
Regulatory issues

Telecommunications

Telstra price caps extended

On 14 December 1998 the Minister for Communications, Senator Richard Alston, announced a six-month extension of the existing telecommunications price cap regime, to allow for consultation on the form the price caps regime should take in the future.

The expiry date has been extended from 31 December 1998 to 30 June 1999. The Government intends to issue a discussion paper and a report prepared by Access Economics, for comment.

The existing price cap regime imposed on Telstra under the Telstra Corporation Act:

- requires Telstra to reduce the price of a basket of its main services (connections; line rentals; local, trunk and international calls; leased lines and mobile services) by 7.5 per cent in real terms each calendar year;
- requires Telstra to reduce its standard prices for residential customers, for connections, line rentals, trunk calls and international calls, by 1 per cent in real terms each year;
- prohibits Telstra from raising the price of untimed local calls above 25 cents per call for calls made from residential or business phones, and 40 cents per call for calls made from a public payphone;
- requires Telstra to obtain the prior consent of the Commission where it proposes to increase a charge that is subject to the price control arrangements by more than the CPI during a year; and
- make Telstra's charges for directory assistance subject to notification and disallowance by the Minister.

The price control arrangements are administered by the Commission.

Pay TV inquiries

On 23 December 1998 the Commission announced two public inquiries concerning the declaration of pay TV services. The inquiries relate to the declaration of an analogue-specific service, and a technology-neutral service which would include digital services.

The Commission has issued discussion papers outlining the process for each inquiry and seeking written comments by 1 February 1999. It is interested in the views of industry participants, consumer groups and other members of the public on specific issues outlined in the papers.

The Commission expects to release a draft report on the analogue-specific inquiry by the middle of February and a draft report on the technology-neutral inquiry in the middle of March 1999.

The discussion papers are available from the Commission's website.

Draft determination on Telstra's proposed interconnect prices

On 19 January 1999 the Commission announced its draft determination rejecting Telstra's proposed charges to other carriers for interconnecting to its network.

On 7 November 1997 Telstra submitted to the Commission an undertaking specifying its proposed terms and conditions (including the proposed charges) for interconnection to its Public Switched Interconnection Network. Interconnection enables long-distance carriers, such as Optus and AAPT, to offer long-distance telephone calls to customers connected to Telstra's network.

Under the Trade Practices Act, Telstra is encouraged to reach commercial agreement with carriers such as Optus and AAPT over the terms and conditions of interconnection. If

they cannot agree, then the Commission can arbitrate.

As an alternative to arbitration, the Act provides that Telstra may submit an undertaking to the Commission specifying the terms and conditions of interconnection. The Commission must not accept the undertaking unless it believes the terms and conditions are reasonable.

The Commission's investigation of the undertaking included an independent analysis by international experts National Economic Research Associates of the costs of providing interconnection in Australia based on efficient telecommunications practices; an examination of the costs Telstra has incurred in the past in providing interconnection; and comparisons with best practice charges for interconnection overseas.

The Commission concluded that for the proposed charges to be acceptable, they would need to be halved. Moreover, it concluded that some of the non-price terms and conditions in the undertaking would provide Telstra with too much discretion over how interconnection is provided. This would be likely to further disadvantage Telstra's competitors and reduce the benefits of competition to consumers.

A report detailing the reasons for the draft determination is available on the Commission's website.

Electricity

NSW vesting contracts

On 18 December 1998 the Commission issued a draft determination proposing to grant authorisation to Type 1 and Type 2 vesting contracts struck between NSW electricity generators and retailers, with conditions.

The Commission received the application for authorisation of the contracts in June 1998 and undertook extensive market inquiries and analysis of the contracts, including a review by London Economics.

The Commission also extended its interim authorisation for the vesting contracts until 30 June 1999 to ensure adequate time for the

consideration of further submissions and consultations before issuing a final determination.

Background

Under transitional arrangements for the national electricity market, vesting contracts are contracts established by State Governments between their local generators and retailers. They are designed to provide a range of outcomes, including a progressive rate of exposure to competition, hedging protection for retailers against volatile spot prices and revenue stability for generators and retailers.

In New South Wales, these contracts cover approximately 30 per cent of the total electricity load. This portion is still governed by regulated (rather than competitive) prices and local retail franchises.

There are two forms of contract in the NSW arrangements.

The Type 1 contracts are two-way hedge contracts with an average strike price. When spot prices are above the strike price, generators reimburse the difference to retailers; when spot prices are below the strike price, retailers reimburse generators. The Type 1 contracts submitted by the applicants are based on a series of strike prices that yield a State-wide weighted average of \$44.50MWh for most of the vested franchise load.

The Type 2 contracts apply during weekday peak periods and equivalent periods on weekends and public holidays. They can cover between 13 and 25 per cent of the franchise load. These contracts incorporate a price cap (based on the same prices as for the Type 1 contracts) and a floor price which operates as a binary option.

The binary option in the Type 2 contracts operates so that generators receive the full floor price plus the spot price, whenever the spot price is below the floor price. At spot prices at or above the floor, generators receive the spot price, but only up to the limit set by the one-way price cap in favour of retailers. When the spot price is at or above the price cap, retailers receive from generators the difference between the spot and strike prices.

Conditions of authorisation

The conditions, which must be satisfied before authorisation is granted, address the Commission's concerns regarding the competition impact of the contract pricing arrangements, including the issues of stranded costs and cross-subsidies, and the proposed term of the vesting contracts.

The applicants submitted that introduction of the Type 2 contracts permitted a higher level of vesting against franchise load. The binary floor reduces the opportunity for retailers to contract for electricity at lower prices and sell it to customers at the higher franchise rate. To the extent that the Commission's conditions change the strike prices and/or operation of the binary floor, other conditions seek to remove any residual surplus revenue from retailers by way of a levy or dividend.

The conditions, which apply to both types of vesting contract, are as follows.

- The strike prices in the Type 1 contracts must be reduced from \$44.50MWh to \$37.00MWh, reflecting the cost of efficient new entry into generation. Any surplus revenue to retailers from this lower price should be recovered from the retailers by way of a levy or dividend.
- The binary option in the Type 2 contracts must not apply on Saturdays, Sundays and public holidays and can only operate in peak periods. The price caps in these contracts must match the new average strike price (\$37.00MWh) in the Type 1 contracts.
- If the cross-subsidies created by the difference between low spot prices and the implied costs (\$38.00MWh) in the franchise tariffs are not corrected by the binary floor, this effect must be corrected by a levy or dividend on the retailers.
- The term of the third tranche vesting contracts must end by 31 December 2000, not by the end of February 2002.

The draft determination, along with the London Economics report, is available from the Commission's website.

The pre-decision conference will begin on 16 February and is then adjourned until 13 April 1999.

NSW electricity transmission revenues issues paper

On 17 December 1998 the Commission released an issues paper on determining the revenue cap for Transgrid, the provider of transmission network services in New South Wales.

The Commission is reviewing Transgrid's revenue cap, which is to take effect from 1 July 1999. The review is being conducted in conjunction with the NSW State regulator, the Independent Pricing and Regulatory Tribunal.

The Commission has sought public comment on the paper. It expects to make a draft determination in April 1999 and, following further consultation, a final determination around May 1999. As part of the public consultation the Commission will make available on its website the submissions it has received from Transgrid.

The Commission's Transgrid decision will coincide with its release of a Draft Statement of Regulatory Intent for Transmission Networks. In May 1998 the Commission released an issues paper seeking comment from interested parties on key issues relating to its role as transmission price regulator (as required by Chapter 6 of the National Electricity Code). The Commission is currently preparing a draft document setting out how it intends to regulate transmission networks. The draft will discuss the Commission's position on the determination of the revenue cap, in particular, key issues such as asset valuation, the weighted average cost of capital, and incentive regulation.

The regulatory framework is designed to promote competition in upstream and downstream markets, and provide an equitable allocation of efficiency gains between customers and transmission companies, while maintaining service standards.

Both issues papers are available from the Commission's website or from its Canberra office.

National Competition Council

NCC annual report round-up

The following item was extracted from the National Competition Council's newsletter, NCC Update, Nov/Dec 1998, and its Annual Report 1997-98.

The NCC tabled its annual report in the Commonwealth Parliament in November 1998. The report discusses the progress that governments have made to date in implementing the National Competition Policy (NCP) reform program as well as the benefits flowing from the implementation of the NCP and related reforms.

The most striking of these benefits was price reductions of up to 40 per cent for rail freight and 60 per cent for energy. The report notes that major price reductions in energy and transport can substantially lower business costs and increase household spending power. It also suggests that competition policy may be helping to keep Australia's inflation rate down and insulate Australia from changes in the world economy.

NCP is described as a balanced program of reforms that seeks to harness competition, where it is appropriate, to boost economic performance. In practice, this means that, while NCP can mean reductions in some regulation, it also involves increases in other areas of regulation and improvements or enhancements to some existing regulation.

The report also discusses the way that public interest issues — such as jobs, regional development, community service obligations, health and safety, the environment, consumer interests, business viability, and the social effect of change — are balanced against economic imperatives under NCP.

It sets out reasons why governments should be giving more weight to equity and fairness, relative to overall economic growth, than they have in the past. To address equity, governments may particularly need to examine their policies on tax, social security, labour market reforms and community services.

The report concludes that equity remains a matter that is covered by, and must be weighed

under, the NCP public interest test when deciding whether a reform option should be implemented.

The report also details the NCC's contribution to the National Competition Policy, according to its four main roles:

- to assess jurisdictions' progress in implementing the NCP reforms;
- to evaluate applications relating to the National Access Regime;
- to undertake other work as requested by Australian governments; and
- to increase understanding and to provide advice on the NCP process generally.

Based on its assessment of each State and Territory Government's progress in meeting its commitments to NCP reform, the NCC recommends to the Treasurer whether jurisdictions should receive full NCP payments from the Commonwealth.

The NCC completed its first assessment of jurisdictions' progress with NCP reforms in 1997. In June 1998 it revisited a number of residual matters from its first assessment, concluding that in most of these matters satisfactory progress had been made and recommending to the Treasurer that the full NCP payment be made. In the case of the NSW rice review it concluded that satisfactory progress had not been made and recommended that \$10 million be deducted from that jurisdiction's payments unless domestic deregulation occurs by 31 January 1999. The Treasurer has reserved his decision until early 1999. In the case of gambling legislation the NCC considered that the issues were better resolved outside the first tranche assessment process.

Under the National Access Regime the NCC is required to assess applications and make recommendations to the relevant government on:

- whether infrastructure services should be 'declared' for access; and
- whether particular State or Territory access regimes should be 'certified' as being effective under the national provisions.

For all but one NCC recommendation in favour of declaration, the relevant Minister decided not to declare the service. Each of these related to infrastructure services owned by a State Government, meaning that the State Premier was the relevant Minister.

In all of these cases, and in the case where the relevant Minister (the Commonwealth Treasurer) did declare the service, the Minister's decision has been appealed to the Australian Competition Tribunal.

In 1997 the NCC also made recommendations on three applications for certification of State/Territory access regimes. It recommended that two be certified as effective. The third, which relates to the NSW rail access regime, has been subject to considerable dialogue between the NCC and the NSW Government and several revisions have been made to the application. The matter is not yet finalised.

Under its broader work program, the NCC completed the review of the *Australian Postal Corporation Act 1989* and began a review of subsections 51(2) and 51(3) of the *Trade Practices Act 1974*. The NCC released its report of the review of the Postal Act in February 1998 following extensive consultation with interested parties. The annual report details the NCC's recommendations and the Government's response.

Subsections 51(2) and 51(3) of the Trade Practices Act provide for the exemption of certain businesses and/or commercial arrangements from some of the anti-competitive provisions of the Act. The NCC is required to give its recommendations to the Treasurer by 5 March 1999.

The report notes that the NCC is redeveloping its communication strategy to address what it sees as a change in public debate and awareness of the NCP. It is focusing on correcting misunderstandings about NCP and highlighting the public interest safeguards built into the NCP agreements. It is also relying less on the media and speaking directly with communities directly affected by reform.

The NCC Annual Report is available from its website at:
<http://www.ncc.gov.au>