an efficiency point of view, insufficient regulatory regime is partially compensated in incentive-based regulation. Mimicking the situation in a competitive environment, a given regulatory path for reducing inefficiencies, combined with bonuses and penalties, provides incentives mainly for productive efficiency. However these incentives affect mainly short-term potential for increasing efficiencies in operational expenditures (OPEX). Long-term incentives for investments into an intelligent infrastructure, which lead to a dynamically efficient resource allocation in capital expenditures (CAPEX) are not sufficiently promoted by incentive-based regulation. Here we identify a regulatory dilemma.

In order to classify dynamic efficiency more precisely, Müller, Growitsch and Wissner (2010) differentiate between process and product innovations. Process innovations can be described as innovations without an investment nature – that is, innovations that make the operation of energy networks more efficient. This increase in efficiency often leads to a reduction of OPEX and relates to the previously discussed area of productive efficiency. Product innovations on the other hand, can be understood as capital-intensive investments in a physical, technological upgrading of the network infrastructure – creation of a smart grid. Even though these innovations may display short-term static inefficiencies, they may result in long-term dynamic efficiency; and may reduce the need for network expansion. Both types of innovation require expenditures in research and development (R&D). The regulatory implications of R&D are extensively discussed in Bauknecht (2010).

A brief overview follows of the literature on the relationship between long-term efficient investments

(reflecting dynamic/innovative efficiencies) and the regulatory classification of this investment category from the point of view of economic theory. A dynamic development is determined by process innovation and investment in new technologies. This not only implies the creation of additional demand, but also long-term cost reduction and the realisation of technological progress. Dynamic efficiency thus implies that welfare reaches a maximum over time. This allows for temporary static inefficiencies, assuming that dynamically efficient investments and innovation are not always cost efficient from a short-term perspective.

The academic literature discusses network innovations, especially in grid-bound energy supply, rather cursorily and mainly refers to generic, theoretical considerations and models as well as experiences from other network industries (in particular, telecommunications). Magat (1976) was among the first to examine the effects of rate-of-return regulation, cost-plus regulation and cap-regulation on speed and direction of technological progress. Likewise, Cabral and Riordan (1989) and Clemenz (1991) address this issue. In contrast to cost-based regulation, companies under incentive-based regulation are incentivised by its characteristic decoupling of costs and prices, and therefore have incentives to employ a more flexible and more efficient management of costs. At the same time, however, the authors emphasise the challenge of anchoring adequate regulatory instruments to enhance dynamic efficiency.

Bailey (1974) shows how longer regulation periods urge monopolistic firms to boost innovation by allowing them to benefit for longer from innovation-induced efficiency gains (compared to their previously permitted costs) and thus to maximise their innovation-induced profits. Sweeney (1981) deals with the resulting trade-off – does it pay for a profit-maximising company under regulation to implement cost-reducing innovations or to postpone them? Sweeney shows that the detailed design of the regulatory regime becomes a critical factor, in particular the length of regulatory period.

Lyon and Huang (1995) discuss the problem of innovating in the context of asymmetric regulation (defined as different companies in the same sector being subject to different regulation) which they relate to the concept of rivalry in innovation. They show that a regulated firm has less incentive to innovate than its unregulated counterparts. Regulatory restrictions with regard to innovation surpluses diminish incentives to invest in technological progress. However, this may result in a profitable chance for the unregulated competitor since its innovations cannot be imitated by the regulated

company. Asymmetric regulation could be recommended if the existence of only one innovating company would be rational from a welfare-economic point of view – if an innovation promises specific potential for cost reduction which can be passed on to the customers. However, the authors point out that the problem of an optimal regulatory response to innovations and incentives to innovate – especially regarding a possible imitation of innovation – has not yet been solved.

Within the context of a fundamental debate, Armstrong and Sappington (2006) indicate that, even though incentive-based regulation can generate substantial incentives for short-term-oriented innovations, it does nevertheless barely provide incentives for long-term-oriented infrastructure investments (network innovations in a smart-grid context). Bourreau and Dogan (2001) point out that, from a welfare-economic point of view, price-cap regulation can result in a higher consumer surplus in the long run if innovation is implemented as a continuous process. Hence, the authors consider this approach, among all kinds of regulation (e.g., rate-of-return regulation), to be the most suitable regime for stimulating innovations in terms of technological progress. Baake, Kameke and Wey (2005) discuss a regulatory regime for innovative markets in telecommunications. The authors argue that cost-based regulation does not cover incentives for 'leapfrogging' competition, and hence, the dynamics of infrastructure-based competition due to a focus on static inefficiencies. This would hamper the emergence of infrastructure-based competition in the highly dynamic telecommunications industry.

## International Experience

In order to enrich the academic debate, this paper reviews pertinent international experiences to see what kind of approaches are taken to customise the regulatory framework to better stimulate investments and asset innovation. It refers to three examples, namely Germany, the United Kingdom and Italy. These countries are revising or plan to revise their regulatory approach towards investments and innovation in different ways.

### **Germany: emerging incentive regulation**

Germany has been implementing since 2009 an incentive regulation scheme. Regulatory measures apply to a large number of regulatees; this is more than 800 distribution network operators (DNOs) in electricity and gas. As per the German Energy Act 2005, regulation focuses on incentives for an efficient network operation, including an adequate rate of return (i.e., productive efficiency). Therefore, the appropriate treatment of investments and inherently

innovation<sup>1</sup> is critically reflected on a continuous basis. Two WIK studies (see Growitsch, Müller and Stronzik, 2010, and Stronzik, 2011) find that the ability to invest in terms of replacement investments is not jeopardised by the current German design of incentive regulation. Moreover, the implementation of quality regulation as from 2012 is supposed to further balance an optimal level of network reliability. Expansion investments are incentivised by additional cost-based instruments increasing the allowed revenues (e.g., investment budgets – mainly for transmission networks – or the expansion factor providing for permanent and considerable changes in the distribution task of DNOs, for example, in terms of supplied area or connection of distributed generation). In contrast, innovative network investments are neither sustainably promoted by explicit regulatory stimuli nor are they attractive to an economically optimising network operator. This is mainly due to the current design of TOTEX-benchmarking, which would rank a network operator investing in new technologies (involving an increase in CAPEX), *ceteris paribus* as more inefficient than its non-investing/non-innovating peers. Moreover the intrinsic time-lag in the German regulatory scheme leads to a delayed CAPEX recovery for new investments in the allowed revenue cap of three to seven years. That is, benefits due to innovative investments would only capitalise with a certain lag (Stronzik, 2011).

As theory and current regulatory practice in Germany suggest, complex trade-offs arise between the principle of an efficiency-oriented network operation (productive efficiency) and incentives for dynamically efficient investments. Therefore, current discussions and research activities (e.g., IRIN) focus on this issues.

### **United Kingdom: the RIIO model**

Empirical evidence (Jamashb and Pollitt, 2007) and Ofgem's (2010a) overall appraisal suggest that RPI-X regulation significantly reduced distribution charges and improved the network operators' efficiency. However, critical reflection about the British regulatory approach with all its multifaceted features initiated a review of whether it is 'fit for purpose' given the upcoming challenges for networks triggered by

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<sup>1</sup> Investments can be categorised into replacement investments (maintain reliability of existing network structure), expansion investments (upgrade network structure in terms of capacity) and network innovation (CAPEX-driven technological upgrade of assets, e.g., smart grids, bearing the potential to reduce network expansion).

ambitious decarbonisation and sustainability targets. The targets set by the British Government stipulate a reduction of 80 per cent in greenhouse gas emissions by 2050, and decarbonised electricity generation by 2030, requiring a paradigm shift of all energy-related activities. Ofgem's RPI-X@20 initiative is an in-depth review of energy-network regulation aimed at finding an optimal framework enabling energy network companies to operate networks required for a sustainable low-carbon energy sector.<sup>2</sup>

The new regulatory framework, which will come into effect as from 2013, is known as the RIIO model, abbreviated for Revenue set to deliver strong Incentives, Innovation and Outputs. The underlying regulatory formula can be synthesised as the following equation: Revenues = Incentives + Innovation + Outputs (Ofgem, 2010a).

Overall, the RIIO model is based on the RPI-X framework. Whilst some existing features were enhanced, others were retained and new dimensions were added. Two pertinent elements characterise the new scheme – it is output-driven and takes a forward-looking perspective to deliver 'long term value for money' in order to promote smarter networks for a low-carbon future, keeping in mind the 2030 and 2050 targets. This is reflected in the more holistic treatment of capital expenditures (Ofgem 2010a, 2010b).

One feature is that the network operator is supposed to set out its investment strategy to meet the long-term targets. This involves a well-justified business plan linking anticipated expenditures to the delivery of so-called primary outputs, including customer satisfaction, reliability and availability, safety, conditions for connection, environmental impact and social obligations. With the instrument of 'secondary deliverables', the framework moreover provides the opportunity for network operators to include expenses in their business plans aimed at innovative projects where costs would occur immediately, but benefits would only occur within a longer time horizon. These 'secondary deliverables' could form milestones in project delivery. With regard to price control, this implies that network operators will only be allowed to raise revenues from consumers given the milestone is reached. On the one hand, this approach has been chosen to provide certainty to network operators to engage in long-term investments; and on the other, to make sure that customers do not overpay and they will only be

required to pay (more) when there is certainty that network operators will deliver benefits in the long run. However, this instrument requires a deep level of involvement and scrutiny for both network operators and Ofgem. Therefore, it will only be applied to large investments associated with a high level of uncertainty.

In addition, the network operator is required to consider alternative options to deliver outputs making an optimal compromise between OPEX and CAPEX deployment. This includes a thorough consideration of all implications an investment might have even beyond the eight-year regulatory period. Under this approach, the regulator requires a cultural change in the company's operational business and rewards long-term, innovative thinking. The network operator's response to this framework will be assessed by the regulatory toolkit controlling efficient expenditures. If considered necessary, the regulator may scrutinise specific expenditures by using benchmarking techniques to reveal efficient cost, or if feeling concerned about a particular investment project, the regulator may require a detailed bottom-up justification of the project. The benchmarking approach will be based on a TOTEX benchmarking to avoid an OPEX-CAPEX bias. However, benchmarking results will no longer form the logical basis to determine the allowed revenues, but will rather be considered as 'one piece of evidence' as regards the network operator's cost structure.

Besides, different refinements were made in regulatory financing arrangements. The RIIO model transparently sets out the different principles of financeability in order to provide a clear *ex ante* framework for investors, companies and other involved parties. Overall the RIIO model assumes a long-term view of financeability. Amongst others, this implies that the companies' capitalisation policy is supported by a fixed percentage determining the OPEX/CAPEX split of the respective company. That is, the company may capitalise a certain amount during the price-control period. The percentage is determined based on the submitted CAPEX presented in the business plan.

Regarding the depreciation rate, the RIIO model will henceforth refer to the average expected economic lifetime of the assets. Previously, the regulator reduced the lifetime of the assets to an assumed regulatory lifetime that was significantly lower than the physical one. This policy has been pursued in order to drive companies' perceived financeability due to higher cash flows. Hence the regulator is aware that the new approach may slow down the expected return on investment and will consider, if

<sup>2</sup> The Ofgem RPI-X@20-initiative has been addressed by S Littlechild in *Network*, Issue 34 December 2009.

appropriate, a transition period with some flexibility with respect to regulated revenues (Ofgem, 2010b).

To summarise, the emerging RIIO model puts investment in a long-term context, designs regulatory functionalities for overarching sustainability and decarbonisation targets, and adjusts related regulatory instruments accordingly to facilitate a long-term value-for-money consideration. However, the enhancements of RIIO mentioned above simultaneously risk a rather 'heavy handed' regulatory approach due to the high level of regulatory scrutiny. The yet due practical regulatory implementation of RIIO has to prove if the new functionalities actually deliver a dynamically efficient outcome. Notwithstanding these caveats, Ofgem can be considered as the pioneer in pursuing new regulatory design options.

#### ***Italy: continuous and pragmatic enhancement of incentive regulation***

Tariff regulation is implemented through a price-cap mechanism with efficiency goals for transmission, distribution and metering services set by the Italian regulator, Autorità per l'Energia Elettrica e il Gas (AEEG), over a four-year regulatory period. The electricity sector currently undergoes the third regulatory period (2008-11). The planned productivity gains for this period amount to 2.3 per cent for transmission, 1.9 per cent for distribution and 5.0 per cent for metering (AEEG, 2009). Note that the before-mentioned X-factor only applies to operating cost as from the current regulatory period. In the previous ones, the price-cap mechanism was also applied to amortisation and depreciation (regulatory period 2004-2007) and additionally to the return on capital (regulatory period 2000-2003) (AEEG, 2008).

The AEEG updates tariffs on an annual basis. This update provides for two cost categories. Firstly, it takes into account the reduction in real terms regarding operating costs. Secondly, it contains a review of depreciation and return on invested capital, to adapt for new infrastructure investments to improve security of supply, competition, and quality of service. As regards the investment update, companies annually report their investments made in the year  $t-1$ , which will be allowed in the tariffs for the year  $t+1$ .

In addition to this regulatory change to focus solely on OPEX efficiency as from this regulatory period, the Italian regulator has also revised the approach towards investments. From now on, the regulator discriminates between different investment categories for transmission and distribution investment respectively, which are associated –

provided they fall in a certain category – with an extra return on investment. On the transmission level, this new incentive system allows an extra return for (i) investments dedicated at the development of transmission capacity in order to reduce congestion between market zones and intrazones, and (ii) investments in Net Transfer Capacity (NTC) on electricity borders. The extra allowance amounts to 3 percentage points extra return on invested capital for 12 years over the 6.9 per cent base rate of return. On the distribution level, this new regulatory instrument grants an extra return of 2 percentage points over the 7 per cent base return for crucial investments for the distribution system – new HV/MV transformation stations; replacement of existing transformers with low-loss transformers; MV active-grid automation, protection and control systems; etc.

Supplementary to these additional allowances for specific investments, the AEEG also introduced efficiency indicators for investments in order to measure the extra benefit that individual investments bring to the system as from 2011. The objective of these indicators (relevant for both transmission and distribution investment) is to define an order of priority for infrastructure investments and objective criteria to grant an adequate rate of return for expansion investment (AEEG, 2008).

In parallel, the Italian regime includes instruments to promote innovation. A first instrument has existed since 1999, consisting of a general R&D component in the network tariff, which is paid by all consumers. The Italian regulator is responsible for determining this levy, which currently amounts to 0.03 Euro-cent/kWh. The objective of this levy is to fund R&D activities that have an impact on the electricity system.<sup>3</sup> Over and above, the regulatory authority incentivises demonstration projects within a competitive procedure. Selected projects will be awarded with an increased WACC of 2 percentage points for 12 years (Meeus, Saguan, Glachant and Belmans, 2010).

Overall, the Italian approach can be considered as pragmatic. The incentive regulation scheme was enhanced on a continuous basis to better provide for the required investments in a changing energy market. However, the increased rate-of-return may involve demarcation problems identifying and isolating the appropriate investments for a higher rate of return. Moreover, it includes a regulatory presumption on a certain technology as the supported investment categories in a smart-grids context are highly specified.

<sup>3</sup> More information here: <http://www.ricercadisistema.it/>

## Concluding Comments

This paper has addressed the question of whether incentive regulation provides the right investment stimuli to enable the paradigm shift towards smart grids (dynamic efficiency). Scrutinising the pertinent economic literature, we find that conventional cost-based regulation methods (rate-of-return and cost-plus regulation) include incentives for allocative efficiency only. In contrast, incentive regulation provides incentives mainly for productive efficiency. These incentives mainly affect short-term potential for increasing efficiencies in OPEX. Dynamically efficient investments, however, are not sufficiently promoted. Hence, the analysis identifies a regulatory dilemma in terms of incentives for investment in an intelligent network infrastructure enabling a dynamic resource allocation in terms of CAPEX.

Complementing the insights from regulatory economics, this paper presents case studies of regulatory regimes implementing increased regulatory measures towards investments in a smart-grid context. The UK, which can be considered as a pioneer, has changed its regulatory focus from cost-efficiency to a holistic innovation and output-oriented approach with a forward-looking, long-term value-for-money perspective. The downside, however, is that it is very planning-intense and has a high level of regulatory scrutiny. Italy's approach implies a less-holistic, but rather straightforward, solution where the regulator may increase the rate of return for specific investments in a smart-grid context. This involves demarcation problems and technology preferences given by the regulator.

To advance incentive regulation with respect to smart grids, decision makers should critically reflect upon the 'fit for purpose' of regulatory incentives on a regular basis. However, emerging incentive regulation schemes should not be changed substantially in order to allow the desired effects in terms of cost efficiency to unfold. This should provide a more robust basis for further evaluation. Nevertheless, regulatory reflection should take into account a gradual, anticipative 'smartening' of regulatory incentives.

At first, this might involve a promotion of smart-grid related demonstration projects backed by an innovation fund for which network operators may apply. Based on the project insights, and if considered appropriate, a readjustment of investment incentives could follow. However, related measures should not focus on specific incentives for smart grids in order to avoid demarcation problems and to allow for a certain corporate scope to optimise the network structure either with 'copper' or 'intelligence'. More suitable would be an indirect incentive covering – but

not specifically targeting – those investments in a smart-grid context that are currently not sufficiently covered by the regulatory regime. In practice, this incentive could, for example, come in the form of an investment bonus – an increased rate of return granted for new investments, both copper and intelligence. In parallel, an allowance for R&D expenditures could be a temporary supportive instrument. In this context, we emphasise the importance of double-checks prior to the implementation of additional incentives. The former should focus on potential double counting implied in different regulatory instruments (e.g., benchmarking, quality regulation or cost-based elements). These caveats are formulated to protect the final customer who, in the end, pays, and should not be charged twice for the same investment.

Finally, the most challenging issue is to transfer environmental policy targets and their implications on networks into adequate regulatory functionalities. Reconfigured incentives aiming at smart grids should strike a good balance between the right timing of implementation, pragmatism avoiding a too-ambitious level of regulatory involvement and overly targeted incentives which might imply regulatory presumption on the right technology.

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## Critical Issues in Regulation – From the Journals

**‘Price Cap Regulation: What Have We Learned from 25 Years of Experience in the Telecommunications Industry?’**, David Sappington and Dennis Weisman, *Journal of Regulatory Economics*, 38 (3), 2010, pp. 227-257.

Since the mid-1980s, price-cap regulation (PCR) has become an increasingly popular form of regulation in telecommunications markets. This paper reviews the experience with PCR in the telecommunications industry and identifies implications for regulatory policy in other industries, including the energy sector.

Recent empirical studies of the impact of PCR on performance in telecommunication markets provide evidence of substantial gains for both industry and consumers. For example, Abel (2000) reports that under PCR, telecommunication prices have either fallen or remained constant, productivity has typically increased, modern infrastructure has been deployed at a more rapid rate and regulated firms have performed at least as well as firms operating under other forms of incentive regulation.

Empirical analysis also reveals that there is no systematic relationship between PCR and telecommunications service quality. While traditional economic theory predicts that a price cap will cause a firm to reduce the quality of its service, studies show that under PCR the telecommunications industry has not experienced pervasive or persistent declines in service quality. The authors provide several explanations for this deviation from economic theory. One explanation maintains that a PCR plan deters a regulated firm from reducing its service quality by stipulating quality standards and imposing financial penalties if standards are not met. Another relates to a firm’s desire to operate under PCR instead of alternative regulatory policy, such as rate-of-return regulation. Early PCR plans were terminated because of perceived problems with service quality. The authors suggest that these terminations signalled to firms the default outcome of a noticeable decline in service quality.

The flexibility of PCR helps to explain its popularity in practice. The authors identify four key elements of a PCR plan that account for its flexibility. These elements can be adjusted not only to the environment in which it is implemented but also to the primary goals which it is intended to achieve. The four key elements are the X factor, the Z factor, the nature of the plan review and the structure of the basket of regulated services. For instance, a regulator can adjust the X factor to impose appropriate incentives for cost reduction that produce gains for both consumers and the firm.

After reviewing PCR in the telecommunications industry, the authors identify implications to consider when assessing the merits of PCR in other industries. They note that the gains of PCR in the telecommunications industry may be related to its unique environment and regulatory goals. For example, while the telecommunications industry did not experience persistent declines in service quality, it did experience transitory declines. In the case of the energy industry, the authors argue that the general public is likely to have a lower tolerance for power outages than for disruptions in telecommunication services.

**‘The Lerner Index of Monopoly Power: Origins and Uses’**, Kenneth Elzinga and David Mills, *American Economic Review: Papers and Proceedings*, 101(3), 2011, pp. 558-564.

The Lerner Index is, perhaps, the best known index of market power in economic textbooks. It is defined as the ratio of the gap between the price and marginal cost of a service to the price. This paper provides history of the Lerner Index and its application in economic theory and antitrust analysis.

The Lerner Index was first proposed by Abba Lerner in 1934. It is a measure of the degree of ‘market imperfection’ – that is, the extent to which a market departs from the theoretical ideal of perfect competition. A Lerner Index of zero indicates an absence of market power. The larger the Lerner Index, the greater is the extent of market power (up to a theoretical maximum of one). The strength of the Index is that, in making an assessment of a firm’s market power, it directs attention away from questions about ‘the firm’s profit level, its absolute size, and the rhetoric of its business documents’ and towards simple, objective factors – the relationship between the firm’s price and its marginal cost. Furthermore, if a firm is seeking to maximise its profits, there is a simple relationship between the Lerner Index of a firm and the elasticity of the demand curve it faces. In 1981, Landes and Posner argued that the Lerner Index is the single authoritative measure of market power, allowing us to do away with assessments of market share or entry barriers: ‘if we knew the elasticity of demand facing a firm ... we could measure its market power directly ... without troubling ourselves about what its market share was’.

The Lerner Index has become mainstream in the economic literature on competition policy and industrial organization. However, it is recognised that the index has weaknesses. While it provides a measure of the price-marginal cost margin, it says

nothing about the size of the deadweight loss, or whether pricing at marginal cost is even feasible – for example, when there are increasing returns to scale. It assumes a simple linear price and ignores the possible tendency of monopolist seeking a ‘quiet life’ to allow its costs to inflate. Nevertheless, the use of the Lerner Index is firmly embedded in economists’ thinking. In 2011, Louis Kaplow argued that a focus on the Lerner Index would allow us to do away with conventional approaches to market definition.

The Lerner Index has not been widely accepted in the antitrust literature. The authors note that the Lerner Index has only been cited in a few antitrust cases and ‘we are unaware of any case in which the Index played a pivotal role. ... Courts have been hesitant to infer the existence of market (or monopoly) power from evidence based on the Lerner Index alone’. The authors suggest that this hesitancy to adopt the Lerner Index might be because, in practice, almost all firms possess a degree of market power and identifying when antitrust action can reduce that market power is difficult.

**‘The Effect of Mergers on Consumer Prices: Evidence from Five Mergers on the Enforcement Margin’**, Orley Ashenfelter and Daniel Hosken, *Journal of Law and Economics*, 53(3), August 2010, pp. 417-466.

In the United States, corporate mergers are governed by the Hart-Scott-Rodino (HSR) Act, which requires merging parties to file basic details of the proposed merger with two regulatory agencies – the Federal Trade Commission and Antitrust Division of the Department of Justice. A regulatory agency must be assigned to the investigation within 30 days, and must decide whether more comprehensive information is required from the merging parties. Every year, thousands of mergers or acquisition requests are filed, of which the large majority are authorised to proceed without full investigation by either regulator. For instance, 37,201 mergers or acquisitions were filed with the regulators between 1991 and 2004, of which approximately 97 per cent allowed to proceed without full investigation. Of the three per cent subject to a full investigation, roughly 65 per cent did not go ahead as proposed. That is, they were either abandoned, blocked or modified.

This article attempts to assess the effectiveness of the regulatory agencies in respect of their authorisation decisions. The authors’ approach is to estimate an upper bound on the negative impact of those mergers that the regulatory agencies had authorised. In order to do so, the authors selected a sample of five mergers which the regulatory agencies had authorised. The chosen sample comprised five mergers which the authors believed, in advance of performing econometric analysis, would be likely to result in significant post-merger price increases.

Retail scanner data were used to estimate the price increases that resulted from the five mergers. The measured price increases represent an upper bound on the price increases of authorised mergers, and a lower bound on the price increases that would have resulted if blocked mergers had, instead, been authorised.

The study finds that four of the five mergers in the sample resulted in consumer price increases, typically between three and seven per cent. The authors note that while price increases of this magnitude may seem relatively modest, nonetheless, when coupled with the large volumes of trade in these industries, they imply substantial transfers from consumers to producers. In the four mergers that resulted in economically significant price increases, manufacturers did not increase all of their prices uniformly. Instead, a merged firm tended to increase the price of one of its products (or set of products), while leaving the prices of its other products approximately unchanged. For example, following the one billion dollar acquisition of Quaker State by Pennzoil in December 1998, the merged firm increased the price of its Quaker State products while holding the price of Pennzoil products relatively fixed. This was followed by considerable shift of market share from Quaker State to Pennzoil brands.

The authors find that the estimated effects on prices are generally sensitive to the empirical specification, including the choice of the control group, the measure of prices and the window of time surrounding the merger. Importantly, however, the conclusion that consumer prices did not decrease, and most likely increased, remains constant regardless of empirical specification. The authors acknowledge, however, that this study has a significant limitation: efficiency gains from mergers may take longer to emerge than the periods of time specified in the study.

**‘Transforming Telecommunications Technologies – Policy and Regulation’**, Martin Cave and Keiko Hatta, *Oxford Review of Economic Policy*, 25 (3), 2009, pp. 488-505.

This article outlines the different approaches of regulators and governments in relation to investment in next generation access (NGA) to broadband. Note that since publication, the policies discussed in this article may have changed.

In the Netherlands and the United States, the major NGA investors are cable companies. Cable penetration is over 90 per cent, and the upgraded networks are capable of delivering broadband speeds equivalent to Fibre-to-the-Node (FTTN). Access to fibre networks in the United States has not been regulated since 2004, as the networks are subject to competitive pressures from cable companies. In the

Netherlands, the telecommunications incumbent KPN merged with a fibre network specialist in 2008 and began an early roll-out of FTTN. The merged entity is subject to price control on the provision of mandatory access to passive assets, including unbundled fibre.

In most jurisdictions, however, as a consequence of insufficient competitive pressures, the dominant incumbent may choose to delay investment in NGA. Regulators may, therefore, need to consider some form of regulation that provides an incentive for timely investment but still ensures that, once built, the network is used efficiently and can be accessed by other service providers. For example, the Spanish regulator imposed on its incumbent, Telefónica, an obligation to make access available to a wholesale broadband product capable of speeds of up to 30 Mbps, and thus allowed the incumbent exclusive access to higher speeds. In 2009, the UK regulator OfCom indicated its intention to mandate access to wholesale products with active components at unconstrained prices and also to mandate access to passive assets, but at cost-based prices. The EC proposed offering regulatory concessions if operators successfully co-ordinate to invest in NGA. In some circumstances, the French regulator requires operators to share the costs of installing multi-fibre to prevent bottle-necks being created.

Some instances of government intervention in the NGA are presented as part of a social equity package to ensure the extension of broadband into non-commercial areas. For instance, Japan has one of the highest fibre network uptakes in the OECD, and its 2010 NGA strategy included providing subsidies for taking high-speed broadband to rural areas. The Japanese government's goal of making fibre access available to 90 per cent of households has already been achieved. In 2009, the UK government planned to assist the spread of NGAs by creating a fund that would be available on a competitive basis to subsidise NGA expansion into non-commercial areas. Similarly, the Singapore government initiated a competitive tendering process for proposals to build and operate its proposed NGA network, reducing the required government subsidy from S\$5 billion to S\$1 billion. The aim was to provide competitively priced, high-speed broadband to all homes, businesses and schools.

In other cases, government intervention is justified by an 'industrial policy' rationale, according to which government funding would enable or bring forward 'infrastructure transformation', ensuring considerable beneficial network effects and externalities. For example, since 1995, Korea has implemented a comprehensive infrastructure plan which involves the provision of government subsidies to competitive private investors. In 2009, the New Zealand government proposed NZ\$1.5 billion co-funding to

form local fibre companies with private investors. According to this proposal, the local fibre companies would construct fibre-optic infrastructure and provide open access on equivalent terms. In the European Union, public investment is subject to a 'market economy investor test' based on the number of competing infrastructures, although none of the proposed public investments in broadband have failed this test.

**'Quo Vadis Efficiency Analysis of Water Distribution? A Comparative Literature Review'**, Matthias Walter, Astrid Cullmann, Christian von Hirschhausen, Robert Wand and Michael Zschille, *Utilities Policy*, 17, 2009, pp. 225–32.

In the UK, water-distribution companies have been subjected to price-cap regulation administered by the Water Service Regulation Authority (Ofwat). Since 1994, periodic reviews have undertaken benchmarking analysis based on a number of efficiency estimation techniques, such as Data Envelopment Analysis (DEA), Corrected Ordinary Least Squares (COLS) and Stochastic Frontier Analysis. Other more recent applications of benchmarking for regulatory purposes include the yardstick competition in water distribution in Italy and the sunshine regulation for the Dutch drinking water sector. In recognition of the increasing use of benchmarking in the water distribution industry, this paper provides a literature review of studies of the efficiency of water distribution companies. The eighteen studies reviewed differ in terms of sample coverage, estimation method, model specification and research question. The review provides insight into key factors that affect the efficiency of the water utilities, and draws attention, in particular, to the following factors. The first is the influence of the kind of ownership (public versus private) on efficiency. No clear conclusion about the impact of the type of ownership can be drawn. The impact of the type of ownership may interact with the institutional and regulatory factors in driving efficiency and productivity changes. Second, structural variables (e.g. population density) and quality variables are found to be important exogenous factors which influence costs and which therefore should be accounted for in evaluating efficiency performance. Third, scale has a significant influence on efficiency. The literature shows evidence of both economies of scale (up to certain levels) and also economies of scope between water and sewerage. More importantly for water distribution, economies of density can be present in various forms such as customer density, network density and production density.

The authors consider the inherent methodological and data issues associated with efficiency analysis of the complex operation of water utilities as a whole or in part. They suggest that panel data should be used

where there are a small number of comparable water utilities in operation. Nevertheless, they consider that water benchmarking techniques must be improved before efficiency results are directly used in setting regulatory objectives.

**‘Market Risk Premium Used in 56 Countries in 2011: A Survey with 6,014 Answers’**, Pablo Fernández, Javier Aguirreamalloa and Luis Corres, Working Paper WP-920, IESE Business School, University of Navarra, 2011.

This article provides an analysis of the results of an international survey on the Market Risk Premium (MRP) that was conducted in early 2011. Of the 3,998 survey responses that provided an estimate of the MRP, 40 were from Australia and offered an estimate of the MRP for the Australian equity market. The average of these 40 estimates of the Australian MRP was 5.8.

The survey was distributed in March and April of 2011 to 19,500 academics, analysts and managers of companies. The respondents were asked to complete the following statement: ‘The Market Risk Premium that I am using in 2011 for my country is: %.’ The authors received 3,998 responses providing a specific MRP and 2,016 responses stating that the respondent did not use the MRP.

Of the 40 answers received for Australia, 15 were from academics, 21 from analysts and 4 from managers of companies. The average of the estimates of the MRP received from academics was 6.2, from analysts 5.4 and from managers 6.5. Moreover, while the overall average for Australia was 5.8, the median was significantly lower, at 5.2.

The questions posed to survey respondents were prefaced with some introductory comments, which included the following sentence: ‘We are conducting a survey on the Market Risk Premium (MRP) that companies, analysts and professors use to calculate the required rate of return in different countries.’ The authors argue that the phrase ‘the required rate of return’ refers to a different concept than the expected rate of return. For a given investor, his required rate of return on a share is the same as the market’s expectation of the rate only if the market price of the share is equal to his own valuation of the share. This survey can be distinguished from most of the surveys about the MRP, therefore, in that it asks about the required premium rather than the expected premium. The article concludes by urging readers to distinguish between the various different concepts of the equity premium, including the historical measure, the expected measure and the required measure.

**‘Equity Risk Premium Survey: Results and Comments’**, Anthony Asher, *Actuary Australia*, 161, July 2011, pp. 13-15.

This article reports the results of a survey on the Equity Risk Premium (ERP), which was conducted in February 2011 by a group of actuaries. The survey found that the average ERP expected over the next 12 months is 4.7 per cent, while the average expected over the next ten years is 4.9 per cent. The standard deviation of the former estimate is 2.5 per cent, and of the latter 2.0 per cent. In these estimates, franking credits were taken into account.

The survey was distributed to actuaries, and there were 58 respondents. Most of the respondents were associated with Investment and Wealth Management, Insurance, Superannuation and Banking. On average, respondents had about 15 years of experience as actuaries. The respondents were asked about how they used their ERP estimates, and the most common answer was that the ERP was used for ‘portfolio construction/asset allocation’.

The survey asked the respondents what factors determined the ERP. Most of those who responded to this question identified expected economic growth as the most important factor. The second most important factor was earnings yields. The article then reports the results of statistical tests on the relationships between the ERP and economic growth, and the ERP and earnings yields. While the author found that these relationships were statistically significant, he encouraged readers to be cautious in interpreting the results. First, the statistical tests are sensitive to the choice of the period and the set of variables. Second, with respect to the relationship between the ERP and economic growth, the direction of causation is unclear. In particular, it is unclear whether share prices tend to fall because of an anticipation of a fall in economic growth, whether falls in economic growth occur because of falls in share prices, or whether the two events have a common cause. His conclusion, therefore, is that the tests ‘support, but do not prove, the views of those who responded’.

Respondents were also asked about how they would adjust their assessments of the ERP for various factors. There were 38 responses to a question about whether an adjustment would be made for franking credits, and 10 of those 38 respondents said that they would not. Moreover, 24 respondents said that they would not make any adjustment for international shares. This surprised the author, who had expected that respondents would uniformly make a negative adjustment for overseas equity returns.

The author compared the survey results on the ERP with other estimates of the ERP – in particular, an estimate arrived at on the basis of realised dividend

yields. He judges that, when compared to this alternative estimate, the mean survey results of 4.7 and 4.9 per cent are 'not unreasonable'. The article concludes that 'one of the values of this sort of survey is to highlight that expectations for the ERP much in excess of 5% are extreme – as well as conservatism of those much below'. [Read more](#)

## Regulatory Decisions in Australia and New Zealand

### Australia

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

##### ACCC Issues Draft MTAS Final Access Determination

On 23 September 2011 the ACCC released a draft final access determination (FAD) for the domestic mobile terminating access service (MTAS) for public consultation under the new telecommunications access regime. The MTAS is a technology-neutral wholesale input, used by providers of voice calls from fixed line, mobile and IP networks, in order to complete voice calls to end users directly connected to digital mobile networks. ACCC pricing principles reduced the rate for the MTAS from 21 cents per minute in 2004 to 9 cents per minute from 1 July 2007. The rate has remained at 9 cents per minute since that time and the current pricing principles expire on 31 December 2011. These previous price reductions have led to increased competition in the retail mobile services market. The draft FAD implements price reductions for the regulated MTAS rate, from 6 cents per minute on 1 January 2012 to 3.6 cents per minute on 1 January 2014. While parties will still be able to negotiate their own agreements, an access determination will establish benchmark terms and conditions for access seekers. The ACCC seeks comments on the draft FAD for regulation of the MTAS, which is available on the ACCC website. Submissions close on 21 October 2011. [Read more](#)

##### ACCC Issues Final Decision on Airservices Australia's Price Notification

On 22 September 2011 the ACCC issued its final decision on Airservices Australia's price notification submitted on 22 August 2011. The ACCC's view is that the proposed price increases for air-services, such as air traffic control, are too high and would cause Airservices to over-recover its costs by \$35 million over five years. Airservices is the monopoly provider of *en route* air navigation, terminal navigation and aviation rescue and fire-fighting services in Australia. The ACCC was prepared to accept the methodology that Airservices used for its 2004-05 pricing proposal for determining the rate of return. However, the methodology in this proposal differed from the previous pricing proposal since it proposed to change one of its parameters used to estimate its rate of return. The ACCC considers that it is not appropriate to alter one rate-of-return

parameter without conducting a full review of all the parameters. [Read more](#)

##### Issues Paper on Exemptions for Fixed-Line Services

On 1 September 2011 the ACCC reported the release of an issues paper on varying the final access determinations (FADs) in respect of the exemption provisions for the following declared fixed-line services: Wholesale Line Rental (WLR), Local Carriage Service (LCS), and Public Switched Telephone Network Originating Access (PSTN OA). This follows the ACCC's final report into FADs, published in July 2011, where it stated that the issue of the future operation of the exemptions relating to the WLR, LCS and PSTN OA services required further investigation and consideration. The issues paper considers whether the exemption provisions in the FADs should be varied, revoked or maintained. The ACCC will not consider varying or revoking any other provisions in the FADs that do not relate to exemptions. Submissions on the issues paper were required by 30 September 2011. [Read more](#)

##### Draft Decision on CBH's Proposed Bulk Grain Port Terminal Services Access Undertaking

On 23 August 2011 the ACCC announced the issuing of a draft decision on access arrangements for wheat exporters at Co-operative Bulk Handling's (CBH's) ports at Kwinana, Geraldton, Albany and Esperance in Western Australia. This follows CBH submitting an undertaking in March 2011 that proposed to replace the auction system currently used to allocate access at its port terminal services with a 'two tiered system' with up to 60 per cent of port capacity offered to large-volume shippers prior to holding open auctions for the remaining capacity. The ACCC's preliminary view is that the existing arrangements should be retained. The ACCC is concerned that the two-tiered system in the form proposed may disadvantage mid-sized and smaller exporters without necessarily benefiting wheat growers or the Australian economy. In response to suggestions from the ACCC, CBH has provided a revised draft of the undertaking retaining the existing auction system and suggesting amendments to address the other issues identified. It is the ACCC's preliminary view that, if the revised draft is submitted, the ACCC would accept the undertaking. Submissions on the draft decision were required by 13 September 2011. [Read more](#)

## Final Access Determinations for Fixed-Line Telecommunications Services

On 1 September 2011 the ACCC commenced a public inquiry on varying the final access determinations (FADs) in respect of the exemption provisions for the following declared fixed line services:

- Wholesale Line Rental (WLR)
- Local Carriage Service (LCS) and
- Public Switched Telephone Network Originating Access (PSTN OA).

This inquiry will consider whether the exemption provisions in the FADs should be varied, revoked or maintained. The inquiry will not consider varying or revoking any other provisions in the FADs that do not relate to exemptions. The ACCC has released an issues paper to assist industry and other interested parties in making submissions to the inquiry. The issues paper discusses the issues and sets out the matters on which the ACCC is seeking information and industry views. Submissions on the issues paper are due by 30 September 2011.

On 20 July 2011 the ACCC announced its issuing of final access determinations (FADs) for the fixed-line telecommunications services following the completion of its public inquiry. The FADs detail wholesale access prices for the fixed-line network which will apply for a three-year regulatory period commencing on 1 July 2011 and expiring on 30 June 2014. The FADs incorporate prices included in the interim access determinations of March 2011, for the period from 1 January 2011 to 30 June 2011, however, the final prices differ from the draft prices proposed in the ACCC's April 2011 Discussion Paper. The Unconditioned Local Loop Service (ULLS) price is slightly lower than the draft prices while the Wholesale Line Rental (WLR) price is slightly higher. Prices have been set for a three-year, rather than the draft five-year regulatory period, as there was broad industry agreement on the difficulty of forecasting for such a long period given uncertainty about the timing of the deployment of the National Broadband Network (NBN). [Read more](#)

## Discussion Paper on Telstra's Structural Separation Undertaking and Draft Migration Plan

On 30 August 2011 the ACCC published a discussion paper on Telstra's structural separation undertaking and a draft migration plan. The objective of the undertaking and plan is to progressively implement structural reform of telecommunications through Telstra ceasing to supply fixed-line voice and broadband services over its copper and HFC networks, and instead supplying those services using

the NBN. The ACCC's preliminary view is that Telstra's undertaking can not be accepted in its current form and that important changes are required. The ACCC's main area of concern relates to the adequacy of Telstra's proposed interim equivalence and transparency measures. Submissions on the discussion paper were required by 27 September 2011. [Read more](#)

## Discussion Paper on Non-NBN Local Bitstream Access Service Description

On 18 August 2011 the ACCC issued a discussion paper seeking submissions on the service description for a Layer 2 bitstream service. The consultation is the first step in issuing a declaration that creates the ACCC's role in regulating this service. Layer 2 bitstream services (also known as the local bitstream access services) are used to carry digital data on telecommunications networks. This declaration is intended to cover the 'last mile' fibre to residences and small businesses on networks that are not owned by NBN Co. In order to declare this service under new provisions of the Competition and Consumer Act 2010, the ACCC must develop a service description specifying which services are to be covered by the declaration. This declaration will oblige service providers to adhere to the Standard Access Obligations, and it will only apply to services supplied using a designated superfast telecommunications network, which is a network used to supply a Layer 2 bitstream service. Submissions on the discussion paper were required by 16 September 2011. [Read more](#)

## Draft Decision on ABA's Proposed Bulk Grain Port Terminal Services Access Undertaking

On 11 August 2011 the ACCC issued a draft decision on the access undertaking proposed by Australian Bulk Alliance (ABA). ABA's proposed undertaking relates to the provision of access to services at the Melbourne Port Terminal for use by wheat exporters, where no existing undertaking applies. The ACCC's preliminary view is that the overall approach of ABA's proposed undertaking is likely to be appropriate. However, the ACCC has identified a number of improvements which should be made to ensure ABA's undertaking is consistent with industry-wide standards. Submissions on the draft decision were required by 31 August 2011. [Read more](#)

## Draft Decision on Viterra's Proposed Bulk Grain Port Terminal Services Access Undertaking

On 11 August 2011 the ACCC released a draft decision on arrangements for wheat exporters at Viterra's six wheat export ports in South Australia. The ACCC's preliminary view is that the introduction

of an auction system would address its main areas of concern. Viterra initially submitted an undertaking that proposed to continue current arrangements. The ACCC, however, considered that the continuation of the existing first come, first served system for allocating shipping slots was not appropriate. In response to suggestions from the ACCC, Viterra submitted a revised draft of the undertaking introducing an auction system from mid-May 2012. To increase competition before then, Viterra will also make slots available for other exporters for January to April 2012 at the deep-sea terminals at Port Lincoln and Port Adelaide Outer Harbour. Submissions on the draft decision were required by 31 August 2011. [Read more](#)

## **Issues Paper on Non-Discrimination Guidance for NBN and Superfast Telecommunication Networks**

On 17 August 2011 the ACCC announced the release of an issues paper relating to the preparation of explanatory material on new non-discrimination provisions that form part of the Competition and Consumer Act 2010. NBN Co and other designated superfast telecommunications networks will be prohibited from discriminating between access seekers, except under limited circumstances. The ACCC is required to publish explanatory material relating to these non-discrimination provisions on its website. The issues paper is the first step in a consultation process that will inform the development of the explanatory material. The deadline for submissions was 8 August 2011. The ACCC expects to release final explanatory material in late 2011.

## **ACCC Sets Water Infrastructure Pricing Principles for the Murray-Darling Basin**

On 17 August 2011 the ACCC announced the release of pricing principles for price approvals and determinations made under the Water Charge (Infrastructure) Rules (WCIR). The WCIR provides for price approvals and determinations of certain rural water infrastructure operators in the Murray-Darling Basin by either the ACCC, or a state agency accredited by the ACCC. These price approvals and determinations will apply to charges for many non-urban water services provided by State Water, Goulburn-Murray Water and Lower Murray Water. Other operators may be conditionally covered by the WCIR. The principles outline the ACCC's approach to making price approvals and determinations under the WCIR. The ACCC is proposing that, as a term and condition of accreditation, state agencies will also be required to apply the principles. In developing these principles, the ACCC issued draft pricing principles for public consultation, and it received five submissions in response. The ACCC has considered the matters raised during consultation

in preparing the version of the pricing principles released. [Read more](#)

## **ACCC Publishes Information Paper on Fibre and Cable Broadband Speeds**

In July 2011 the ACCC released an information paper to assist providers of hybrid fibre-coaxial (HFC) and fibre-to-the-premises (FTTP) broadband internet services in complying with the Competition and Consumer Act 2010. The information paper provides guidance to ISPs on the factors to consider when making representations regarding the data transfer rates – or 'speeds' – available to customers acquiring HFC or FTTP internet services. The paper relates to services provided over the National Broadband Network (NBN), as well as services being provided over pre-existing HFC and FTTP networks. [Read more](#)

## **ACCC Reviews Exemptions in Final Access Determinations for Fixed-Line Services**

On 28 July 2011 the ACCC announced it will review whether geographic exemptions from regulation should be included in final access determinations (FADs) for the declared fixed-line services. This follows the ACCC noting in its April 2011 Discussion Paper on FADs for fixed-line services, that it would consider the future operation of the exemptions in respect of wholesale line rental, PSTN terminating access and the local carriage service. The ACCC's preliminary view was to incorporate the effect of the previous ordinary and class geographic exemptions made by the Australian Competition Tribunal and the ACCC for these services. However, the ACCC is concerned that competitive pressures on Telstra in the exempt exchanges may not be meeting the expectations made at the time of the original exemption decision. The ACCC is also concerned that wholesale service offers in the exempt exchanges may be on substantially less favourable terms than those available in regulated exchanges. Submissions have also raised a wide range of issues, including the implications of the National Broadband Network on investment in, and deployment of, equipment to produce services subject to the geographic exemption and the creation of a competitive market for services such as wholesale line rental. The ACCC therefore considers the complex issues raised concerning the operation and impact of the exemptions on markets require further investigation. [Read more](#)

## **ACCC Accepts GrainCorp Wheat Port Access Arrangements**

On 28 July 2011 the ACCC announced its acceptance of GrainCorp's wheat port access undertaking for October 2011 to September 2014. The undertaking relates to the provision of access to

services for the export of bulk wheat at seven grain terminals operated by GrainCorp in Queensland, New South Wales and Victoria. These terminals are: Queensland: Fisherman Islands, Gladstone and Mackay New South Wales: Carrington and Port Kembla, and Victoria: Geelong and Portland. The access arrangements are a publish-negotiate-arbitrate approach to access provision with capacity allocated between users on a first-come, first-served basis. The arrangements replace GrainCorp's current undertaking, which was accepted by the ACCC on 29 September 2009. The ACCC identified some areas of the existing arrangements for improvement. The main changes from the current arrangements are that the ACCC will have the ability to intervene if there is a material change to GrainCorp's port loading protocols that raises concern under the terms of the undertaking. Other changes include the information gathering powers for the ACCC and a requirement for GrainCorp to provide to the ACCC a copy of the access provision terms to its own trading division. GrainCorp has also included measures to encourage the return of unwanted capacity at peak times and to increase transparency regarding its system of capacity allocation. [Read more](#)

## **Final Decision on Australia Post's Business Mail Prices**

On 28 July 2011 the ACCC announced issuing of its final decision on a proposal from Australia Post to increase prices across a number of its monopoly business mail letter services. The ACCC has confirmed its earlier preliminary view that it should not object to Australia Post's revised proposal. Australia Post is proposing to increase the prices of business mail services, including PreSort services which provide discounts to wholesale bulk mail customers who sort and barcode mail prior to lodgement. Australia Post is also proposing to change its Off-Peak PreSort letter services to make them more attractive to its bulk mail customers, by reducing the current delivery window of four business days to two. The increased gap between Off-Peak and Peak prices could further encourage more efficient use of the postal network. In addition, Australia Post had revised its initial proposal so that it now includes smaller increases to Off-Peak business mail services than originally proposed, in some cases less than half as much. Following that revision, some of the increases proposed by Australia Post include: small (PreSort) Regular letter (delivered in the state of lodgement) prices increase from 42.7 cents to 45.7 cents, small (PreSort) Off-Peak letter (delivered in the state of lodgement) prices increase from 41.6 cents to 41.9 cents. [Read more](#)

## **ACCC Accepts ARTC Access Undertaking for Hunter Valley Rail Network**

On 28 July 2011 the ACCC announced it had accepted an access undertaking from the Australian Rail Track Corporation (ARTC) for the Hunter Valley rail network. The undertaking aims to promote efficiency and investment in the Hunter Valley rail network and export coal chain. The Hunter Valley rail network transports coal from the region's mines to the Port of Newcastle for export. It is one of the largest and most complex coal export operations in the world, since it transports around 100 million tonnes of coal for exported every year, worth about \$9 billion per year in export earnings to Australia. The rail network is also used by passenger trains, grain trains, north-south freight trains crossing the network, and coal trains supplying domestic users such as power stations. An extensive consultation and development process involved the coal industry, non-coal users of the network, rail operators, port operators, the Hunter Valley Coal Chain Coordinator and the ARTC. The ACCC approved arrangements which include: the negotiation of long term access contracts between users of the rail network and the ARTC, processes for new investment in the rail network, in consultation with stakeholders, and incentives to promote alignment of all coal chain contracts and efficient use of the Hunter Valley infrastructure. [Read more](#)

## **Next ACCC Chairman Announced**

On 7 July 2011 the ACCC announced that the Governor-General has appointed Rod Sims as the next Chairman of the Australian Competition and Consumer Commission (ACCC) after he received the unanimous support of the States and Territories. Mr Sims has a broad range of experience in competition advice and policy across both the private and public sectors. He commenced a five-year term from 1 August 2011. [Read more](#)

## **Public Inquiry into Final Access Determination for Regulated Transmission Services**

On 7 July 2011 the ACCC announced the issuing of a discussion paper to begin a public inquiry into making a final access determination (FAD) for regulated transmission services, the domestic transmission capacity service (DTCS). The ACCC seeks views on how to ensure that regulated prices are appropriate to distance, capacity and the level of protection provided for services in the event of failure. As an outcome of a previous public inquiry process, the prices of regulated transmission services will be set by benchmarking current prices of competitive transmission services. The ACCC expects to make a FAD before the end of 2011. The deadline for submissions was 29 July 2011. [Read more](#)

## Australian Energy Regulator (AER)

### AER Disappointment at Queensland Generator Stanwell Decision

On 30 August 2011 the AER reported its disappointment at the Federal Court decision to dismiss the AER's case regarding Queensland generator Stanwell Corporation Limited in relation to alleged breaches of the National Electricity Rules. The AER instituted proceedings against Stanwell on 28 July 2009 alleging that Stanwell had breached the good faith provision of the National Electricity Rules. [Read more](#)

### Draft Determination on Victorian Smart Meter Costs and Charges

On 28 July 2011 it was announced that the AER has issued its draft determination on the Victorian distribution network service providers (DNSPs) Advanced Metering Infrastructure (AMI; 'smart meter') budgets and charges for 2012-15. Based on the information currently available, the AER considers the total AMI budgets for the Victorian DNSPs for this second deployment period should be \$760 million, a reduction of around 39 per cent from the proposed amount. The AER has previously set smart meter budgets and charges for the 2009-11 period. The DNSPs are required by the Victorian Government to deploy smart meters over a four-year period ending 31 December 2013. Submissions were required by 9 September 2011. The AER intends to make a final determination at the end of October 2011. [Read more](#)

### Access Arrangement Final Decisions for SA and QLD Gas Distribution Networks

On 17 June 2011 it was announced that the AER has released its final decision on Envestra Ltd's access arrangement proposal for its South Australian (SA) and Queensland (QLD) gas distribution networks, and on APT Allgas' access arrangement proposal for its QLD gas distribution network. The AER's final decision sets out the network charges and terms and conditions of access for the SA and QLD gas distribution network for the period from 1 July 2011 to 30 June 2016. The AER has not accepted the revised access arrangement proposals. The final decisions outline the revisions proposed by the AER to the revised access arrangement proposals and access arrangement information for each network. [SA - Read more](#) [QLD - Read more](#)

### AER Releases Aurora Energy's Electricity Distribution 2012-17 Regulatory Proposal

On 17 June 2011 the AER released Aurora Energy's regulatory proposal for the period 1 July 2012 to 30 June 2017. The AER also released draft distribution

negotiating service criteria for consultation. Under the National Electricity Rules (NER), the AER must determine how Aurora Energy's distribution services will be regulated from July 2012. As part of this process, Aurora Energy is required to submit a regulatory proposal to the AER. The AER is then required to review the regulatory proposal and publish a draft and final determination. Submissions on the regulatory proposal of Aurora were required by 12 August 2011. [Read more](#)

### Tribunal Issues Decision on AER Electricity Distribution Determinations for South Australia and Queensland

On 25 May 2011 the AER reported that on 19 May 2011 the Australian Competition Tribunal issued its decision on the appeals by the South Australian (ETSA Utilities) and Queensland electricity distribution network operators (Energex and Ergon Energy), and has allowed them to recover additional revenues. These appeals were made against the AER's May 2010 distribution determinations for these operators. All three operators applied for a review of the AER's decision on the estimated cost of corporate income tax, and ETSA Utilities and Ergon Energy also applied for a review of other aspects of the AER's determination. The Tribunal's decision allows the three network operators to recover additional revenues of about \$842 million, which is approximately a five per cent increase to total revenues over the five-year regulatory period. Specifically, ETSA Utilities, Energex and Ergon Energy have been permitted to recover an additional \$301 million, \$298 million, and \$243 million respectively. [Read more](#)

## National Competition Council (NCC)

### Application for Certification of the South Australian Rail Access Regime

On 26 July 2011, in accordance with the NCC's final recommendation, the Commonwealth Minister released his decision to certify the South Australian Rail Access Regime under the *Competition and Consumer Act* for 10 years. [Read more](#)

### Application for Certification of the Dalrymple Bay Coal Terminal Access Regime

On 11 July 2011, in accordance with the NCC's final recommendation, the Commonwealth Minister decided to certify the Dalrymple Bay Coal Terminal access regime as effective, for a period of ten years. [Read more](#)

### Third Party Access to Pilbara Railways

On 4 May 2011 the Full Court of the Federal Court handed down its judgment upon appeals from Rio Tinto and Fortescue Metals Group, following reviews of the Treasurer's decisions relating to four applications for access to Pilbara iron ore railways. Broadly, the Australian Competition Tribunal: affirmed Treasurer Wayne Swan's 20-year declaration of BHP Billiton's Goldsworthy Railway Service; affirmed the declaration of Rio Tinto's Robe Railway Service (albeit for a shortened period of 10 years); set aside Treasurer Swan's 20 year declaration of Rio Tinto's Hamersley Railway Service; and affirmed the then Treasurer Peter Costello's deemed decision not to declare BHP Billiton's Mt Newman Railway Service. [Read more](#)

## Australian Energy Market Commission (AEMC)

### Publication of Directions Paper Regarding the Potential Generator Market Power Rule Change

On 22 September 2011 the AEMC published a Directions Paper setting out its proposed approach to the definition of market power in the context of the NEM for the purposes of assessment of the Potential Generator Market Power in the NEM Rule change request. [Read more](#)

### Request for Advice on Energy Market Barriers for Electric and Natural Gas Vehicles

On 5 September 2011 the AEMC announced its intention to publish by October 2011 a Scoping Paper, in response to its 28 July 2011 receipt of a Request for Advice from the Ministerial Council on Energy in relation to identifying and addressing the barriers that exist in the energy market frameworks for the economically efficient uptake of electric (EVs) and natural gas vehicles (NGVs). The Scoping Paper would facilitate stakeholder consultation. [Read more](#)

### AEMC Consults on Short Term Trading Market Schedule Variation Rule Change

On 30 August 2011 the AEMC commenced consultation on a rule change request that was submitted by the Australian Energy Market Operator (AEMO) in respect of a timing provision in the National Gas Rules (NGR) relating to the Short Term Trading Market (STTM). It seeks to remove a provision from the NGR with the intention that it be replaced with an equivalent, albeit amended, provision in the STTM Procedures, which are administered by the AEMO. The purpose of the rule

change request is to facilitate more efficient STTM operations for trading participants. The deadline for submissions was 29 September 2011. [Read more](#)

### Inter-Regional Transmission Charging – Consultation on Discussion Paper

On 25 August 2011, the AEMC announced its publication of a Discussion Paper intended to assist in the development of a uniform national inter-regional transmission charging methodology. Submissions were required by 23 September 2011. [Read more](#)

### Various Hedging Instruments in the Declared Wholesale Gas Market Rule Change Request – Final Rule Determination

On 25 August 2011, the AEMC published a Rule to enable participants in the Declared Wholesale Gas Market (DWGM) to better manage their financial risks. Its key purposes are to allow participants to renominate their AMIQ profiles and renominate AMDQ between system injection points during the gas day, and to provide for participants to nominate injection hedges and agency injection hedges collectively to close proximity injection points. [Read more](#)

### AEMC Consults on Inter-regional Transmission Charging Rules

On 25 August 2011 the AEMC published a discussion paper and an information paper on inter-regional transmission charging. This follows the MCE proposing a rule change request in respect of inter-regional transmission charging in the form of a Load Export Charge (LEC). Following submissions on the draft rule determination, the AEMC decided to delay making the final rule determination in order to seek feedback on further options in a discussion paper. A key reason was because the AEMC considered there was an inconsistency in the calculation of the LEC that could undermine the efficiency of the approach. The deadline for submissions was 23 September 2011. [Read more](#)

### AEMC Publishes Report on Possible Future Retail Electricity Prices

On 26 July 2011 the AEMC announced publication of its report into future possible retail electricity prices, titled *Future Possible Retail Electricity Price Movements: 1 July 2010 to 30 June 2013*. This report sets out possible future retail electricity prices and the drivers of these prices at a national level, and in each state and territory in Australia from 2010-11 to 2012-13. Actual electricity prices and cost components in 2009-10 have been used as a base year for comparison. This follows the Ministerial Council on Energy (MCE) directing the AEMC to report on trends in residential electricity price

movements over the next three years, as requested by the Council of Australian Governments (COAG). This report was submitted to the MCE on 30 November 2010. Since then a number of price determinations and policy announcements have occurred and, as a result, some of the data in the report are now outdated. [Read more](#)

### **AEMC Releases Draft Rule for the Application and Operation of Administered Price Periods Rule Change Proposal**

On 21 July 2011 the AEMC released its draft Rule determination for the Application and Operation of Administered Price Periods Rule Change Proposal. Submissions were required by 1 September 2011. [Read more](#)

### **Issues Paper on Consumer Choices and Efficient Electricity Consumption**

On 15 July 2011 the AEMC called for public comment on its issues paper for the review: 'Power of Choice – Giving Consumers Options in the Way They Use Electricity'. The due date for submissions to questions raised by the issues paper was 26 August 2011. [Read more](#)

### **AEMC Publishes Version 45 of the National Electricity Rules**

On 14 July 2011 the AEMC published Version 45 of the National Electricity Rules to incorporate the National Electricity Amendment (Tasmania Tranche 5a Procedure Changes) Rule 2011 No 8, which commenced operation on 14 July 2011. Version 45 of the Rules is available on the AEMC's website and at the AEMC's office. [Read more](#)

### **Publication of Final Report on Review into the Use of Total Factor Productivity (TFP)**

On 7 July 2011 the AEMC announced publication of a review which found that using a TFP-based methodology could contribute to improvements in electricity and gas network regulation to achieve more efficient outcomes for consumers. The AEMC is at this stage proposing initial rules which will facilitate data collection and the assessment of whether the necessary conditions for introducing TFP are met. [Read more](#)

## **Australian Capital Territory**

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

#### **ACT Electricity Feed-in Scheme Summary Report – June 2011**

The Electricity Feed-in Scheme for feed-in from renewable energy generators to the electricity network is established under the *Electricity Feed-in (Renewable Energy Premium) Act 2008 (ACT)*. The Scheme commenced on 1 March 2009. A summary report on Scheme activity for the period 1 March 2009 to 30 June 2011 (updated for the June 2011 quarter) was made available on 8 August 2011. [Read more](#)

#### **ACT Greenhouse Gas Abatement Scheme: Compliance and Operation of the Scheme for the 2010 Compliance Year**

The Commission's report was provided to the Minister for the Environment and Sustainable Development, Simon Corbell MLA, on 30 June 2011. A copy of the report was made available on 6 July 2011. [Read more](#)

#### **Licensed Electricity, Gas, Water and Sewerage Utilities: Compliance and Performance Report for 2008-09**

A copy of the Commission's report was made available on 6 July 2011. [Read more](#)

## **New South Wales**

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

#### **Draft Report – The Incorporation of Company Tax in Pricing Determinations**

On 8 September 2011 the IPART released a draft report that considers an alternative approach to estimating tax liability of regulated businesses. In calculating a regulated business's costs for the purposes of setting prices, the IPART allows an amount to reflect the tax paid by the business. Currently, the IPART estimates a pre-tax weighted average cost of capital (WACC) and applies this to the capital base of the business. The tax rate used is the statutory tax rate. The IPART is considering moving to an alternative approach that better estimates the tax liability for regulated businesses. Submissions are required by 28 October 2011. [Read more](#)

## **Issues Paper – Solar Feed-in Tariffs – Setting a Fair and Reasonable Value for Electricity Generated by Small Scale**

On 11 August 2011 the IPART released an Issues Paper, as requested by the NSW Government, to review actions the NSW Government might take to stem the costs arising from the installation of small scale photovoltaic (PV) units in NSW, as well as reviewing their impact on electricity prices and consumers while continuing to support a sustainable solar PV industry in the state. The generosity of the Solar Bonus Scheme subsidies and the higher-than-expected uptake of solar PV have resulted in much higher than anticipated costs to governments and electricity retailers. These higher costs have contributed to the recent rises in electricity prices from 1 July 2011 and increased the burden on taxpayers. In light of these costs, the NSW Government closed the Solar Bonus Scheme to new participants on 1 July 2011 and asked the IPART to conduct this review. Submissions were due by 12 September 2011. [Read more](#)

## **Reviews of the Cost of Capital Parameters for Sydney Desalination Plant Pty Ltd – August 2011**

On 17 August 2011 the IPART released two reviews by Kevin Davis of the Australian Centre for Financial Studies and by SFG Consulting into the cost of capital parameters for Sydney Desalination Plant Pty Ltd. [Read more](#)

## **Discussion Paper – Review of Access Pricing on the NSW Grain Line Network – Public Hearing – 5 August 2011 – IPART Offices**

On 28 July 2011 the IPART announced that a public hearing would occur at its offices to discuss the question of maintaining or upgrading the existing network, and whether the Government should bear the full cost of an upgrade. Several submissions had been received from Asciano, GrainCorp and the NSW Farmers' Association. The output from the hearing, stakeholder submissions, follow up information, and its own research will inform the IPART's draft recommendations and report to be released in October 2011. [Read more](#)

## **Working Paper – Incentives for Cost-saving in CPI-X Regimes**

On 21 July 2011 the IPART released a working paper defining the inherent incentives for cost or efficiency savings in the standard CPI-X regime. Certain incentive properties are inherent in the way IPART currently applies the building block approach in CPI-X pricing reviews. The paper considers how the counter-incentive, and other undesirable incentives

within the CPI-X framework, might be overcome. In particular, the IPART shows how three regulators – Ofwat and Ofgem in the UK and the AER in Australia – have sought to create mechanisms that reward utilities for making cost savings. [Read more](#)

## **Discussion Paper – Cambridge Economic Policy Associates Ltd (CEPA) – Regulated Monopoly Service Providers and Customer Views, Preferences and Willingness to Pay – A Report for the IPART, June 2011**

On 1 July 2011 the IPART released a discussion paper created by CEPA, working with staff from the IPART. Regulators are increasingly seeking to enhance their consumer engagement processes and approaches, and this paper considers the approaches to consumer engagement that are employed around the world. [Read more](#)

## **Northern Territory**

### **Utilities Commission**

#### **Statement of Approach on Compliance**

On 5 September 2011 the Commission announced it was developing a Statement of Approach on Compliance setting out the Commission's expectations with respect to compliance. The Commission considers that regulated businesses and interested parties have an active role to play in the development of an effective compliance framework. Submissions were required by 19 September 2011. [Read more](#)

#### **Review of Electricity System Planning, Monitoring and Reporting**

#### **Review of Electricity System Planning and Market Operation Roles and Structures**

On 5 August 2011 the Commission released Draft Reports for the Review of Electricity System Planning, Monitoring and Reporting and the Review of Electricity System Planning and Market Operation Roles and Structures. Feedback was required by 2 September 2011. [Read more](#)

## Queensland

### Queensland Competition Authority (QCA)

#### Proposed Standard Access Agreements

On 9 September 2011 the QCA published seven submissions received from stakeholders commenting on QR Network's 29 April 2011 proposed alternative form of standard access agreements. [Read more](#)

#### Regulatory Fee

On 8 September 2011 the QCA published its decision as to the regulatory fee it will charge to Dalrymple Bay Coal Terminal (DBCT) Management. The *Queensland Competition Authority Regulation 2007* provides for the QCA to charge fees for the provision of regulatory services. In the past, the QCA's fee charged to DBCT Management reflected a partial recovery of the QCA's costs in regulating DBCT. In September 2010, the QCA decided to recover the full cost of providing regulatory services to most regulated entities including DBCT Management. [Read more](#)

#### Annual Revenue Requirement (ARR) Increase 1 January - 30 June 2011

On 12 August 2011 DBCT Management sought approval for a one-off increase in the ARR for 1 January to 30 June 2011. The 2010 Dalrymple Bay Coal Terminal undertaking sets the ARR for the terminal as at 1 January 2011. On 9 August 2011, DBCT Management submitted a draft amending access undertaking (DAAU) to amend the 2010 DBCT undertaking to make a one-off increase in the ARR for the period of 1 January 2011 to 30 June 2011 of \$2,166,969 million to adjust for an error DBCT Management made in its calculation of the ARR for this period. The QCA has issued DBCT Management with a notice of investigation, under s.146 of the QCA Act, stating its intention to commence an investigation into the submitted DAAU. Submissions to the QCA in respect of the DAAU are required by 8 September 2011. If no submissions are received within this time frame, the QCA may consider proceeding directly to a Final Decision on this matter. [Read more](#)

#### Review of Electricity Pricing and Tariff Structures

On 10 August 2011, the QCA published submissions received regarding its issues paper. The paper follows a request from the Minister for Finance and the Arts and Acting Treasurer and Minister for State Development and Trade, under the Queensland

Competition Authority Act 1997. The QCA is required to investigate, and report on:

- (a) an alternative retail electricity pricing methodology for the determination of the cost components under an N (network) + R (retail) approach; and
- (b) an alternate set of retail electricity tariffs, based on an N+R approach, which could be applied from 1 July 2012.

The QCA must provide a Draft Report in March 2012 and a Final Report by 31 May 2012. [Read more](#)

#### 2011-12 Final Report on SEQ Grid Service Charges

On 1 August 2011 the QCA released its Final Report regarding the SEQ Grid Service Charges for 2011/12. This responds to the 9 February 2011 Direction Notice received from the Minister for Energy and Water Utilities, requiring the QCA to investigate and recommend Grid Service Charges (GSCs) for the Grid Service Providers to apply in 2011-12, and to recommend a process for adjustments of the GSCs including Review Thresholds. [Read more](#)

#### Proposed Access Conditions: Wiggins Island Coal Export Terminal (WICET) Stage 1 Rail Infrastructure

On 25 July 2011 the QCA published submissions received in relation to QR Network's 11 May 2011 access conditions report. The QCA will consider all submissions received as part of any assessment, and ultimate approval of, the access conditions for the construction of rail infrastructure to support Stage 1 of the WICET development. On 21 July 2011 the QCA also agreed to grant an extension on the negotiation period for the WICET stage 1 access conditions from 60 days to 105 days (providing an additional 45 days up until the 24 August 2011). Both QR Network and the WICET Stage 1 users requested this extension to enable the final stages of the negotiation to be concluded. [Read more](#)

#### Interim Price Monitoring of South East Queensland (SEQ) Water and Wastewater Distribution and Retail Activities

On 8 July 2011 the QCA announced commencement of its 2011/12 SEQ Interim Water and Wastewater Price Monitoring Investigation. The Treasurer and the Minister for Finance and Minister for The Arts have referred the monopoly distribution and retail water and wastewater activities of Queensland Urban Utilities, Allconnex Water and Unitywater to the QCA for price monitoring covering the period from 1 July 2011 to 30 June 2013. Submissions for 2011/12 were required by 31 August 2011. [Read more](#)

## South Australia

### Essential Services Commission of South Australia (ESCOSA)

#### 2011 Determination of Solar Feed-in Tariff Premium

On 26 August 2011 the ESCOSA released an Issues Paper for public consultation on the entitlement of customers who install eligible photo-voltaic (PV) generators, to receive an additional premium that reflects the value to a retailer of electricity fed into the network. The amount paid to the customer is to be determined by the ESCOSA. Submissions are sought by 23 September 2011. [Read more](#)

#### Review of REED Energy Efficiency Activities – Final Decision

On 8 July 2011 the ESCOSA released the REES Activity Review Final Decision and accompanying Consultant's Report completing the review of the approved list of Energy Efficiency Activities for the Residential Energy Efficiency Scheme (REES). The review was being conducted in three phases with any amendments to the list to take effect from 1 January 2012. [Read more](#)

#### 1 August 2011 Electricity Standing Contract Price Adjustment

On 7 July 2011 the ESCOSA released its decision on the standing contract prices which AGL South Australia Pty Ltd (AGL SA) will be allowed to charge its customers from 1 August 2011 to 31 July 2012. The standing contract price is the retail electricity contract that AGL SA must offer to all South Australian small customers (those consuming less than 160 MWh per annum). [Read more](#)

## Tasmania

### Office of the Tasmanian Energy Regulator (OTTER)

#### Reliability Review

In August 2011 the OTTER commenced its review of the performance of the electricity supply industry, in terms of the reliability of the integrated Tasmanian power system, to identify and analyse the issues that are likely to influence the future reliability of the power system in the medium term (the next three to five years) and the impact on end-users. Input to a draft report on the review was required by 2 September 2011. A workshop will take place in October 2011 to identify, explore and discuss

reliability issues, and a final report will be published in December 2011. [Read more](#)

#### Price Comparisons

In August 2011 the OTTER published its sixth APAYG Price Comparison Report (rates as at 13 July 2011) that compares APAYG rates effective from 13 July 2011 with the standard regulated tariffs available for residential customers as at 1 July 2011. The Report includes a comparison of APAYG and regulated tariff prices for concession card holders. Price comparison reports are prepared regularly to provide an overview of the pricing environment in both the electricity and gas retail markets. The reports include a comparison of retail products available in Tasmania for small customers (Aurora Pay As You Go and standard regulated tariffs) and a comparison of distribution network pricing across Australia. Aurora Pay As You Go (APAYG) is a prepayment option offered to residential customers as an alternative to electricity supply via the standard tariffs. The OTTER, in its Declaration of Retail Services to be investigated and Terms of Reference for the Price Investigation, Statement of Reasons January 2007, did not include prices charged for APAYG customers in the investigation of maximum prices. Instead, the OTTER made a commitment to monitor and report on price movements and in doing so make comparisons of APAYG costs with standard tariff costs to aid customers in making an informed choice as to which service offers more value to them. The price comparison is based on the typical customer methodology established by the OTTER in 2006. [Read more](#)

#### Inaugural Electricity Market Bulletin: Tasmanian Market Watch

Starting in July 2011, the OTTER will publish weekly electricity market bulletins that summarise the outcomes of the National Electricity Market in relation to the Tasmanian region, as well as other factors affecting the electricity system in Tasmania. The analysis is carried out for the NEM week which is from Sunday to Saturday of each week. Tasmanian Market Watch contains electricity market information that requires the reader to have a basic level of knowledge of the national electricity market and its operations. [Read more](#)

#### Electricity Consultations 2011

On 1 July 2011 the OTTER released its Final Decision and Statement of Reasons on its proposal to amend the Electricity Supply Industry Performance and Information Reporting Guideline to improve the quality and relevance of information provided to it by intermittent generators. The proposal was consulted on in November 2010 and May 2011 and three submissions were received by 3 June 2011 and taken into account in the OTTER's considerations.

**Read more****Australian Energy Regulatory (AER) Public Forum**

In early July 2011 the OTTER announced that the Australian Energy Regulator (AER) would be making a determination governing the prices that Aurora Energy charges for its electricity distribution services from 1 July 2012. The AER held a public forum on 19 July 2011 in relation to Aurora Energy's regulatory proposal.

**Victoria****Essential Services Commission (ESC)****Water Price Review 2013-18**

See Notes on Interesting Decisions.

**Metro Trains Melbourne Pty Ltd (Metro) Access Arrangement Renewal**

On 24 August 2011, the ESC made its final decision in relation to Metro Trains Melbourne Pty Ltd (Metro's) proposed access arrangement. The ESC's final decision is to not approve Metro's access arrangement in respect of the metropolitan rail network. The *Rail Management Act 1996* (RMA) sets out an access regime that requires Metro to have in place, at all times, an access arrangement which sets out the terms and conditions and process by which access to the rail network may be obtained. Metro is the access provider and operator of the metropolitan rail network and provides access to freight operators in return for a fee (an access price) so that freight operators can use the rail network to provide a freight haulage service. In making its final decision, the ESC has taken into account the matters it is required to as outlined in Section 38ZI of the RMA. The legislation provides that where revisions have been submitted by Metro, the ESC must be satisfied that the revisions address the matters specified in the RMA. Where the ESC is not satisfied, the legislation provides that the ESC must not approve the proposed access arrangement, and must make the access arrangement itself. The ESC has therefore made the access arrangement for Metro. The access arrangement includes the ESC's determined access price path as well as the non-price amendments. **Read more**

**Western Australia****Economic Regulation Authority (ERA)****Final Decision – Review of the Requirements for Railway Owners to Submit Floor and Ceiling Costs**

On 25 August 2011 the ERA published its final decision relating to its Review of the Requirements for Railway Owners to Submit Floor and Ceiling Costs. The final decision ensures that railway owners will provide, at the commencement of the application of the Code to their railway, a working costing model which will ensure adequate transparency of costs to potential access seekers. The ERA has decided to continue this practice in response to submissions which argued that a basic level of cost transparency is required to support the aims of the WA Railways Access Regime. **Read more**

**Final Determination – Western Power Regulatory Test Waiver for Proposed Augmentation to Supply Southdown Mine**

On 23 August 2011 the ERA released its final determination on Western Power's regulatory test waiver application of 16 June 2011, for a proposed major augmentation to supply the proposed Southdown magnetite mine, approximately 90 km north east of Albany. This proposal was submitted under section 9.24 of the *Electricity Networks Access Code 2004*. The proposed mine is a joint venture comprising Grange Resources Limited and Sojitz Resources and Technology Limited. In response to requests for further information from the ERA, Western Power made two further submissions on 8 July 2011 and 2 August 2011. **Read more**

**Presentation to Eleventh Energy in Western Australia Conference, 17 August 2011**

On 19 August 2011 the ERA published the presentation by Lyndon Rowe, Chairman of the ERA, entitled 'Energy Regulation and Its Role in WA'. **Read more**

**Inquiry into the Efficiency of Synergy's Costs and Electricity Tariffs**

On 11 August 2011 the ERA announced that, at the request of the Treasurer, it was conducting an inquiry into the efficiency of the Electricity Retail Corporation's (Synergy) costs and electricity tariffs. The ERA would determine the efficient cost-reflective level for each regulated retail tariff available in the South West Interconnected System (SWIS). The SWIS covers the more densely populated areas of

the State from Kalbarri in the north, to Kalgoorlie in the east and to Albany in the south. In conducting the inquiry, the ERA would consider and develop findings on the efficiency of Synergy's operating and capital expenditure programmes and procurement of wholesale electricity and renewable energy certificates. Submissions were required by 9 September 2011. [Read more](#)

## ERA's 2011/12 Work Plan

On 21 July 2011 the ERA published its work plan, which sets out the activities that the ERA will undertake during the 2011/12 financial year associated with its key functions. [Read more](#)

## Inquiry into State Underground Power Program Cost Benefit Study

On 1 July 2011 the ERA released its draft report inquiring into the costs and benefits of the State Underground Power Program (SUPP). The SUPP was introduced by the State Government in 1996 to replace existing overhead electricity distribution lines and poles with underground lines. Over 95 per cent of the program's costs are for major residential projects in existing suburbs. The remaining costs are for special projects to enhance particular local areas of scenic, tourism or heritage significance. The ERA has identified the costs and benefits of the SUPP major residential projects and quantified these where possible. The ERA found that the program has been of positive value to Western Australians, producing benefits in the order of two and a half times the cost of the program. The Treasurer approved an extension for the ERA to deliver the final report for the inquiry, from 31 July 2011 to 30 September 2011, in order to provide sufficient time for public consultation on the draft report. Submissions were required by 12 August 2011. [Read more](#)

## New Zealand

### Commerce Commission (NZCC)

#### NZCC Issues First Mobile Monitoring Report

On 15 September 2011 the New Zealand Commerce Commission (NZCC) issued its first mobile monitoring report, which finds that there has been a small increase in calls and text messages between mobile networks, following the reduction of wholesale termination rates for mobile calls and text messages. The report shows traffic across mobile networks has increased in the three-month period from May to July 2011, and that the difference between the average costs of calls within networks and between networks has narrowed. Between May and July 2011, cross-network traffic increased by 1.2 per cent for mobile calls, and 2.9 per cent for text messages. At the

same time, the price difference between on-net and off-net services decreased by 4.4 per cent for mobile calls and by 3.4 per cent for text messages. As part of the NZCC's determination on mobile termination access services (MTAS), the NZCC is collecting mobile data on a monthly basis which it will report on quarterly. [Read more](#)

#### Draft Review of Prices for Unbundled Copper Local Loop Service

On 9 September 2011 the NZCC released a corrected version of its draft review of prices for the Unbundled Copper Local Loop Service (UCLL). Under changes made to the Telecommunications Act the NZCC is required to calculate an average price for the UCLL service, to be implemented three years after separation day. The NZCC has also updated the prices of the current urban and non-urban UCLL prices, and UCLL connection charges. The UCLL service allows Telecom's competitors to use Telecom's copper network between the exchange and the end-user's premises to provide their own services to their customers. The NZCC had undertaken an international benchmarking exercise to determine the movement of UCLL prices since 2007 when the UCLL STD was put in place. Submissions on the draft decision were required by 30 September 2011. Cross submissions will then be due on Wednesday 12 October 2011. If substantive issues arise in submissions which would benefit from a Conference being held, then the Conference will be held on Wednesday 19 October 2011. A final decision is expected by 18 November 2011. [Read more](#)

#### Competition for Wholesale Broadband Services Remains Limited

On 2 September 2011 the NZCC published its review of access to competitive broadband services and concluded that Telecom faces limited competition in the New Zealand market. As a result wholesale broadband access will remain subject to the terms of the unbundled bitstream access (UBA) Standard Terms Determination. The UBA service is a wholesale broadband service that allows telecommunications operators to differentiate their retail products from Telecom's retail broadband services. Telecom is required to provide other telecommunications operators access to the regulated UBA service on request. In areas where Telecom faces effective competition, it would no longer be required to provide the regulated UBA service. [Read more](#)

#### Setting Starting Prices for Gas Pipeline Businesses

On 22 August 2011 the NZCC released a discussion paper outlining its proposed approach to the setting

of starting prices for gas pipeline businesses. The NZCC proposes establishing starting prices that are based on the current and future profitability of each supplier and sets out in its paper the approach it intends to follow to do this. Feedback is sought on the proposed approach by 28 September 2011. Cross submissions are due by 7 October 2011. The NZCC will release its Draft Decisions in November 2011. [Read more](#)

## Review of Wholesale UBA Price

On 28 July 2011 the NZCC released its final determination of unbundled bitstream access (UBA) pricing following a review of UBA pricing components (including coverage, ISP services, bundle discounts and data transmission). As a result of the review the NZCC has updated the amount deducted from the UBA price to reflect the value of Telecom's internet service provider (ISP) services. The value of this component of the UBA price has increased to reflect the value that Telecom currently attributes to ISP services provided to its own customers.

Telecom is due to submit a service adjustment for approval by 31 August 2011. The changes in price from this review and the service adjustment will be implemented in September and backdated to 1 July 2011. [Read more](#)

## Proposed Adjustments to Prices for Electricity Distribution Services

On 19 July 2011 the NZCC issued a draft decision to reset regulatory controls for 16 electricity distribution businesses from 2012-2015. The proposed reset would implement new regulatory rules and processes—called input methodologies—set by the NZCC in December 2010, and result in price adjustments. A final decision will be made by 20 October 2011 and any changes arising from a reset of prices will apply from 1 April 2012.

Due to the Canterbury earthquakes, the draft decision does not apply to Orion New Zealand Limited. Separate discussions between Orion, the NZCC and central Government are taking place to tailor appropriate regulatory arrangements. [Read more](#)

## Competition Improves Broadband Browsing Speed says Commerce Commission

On 14 July 2011 the NZCC released a report as part of a continuing series measuring the performance of New Zealand's broadband services. The findings of this report are that increased competition from unbundled copper local loop services has improved broadband performance. [Read more](#)

## Release of Draft Capital Expenditure Input Methodology for Transpower

On 1 July 2011 the NZCC released its draft determination and reasons paper on an input methodology for approving Transpower New Zealand Limited's capital expenditure proposals. The input methodology provides an approval process for investments in the national grid. This is important because Transpower anticipates capital expenditure of up to \$3billion over the next five years. Submissions were due by 12 August 2011 and cross-submissions by 26 August 2011. The NZCC will publish a final determination and reasons paper by 1 February 2012.

## Notes on Interesting Decisions

### ESC: The 2013 Water Price Review

In 2012 the Essential Services Commission (ESC) will begin reviewing the prices to apply to water and sewerage services provided by Victoria's 19 water businesses for the period July 2013 to June 2018. Each business will be required to release a draft Water Plan before formally submitting its final Water Plan on which its prices will be based. These Water Plans should clearly articulate and commit to the prices to be charged and the services to be delivered over the regulatory period. The Water Plans will be assessed against regulatory principles outlined in the Water Industry Regulatory Order (WIRO) in preparing for the 2013 Water Price Review. The ESC and water businesses have singled out urban tariffs as an area for early engagement.

In that context, the ESC held an industry seminar on Urban Water Tariffs on 31 March 2011 to hear about key themes, issues and opportunities for setting tariffs for the next regulatory period. The release of an Issues Paper is a further step in the ESC's engagement on urban water tariff issues. The ESC then intends to issue a Guidance Paper to the water businesses for the 2013 Water Price Review later in 2011. That paper will address both revenue and tariff issues related to the full range of services. It will also take into account any changes in the policy and regulatory environment, including any amendments to the WIRO. Consistent with good regulatory practice, the ESC's decisions reflect a combination of the legal and regulatory framework and the specific context for the review. In general, the regulatory framework does not change, however the technology, industry and economic context can change significantly. In the case of the 2013 Water Price Review the ESC is aware of a number of new developments and changes in the context since the last reviews.

In carrying out its role the ESC is guided by:

- the regulatory framework set out in the Essential Services Commission Act 2001 (ESC Act) and the Water Industry Act 1994
- the Regulatory Principles set out in the WIRO
- the National Water Initiative (NWI) pricing principles.

This legal and regulatory framework recognises that water businesses are monopoly providers and so could use market power to set prices that exceed efficient costs and/or set service standards that are not consistent with community expectations.

The ESC Act provides that the primary objective is to promote the long-term interests of Victorian consumers having regard to the price, quality and reliability of essential services. In seeking to achieve this primary objective, the ESC must have regard to:

- efficiency in the industry and incentives for long-term investment
- the financial viability of regulated industries
- the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries
- the relevant health, safety, environmental and social legislation applying to the industry
- ensuring users and consumers (including low income or vulnerable customers) benefit from the gains from competition and efficiency, and
- consistency in regulation between states and on a national basis.

The Water Industry Act 1994 contains the following additional objectives that must be met in regulating the water sector:

- wherever possible, ensure that the costs of regulation do not exceed the benefits
- regulatory decision-making and regulatory processes have regard to any differences in the operating environments of regulated entities; and
- regulatory decision-making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities.

The procedural requirements include the need for businesses to consult with customers and relevant regulatory agencies before submitting the Water Plan to the ESC for assessment.

The WIRO was made in 2003 and amended in October 2005. The Department of Sustainability and Environment is currently reviewing the WIRO. The WIRO establishes a 'propose-respond' model in which a water business proposes tariffs and prices to the regulator, and if that proposal meets the WIRO requirements, the regulator must approve it. This model does not allow the regulator to decide if there is a better proposal than the one the water business has made. The WIRO principles relevant to tariffs are:

- they provide appropriate signals about the costs of providing services and incentives for sustainable water use
- they take into account the interests of customers
- customers or potential customers are readily able to understand the prices charged or the manner in which they are to be calculated or determined
- relevant costs incurred in administering tariffs are efficient.

The National Water Initiative (NWI) pricing principles were endorsed by the Natural Resource Management Ministerial Council on 23 April 2010. The ESC Act requires that the ESC has regard to these principles. Relevant NWI pricing principles are the principles for urban water tariffs, and principles for recycled water and stormwater reuse.

## **Productivity Commission (PC) Releases Draft Report for Economic Regulation of Airport Services**

On 26 August 2011 the PC released its draft report into the *Economic Regulation of Airport Services*. The report concluded that aeronautical charges do not indicate misuse of market power, that quality outcomes are generally satisfactory and that airport charges and profits look reasonable compared with outcomes at airports overseas. However, relationships between some airports and their customers have been strained. The PC considers the light-handed approach to airport regulation has been effective, and it attributes this to the presence of a credible threat of sanction for any airport that abuses its market power. The PC also proposed that the ACCC be afforded the power to direct an airport to 'show cause' why its conduct should not be subject to a 'forensic' price investigation and, if it is dissatisfied with the response, to recommend that the Government activate such an investigation. Feedback on the draft report was required by 23 September 2011. [Read more](#)

## Regulatory News

### 2011 ACCC Regulatory Conference

The full set of papers and presentations is now available on the ACCC website at: [2011 ACCC Regulatory Conference](#)

### New ACCC/AER Working Papers

In August 2011 the fourth paper in the working paper series was published on the ACCC website. The paper, titled *Public Utility Regulation in Australia: Where Have We Got To? Where Should We Be Going?*, is written by Dr Darryl Biggar. Working paper four is available at the following [link](#).

Working paper number five, titled *Evaluation of Australian Infrastructure Reforms: An Assessment of Research Possibilities*, is scheduled for release in late October 2011.

*Network* is a quarterly publication of the Australian Competition and Consumer Commission for the Utility Regulators Forum. For editorial enquiries please contact Rob Albon ([Robert.Albon@acc.gov.au](mailto:Robert.Albon@acc.gov.au)) and for mailing list enquiries please contact Genevieve Pound ([Genevieve.Pound@acc.gov.au](mailto:Genevieve.Pound@acc.gov.au)).