Economic Regulation Authority

Western Australia

29 April 2005

Dr Brian Fisher
Chairman
Infrastructure Taskforce
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Dear Dr Fisher

DISCUSSION PAPER: EXPORTS AND INFRASTRUCTURE

I refer to the recent discussion paper on exports and infrastructure in which the taskforce you chair invites submissions from interested parties in relation to bottlenecks that may exist in infrastructure provision which may in turn be limiting Australia's export potential. The delay in this response is regretted.

The views formed by the taskforce and the recommendations put to government potentially have important implications regarding the shape of the future landscape, not just for investment in export infrastructure but also in the approach taken towards regulating key infrastructure facilities that form part of the production process inherent within the export chain.

In light of the extent of recent media coverage critical of infrastructure regulation (on occasion, clearly from a vested interest point of view) it is important that the taskforce be aware of some of the issues in regulatory policy from an operational perspective, in order to arrive at a balanced and considered position prior to delivering its final report to government.

Requirement for economic regulation

The overarching objective of regulation is to promote – insofar as it is possible – the allocative efficiency and overall economic welfare that would otherwise come from a competitive market environment. Monopoly infrastructure is regulated to both facilitate competition in upstream and downstream markets by ensuring access on fair and reasonable terms, and to protect end-users including exporters that compete on international markets (and thereby the efficiency of the economy) by ensuring that service providers are not extracting monopoly rents. It is not to prevent efficient infrastructure investment – such an outcome would not be in the long-term interests of consumers.

While there has been significant media coverage in recent times regarding a number of regulatory decisions, it is important to remember the success of the regulatory regime to date. The Productivity Commission itself acknowledges (in its recent review of the national Gas Access Regime) that the regime "has delivered benefits through determining the terms of third party access to pipelines and facilitating competition in upstream and downstream markets". It would be of concern if the recommendations of the taskforce were to pre-empt, or worse still jeopardise, a rigorous and transparent process of considering appropriate revisions to the regulatory environment such as that already established within the framework of the Ministerial Council on Energy.

Timeliness of regulatory decision making

The decision making process may be protracted at times. If there is a way of improving the regulatory process without watering down its effectiveness in gathering sufficient relevant information in a timely fashion, then this would be appropriate. However, development of an improved mechanism would need to be cognisant of the existence of information asymmetries (and that the design of the regime can encourage service providers to withhold relevant information) and the necessity of regulators having sufficient time to be able to objectively assess compliance with the regulatory regime's requirements. A compromised or rushed regulatory process that does not facilitate a proper consideration of the issues can leave consumers and/or upstream and downstream markets exposed to the exercise of market power in pricing and service provision, leading to significant long term costs and ultimately to the detriment of the Australian economy.

It is our experience that delays are more likely to occur when unrealistic proposals are put forward by asset owners (or when there is an incentive for asset owners to delay the process). When circumstances such as this arise, it is necessary for the regulator to more carefully investigate matters, as information provided in these circumstances cannot be relied on. It is also important that affected parties have a forum and sufficient opportunity to comment (a strong positive factor in support of the current regulatory regime). However, this inevitably leads to a review taking longer than might otherwise be the case if all parties had the incentive to pursue the economically efficient outcome from the beginning.

Indeed the design of the regulatory regime may in fact encourage ambit claims by infrastructure owners in the first instance, in order to preserve upside potential in the final decision of the regulator (or in a subsequent appeals process) taking into account the legitimate business interests of the service provider. The Dalrymple Bay Coal Terminal matter provides some insight regarding this issue. Prime Infrastructure initially sought a significant increase in the regulated tariff (to $2.77/tonne) yet subsequently welcomed the ultimate tariff ruling by the Queensland Competition Authority ($1.72/tonne), describing it as a favourable outcome (and upgrading profit forecasts) despite it falling well short of the ambit claim (and indeed the preceding charge not set through independent regulation of $2.05/tonne).

The difficulty for the regulator in this instance was further exacerbated by the divergent expectations of users relative to the views of the service provider (which, in the Dalrymple Bay Coal Terminal example, could itself also be considered an ambit claim (users suggesting a charge of less than $1.00/tonne), probably similarly

encouraged by the bargaining process inherent within the regime). So it is not surprising a protracted deliberation period was required in order to adequately balance the competing needs of infrastructure users and providers when such divergent expectations were present, notwithstanding the underlying pressure coming from the unprecedented (and unforeseen) increase in demand for coal and export facilities.

The regulatory regime has many examples where realistic claims are processed relatively quickly. The initial round of assessments is always a learning curve for all participants. The next time round all participants are all better informed and more knowledgeable (and, in the case of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the Gas Code), asset values are locked in). Notwithstanding a relatively small number of unique circumstances, second round decisions have generally been quicker.

A regime that people now better understand and is relatively predictable is far more preferable than a continually changing regime that will generate uncertainty, for providers, consumers and upstream and downstream markets (most importantly including those competing in international markets). The case for change needs to be strong and substantiated to justify the risk of introducing new regulatory uncertainty.

Regulatory risk and rates of return

Given the consistent approach taken by regulators across Australia in applying the building blocks approach to price cap regulation (particularly with respect to regulated asset values and costs of capital), it is difficult to argue there is evidence of significant regulatory risk. The owner of any existing or proposed new infrastructure is able to predict with a considerable degree of certainty, and within fairly narrow ranges, the approach likely to be taken by a regulator.

If regulation was stifling efficient investment, that would provide reason to implement changes to the national access regime embodied within Part IIIA of the *Trade Practices Act 1974* and the Gas Code. However, such changes must be based on facts and not assertions. If anything, the available evidence supports a view that regulation has not stifled efficient investment. Regulated assets are popular among investors and generally trade at a premium to their regulated asset value, and the financing industry quite openly acknowledges the high degree of certainty provided by the Gas Code and the consistency in decision-making by regulators based on that Code. Recommending changes to the regulatory regime in a piecemeal way (particularly if progressed through a hurried and less than fully inclusive way) risks generating uncertainty and introducing greater regulatory (and perhaps sovereign) risk which could counteract any efforts to encourage investment in Australia's infrastructure.

Claims by some commentators that "jurisdictional regulators compete to see how low they can go" (in reference to the setting of regulated rates of return) appear to be poorly founded. Interest rates, and hence the cost of borrowing, has been declining for a number of years. It should be no surprise, therefore, that regulated rates of return would follow market trends. Regulators seek to reflect commercial rates of return consistent with efficient investment.

Furthermore, despite heated media debate, the final rate of return handed down by the Queensland Competition Authority for the Dalrymple Bay Coal Terminal is not

outside the range of what other regulators have recently determined for respective infrastructure pricing decisions across Australia. Interestingly, the new owners of the Dampier to Bunbury Natural Gas Pipeline have submitted in their recent proposed access arrangement a proposed rate of return similar to that which was afforded to the Dalrymple Bay Coal Terminal in the recent Queensland Competition Authority decision, implying such a rate of return is consistent with the legitimate business interests of service providers.

It is also worth remembering that regulated tariffs are in the form of 'safety nets' and providers and users (in the case of the Dalrymple Bay Coal Terminal, large coal companies) can come to their own commercial arrangements which a regulator will not interfere with. There is nothing stopping those users (particularly those that are in a strong position, for example large sophisticated companies) from negotiating mutually acceptable terms and conditions with service providers outside of the regulatory regime. The recent sale process of the Dampier to Bunbury Natural Gas Pipeline in Western Australia is a case in point, which included major gas users voluntarily entering into a "Standard Shipper Contract" which differed from the regulated tariff in order to secure immediate capacity expansion of the pipeline (and, according to the new owners, enable a price to be paid for the pipeline which the banks would accept and so remove the banks' ability to restrict capacity expansion).

Concluding comment and invitation for further discussion

A number of the issues discussed above were explored in greater detail in the recent Utility Regulators Forum paper to the Ministerial Council on Energy regarding possible revisions to the energy regulatory environment to achieve greater economic efficiency through enhancing regulatory decision making and appeals processes. The views expressed in the paper reflect the Utility Regulators Forum's keenness to play a positive role in assisting the Ministerial Council on Energy in its efforts to strengthen competition and encourage investment in the energy market by improving the quality of energy regulation. A copy of the Utility Regulators Forum paper is attached for the information of the taskforce.

I believe the views expressed in both the attached paper and this letter are deserving of consideration by the taskforce in the context of its deliberations. I understand the taskforce will be meeting with infrastructure owners, key industry participants and government representatives in Perth on Monday 2 May 2005. As it happens, the Economic Regulation Authority itself is meeting all day in Perth on Monday and we would be delighted to avail ourselves of the opportunity to discuss the above issues in greater detail with the taskforce during its Perth visit. I understand that arrangements are in place for this to happen and I look forward to meeting with you on Monday.

Yours sincerely

LYNDON ROWE
CHAIRMAN

Western Australia

Economic Regulation Authority

Our Ref: 1135/04

7 April 2005

The Hon Ian Macfarlane MP
Chairman
Ministerial Council on Energy
Parliament House
CANBERRA ACT 2600

Dear Chairman

UTILITY REGULATORS FORUM JOINT PAPER TO THE MINISTERIAL COUNCIL ON ENERGY

The Utility Regulators Forum is pleased to take this opportunity to inform the Ministerial Council on Energy (**MCE**) on possible revisions to the energy regulatory environment to achieve greater economic efficiency by enhancing regulatory decision making and appeals processes. Appendix 1 outlines the membership and functions of the Utility Regulators Forum.

The enclosed paper contributes detailed views regarding a range of operationally-based regulatory issues and so informs the MCE deliberations in the context of the energy sector reform program. The Utility Regulators Forum hopes these views are particularly relevant for the development of the joint Commonwealth, State and Territory Government response that is being coordinated through the MCE to the Productivity Commission's Review of the Gas Access Regime.

In particular, this paper provides detailed views regarding:

- support for the incorporation of an overarching objective of economic efficiency to provide clear guidance to regulators for resolving any tension between subordinate objectives in the exercise of regulatory discretion;
- concerns regarding the purported distortionary effects of regulation on investment and the proposed premium to offset regulatory risk, and the need to ensure there is sufficient accountability to secure long-term reliability;
- design issues of the proposed light-handed regulation/monitoring framework that require careful attention;

- concerns regarding the direction of revisions regarding the approach used for setting reference tariffs (particularly the "point within a reasonable range" recommendation);
- the need for appropriate regulatory accounts and information gathering powers to ensure sufficient information for good decision making in regulation; and
- the need for realistic timeframes to undertake reviews.

The views expressed in this paper are focused on a range of operational regulatory issues and on appropriate regulatory amendments that are intended to improve the efficiency and effectiveness of energy regulation. In particular, they are aimed at strengthening competition and encouraging investment in the Australian energy market, consistent with the outcomes sought by the MCE through its efforts to streamline and improve the quality of economic regulation across energy markets.

On behalf of members of the Utility Regulators Forum, I encourage the MCE to consider the views expressed in this paper in the context of the energy sector reform program.

Yours sincerely

LYNDON ROWE
CHAIRMAN
ECONOMIC REGULATION AUTHORITY

On behalf of the Utility Regulators Forum

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THE UTILITY REGULATORS FORUM

In 1997 the Australian Competition and Consumer Commission, in conjunction with other Commonwealth, State and Territory regulatory agencies and policy advisers, established a Utility Regulators Forum.

The Forum's purpose is to foster understanding of the activities of various regulators operating in different jurisdictions and industries as they implement microeconomic reform. The Forum is an acknowledgment of the fact that, in some circumstances, regulators, regulated firms and consumers receive clear benefits from an integrated approach to regulation.

While the specific functions of regulators may vary, all regulators generally aim to encourage efficient price-setting principles, ensure access to essential facilities, and minimise inefficiencies in inter-state trade.

Membership of the Utility Regulators Forum consists of:

ACT Independent Competition and Regulatory Commission (ICRC)

Australian Competition and Consumer Commission (ACCC)

Commerce Commission New Zealand

Economic Regulation Authority, Western Australia (ERA)

Essential Services Commission of South Australia (ESCOSA)

Essential Services Commission, Victoria (ESC)

National Competition Council (NCC)

NSW Independent Pricing and Regulatory Tribunal (IPART)

Office of the Tasmanian Electricity Regulator (OTTER)

Queensland Competition Authority (QCA)

Tasmanian Government Prices Oversight Commission (GPOC)

Utilities Commission Northern Territory

PAPER TO THE MINISTERIAL COUNCIL ON ENERGY
BY THE UTILITY REGULATORS FORUM

INTRODUCTION

In recognition of the importance of the current Ministerial Council on Energy (**MCE**) process for the reform of energy sector policy and regulation in Australia, the Utility Regulators Forum is pleased to take this opportunity to inform the MCE of its views regarding possible revisions to the energy regulatory environment to achieve greater economic efficiency by enhancing regulatory decision making and appeals processes.

The Utility Regulators Forum's views specifically address certain aspects of the Productivity Commission's Review of the Gas Access Regime (**the PC Report**), and are intended to assist the MCE in its coordinating role in the development and implementation of regulatory reforms by the Commonwealth, State and Territory governments in response to that report. However, the Forum's views can also be interpreted more broadly as addressing operational issues that require review and reform in the context of the arrangements that apply in the regulatory sector as a whole. The views also apply irrespective of whether (or when) a single national regulator (the Australian Energy Regulator) is to take over regulatory responsibilities from individual jurisdictional regulators.

Regulators are well placed to provide insights on these issues of importance to the MCE, in light of their considerable practical experience in administering and enforcing the various provisions of the current regulatory regime. The views expressed within this paper are focused on a range of operational regulatory issues and on appropriate regulatory amendments intended to improve the efficiency and effectiveness of energy regulation. In particular they are aimed at strengthening competition and encouraging investment in the Australian energy market, consistent with the outcomes sought by the MCE through its efforts to streamline and improve the quality of economic regulation across energy markets.

OBJECTIVES AND AN OVERARCHING OBJECTS CLAUSE

The lack of clarity about the fundamental objective of the legislation — and about the interaction between, and the emphasis to be placed on, subordinate objectives and criteria in different sections of the legislation — has created uncertainty about its interpretation and application for regulators, access providers and access seekers alike.

Having an overarching objective, as recommended by the Productivity Commission (*PC Report recommendation 5.1*), would assist in bringing more certainty and clarity to the legislation by providing clear guidance to regulators for resolving any tension in subordinate objectives when exercising regulatory discretion. The benefits include: reducing the current uncertainty about the Code's purpose, interpretation and application; providing a guiding reference point for weighting and balancing subordinate objectives and principles in the Code's operational sections; and increasing the consistency of the Code's interpretation and application by regulators, appeal tribunals and the courts.

The Utility Regulators Forum therefore sees significant merit in the introduction of an overarching objective to be applied to the framework for third party access to monopoly infrastructure in the energy sector. The Forum supports the objects clause being couched in terms of focusing on economic efficiency, consistent with the overarching objective of regulatory intervention being to promote – insofar as it is possible – the crucial resource allocation efficiency and overall economic welfare that would otherwise come from a competitive market environment.

However, in our view the introduction of an overarching economic efficiency objective would obviate the need for deletion of the subordinate objectives relating to regulators being required to have regard to the interests of users and the service provider (*PC Report recommendation 5.4*). The Utility Regulators Forum considers the retention of subordinate objectives will assist the regulatory process, by providing guidance to the regulator and interested parties on matters to be taken into account in interpreting the principal objective and in exercising the discretion which that necessarily involves.

REGULATION, INFRASTRUCTURE INVESTMENT AND LONG-TERM RELIABILITY

The PC Report suggests that regulation *may* be having a “chilling” effect on what would otherwise be efficient investment, due to the presence of regulatory risk and/or regulators applying non-commercial rates of return in setting tariffs. The Productivity Commission’s recommended changes to address what it regards as being this detrimental consequence of regulation have not been supported by reference to facts, evidence or analysis. Rather the PC Report relies on the first principles, theoretical reasoning to support its conclusions and recommendations based on the view that, in the absence of information on the counterfactual, evidence and analysis cannot be used to reach a conclusive view on the issue.

However, there is little evidence of unwarranted regulatory risk given the consistent approach taken by regulators across Australia in applying the building blocks approach to price cap regulation, particularly with respect to regulated asset values and costs of capital. The owner of any existing or proposed new infrastructure would be able to predict with a considerable degree of certainty, and within fairly narrow ranges, the approach likely to be taken by a regulator. Further, the evidence would suggest that rates of return set by regulators have not been low in commercial terms.[1] Regulated assets remain attractive and profitable investments at regulatory values and rates of return set by regulators, often trading at a premium to their regulated value which arguably suggests that regulated rates of return exceed returns expected by the market from infrastructure assets.[2]

This evidence lends support to the view that regulatory risk is not a significant issue for investors, nor does regulation have a distortionary effect on efficient investment. In the absence of any empirical evidence, there would not appear to be any reason for

[1] For example, see evidence presented in The Allen Consulting Group (2004) and Willett (2005). Indeed, financial analysts in fields unrelated to regulation typically take a much harder line in applying asset pricing models than has been the practice of Australian regulators (e.g. see UBS valuation for Australia Gas Light Company (UBS Investment Research, 31 January 2005) in which a market risk premium of 5% was adopted for valuation purposes.

[2] See article by Glenda Korporaal (*The Australian*, 21/3/05, p29) on profitability of Cheung Kong Infrastructure’s Australian assets.

requiring the consideration of a premium to offset regulatory risk (*PC Report recommendation 7.10*). Nor would there appear to be a need for further guidance to prevent regulators from setting non-commercial rates of return or otherwise deterring efficient investment. In fact, to do so would create the real possibility of setting rates of return too high, which would be likely to encourage inefficient investment and/or merely return excessive rents to the service provider.

Beyond the issue regarding the adequacy of revenue and returns, another key issue that requires attention is the need to ensure that service providers are accountable for securing long-term reliability. As has become apparent recently (for example, in the case of Victorian electricity distribution[3]) sufficient regulated returns intended to facilitate timely investment in maintaining and upgrading infrastructure does not automatically translate into actual expenditure to ensure long-term reliability. Lower expenditure on maintenance and replacement of ageing assets by service providers in order to augment earnings may ultimately result in an increasing risk of a catastrophic event or declining future reliability being borne by consumers.

Accordingly, the debate about providing incentives and financing capacity for regulated infrastructure owners to be able to undertake necessary long-term investments needs to be balanced by an explicit recognition of the market power and commercial incentives of natural monopoly infrastructure operators. These are such that infrastructure owners will not necessarily deliver reliability outcomes that serve the public interest simply as a result of providing them with higher regulated revenues and returns.[4]

It is difficult for a regulator to scrutinise the validity and effect of the purported 'efficiency gains' arising from under expenditure on maintenance or replacement (particularly in an environment of less informed regulation as envisaged by the PC Report). Therefore consideration needs to be given as to whether, where regulators have approved prices and revenue earnings sufficient to afford investment in long-term reliability requirements, the current regulatory arrangements offer sufficient assurance to service users that service providers will actually undertake the investment required to deliver reliability in the medium to long term.[5] Service providers need to be sufficiently accountable for long-term service provision (for example, through service standard benchmarks, penalties, licence conditions, etc.) such that the community, having paid prices based on forecast investment requirements, can be confident the pursuit of short-term commercial imperatives does not jeopardise long-term reliability and security of supply.

LIGHT-HANDED REGULATION / MONITORING

One of the key recommendations in the PC Report is the proposal to introduce a lighter-handed form of regulation along side the current access arrangement framework. While this proposal is supported, there are a number of critical design issues that require

[3] For example, see Essential Services Commission, Victoria (2004).

[4] This point applies particularly to existing natural monopoly infrastructure service providers with established upstream and downstream markets. It is necessary to distinguish greenfields infrastructure investments and those that are demonstrably subject to increasing contestability from the analysis presented in this section, which is directed to genuine natural monopolies which are subject to coverage and direct price regulation.

[5] This issue is explored in greater depth in Essential Services Commission, Victoria (2005).

careful attention. In particular, it is necessary to clarify the obligations that will be placed on service providers and the process for switching between the two forms of regulation.

When considering the shape of the light-handed framework it is crucial to note that regulation (including light-handed approaches) will apply only to covered pipelines. Covered pipelines by definition possess a substantial degree of market power that could be used to adversely affect competition in an upstream or downstream market. It is therefore essential that the threat of future regulatory action is clear and credible if more light-handed regulatory approaches are to be effective in preventing the misuse of such substantial market power.

Industry participants must have a clear understanding of the principles of the regime and the consequences of transgression (i.e. reverting to the more heavy-handed regulatory approach in the event of poor behaviour). The credibility of the regime will be determined by the clarity regarding the basis for exercising such a threat, who will make such a decision and their willingness to act upon such a threat.[6] The design of the test for switching between regulatory frameworks requires careful attention and, consistent with the PC Report's objective of reducing the costs of regulation, appeal mechanisms on the form of regulation to apply should be kept to a minimum.

Any effective light-handed regulatory model employed for covered pipelines will also need to address asymmetric information issues. If industry participants believe the regulator will be unable to acquire sufficient information to verify potential breaches, the regulatory threat will not be credible. If information disclosure expectations are made clear at the outset (e.g. specific regulatory accounting guidelines, etc.) many of the problems of asymmetric information can be overcome. Some level of ring fencing may also be needed when the pipeline is part of an integrated business or closely associated with businesses operating in related markets, as vertical integration lessens the potential effectiveness of price-monitoring models when anticompetitive leveraging is possible (particularly if the regulator faces significant information asymmetries). The light-handed regime also must meet the minimum standards of Part IIIA of the *Trade Practices Act 1974* so that it can be certified as effective by the relevant Minister on advice of the National Competition Council (hence providing protection against declaration).

THE APPROACH USED FOR SETTING REFERENCE TARIFFS

The need to clarify the provisions in existing regulatory regimes regarding the approach used in setting reference tariffs (for example, cost allocation, rate of return, etc.) is recognised. However, the direction of the recommended revisions to section 8.31 of the National Gas Code mandating approval of any proposed value that lies within a range of plausible estimates is cause for concern (*PC Report recommendation 7.9*).

[6] For example, due to successive New Zealand governments having staked substantial political capital on the virtues of light-handed regulation, this meant that the threat of regulatory intervention was never particularly credible. Incumbents ultimately discounted the likelihood of regulatory intervention, and the regulatory arrangements constituted very little, if any, constraint on the behaviour of utility businesses – see discussion in NERA 2004 (p27).

Unless specific recognition is given to the range of values reflecting "prevailing conditions in the market for funds" at a point in time, the very wide range of values that may be derived from historical information using statistical analysis may make it difficult for a regulator to reject a value that is clearly inappropriate. The Utility Regulators Forum has significant concerns regarding the PC Report's recommended revisions to the rate of return provisions unless explicit limitations are imposed on the potential breadth of the 'plausible' range. Further, by affording the service provider the ability to select the value from within the range that produces the highest reference tariff, the Productivity Commission's recommended 'point within the range of plausible values' approach undermines the role of the regulator and will seriously compromise the regulatory regime and, therefore, inhibit the achievement of economically efficient outcomes.

In terms of the provisions in existing regulatory regimes, recent and current appeals processes[7] that have suggested that a regulator's task is only to disallow a pricing proposal if it is outside of a 'reasonable range' have the potential to substantially change the application of regulation in a manner that may not have been intended by governments. Such an approach advantages natural monopoly service providers in pursuing their commercial interests through the regulatory process and substantially impedes the capacity of regulators to balance the interests of service providers against those of users and the wider community. There is therefore a need to clarify the legislation's existing provisions in this regard.

The Utility Regulators Forum considers it important that the regulator retains the discretion to decide whether the proposed point estimate is consistent with the regulatory regime's objectives in arriving at an economically efficient outcome. These matters assume even greater significance when it is recognised that minor point adjustments to values such as the rate of return can significantly impact regulated revenue, which could ultimately be to the detriment of competition in upstream and downstream industries.

The Utility Regulators Forum is supportive of flexibility being provided within the regulatory regime for exploring alternative methods for calculating regulated revenues, where they have the potential to create stronger incentives while simultaneously reducing information asymmetry, forecasting problems and the overall cost and intrusiveness of regulation. It is of concern therefore that the Productivity Commission proposes that such innovations in methodology should only be proposed by service providers with the option for regulators to reject proposals that are inconsistent with the principal objective of the regimes (*PC Report recommendation 7.5*). Such an approach would be likely to limit proposals for methodology change to those that were seen as advantageous to service providers and may well exclude a range of methodologies which would overcome current regulatory shortcomings and better achieve the regime's objectives.[8]

[7] For example, the GasNet decision in the Australian Competition Tribunal and the Epic Energy appeal to the Western Australian Gas Review Board.

[8] For example, the current work on exploring total factor productivity as an alternative method for calculating total revenue.

REGULATORY ACCOUNTS DATA AND INFORMATION GATHERING POWERS

Access to relevant data by the regulator is essential for effective regulation of any sort. Informed regulation and public transparency are of particular importance given the monopoly power of service providers, the existence of information asymmetries and the necessity of the regulator being able to objectively assess compliance with the regulatory regime's requirements. Approving regulated revenues under the current building blocks approach, or indeed under alternative methodologies currently being considered (e.g. total factor productivity), relies fundamentally on reliable, credible historical data reported regularly and consistently both to assess and report on performance for reasons of transparency and accountability, and to inform cost and revenue forecasts as the basis for price cap decisions.

Whilst the PC Report goes some way to addressing the issue of maintaining information (e.g. *PC Report recommendation 7.12*), problems remain in implementing requirements for the keeping of regulatory accounts and provision of the information to regulators. The PC Report recommendations appear to lack clarity, particularly with respect to:

- the scope for issuing regulatory accounting guidelines to identify and define the information required, noting that they are only referenced under the ring fencing provisions of the Code;
- the status and appropriateness of Attachment A to the Code, which has never been reviewed in the light of regulatory experience and specifies data which is not relevant while omitting other information relevant to effective regulation; and
- whether the provision of non-financial data is precluded, which will be a significant issue if regulators are constrained from using state-based legislative powers (foreshadowed under *PC Report recommendation 7.14*).

Regulators are conscious of the need to limit data collection to that which is clearly relevant to the task. But to limit information collection which is necessary to effective informed regulation undermines the public policy objectives of the regime. Regulators need sufficient powers and flexibility to specify the financial and non-financial information that is required and the frequency of such information reporting, to suit the different circumstances of each pipeline or electricity network. Even the most light-handed model of regulation requires reliable, credible and consistent information, as regulators operating on insufficient information can leave consumers and/or upstream and downstream markets exposed to the exercise of market power in pricing and service provision.

TIMELINESS AND APPEALS PROCESSES

The recommendation to remove a regulator's ability to extend access arrangement review periods (*PC Report recommendation 11.1*) fails to recognise the reality of regulatory reviews. The approach recommended by the Productivity Commission is incompatible with stakeholders' and review bodies' expectations regarding the level of diligence to be exercised by regulators, and as a result would have the potential to compromise effective decision making. The Utility Regulators Forum is concerned that placing severe limitations on timing for some steps of the process could lead to

regulators being faced with inadequate information thereby deciding not to approve an arrangement that with the benefit of additional information might be approved. However, agreed realistic timeframes for conducting reviews could be contemplated.

Furthermore, there is an element of inconsistency between proposals for more restrictive time limits on regulators whilst also proposing greater scope for review. In light of recent rulings by appeals bodies, there would appear to be a requirement for an even higher and more cautious standard of conduct by the regulator. In order to preserve the level of public consultation that stakeholders expect, regulators are likely to be more inclined to present analysis and take tentative views in issues papers or discussion papers and take more definite positions within their draft decisions, adding to the time required to conduct the approvals process. There is the potential for decisions to be excessively formal and legalistic or for decisions to be structured to minimise the risk of being overturned on appeal rather than to make them readable and comprehensible to a wide range of interested stakeholders.

It is also questionable whether it is efficient for merit review bodies to be tasked with replicating entirely the pricing decisions made by regulatory bodies (*PC Report recommendation 11.4*), as views on these intricate details are developed over much longer periods and with the support of expert analysis and extensive consultation. At the same time, there is the need to curb the incentive for “cherry picking”, in reference to service providers challenging specific aspects of decisions in isolation, where there is significant potential upside associated with individual issues when not reviewed from a holistic perspective. Therefore, it is considered the most appropriate role for merit reviews is to focus on remedying clearly inappropriate decisions.

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