Critical Issues in Regulation – From the Journals


This paper reviews recent advances in the measurement of production and welfare within the national accounts. It primarily draws on the literature in the United States and from international organisations. When it was developed, the originators of the Gross Domestic Product (GDP) intended it to be a measure of production rather than a measure of welfare. According to Dale Jorgenson, the absence of a measure of welfare in the national accounts has led to the widespread misuse of the GDP to proxy welfare. Further, in the author’s view, measures of welfare are needed to appraise and evaluate the outcomes of changes in economic policies. Concepts that describe the income distribution, such as poverty and inequality, fall within the scope of welfare rather than production. It is argued in this paper that expanding the framework beyond the national accounts has led to important innovations in the measurement of both production and welfare.

There are 174 items in the reference list, with year of publication ranging from 1895 to 2017. Economists cited include Kenneth Arrow, Gary Becker, Angus Deaton, Erwin Diewert, Simon Kuznets, Paul Samuelson, Amartya Sen, Robert Solow and James Tobin. Dale Jorgenson himself has been publishing articles and books in this field for over fifty years, and twenty of the items in the reference list have him as either sole author or co-author.

The article can be accessed by subscription to *The Journal of Economic Literature*.


This paper is about the value of a statistical life (VSL). The author, W Kip Viscusi from Vanderbilt Law School in Nashville, has made previous contributions to the VSL literature, including a book titled *Pricing Lives: Guideposts for a Safer Society*, published in 2018 by Princeton University Press. Professor Viscusi observes a ‘pronounced shift … from the human capital or cost of death approach to a WTP [willingness to pay] measure’. The WTP approach is described as ‘the established economic principle’ and a ‘foundational component of benefit-cost analysis’. It involves the derivation of estimates of the VSL based on either revealed preference or from stated-preference studies where respondents are asked about their WTP for risk reduction.

The paper contains an international review of the application of VSL, which reveals substantial differences in estimates between countries. There is a particular focus in this article on two aspects of the results of these studies. First, it considers the relationship within a country between individual income and VSL, which is found to be broadly positive – ‘individuals’ WTP for fatality risk reductions rises with income’ (p. 6). Professor Viscusi also observes that ‘agencies have been understandably reluctant to fine-tune the VSL for cross-sectional income differences’ (p. 7). Second, there is a discussion of the relationship between age and VSL, where the WTP for risk reduction may decline with age. In this regard, there is a discussion of a situation in the United States where ‘devaluation of life for those over 65 in the regulatory impact statement generated a political firestorm’ (p. 5).

There are seven sections in the paper: The Necessity of Pricing Lives; Implementing the Value of a Statistical Life Approach; International Applications of the VSL; Variations of the VSL by Age, Income and Differences in Risk Taking (two subsections); Making Sense of VSL Disparities; Applications to the Courts, Regulatory Enforcement, and Business Decisions; and An Agenda for the International Valuation of Life.
There are twenty-five items in the reference list, with year of publication ranging from 1985 to 2018. The reference list includes the works of Peter Abelson which review VSL estimates for Australia.

The article can be accessed by subscription to the *Economic Record*.


This paper revisits the rule for efficient extraction of a mineral resource that was first derived by Harold Hotelling in a 1931 paper. Specifically, this paper contains an analysis of optimal contracts for resource extraction in the context of 'asymmetric information'. The analysis stresses what the authors see as a fundamental dilemma between extracting information (which is the essence of asymmetric information) and physically extracting the resource itself. Reducing the information rent of concessionaires who hold private information on the initial value of their fields requires diminishing extraction, leaving valuable resource in the ground.

The point of departure is the Hotelling rule for efficient extraction of a mineral. This stipulates that the resource price must reflect the scarcity rent. Economic efficiency requires that, at any point in time, the marginal value of the last unit extracted covers both the current marginal cost (which is a function of current reserves) and the shadow cost of increasing the extraction cost from that date on by depleting reserves. Those reserves decrease up to the point where the marginal cost of extraction is equal to the ‘choke price’, and further extraction ceases at that point.

The authors of this paper derive what they call a ‘virtual Hotelling rule’ that characterises the dynamics of resource extraction in such scenarios. Asymmetric information requires replacement of the marginal cost of extraction by the virtual marginal cost of extraction that is greater than the actual marginal cost. This explains the inefficiently low amount of extraction. Although fields (for example, gas) of different initial values would follow the same extraction paths under complete information, these paths differ under asymmetric information, with fields of smaller magnitude being less extracted.

From an implementation viewpoint, the authors show that the optimal contract for a concessionaire may be (but is not always) implemented with a menu of licence contracts. Contractors operating on fields with larger initial stocks receive a higher payment per unit of output (or, equivalently, pay a lower royalty), but must also pay in advance a greater licence fee to obtain the extraction right.

The authors generalise their model to the case of a market of concessionaires. Under asymmetric information, constrained efficiency requires that all active fields at a given point in time operate at the same virtual marginal cost of extraction. This is a modification of what is known as the ‘Herfindahl principle’. Because virtual costs differ across producers with different initial stocks, active businesses are not all producing the same amount even though their extraction technologies are identical. The authors again obtain the virtual Hotelling rule in such an environment, and demonstrate that, in this circumstance, the market price converges faster to its long-run limit under asymmetric information. This provides ‘an important empirical check’ to assess the validity of their approach in future research.

Beyond this empirical aspect, the authors say that their model also offers a building block that could be extended in various directions. These extensions might impact on the magnitude of the rent-efficiency trade-off highlighted in this paper.

There are fifty-four references in the list, with year of publication ranging from 1931 to 2017. Economists cited include Mark Armstrong, David Baron, Orris Herfindahl, Jean-Jacques Laffont, Roger Myerson, David Sappington and Jean Tirole. A classic reference is Harold Hotelling’s ‘The Economics of Exhaustible Resources’ published in *The Journal of Political Economy* in 1931.

The article can be accessed by subscription to *The RAND Journal of Economics*.


This paper is about regulatory agencies that seek to promote price stability. A rationale for this practice might be that regulators aim to protect customers’ relationship-specific sunk investments. The authors develop a simple model where commitments to future rigid prices may increase welfare when customers need to make such investments. The authors then use data from the Swedish district heating system during the period from 1998 to 2007 to explore the impact of monopoly pricing decisions on the take-up rate of district heating.

The authors focus on decisions where customers make long-term sunk investments in a service while subject to uncertainty about future usage prices. Given that customers are forward-looking and risk averse, the authors show that welfare increases if the supplier can commit to a price scheme. As this commitment is not credible without third-party
enforcement, price regulation could play a role. Specifically, the authors show that, in their model, the lower the future price level and the lower the uncertainty of future prices, the higher the propensity to make sunk investments.

In the empirical part of the paper, the authors test whether customers are forward-looking and risk averse. The authors use data from the Swedish district heating market where customers are required to make a material long-term sunk investment in a heat-exchange device in order to take up the district heating service. Faced with this investment decision, customers form a view about the future path of prices through the slope of the long-term price trend. Their (average) preference for risk is measured through the volatility of prices around the long-term price trend. The empirical results are assessed as being robust and consistent with the assumptions. Specifically, the authors find that both the price slope and volatility are negatively related to sunk investments in district heating.

There are six sections in the paper: Introduction; District Heating in Sweden; Conceptual Framework (three subsections); Data; Estimation (two subsections); and Conclusion. In addition, there are two appendices.

There are forty-five items in the reference list with year of publication ranging from 1973 and 2012. Economists cited include Michael Crew, Victor Goldberg, Paul Kleindorfer, Daniel McFadden and David Newbery. A classic reference is Victor Goldberg’s ‘Regulation and Administered Contracts’ that was published in The Bell Journal of Economics in 1976.

The article can be accessed by subscription to The Journal of Regulatory Economics.


This paper analyses cost efficiency of Distribution System Operators (DSOs) when model specification and variable selection are difficult to determine. It contains a discussion of a Bayesian approach to this analysis. Bayesian-model selection and inference-pooling techniques are adopted in a stochastic frontier analysis to mitigate the problem of model uncertainty. Adequacy of a given specification is judged by its posterior probability, which makes the benchmarking process more transparent and more objective. The proposed method is applied to one of the DSOs operating in Poland. The authors find that variable selection plays an important role, and that models which are the best at describing the data, are rather ‘parsimonious’. The authors rely on just a few variables determining the observed cost. However, these models also show relatively high average efficiency scores among analysed objects.

The paper is structured as follows. In Section 2, the authors present the Bayesian Stochastic Frontier Analysis used in the empirical study. In Section 3, the authors outline Bayesian model selection and averaging techniques, and how the recently developed class of Corrected Arithmetic Mean Estimators of the marginal data density value is adopted in the DSO cost-efficiency analysis framework. In Section 4 there is a description of an empirical study which analyses cost models and cost-efficiency rankings of business units of a Polish DSO. Section 5 concludes with a discussion.

There are sixty-eight items in the reference list with year of publication ranging from 1979 and 2017. Economists cited include Tim Coelli, Erwin Diewert, John Hicks and Michael Pollitt.

The article can be accessed by subscription to The Energy Journal.


This paper investigates the current state of market integration among European electricity day-ahead spot prices. In their empirical analysis the authors utilise a large sample of hourly spot prices of twenty-five European markets for the period from 1 January 2010 to 30 June 2015, and combine these data with other relevant data such as hourly interconnector capacities and the existence of market coupling. In general, the authors’ findings suggest that the integration among European electricity markets has a large potential for improvements from additional capacity investments and further promotion of market coupling.

There are seven sections and an Appendix. Section 1 is an introduction. Section 2 surveys the literature. Section 3 is titled ‘Market Integration and Spot Price Convergence’. Section 4 sets out the methods (cointegration; error correction model). Section 5 sets out the data and descriptive statistics. Section 6 sets out the results (in three subsections). Section 7 concludes.

There are two main conclusions in the paper. Firstly, empirical results from cointegration analysis indicate that market integration increased from 2010 to 2012, but thereafter declined until 2015. This was in spite of the introduction of market coupling in many markets. Secondly, the authors empirically assess error correction after price shocks and reach the conclusion that markets’ strength of the error-correction mechanism is modest.
There are thirty-three items in the reference list, with year of publication ranging from 1987 to 2016. Economists cited include David Newbery and Clive Granger.

The article can be accessed by subscription to The Energy Journal.


This paper provides evidence on the decision of consumers to move from an ‘old’ (copper-based) broadband technology to a ‘new’ (fibre-based) broadband technology. It takes into account the impact of regulatory interventions imposed on the old technology. The analysis in this article is based on a sample of EU25 countries (25 European Union member states) using panel data from 2003 to 2015 on the adoption of fibre-based broadband technology by households and businesses. The results suggest that an increase in the regulated price for accessing the old network favours consumer adoption of the new technology. In particular, the authors find that an increase in the unbundling price of 10 per cent increases fibre-based adoption in the range of 0.7 to 1.0 per cent. The authors suggest that the results also provide insights on the take-up rate of the new technology – that is, on the ratio between adopted and deployed fibre-based services and networks. By comparing the quantitative effects of regulation, the authors find that an increase in the access price decreases the take-up rate, meaning that the impact of a greater access price on fibre coverage is stronger than on fibre adoption.

The paper has seven sections: Introduction; Literature Review; A Theoretical Model and Testable Hypotheses; Empirical Specifications; Data (four subsections); Empirical Results and Policy Implications (two subsections); and Summary and Conclusions. In addition, there is a data Appendix.

There are forty-one items in the reference list, with year of publication ranging from 1981 to 2016. Economists cited include Marc Bourreau, Robert Crandall, Michael Katz, Carl Shapiro and Ingo Vogelsang.

The article can be accessed by subscription to *Industrial and Corporate Change*.


This paper is about the role of cooperation in the context of fibre-to-the-basement/home (FTTB/H) deployment. The authors argue that cooperation is able to play an important role in two main ways. First it enables the distribution of both deployment costs and risks among several actors. Second, cooperation enhances the degree of network capacity utilisation and thus accelerates the overall extent of FTTB/H deployment. Co-investment models represent a segment of cooperative forms that focus on the cooperative deployment of new infrastructure. While these models have not yet been realised in Germany, the authors observe that the experience from other European countries suggests that co-investment models may contribute significantly to increase FTTB/H coverage in Germany.

The ‘joint-venture model’, the ‘investor model’ and the ‘swapping model’ are distinguished as three basic co-investment arrangements, with each having different governance structures and incentive schemes. Incentives of telecommunications businesses to participate in co-investment models can differ to some extent – incumbent operators may have different motives compared with alternative network operators. Arrangements and motivations depend on: specific market structures; framework conditions; and business-related aspects.

While there are positive effects on economic efficiency, the authors observe that co-investment arrangements may also negatively affect competition by allowing collusive behaviour. This especially accounts for co-investment deals, where SMP businesses are involved. These possible negative effects may need to be examined by competition and regulatory authorities, which may impose remedies where deemed necessary. A core objective should be free and non-discriminatory open access for third parties to enable them to recreate the products of the co-investors, and thus actively to compete with them.

After the deployment, asymmetric market shares between co-investing partners may eventuate, possibly leading to difficulties in amortising necessary investments for some parties. In a worst-case scenario, market exit may be imminent. The authors suggest that this risk can be addressed with financial-compensation schemes among the co-investing partners. For example, the wholesale-split approach can reduce the competitive risk of asymmetric market shares after deployment; albeit to the detriment of maximum possible revenue per party.
Experiences with co-investment models in France, Spain and Portugal show the relevance of country-specific structures and framework conditions. Regulated access to passive infrastructure is a key factor in these countries. In Spain and Portugal, co-investment models have been initiated and pushed by market participants. The co-investment agreements in France, on the other hand, have developed less from the market but have been implemented as a targeted state measure. They are coordinated by the regulator and represent a form of symmetrical regulation.

The article, which is available only in the German language, can be accessed from the WIK website.


The central theme of this article is the author's observation that improvements in information and communications technology (ICT) and in labour quality represent 'embodied' technological progress, as distinct from the 'disembodied' residual represented by multifactor productivity (MFP) growth. John Quiggin suggests that the 'seeming paradox' of continued labour productivity growth combined with static MFP may be explained by technological progress now being mostly embodied in improved technology and better-educated workers. It is further suggested that the contribution from microeconomic reform has been, and is likely to remain, marginal.

The Productivity Commission's 2017 report, Shifting the Dial: 5 Year Productivity Review (hereafter the Report),* is the first in a planned series of five-yearly reviews of productivity Australia. John Quiggin's interpretation is that The Report starts from the premise that Australia's productivity growth is too low to sustain improved living standards in the long term; and that its title implies that the central thesis of the Report is that productivity growth rates can and should be increased.

According to the author, if Australia had relied on reform-driven MFP growth for improvements in productivity, its living standards would have been stagnant for decades. Further, in the author's view, under current conditions, productivity growth arises almost entirely from the combination of better educated workers and better and cheaper technology. Further, in the author's view, this conclusion is 'merely a return to the older idea of growth theory, namely that growth arises from increases in inputs of labour and capital, properly measured'.


The article can be accessed by subscription to The Australian Economic Review.

[^: A summary of the PC's Shifting the Dial: 5 Year Productivity Review is included in the December 2017 issue of Network.]

Is a Big Entrant a Threat to Incumbents? The Role of Demand Substitutability in Competition Among the Big and the Small, Lijun Pan and Makoto Hanazono, The Journal of Industrial Economics, 66, 1, March 2018, pp. 30-65.

This paper establishes a model of market competition between large and small firms and investigates the way in which demand substitutability affects how the entry of big firms impacts on incumbent firms. The authors focus on the relative strength of two opposing effects of entry on large incumbent firms' demand: the direct substitution effect among large firms (negative); and the indirect feedback effect through the change in small firms' aggregated behaviour (positive). If the substitutability between large and small firms is sufficiently high, the indirect effect dominates the direct effect and the equilibrium prices and profits of large incumbents increase.

The authors' model shows that welfare effects are ambiguous, which causes them to call for careful assessment when regulating the entry of large firms. The authors observe that many countries enforce laws to restrict large firms' entry. However, the analysis in this paper indicates that the government should be cautious in adopting and enforcing such laws. This is because such restrictions may not always be welfare-improving. If small firms are able to differentiate themselves from large firms, or are essentially complementary to large firms, the entry of a large firm into the local market may improve welfare. This finding suggests to the authors that policy makers should account for the specific demand characteristics in different industries or markets when implementing zoning laws.

There are five sections in the paper: Introduction; The Model (four subsections); Equilibrium Analysis (four subsections); Discussion; and Conclusion. There are two technical appendices.

There are twenty-eight items in the reference list, with year of publication ranging from 1951 to 2018. Economists cited include Jesse Markham, Jeffrey Perloff, Michael Riordan and Steven Salop.

The article can be accessed by subscription to The Journal of Industrial Economics.
Regulatory Decisions in Australia and New Zealand

Australia

Australian Competition and Consumer Commission (ACCC)

Telstra’s Fixed-Line Access Services and Wholesale ADSL – Inquiry into Access Conditions Commenced

On 12 December 2018 the ACCC commenced a public inquiry into making final access determinations for Telstra’s six fixed-line services and for wholesale ADSL. Feedback is sought by 25 January 2019. A more detailed consultation and position paper will be released in February 2019 with feedback required by the end of March.

Digital Transmission Capacity Service (DTCS) – Declaration Draft Report

On 5 December 2018 the ACCC released its Draft Report recommending that declaration of the DTCS access service should continue for five years after the expiry of the current declaration on 31 March 2019.

Fixed-Line Access Services – Declaration to Continue until 30 June 2024

On 26 November 2018 the ACCC announced that it had decided to continue the Declaration of the six fixed-line access services until 30 June 2024.

Electricity Monitoring – Discussion Paper Released

On 21 November 2018 the ACCC released its Discussion Paper for the Inquiry into electricity supply into the National Electricity Market.

Quarterly Wholesale Market Indicators Report Released

On 13 November 2018 the ACCC released its Wholesale Market Indicators Report for the September Quarter of 2018.

Measuring Broadband Australia – Third Report Released

On 5 November 2018 the ACCC released its third Measuring Broadband Australia Report.

Container Stevedoring Monitoring Report 2017-18 Released


NBN Migration Plan – Telstra’s Special Services Variation Approved

On 26 October 2018 the ACCC announced that it had approved Telstra’s Special Services Variation of its NBN Migration Plan.

Australian Competition Tribunal (ACT)

Port of Newcastle Arbitration Determination Review Applications – Case Management and Hearings

The ACT has listed the dates for the Case Management Hearing (1 February 2019 in Melbourne) and the Hearing (6 to 15 May 2019 in Melbourne) for the Applications for Review of the ACCC’s Arbitration Determination by Port of Newcastle Operations Pty Ltd and Glencore Coal Pty Ltd.

Australian Energy Market Commission (AEMC)

Pipeline Capacity-Trading Reforms

On 29 November 2018 the AEMC announced the introduction of new rules, regulations and laws to facilitate its pipeline capacity-trading reforms.

Wholesale Demand Response Rule Change Requests – Consultation Paper

On 15 November 2018 the AEMC published a Consultation Paper on Wholesale Demand Rule Change Requests.

Coordination of Investment in Generation and Transmission – Summary of Submissions Published

See ‘Notes on Interesting Decisions’.

Generator Rebidding in the National Electricity Market – Assessment Published

On 11 October 2018 the AEMC published an assessment of Generator Rebidding in the National Electricity Market.
**Australian Energy Regulator (AER)**

**Wholesale Electricity Market Performance Report 2018 Published**

On 11 December 2018 AER Chair, Paula Conboy, announced the AER’s newly-published report as being the first to look at competition across all NEM regions.

**Electricity Transmission and Distribution – Annual Benchmarking Report 2018 Published**

On 30 November 2018 the AER published its Annual Benchmarking Report 2018 for electricity transmission and distribution.

**Gas Distribution Tariffs for Victoria and Albury in 2019 Approved**

On 16 November 2018 the AER announced it had approved Gas Distribution Tariffs to apply in Victoria and Albury in 2019.

**Forecasting Opex Productivity Growth for Electricity Distribution – Draft Decision**

On 9 November 2018 the AER published its Draft Decision on Forecasting Opex Productivity Growth for Electricity Distribution.

**Victoria’s Electricity Networks Tariff Proposals Approved**

On 8 November 2018 the AER announced it had approved Victoria’s Electricity Networks Tariff Proposals.

**Performance Data for Electricity Distribution Businesses Published**

On 5 November 2018 the AER published Performance Data for Electricity Distribution Businesses.

**National Competition Council (NCC)**

**NCC Annual Report 2017-18 Released**

On 18 October 2018 the NCC’s Annual Report 2017-18 became publicly available following its tabling in the Parliament.

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**Australian Capital Territory**

**Independent Competition and Regulation Commission (ICRC)**

**Electricity Model and Methodology Review**


**New South Wales**

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

**Financeability Test – Final Report**

On 13 November 2018 the IPART released its Final Report on its Financeability Test.

**Proposed Changes to Rural Water Cost Shares**


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**Northern Territory**

**Utilities Commission**

**Port of Darwin Prescribed Port Services Draft Price Determination 2019-22 – Released for Consultation**


**Annual Compliance Report 2017-18 Published**


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**Queensland**

**Queensland Competition Authority (QCA)**

**SEQ Retail Electricity Market Monitoring 2017-18**

On 4 December 2018 the QCA released a report after monitoring the prices that electricity retailers in SEQ charged in 2017-18.
Irrigation Pricing Review Commenced
On 31 October 2018 the QCA announced that it had commenced a review of irrigation pricing in regional Queensland.

SEQ Retail Electricity Market Monitoring September Quarter 2018
On 30 October 2018 the QCA released its SEQ Retail Electricity Market Monitoring Report for the September Quarter 2018.

SEQ Solar FiT Report 2017-18 Released
On 26 October 2018 the QCA released its 2017-18 Solar FIT Report for SEQ.

South Australia

Essential Services Commission of South Australia (ESCOSA)

Ports Price Monitoring Report 2018 Released

SA Water Third-Party Access Regime Review – Consultation Paper
On 2 November 2018 the ESCOSA released a Consultation Paper on the effectiveness of SA Water’s Third-Party Access Regime.

Tasmania

Office of the Tasmanian Economic Regulator (OTTER)
No reportable matters listed.

Victoria

Essential Services Commission (ESC)

Water Performance Report 2017-18 Published
On 4 December 2018 the ESC announced it had published its Water Performance Report which can be accessed through here.

Minimum Feed-in Tariff Proposal for 2019-20 – Consultation Announced
On 4 December 2018 the ESC announced that it was consulting on its Minimum Feed-in Tariff Proposal for 2019-20.

The Port of Melbourne’s Regulated Prices – ESC Provides Informal Feedback
See ‘Notes on Interesting Decisions’

Western Australia

Economic Regulation Authority (ERA)

Reference Tariff Variations for 2019
On 4 December 2018 the ERA published its Reference Tariff Variations for each of: the Dampier to Bunbury Natural Gas Pipeline; the Goldfields Gas Pipeline; and the Mid-West and South-West Gas Distribution Systems.

On 5 November 2018 the ERA announced that it was conducting consultation on the implementation of the debt risk premium from its Rate of Return Guidelines (2018).

New Zealand

New Zealand Commerce Commission (CCNZ)

Improving Retail Service Quality in Telecommunications – Framework Paper Published
On 30 November 2018 the CCNZ published a Framework Paper outlining its approach to implementing new provisions for improving retail service quality.

Consumer Protection and Proposed Process as Chorus Withdraws Copper – Consultation
On 26 November 2018 the CCNZ announced that it was conducting consultation on consumer protection and proposed processes as Chorus deployed fibre and withdrew copper.
Lines Companies Price-Quality Path Resets – Consultation Paper Released

On 15 November the CCNZ released a Consultation Paper on the lines companies price-quality path resets.

Christchurch Airport and Auckland Airport Pricing Decisions – Final Reports Released

On 1 November 2018 the CCNZ released its Final Reports on the pricing decisions of Christchurch Airport and Auckland Airport.
Notes on Interesting Decisions

AEMC’s Study of Coordination of Investment in Generation and Transmission – Summary of Submissions Published

The AEMC is conducting a study of coordination of investment in generation and transmission. The study is reviewing how generators can join the power system and use the transmission network at the lowest possible cost to consumers. The AEMC received 39 submissions to its options paper for its review. Consumer representatives, large users, generators, networks, industry associations, storage proponents, market bodies, state governments, universities and large investors provided feedback in their submissions. The AEMC has organised the feedback into five key areas:

1. Making the Integrated System Plan (ISP) ‘Actionable’: The COAG Energy Council has asked the Chair of the Energy Security Board to take the lead on a work program to ‘convert the ISP into an actionable strategic plan’ and report back to the Council’s December 2018 meeting. This AEMC review is an input into the Energy Security Board’s advice. The options paper, published in September 2018, set out various ways to make the ISP actionable by linking the AEMO’s role of national transmission planner more strongly to the individual investments made by network businesses. The spectrum of options moves from an enhanced status quo, where transmission network businesses keep responsibility for the majority of steps in the transmission planning and investment process, to an option where AEMO would take responsibility for all of the steps as part of the ISP. Stakeholders expressed preferences for options across the full spectrum and some variations on the options that could be considered. In spite of the range of views expressed, nearly all stakeholders agreed the following principles are essential for achieving the best outcomes for consumers when implementing the ISP:

Robust cost-benefit analysis: Stakeholders strongly supported robust cost-benefit analysis of proposed new transmission assets, regardless of whether the need for more transmission is identified in the ISP, or by a transmission business.

Effective and meaningful consultation: Stakeholders broadly agreed there needs to be confidence in the planning process if the ISP is to be made actionable. This requires rigorous and transparent consultation throughout the preparation of the ISP.

Managing risk to consumers: Under the current framework, there are processes to mitigate the risk of paying for inefficient transmission. In considering any changes to the framework, stakeholders agreed that the allocation of risk in any model adopted to implement the ISP should not increase risks for consumers.

2. Applying the Regulatory Investment Test for Transmission (RIT-T): Transmission assets can be very expensive, and once they are built, consumers pay for them for decades. The RIT-T process is used by transmission businesses and the Australian Energy Regulator to weigh up the costs and benefits of proposed investment in the transmission network. It is designed to protect consumers from paying for transmission that is inefficient. Some stakeholders were in favour of maintaining the existing RIT-T arrangements. These stakeholders typically referenced the recent COAG Energy Council review of the RIT-T which concluded the RIT-T remains the appropriate mechanism to ensure that new transmission infrastructure in the NEM is built in the long-term interests of consumers. Other stakeholders considered that the existing RIT-T arrangements were not suited to the energy transformation that is occurring. They suggested that the current RIT-T arrangements are better suited for incremental augmentations, not the transformation that is required. Other reasons were that the current RIT-T is not appropriate for strategic investments and does not get around the problem of coordinating generation and transmission investment. Stakeholders also commented on the timing of the RIT-T process, with most saying the length of the process is appropriate. Several submissions noted there are factors unrelated to the RIT-T process, such as planning and environmental approvals, that can impact on timing.

3. Supporting the Development of Renewable Energy Zones: The options paper considered how the transmission network could be developed to support new renewable energy zones (REZs), such as those identified in the ISP. Some stakeholders suggested this would largely depend on the approach taken to strengthening links between the ISP and decisions on transmission investment. Stakeholders agreed with the AEMC that there are a number of ways that REZs could be facilitated under the current regulatory framework. However, this has not occurred largely due to factors outside the framework. Many stakeholders expressed interest in further exploring ENGIE’s model to create a mechanism for ‘transmission bonds’ to be issued initially to fund transmission investment, as a potential model to accommodate REZs under the current framework without changing access arrangements. Other stakeholders suggested changing access arrangements to facilitate REZs. This could involve
changing generators’ current rights to access and use of the network. However, it was not clear how these changes would only apply to a REZ, and not the broader framework.

4. Managing Network Connection: Of the stakeholders that commented on congestion and access arrangements, consumer representatives typically supported some change to existing arrangements immediately so that some of the risks associated with transmission investment can be placed with generators themselves. Conversely, existing generators did not favour any change to the status quo. Renewable generators typically thought that the current access arrangements were not sustainable, but did not want to take on increased risks associated with changing the current access arrangements. Network businesses agreed that congestion is an issue in the NEM, but that determining how to implement the ISP should be the first priority.

5. Treatment of Large-scale Storage: There was strong support for the development of a new NEM registration category for large-scale battery and pumped hydro storage. Whether under current arrangements or a new NEM registration category, stakeholders predominantly supported the view that large-scale utility storage should not pay transmission use of system charges. However, several stakeholders expressed the view that a cost-reflective charging arrangement would lead to efficient storage-location decisions, and that it was appropriate for storage solutions to pay for use of the transmission system when they act as a load on the system and do not export electricity to the grid.

The AEMC’s next step will be to publish a final report in December 2018.

For more information on the AEMC’s review see here.

ESC Provides Informal Feedback on the Port of Melbourne’s Regulated Prices

The Essential Services Commission (ESC) of Victoria is responsible for administering regulations that govern how the Port of Melbourne recovers its costs from port users. Each year, the Port of Melbourne must submit a tariff compliance statement to the ESC, outlining how it has demonstrated compliance with a pricing order (legislation that regulates how the port sets its prices). Every five years the ESC is required to assess whether there has been any significant and sustained non-compliance with the pricing order. Outside of these five-yearly reviews, the ESC provides interim commentaries on the port’s compliance statements in order to provide guidance to the port and to identify important issues to other stakeholders. The ESC’s commentaries are not an assessment of the port’s compliance with the pricing order, nor do they provide findings on whether any non-compliance was significant and sustained. Rather, the Interim commentaries form part of a continuing discussion with the port and other stakeholders on how the ESC views the regulations affecting the port’s price-setting process. The port then has the opportunity to clarify and provide further justifications for some of its methods in future compliance statements.

In October 2018, the ESC published its interim commentary on the Port of Melbourne’s tariff compliance statement for prices that apply from 1 July 2018 to 30 June 2019. The port’s tariff compliance statement submission also included supporting information such as its regulatory model and a consultant report on the rate of return.

The ESC has provided informal feedback on how the Port of Melbourne set its regulated prices from 1 July 2018 to 30 June 2019. The interim commentary contains various observations on the methods used by the port to set prices over that period. The ESC has identified potential concerns around the port’s benchmark rate of return, how it has reported depreciation and on detailed modelling issues. In particular the ESC made the following main observations:

- the port’s rate of return on capital appears high and requires further justification
- the port needs to clarify whether it is including depreciation and contract revenues in its aggregate revenue requirement
- the port should provide further justification for some detailed elements of its tariff calculations
- the port’s modelling of asset values is complex and should be more transparent
- some areas of the port’s statement require more detailed supporting information.

The port will submit its 2019-20 tariff compliance statement by 31 May 2019. The ESC will commence its first compliance inquiry after 1 July 2021, and, in doing so, will consider whether the port has complied with the pricing order and if any non-compliance was significant and sustained.

For more information see ESC’s Feedback.
Regulatory News

27th Conference on Postal and Delivery Economics
The European University Institute and the Florence School of Regulation will hold the Twenty-seventh Conference on Postal and Delivery Economics in Dublin from 22 to 25 May 2019. Information on the conference is available here.

2019 ACCC/AER Regulatory Conference
The 2019 ACCC/AER Regulatory Conference will be held in Brisbane on Thursday 1 August and Friday 2 August 2019. Check the conference page for updated information.

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