
Regulatory issues

Petrol

Reducing fuel price variability

In early March 2001 the Federal Government asked the Commission 'to examine the feasibility of placing limitations on petrol and diesel retail price fluctuations throughout Australia'.

The Commission released a discussion paper on fuel pricing in June 2001. Thirty-eight submissions were received from a wide cross-section of interested parties. The final report was released on 14 May 2002.

The report noted that volatility in retail petrol prices is generally confined to the major metropolitan cities and some rural towns on major highways. The price cycles in these areas are fairly regular and frequent. They generally exhibit a sawtooth pattern, that is, prices increase rapidly over a short period and then steadily decrease.

The Commission analysed data on the movements in average daily retail prices for unleaded petrol in Sydney, Melbourne, Brisbane, Adelaide and Perth. It found that in the six months from January to June 2001, Melbourne had the largest average movement in daily petrol prices from the bottom of the price cycle to the top of the price cycle (7.5 cents per litre) among the five major metropolitan cities.

The report found that, contrary to a widely held perception, petrol prices are relatively stable on average within a day. Generally, prices changed across these cities just over once per day.

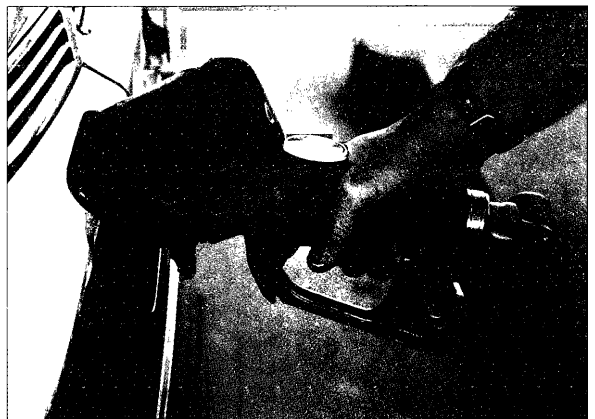
The Commission noted in its report that there are some consumers who are concerned about price cycles. There are other consumers who take advantage of them by buying petrol at the bottom of the cycle when prices are lower. Unfortunately, there is little data available to determine the extent to which consumers are disadvantaged by, indifferent to, or take advantage of price cycles. However, it is likely that consumers, taken in aggregate, benefit overall from price cycles. The two reasons for this are that:

- consumers in aggregate are generally better off with variable prices than with fixed (simple average) ones, because they have the opportunity to buy at the low point of the price cycle
- as indicated by data obtained by the Commission, on average around 60 per cent of the total volume of petrol sold over the petrol price cycle is sold below the average price of the price cycle and around 40 per cent is sold above.

While consumers taken as a whole may benefit overall from price cycles, there are individual consumers who do not. Some of them may be price sensitive and perhaps would change their purchasing behaviour if they were made more aware of price cycles.

The Commission examined options for limiting petrol price cycles, including terminal gate pricing (TGP) with several conditions, limiting price changes to only once in 24 hours, limiting price increases to a specified amount each day, and regulating prices at the retail and wholesale levels.

Several industry participants supported TGP in their submissions to the Commission. However, in discussions about TGP there is often a lack of clarity about which definition of TGP is being used and which conditions, if any, would be applied. To help the Commission assess the effect of TGP on price cycles, Frontier Economics was engaged to report on its economic implications. This report is included in full in the ACCC's report (appendix G).



The Commission examined the fuel pricing arrangements in Western Australia and Victoria (see appendixes D and E of the report). Both states introduced TGP in 2001 and Western Australia implemented additional fuel pricing regulations, such as limiting price changes to only once in 24 hours.

From the report's analysis and submission arguments, the Commission did not support options to limit price cycles. It concluded that the options would have either no effect on price cycles or, when they would have an effect, could lead to higher average retail prices.

The Commission's report recommended that:

- there should be a consumer awareness initiative to increase consumers' understanding of price cycles, and to enable consumers to time their purchases so that they can buy petrol at times when prices are relatively low
- the Government should consider holding discussions with all industry participants to further reform in the petroleum industry
- the current TGP arrangements in Western Australia and Victoria should be monitored closely before a final conclusion is made about TGP
- other options to limit price cycles should not be implemented
- the fuel pricing arrangements in Western Australia should continue to be monitored closely.

In its response to the report the Government agreed to all of these recommendations and asked the Commission to:

- collect and make available the information it considers helpful for consumers and also provide the information to industry, motoring and consumer groups to encourage wide dissemination of this information, including on the Internet
- continue monitoring and report back to the Government by the end of 2002 on the outcomes of the TGP arrangements of Victoria and Western Australia and the fuel pricing arrangements in Western Australia.

The *Reducing fuel price variability* report and submissions to the discussion paper are available from the Commission's website at <<http://www.accc.gov.au>>.

Airservices Australia

In July 2002 the Commission decided not to object to increases in prices for services provided by Airservices Australia. The proposed increases were outlined in a notification of a proposed increase made in accordance with the provisions of the *Prices Surveillance Act 1983*.

Airservices is responsible for various air traffic management functions. It provides en route navigation services, terminal navigation services at 27 airports around Australia and rescue and fire fighting services at 16 airports. As each of these services is declared under the Prices Surveillance Act, Airservices must notify the Commission of any proposed price increase.

In May 2002 Airservices submitted a preliminary pricing proposal to the Commission to lay the groundwork for a formal notification of a proposed increase. The submission proposed:

- a 3.9 per cent increase in en route navigation services
- an average increase of 5.9 per cent in terminal navigation charges, with increases at 9 of the 27 airports where services are provided
- an average increase of 8.1 per cent at the 16 airports where rescue and fire fighting services are provided.

Airservices claimed that price increases were needed for a reasonable rate of return after the downturn in aviation activity (a function of both the terrorist attacks in the United States on 11 September 2001 and the collapse of Ansett).

In determining the price increase needed to enable it to generate a target rate of return, Airservices combined its traffic forecasts for 2002–03 with accounting-based measures of profitability. These elements were then used to determine the required revenue and proposed prices. Airservices also submitted an estimate of required revenue based on the building block method but expressed its reservations about this method.

Airservices argued that despite its dominant market position, it does not behave like a typical monopolist seeking to maximise profits. Rather it claimed that it is a pro-active, competitive and customer-focused organisation as demonstrated by its historical pursuit and attainment of cost reductions of \$100 million per annum, and real price reductions totalling 25 per cent over the past four years. Benchmarking of accounting-based

measures of return was also presented to lend weight to Airservices' claim that it does not extract monopolistic returns.

The Commission undertook a process of public consultation, starting with the release of an issues paper, as part of the process of assessing Airservices' proposal. After releasing a preliminary view in June 2002, the Commission provided another opportunity for interested parties to comment.

Submissions were received from parties including Qantas, Virgin Blue, the International Air Transport Association and the Board of Airline Representatives Australia. Most argued that increased prices were not justified and that the rate of return proposed was not reasonable as the downturn in activity had led to losses in the aviation industry generally. They were concerned about:

- the forecast traffic volumes, which were considered conservative, and the imprecision of longer-term traffic forecasts
- the inadequacy of financial information provided by Airservices generally which made it difficult to assess their claims
- the parameters used in Airservices building block estimation of required revenue
- the use of accounting-based measures of profitability
- the allocation of costs
- the impact on passengers, who potentially faced higher fares, and on international airlines which struggled because of lower demand.

In addition parties argued that the response of a firm in a competitive market to a downturn in activity would be to decrease prices.

In June 2002 the Commission released its preliminary view in which it also raised the following concerns:

- uncertainty about traffic forecasts beyond 2002–03 which, if volumes improved quickly, would mean that the price increase could not be justified in the medium to longer term
- the inability of the Commission to determine the efficiency of Airservices' cost base because of lack of information
- the value of Airservices' asset base
- the potential cross-subsidisation of costs incurred through community service obligations and non-commercial activities.

The Commission addressed these issues in its preliminary view. In particular it examined Airservices' revenue requirements and the reasonableness of the rate of return being generated. It also addressed the regulatory situation that curtails Airservices' ability to change prices quickly and frequently to maintain its constant rate of return pricing policy. Finally, the Commission took into account the initiative taken by Airservices in lowering prices for its services over recent years and the benefits that this had accorded airlines. The Commission concluded that, on balance, there existed a *prima facie* case for at least some price increases for the financial year ending 30 June 2003. However, it also concluded that Airservices could not justify a price increase in the longer term, especially given doubts about volume forecasts and the inadequacy of information on the efficiency of Airservices' cost base and existing prices.

The Commission suggested there were better ways to meet its concerns and gave two examples that would provide for outcomes that could satisfy efficiency and other regulatory-related criteria. These two examples were:

- to increase only the en route charge in recognition that Airservices specifically identified a previous reduction in that charge as temporary
- to temporarily increase prices as proposed for the 2002–03 financial year, with another review of traffic forecasts if a further price increase is sought.

In response to the preliminary view, Airservices submitted three alternative draft notifications. The Commission assessed these using the analysis contained in the preliminary view, additional information it had received, further views expressed by Airservices, and comments from interested parties. The Commission concluded it would be likely to approve a price notification based on the draft, which was similar to one of the examples provided.

On 25 July 2002 Airservices submitted its formal price notification, which was consistent with the Commission's finding. This proposed a 5.1 per cent weighted average increase in prices across all services (comprising an average 5.9 per cent increase for terminal navigation charges at nine airports, an average 8.1 per cent increase for aviation rescue and fire fighting charges and a 3.9 per cent increase in en route charges) for 2002–03 only. The Commission formally responded and released its statement of reasons the same day.

Electricity access arrangements

Murraylink access undertaking—draft decision

On 6 February 2002 the Commission received an access undertaking from Murraylink Transmission Company Pty Ltd (MTC), in accordance with Part IIIA of the Trade Practices Act.

MTC is a market network service provider (MNSP) and proposes to provide access to the Murraylink interconnector, which will be an unregulated link connecting the Victorian and South Australian electricity grids.

The Commission has considered the access undertaking against the statutory criteria set out in s. 44ZZA(3) of the Trade Practices Act. These criteria require the Commission, in assessing the access undertaking, to have regard to:

- the legitimate business interests of the provider
- the public interest, including the public interest in having competition in markets (whether or not in Australia)
- the interests of persons who might want access to the service
- whether access to the service is already the subject of an access regime
- whether the undertaking is in accordance with an access code that applies to the service
- any other matters that the Commission thinks are relevant.

The Commission released a draft decision on 31 July 2002. The Commission considered submissions from TransGrid and the NSW Treasury in its assessment of MTC's access undertaking.

The draft decision determined that the access undertaking, as it had been drafted at the time, should not be accepted, having regard to the criteria set out in s. 44ZZA(3). However, the Commission also determined that if the access undertaking were revised to provide for the confidential disclosure to the Commission of the identity of parties to any agreement on the sale of Murraylink's physical transmission rights, the undertaking should then be accepted.

The Commission invited interested parties to provide submissions in response to the draft decision. Submissions were received from MTC,

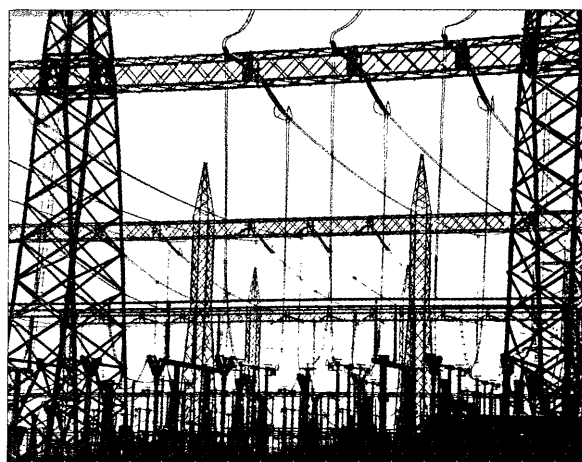
Westpac Energy, TransGrid and the NSW Ministry of Utilities (MEU). MTC's submission also contained a revised access undertaking including the disclosure provision, in accordance with the draft decision's recommendation.

The Commission took these submissions into account before releasing a final decision on 6 November 2002. The final decision accepted the revised access undertaking submitted by MTC, including the disclosure condition foreshadowed in the draft decision. The Commission was therefore satisfied that MTC's revised access undertaking provided an adequate basis for negotiating access to the Murraylink interconnector.

Bidding and rebidding rules—National Electricity Code

On 13 September 2001 the Commission received applications from the National Electricity Code Administrator (NECA) to authorise code changes to the rebidding rules that would enable NECA to work with the National Electricity Market Management Company (NEMMCO) and the market to address issues such as:

- inefficiencies that have contributed to short-term price spikes
- ensuring generators' bids and rebids are made in good faith and therefore represent their genuine intentions at the time they are made
- those aspects of generators' bidding and rebidding strategies that may prejudice the efficient, competitive or reliable operation of the market. For example, curtailing bids or rebids that withhold or withdraw capacity and succeed in artificially raising prices, exploit network constraints or reductions in capacity, or manipulate other aspects of the market design.



The changes, proposed by NECA, are designed to address behaviour considered to be detrimental to market outcomes. The changes respond to concerns of market power being exercised in the national electricity market (NEM) to influence higher prices.

On 3 July 2002 the Commission released its draft determination outlining its analysis and views on the proposed code changes. The code changes proposed by NECA are assessed under Part VII of the Trade Practices Act which requires the changes to result in a net public benefit before they can be given immunity from sections of the Act. In making its decision the Commission must assess the public benefits and anti-competitive detriment likely to result from the proposal. The Act does not require the Commission to decide whether the code changes are the most effective way to address the issue of market power in the NEM. Rather, it requires the Commission to determine whether the changes, or parts thereof, will result in a net public benefit. On this basis the Commission has found that the proposed rule changes, except for one, do not deliver such a benefit. However, the Commission has made some suggestions to NECA on alternative approaches that may be considered.

On 16 July 2002 the Hon. Patrick Conlon, South Australian Minister for Energy, and Macquarie Generation requested that the Commission hold a pre-determination conference.

This was held on 13 August 2002. Interested parties were invited to make brief presentations in response to issues raised in the draft determination. Interested parties were also able to make written submissions to the Commission to address the draft determination. The closing date for submissions was 20 September 2002.

From the pre-determination conference and submissions, the Commission is considering issues raised in response to the draft before making its final determination.

Ring-fencing guidelines

On 27 May 1999 the Commission released its draft statement of principles for the regulation of transmission revenues (*Draft regulatory principles*) which included draft ring-fencing guidelines. In setting out the guidelines the Commission wants to reinforce the effectiveness of the regulatory processes by limiting the ability of the transmission network service providers (TNSPs) to extend their monopoly powers into the contestable parts of the industry.

Following the release of the *Draft regulatory principles*, on 10 September 2001 the Commission released a set of draft transmission ring-fencing guidelines to interested parties for comment. In developing these guidelines the Commission took into account comments by interested parties and recommendations by various state regulators.

Most of the interested parties supported the development of ring-fencing guidelines along the lines of the National Gas Access Code.

The Commission therefore decided to use the ring-fencing provisions of the National Gas Access Code as a model for the NEM. It also selected a set of arrangements that provide the Commission with the flexibility to waive elements of the ring-fencing arrangements, when costs of compliance outweigh benefits.

Ring-fencing guidelines ensure that TNSPs' decisions and actions in competitive activities (such as retail supply) are based on access prices that are published and verifiable.

On 15 August 2002 the Commission released its *Transmission ring-fencing guidelines*.

Under the National Electricity Code all TNSPs must comply with the guidelines. The guidelines, which separate the accounting and functional aspects of prescribed services from those of other services provided by TNSPs, took effect on 1 November 2002.

The guidelines require TNSPs to provide specified financial statements and compliance reports at intervals determined by the Commission and in accordance with any guidelines issued by the Commission.

On 15 August 2002 the Commission also released a draft of the reporting guidelines that it proposed to make under the *Transmission ring-fencing guidelines*. On 23 October 2002 it released the transmission ring-fencing reporting guidelines. As foreshadowed in earlier drafts these are to ensure that a TNSP's reporting obligations under the *Transmission ring-fencing guidelines* are consistent with its obligations under clause 6.2.5 of the code.

A copy of the *Transmission ring-fencing guidelines* and the reporting guidelines can be obtained from the Commission's website at <<http://www.accc.gov.au>>.