

14 December 2007

# Assessment of Price Monitoring in Australia

## A Briefing Note for the AEMC

**NERA**

Economic Consulting

## **Project Team**

Greg Houston

Jennifer Fish

Astrid Dahl

NERA Economic Consulting  
Darling Park Tower 3  
201 Sussex Street  
Sydney NSW 2000  
Tel: +61 2 8864 6500  
Fax: +61 2 8864 6549  
[www.nera.com](http://www.nera.com)

## Contents

<b>1</b>	<b>Introduction</b>	<b>1</b>
<b>2</b>	<b>Background</b>	<b>2</b>
2.1	History of Price Monitoring and Price Surveillance	2
2.2	Current Legislative Framework	4
<b>3</b>	<b>Objectives of Price Monitoring</b>	<b>7</b>
3.1	What is Price Monitoring?	7
3.2	Role of Price Monitoring	8
3.3	Framework for Price Monitoring	9
<b>4</b>	<b>ACCC's Current Monitoring Activities</b>	<b>11</b>
4.1	Airports	11
4.2	Container Stevedoring	18
4.3	Medical Indemnity Insurance	22
4.4	Petrol	26
4.5	Milk	30
4.6	Summary of Features of Monitoring Regimes	33
<b>5</b>	<b>Monitoring of Retail Markets in Other Jurisdictions</b>	<b>34</b>
5.1	United Kingdom	34
5.2	New Zealand	40
<b>6</b>	<b>Application of Price Monitoring to Energy Retail in Victoria</b>	<b>42</b>
6.1	Current Monitoring Regime	42
6.2	Issues for Consideration	42
	<b>Appendix A. Price Inquiries</b>	<b>46</b>
	<b>Appendix B. Price Notification</b>	<b>47</b>
B.1.	Airports	47
B.2.	Air Services	48
B.3.	Postal Services	49

# 1 Introduction

The Australian Energy Markets Commission (AEMC) has recently completed its review of the effectiveness of competition in electricity and gas retail markets in Victoria and found competition to be effective. The AEMC is currently considering transitional arrangements from retail price regulation to a more light-handed framework involving price monitoring.

This briefing note sets out how price monitoring is applied in other industries in Australia and internationally. It is intended to inform the AEMC's thinking as to how a price monitoring regime for energy retail in Victoria should be structured and what such a regime would involve.

The remainder of this note is structured as follows:

- § section 2 provides some background as to the legislative framework for price monitoring in Australia;
- § section 3 considers the objectives of price monitoring;
- § section 4 provides an overview of how price monitoring is currently applied in other industries in Australia;
- § section 5 provides an overview of how price monitoring has been applied in respect of energy retail markets in other jurisdictions;
- § section 6 sets out some discussion of the issues relevant for assessing how price monitoring could be applied in the context of energy retail in Victoria;
- § Appendix A discusses issues related to price inquiries; and
- § Appendix B discusses issues related to price notifications.

## 2 Background

Price monitoring is primarily carried out by the ACCC either informally or pursuant to a Ministerial Direction under Part VIIA of the *Trade Practices Act 1974* (the TPA), which recently replaced the *Prices Surveillance Act 1983*.

This section sets out a brief history of the *Prices Surveillance Act 1983*, details of the Productivity Commission's review of this Act and the current price monitoring framework as set out under Part VIIA of the TPA.

### 2.1 History of Price Monitoring and Price Surveillance

The *Prices Surveillance Act 1983* (PS Act) was initially introduced to operate as part of the Prices and Incomes Policy of the then Commonwealth government.<sup>1</sup> At the time of its introduction, inflation was high and the government emphasised the need for income and price restraint to assist economic recovery. The Prices Surveillance Authority (PSA) was responsible for administering the PS Act with a mission of promoting price restraint and accountability consistent with market outcomes.

The PSA had two statutory functions (1) to consider notifications of price increases by declared companies; and (2) to hold public inquiries.<sup>2</sup> The PSA did not have any statutory powers in regard to price monitoring, although price monitoring did become an increasingly important activity for the PSA over time.<sup>3</sup> In order to conduct its monitoring activities, the PSA relied on publicly available information and the co-operation of firms in providing relevant data.<sup>4</sup>

The PS Act was reviewed by the Productivity Commission (PC) in 2001. In its Inquiry Report the PC noted that the economic environment had changed significantly since 1983 when the PS Act was introduced.<sup>5</sup> Rather than a method for dealing with inflation, prices oversight was seen as a part of competition policy, focusing on pricing by firms with substantial power in important markets.

---

<sup>1</sup> Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report, Report No 14*, 14 August 2001, p xvi at <http://www.pc.gov.au/inquiry/psa>.

<sup>2</sup> In 1987 the PSA published a set of *Guidelines for Pricing Restraint* which outlined its approach to assessing price notifications for declared companies and industries. The guidelines reflected a cost-based approach – notifications were reviewed to ensure that price movements were related to cost movements between notifications, which were generally six to twelve months apart. At the time 63 companies and 23 industries were declared under the Act, most of which were private sector companies that operated in oligopolistic industries and final goods markets. See ACCC, *Statement of regulatory approach to assessing price notifications*, July 2005.

<sup>3</sup> Specific industries subject to price monitoring in 1992 and 1993 included interstate aviation, books, childcare, cinemas, confectionary, credit cards, furniture, harbour towage, motor vehicle replacement parts, paint, pre-mixed concrete, stevedoring, coastal shipping, sugar, Tasmanian LPG, and textiles clothing and footwear. See Industry Commission, *What Future for Price Surveillance?*, Submission to the Prices Surveillance Authority's Review of Declarations under the Prices Surveillance Act 1983, Information Paper, AGPS, Melbourne, p.15.

<sup>4</sup> Industry Commission, *What Future for Price Surveillance?*, Submission to the Prices Surveillance Authority's Review of Declarations under the Prices Surveillance Act 1983, Information Paper, AGPS, Melbourne, p.15.

<sup>5</sup> Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report, Report No. 14*, 14 August 2001, p.xiii.

The PC also noted that the PS Act had substantial deficiencies, namely:

- § it did not have clearly defined objectives;
- § it was easy to implement price notification (an indirect form of price control) without sufficient investigation;
- § inquiries were not required to consider relevant policy options; and
- § there was insufficient guidance as to the role of price monitoring.

The PC recommended that the existing PS Act be repealed and that limited new inquiry and monitoring functions be written into a new part of the TPA. In particular, the PC recommended that the new part of the TPA would:<sup>6</sup>

- § include an objects clause, stating the objectives for the inquiry and monitoring part of the Act;
- § provide for public inquiries into monopolistic pricing where the inquiry should identify and assess alternatives to prices oversight and be able to recommend price monitoring, including the indicators to be disclosed and the period for which monitoring will apply (which normally should not exceed three years and would be limited to a maximum of five years);
- § provide for monitoring, which could be initiated by the responsible Minister following a recommendation from an inquiry or a recommendation from the ACCC or NCC, as an alternative the third party access declaration. The ACCC would be designated the administrator of the monitoring provision and would be required to publish and report on the information being monitored.
- § not provide for price control to be administratively implemented. In the event that an inquiry recommended some form of price control, it would need to be implemented through industry-specific legislation.

The government accepted most of the PC's findings and recommendations.<sup>7</sup> On 1 March 2003 the PS Act was repealed and Part VIIA was inserted in the TPA by the *Trade Practices Legislation Amendment Act 2003* (Act No 134, 2003).

---

<sup>6</sup> *Id.*

<sup>7</sup> In its response to the Productivity Commission Review of the Prices Surveillance Act 1983 the Government noted:

*“The Government believes that the existing price restriction provisions should be available in circumstances that the Minister considers important and in the public interest. Such circumstances might include markets of state or regional significance which are structurally changing due to reform measures and where there is a heightened concern to protect consumers (for example, the public interest required the monitoring of milk prices when the dairy industry reforms were taking effect, and price monitoring helped to confirm the benefits of competition). An objects clause for the new part of the TPA will provide that price surveillance will only be applied in those markets where competitive pressures are not sufficient to achieve efficient prices and protect consumers.”*

The Government disagreed with some of the PC's recommendations and provided additional views on others. In particular the Government was of the view that the TPA should provide for public inquiries in other circumstances, which the Minister might consider important and where there is a public interest. The Government also believed that it should retain discretion on whether an inquiry report or its recommendations be made public. It was also of the view that it would be unreasonably restrictive to require a positive recommendation from a public inquiry before the Minister

## 2.2 Current Legislative Framework

The current price surveillance provisions are set out under section 95 of Part VIIA of the TPA. The main sections of interest in regard to price monitoring are set out below.<sup>8</sup>

### Division 1 - Preliminary

#### [1.95E] 95E. Object of this Part

The object of this Part is to have prices surveillance applied only in those markets where, in the view of the Minister, competitive pressures are not sufficient to achieve efficient prices and protect consumers.

#### [1.95F] 95F. Simplified overview of this Part

(1) This Part deals with 3 main things.

##### Price inquiries

- (2) First, it provides for the Commission or another body to hold price inquiries in relation to the supply of goods or services.
- (3) These inquiries may relate to the supply of goods or services by a particular person. If so, the person's ability to increase the prices of those goods or services during a particular period is restricted. However, there is a way for the person to increase prices during that period.

##### Price notifications

- (4) Second, this Part allows the Minister or the Commission to declare goods or services to be notified goods or services and to declare a person to be a declared person in relation to such goods or services.
- (5) If this happens, the person's ability to increase the prices of such goods or services during a particular period is restricted. However, there is a way for the person to increase prices during that period.

##### Price monitoring

- (6) Third, this Part allows the Minister to direct the Commission to undertake price monitoring.
- (7) This may be in relation to supplies of goods or services in a particular industry or in relation to supplies of goods or services by particular persons.

---

could initiate price monitoring – for example, there may be occasions where the use of monitoring may be preferable prior to initiating any full public inquiry. The Government also proposed to retain its price restriction provisions (no more than 21 days under price notification or 6 months for price inquiries) since their removal would weaken the Government's ability to respond promptly to concerns about price related matters.

<sup>8</sup> Other sections in relation to price inquiries, price notifications and information gathering powers are also included in section 95 – see [www.austlii.edu.au/au/legis/cth/consol\\_act/tpa1974149/](http://www.austlii.edu.au/au/legis/cth/consol_act/tpa1974149/)

## Division 2 – Commission's Functions under this Part

### [1.95G] 95G. Commission's functions under this Part

(1) The Commission's functions under this Part are set out in this section.

#### Price inquiries

(2) The Commission is to hold such inquiries as it is required to hold under section 95H.

(3) The Commission may, with the Minister's approval under section 95H, hold such other inquiries as it thinks fit.

(4) The Commission is to give the Minister a report on the results of each inquiry it holds.

#### Price notifications

(5) The Commission is to consider locality notices and to take, in relation to such notices, such action in accordance with this Part as it considers appropriate.

#### Price monitoring

(6) The Commission is to monitor prices, costs and profits in any industry or business that the Minister directs it to monitor and is to give the Minister a report on the results of such monitoring.

#### General

(7) In exercising its powers and performing its functions under this Part, the Commission must, subject to any directions given under section 95ZH, have particular regard to the following:

- (a) the need to maintain investment and employment, including the influence of profitability on investment and employment
- (b) the need to discourage a person who is in a position to substantially influence a market for goods or services from taking advantage of that power in setting prices
- (c) the need to discourage cost increases arising from increases in wages and changes in conditions of employment inconsistent with principles established by relevant industrial tribunals.



### **Division 5 – Price Monitoring**

**[1.95ZE(ZF)]            95ZE(ZF). Directions to monitor prices, costs and profits of an industry (business)**

- (1) The Minister may give the Commission a written direction:
- (a) to monitor prices, costs and profits relating to the supply of goods or services by persons in a specified industry; and
  - (b) to give the Minister a report on the monitoring at a specified time or at specified intervals within a specified period.

*Commercial confidentiality*

- (2) The Commission must, in preparing such a report, have regard to the need for commercial confidentiality.

*Commission to send person a copy of the report (1.95ZF only)*

- (3) The Commission must send the person a copy of the report on the day it gives the Minister the report.

*Public inspection*

- (3)/(4) The Commission must make copies of the report available for public inspection as soon as practicable after it gives the Minister the report.

### 3 Objectives of Price Monitoring

As noted by the PC, in imperfectly or potentially competitive markets, scrutiny of prices and market performance can be achieved through the publication of key information.<sup>9</sup> This enables customers, the community, policy makers and regulators to monitor market outcomes and gain a better understanding of the workings of the market. Thus, monitoring can enhance market transparency and assist the competitive process.

#### 3.1 What is Price Monitoring?

Price monitoring does not have a precise definition. The PC identified that monitoring may be used either as an instrument of regulation and compliance by the regulator or as a means of observing and understanding the performance of a firm, industry or market.

<b>What is Monitoring?</b>
<p><b>As an instrument of regulation and compliance by a regulator</b></p> <p>The intent in this context is to put pressure on firms to achieve acceptable outcomes in terms of key factors, such as prices, profits and quality. The reporting process is used by the regulator to state publicly whether they are satisfied with the outcomes and whether further action, such as price control, is warranted. The regulator can use the threat of more intrusive forms of regulation (which may be strengthened by public and government support generated by the regulator's report) to persuade the firm to comply with the regulator's formal or informal targets. In this context, monitoring is used as a form of incentive regulation. A variation on this is where monitoring is used to assess compliance of a firm or industry with an agreement it may have with the Government regarding the implementation of a policy.</p>
<p><b>As a means of observing and understanding the performance of a firm, industry or market</b></p> <p>In some situations there may be suspicion about market power. This can arise because of price volatility, a significant increase in price, or deregulation of the industry. Monitoring provides a means of observing and understanding the performance of the firms and the industry. It facilitates the systematic disclosure of information not readily available from other sources, such as reports produced by firms. For example, it may collect, publish and report on segregated company results and key indicators of performance such as prices for certain classes of customers or users, profitability and quality. The monitoring report provides information to the public and policy makers. However, it is not intended to be used to regulate behaviour. Notwithstanding this intent, it is likely to have some effect on the behaviour of firms being monitored. The intent of this type of monitoring is to provide an alternative in circumstances where price control is likely to be inferior to the operation of the market, even though there is some degree of market power that might be exercised.</p>

Source: Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report, Report No. 14, 14 August 2001, p.48.*

<sup>9</sup> Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report, Report No. 14, 14 August 2001, p.47.*

The distinction between these two forms of monitoring appears to be related to the strength of the regulatory threat and the willingness and capacity of the relevant regulator to act on that threat. The former appears to be more appropriate for industries where firms have monopoly characteristics and where the regulator may have the discretion to impose regulation. The latter appears to be more appropriate in those industries open to competition but where there may be some concerns over the strength of competitive pressures in the market.

### 3.2 Role of Price Monitoring

In its submission to the PC review of the PS Act, the ACCC noted that monitoring may have a role in easing public concerns about the exercise of market power and would be the means by which the Government could respond to the exercise of such power:<sup>10</sup>

*“... from time to time there are likely to be areas of the economy where there is considerable public concern about particular pricing outcomes. Government is likely to want to respond to these community concerns. In this situation a price oversight power is required that allows Government to respond. Price monitoring which requires the firm to provide specific cost, profit and price data at regular intervals can be used in the first instance or a public inquiry may be considered to be necessary.”*

The Industry Commission has also previously noted that this role is especially important in industries that have recently been deregulated:<sup>11</sup>

*“In industries previously subject to prices surveillance, a transitional period of prices monitoring may be a useful device for assuring consumers that unforeseen difficulties will be quickly identified. In some industries, there will be rapid public acceptance that prices oversight has seen its day. In others, particularly those with a high public profile, acceptance that there is no longer a role for the [PS Act] may take longer. ... Transitional prices monitoring would allow Governments to avoid stepping away from an industry so quickly that necessary public support for reform is undermined.”*

In its inquiry report the PC concluded that monitoring for a limited period of time, if implemented effectively, may help measure progress against the expected outcomes of reform without unduly interfering in the market. It put the view that it is the threat of price control with other legislative instruments, such as the national access regime and industry-specific legislation that acts as an incentive for firms not to abuse market power, rather than monitoring itself.<sup>12</sup>

---

<sup>10</sup> *Ibid*, reference to ACCC Submission, sub.10, p.38.

<sup>11</sup> Industry Commission, *What Future for Price Surveillance?*, Submission to the Prices Surveillance Authority’s Review of Declarations under the Prices Surveillance Act 1983, Information Paper, AGPS, Melbourne, p.84.

<sup>12</sup> Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report*, Report No. 14, 14 August 2001, p.49.

As noted by the Industry Commission in its submission to the 1994 PSA review of goods and services subject to price surveillance:<sup>13</sup>

*“Where there is less confidence about the extent of market power, the prices monitoring option should be less intrusive [than price control]... In such cases, a compromise solution may be a two year period of prices monitoring to see if surveillance is warranted.*

...

*The only sanction necessary for effective prices monitoring is the power of the Minister to order the PSA to undertake a public inquiry.”*

### 3.3 Framework for Price Monitoring

On the basis of the above, some of the basic principles which should underlie price monitoring regimes include:

- § **Transparency** – the method for monitoring prices should be known, conclusions (where made) or further action should be based on observations and results of monitoring activities (where not confidential) should be published;
- § **Flexibility** – the regime should be sufficiently flexible to allow the monitoring body to report on areas of concern (eg, barriers to entry may not be considered to be substantial at the beginning of a monitoring regime and therefore not reported but this may change over time);
- § **Timeframe** – Price monitoring should not be indefinite (note the PC recommended three years or less or five years in exceptional cases);<sup>14</sup>
- § **Non-intrusive** – price monitoring should not be intended as a form of price control or to entail unwarranted intrusion into the operation of businesses;
- § **Not costly to administer or comply with** – reporting requirements should not be overly onerous on the businesses being monitored.<sup>15</sup>

---

<sup>13</sup> Industry Commission, *What Future for Price Surveillance?*, Submission to the Prices Surveillance Authority’s review of declarations under the Prices Surveillance Act 1983, Information Paper, AGPS, Melbourne, p.84.

<sup>14</sup> Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report*, Report No. 14, 14 August 2001, p.98-99.

<sup>15</sup> In its *Review of the Prices Surveillance Act 1983: Inquiry Report*, Report No. 14, 14 August 2001, p.98-99, the PC noted:

*“There should be legislative powers to require those subject to monitoring to provide data, with financial penalties for non-provision...”*

*Such legislative powers should, however, be subject to checks and balances to ensure that they do not lead to expanding information requests. Under the Commission’s proposal, the indicators to be monitored would be specified by the Minister following the public inquiry. Firms would be protected from information requests by the agency being permitted only to collect the information that is specified in the monitoring declaration by the Minister”*

Bodies such as the PC are also of the view that monitoring should be factual and that the monitoring body should not make any determinations on the appropriateness of prices or make recommendations to the Government using monitoring. As noted by the Productivity Commission:<sup>16</sup>

*“As part of the monitoring report the ACCC could provide some commentary on the data. However, it is important to note that under the monitoring arrangements envisaged by the Commission, the ACCC would not make any determinations on the appropriateness of prices or make recommendations to the Government using this monitoring provision...”*

*Comments by the monitoring agency should be limited to those of a factual or descriptive nature. For example, the agency may wish to comment on the trend in data over the monitoring period or provide a factual comparison with data from the previous monitoring report. This is because...the intent of monitoring is to facilitate information provision, it is not intended to be a form of price control or to entail unwarranted intrusion into the operation of businesses.”*

---

<sup>16</sup> *Ibid*, p.96-97.

## 4 ACCC's Current Monitoring Activities

The ACCC currently conducts price monitoring of airports, container stevedoring, medical indemnity insurance and petrol. It has also previously monitored milk prices. We discuss the ACCC's activities in relation to each of these below.<sup>17</sup>

### 4.1 Airports

Airport operators in Sydney, Melbourne, Brisbane, Adelaide and Perth<sup>18</sup> are currently subject to monitoring of prices, costs and profits by the ACCC under a Ministerial Direction (Direction 29) now operative under Section 95ZF of the TPA.<sup>19</sup> The Direction specifies that monitoring shall occur with respect to 'aeronautical services and facilities'.<sup>20</sup>

#### 4.1.1 Background

The Government undertook the privatisation of airports via the sale of long term leases between 1997 and 2003. Due to the perceived potential for inefficient pricing through the misuse of market power, all airports in capital cities and some regional airports<sup>21</sup> were Declared under the PS Act and became subject to price notifications. Some services provided at these airports were not subject to the declaration and were instead subject to price monitoring.<sup>22</sup> The ACCC was required to monitor prices at all airports for non-declared

---

<sup>17</sup> Information in relation to the ACCC's activities can be found at [www.accc.gov.au/content/index.phtml/itemId/3671](http://www.accc.gov.au/content/index.phtml/itemId/3671)

The ACCC also maintains an informal oversight of bank fees and charges although it does not publish the findings of its monitoring activities. It also monitors public liability and professional indemnity insurance premiums, but with respect to the impact of various reforms on premiums rather than the justifiability or efficiency of premiums. In 2003, the ACCC began monitoring premiums on a six-monthly basis and was initially requested to monitor premiums for a period of two years. In 2005, the ACCC's monitoring role was extended for a further three years, reporting annually, however no reports have been published since July 2005.

<sup>18</sup> Prior to July 2007 Darwin and Canberra were also subject to the Direction.

<sup>19</sup> Parliamentary Secretary to the Treasurer, Ministerial Direction No. 29 at <http://www.accc.gov.au/content/index.phtml/itemId/729295>

<sup>20</sup> The definition of 'aeronautical services and facilities' going forward will, very broadly, encompass both aeronautical and aeronautical-related services as detailed in footnote 22 below, with some minor amendments.

<sup>21</sup> In addition to Perth, Darwin, Brisbane, Sydney, Melbourne, Hobart, Adelaide and Canberra, regional airports at Alice Springs, Launceston, Coolangatta and Townsville were also subject to regulation.

<sup>22</sup> Aeronautical services were subject to price notification whereas aeronautical related services were subject to price monitoring. Non-aeronautical related services were not subject to price monitoring.

Aeronautical services include:

(a) Aircraft movement facilities and activities, being: Airside grounds, runways, taxiways and aprons; Airfield lighting, airside roads and airside lighting; Airside safety; Noise-in guidance; Aircraft parking; Visual navigation aids; Aircraft refueling services; and

(b) Passenger processing facilities and activities, being: Forward airline support area services; Aerobridges and airside buses; Departure lounges and holding lounges (excluding VIP areas); Immigration and customs service areas; Security systems and services; Baggage make-up, handling and reclaim; Public areas in terminals, public amenities, public lifts, escalators and moving walkways, and Flight information display and public address systems.

These same services were and continue to be declared in the case of Sydney Airport with respect to provision to regional air services.

aeronautical related services (defined within the instruments) and to report to the Treasurer annually with respect to these.

Between 2001 and 2002, following a PC review of airport regulation, price regulation and monitoring arrangements were substantially altered.<sup>23</sup> In line with the PCs recommendations, the Government revoked previous declarations, ending the price cap regime, and introduced a 'light handed' approach to regulation via price monitoring of previously notified services at Sydney, Melbourne, Brisbane, Adelaide, Canberra, Darwin and Perth airports. This approach was backed by the ongoing and explicit threat of potential re-regulation of prices if necessary as well as the threat of declaration and access regulation under Part IIIA of the TPA.<sup>24</sup>

The motivation behind the change was to avoid:<sup>25</sup>

*"...unnecessary regulatory intrusion. Such intrusion under the price cap regime was widely acknowledged to have inhibited investment, diverted management resources to dealing with the regulator and impeded the development of normal commercial relationships between airports and airlines."*

In 2006 the PC reviewed the effectiveness of the new light-handed approach.<sup>26</sup> In its inquiry report the PC recommended the continuation of the previous light-handed monitoring arrangements, with some amendment:<sup>27</sup>

§ Clarification of the trigger and process for investigating price changes and potential re-regulation following price monitoring.

This was identified as a weakness in the existing arrangements in that the lack of clarity as to when and how price monitoring would lead to investigations reduced the credibility of the threat to re-regulate prices. Specifically, the PC recommended that each year the Government publicly declare that no investigation is necessary, or that the airport must show cause why further investigation should not be instigated;

§ No asset revaluations be allowed going forward (for the purpose of assessing prices) and a cut-off date of 30 June 2005 for the recognition of previous revaluations.

Under the existing arrangements, revaluations could potentially be used to inflate charges, while having only weak justification from an efficiency perspective. Revaluations were found to have impeded negotiations between airlines and airports. Consequently, the PC recommended that no revaluations, particularly of land assets, be recognised in assessing the reasonableness of prices; and

---

Aeronautical – related services include Landside vehicle access to terminals, Landside vehicle services including Public and staff car parking (excluding valet) and Taxi holding and feeder rank services on airport, Check in counters and related facilities, and Aircraft light and emergency maintenance sites and buildings.

See Appendix B for further detail in relation to price notifications in relation to airports.

<sup>23</sup> Productivity Commission, *Review of Price Regulation of Airports Services: Inquiry Report*, 14 December 2006.

<sup>24</sup> *Ibid.*, p. xiii.

<sup>25</sup> *Ibid.*, p.4.

<sup>26</sup> *Ibid.*, p. xiii.

<sup>27</sup> *Ibid.*, p. xxix.

§ Augmentation of guiding principles of the light-handed approach to articulate that airports and airlines are expected to reach privately negotiated, tailored commercial outcomes rather than rely on recourse to arbitration.

In addition, the PC made some recommendations as to the scope and method of monitoring and reporting by the ACCC. These are discussed in more detail below.

#### 4.1.2 Methodology adopted

From 2002 the ACCC has reported annually to the Government following the close of each financial year with the findings of its price monitoring activities.<sup>28</sup> In the past, the ACCC has also produced an annual quality of service report under quality monitoring and reporting requirements set out in the Airports Act.<sup>29</sup> In future, the ACCC intends to publish a single price and quality monitoring report.

The ACCC does not express any view as to the reasonableness of airport charges. Its annual report is purely factual and is designed to 'inform' government decisions. The ACCC report focuses on key indicators, calculated from the regulatory account information as follows:<sup>30</sup>

- § total number of passengers;
- § total revenue;
- § aeronautical and aeronautical-related operating revenue (adjusted) per passenger;
- § aeronautical and aeronautical-related operating expenses per passenger; and
- § operating margin per passenger (based on the above).

Although the ACCC receives disaggregated information, indicators are reported on a per airport per passenger basis without any further disaggregation.

With respect to the above, the ACCC examines both trends over time and across airports, noting differences and any contributing factors that might explain significant changes over time or across locations. It specifically examines trends in tonnage landed and passenger numbers that might explain changing profitability of individual services or service categories.

The ACCC also assesses return on assets calculated as EBITDA (aeronautical and total) over average tangible non-current (aeronautical and total) assets, and notes any increase/decrease and difference between the two measures. This measure is preferred over return on equity due to the unusual ownership arrangements of most airports, where shareholders may also be significant debt-holders. The ACCC also prefers tangible assets only to be included as it does not consider that intangibles due to restructuring reflect the operating profitability of the underlying service provision.

---

<sup>28</sup> The ACCC's latest monitoring report, *Airports price monitoring and financial reporting 2005–06* can be found at <http://www.accc.gov.au/content/index.phtml?itemId=781192>.

<sup>29</sup> Productivity Commission, *Review of Price Regulation of Airport Services: Inquiry Report*, 23 January 2002, p. 56.

<sup>30</sup> The reporting and monitoring processes and methodology have been in the main stable since 2002, with little or no change in the indicators used and focus of analysis.



The ACCC uses aeronautical operating revenue (adjusted) per passenger as the primary measure of aeronautical prices. In order to ensure comparability over time, revenue is adjusted to account for changes in the industry or regulatory environment. In its 2006 report the ACCC notes that ideally it would construct a price index but due to information difficulties it cannot take this approach.<sup>31</sup>

Aeronautical-related services are not examined in detail – the key focus of the ACCC's monitoring activities is on aeronautical services, potentially due to the greater transparency and consistency of reporting in the regulatory accounts for aeronautical services.

The ACCC examines in further detail trends in revenue, cost and margin per passenger, and return on capital for aeronautical services for each location, disaggregated by service sub-category. In addition, it reviews movements in tangible and total assets at each location.

The ACCC also reports on volume trends using passenger and tonnage indicators constructed from the regulatory accounts. It also publishes the detailed regulatory financial accounts of each location, and operational statistics provided by operators.

While the ACCC is only required to monitor prices of aeronautical and aeronautical-related services, it also reports on aggregate revenue, costs and returns for each location due to problems with classification of services between aeronautical-related and non-aeronautical categories.

#### 4.1.3 Information requirements

The ACCC performs its monitoring function using information provided annually by operators. Operators provide the ACCC with a copy of their audited regulatory accounts, which they are required to prepare under the *Airports Act 1996*. Under that Act, airports must prepare consolidated financial statements in accordance with AIFRS accounting standards. Regulation 141(2) of the *Airports Act* requires:

*“consolidated financial statements for the operations, in relation to the airport, of itself and all airport-management companies at the airport, showing financial details in relation to the provision of aeronautical services and non-aeronautical services separately.”*

In accordance with regulations, airports must disclose or provide with the accounts.<sup>32</sup>

**§ Profit and Loss and Balance Sheets disaggregated into aeronautical and non-aeronautical services;**

---

<sup>31</sup> ACCC, *Airports price monitoring and financial reporting 2005–06*, p. 9.

<sup>32</sup> The *Airports Regulations 1997* require accounts prepared and lodged by the airports to be compliant with certain financial reporting requirements under the *Corporations Law* and AIFRS accounting standards, and accompanied by an Auditor's Certificate. In addition, the Regulations require certain additional data to be collected and provided to the ACCC. In meeting these requirements, certain information must necessarily be disclosed. The listing above highlights certain of those items, and is not an exhaustive account of the record keeping and reporting obligations required to be met by monitored airports. A copy of the *Airports Regulations 1997* is available at: [http://www.frl.gov.au/ComLaw/Legislation/LegislativeInstrumentCompilation1.nsf/0/3F6391AF9D404E98CA25730D00031892/\\$file/Airports1997.pdf](http://www.frl.gov.au/ComLaw/Legislation/LegislativeInstrumentCompilation1.nsf/0/3F6391AF9D404E98CA25730D00031892/$file/Airports1997.pdf).

- § schedule of maintenance and repair expenses disaggregated between aeronautical and non-aeronautical services;
- § separate Fixed Asset Movement reconciliations for aeronautical and non-aeronautical assets, and basis for allocation;
- § inter-service transactions; and
- § schedule of operational statistics containing the following indicators:
  - total embarking and disembarking passenger numbers;
  - average staff equivalents disaggregated into aeronautical and non-aeronautical staff; and
  - total area (hectares) disaggregated into aeronautical and non-aeronautical usage.

In addition, the ACCC's reporting guideline<sup>33</sup> stipulates further information required to be provided to the ACCC in order for it to meet its monitoring obligations under the TPA, where this information is not already contained within the regulatory accounts. This information significantly extends the disclosure requirements of airports under the Airports Act and includes:

- § schedule of operational statistics containing the following indicators:
  - passenger numbers disaggregated into domestic, international, international transit and domestic on-carriage;
  - aircraft movements disaggregated into regular public transport and general aviation movements;
  - total tonnes landed;
- § supporting schedules of revenue detailing the breakdown between aeronautical and 'aeronautical-related' services, and respective subgroups;<sup>34</sup>
- § schedule of charges with respect to both services and sub-groups, showing unit base and charge per unit (eg, passengers and fee per passenger);
- § schedule of aeronautical cost allocations and basis of allocation, disaggregated into aircraft movement and passenger processing categories;
- § schedule of aeronautical-related cost allocations and basis of allocation, disaggregated into subgroups; and
- § statement of estimated WACC (requested by the ACCC, not required to be audited).

The Guideline also requires the disclosure of material deviations from cost allocation principles set out within the guideline, changes to accounting policies and material changes in items normally included or excluded from the regulatory accounts.

---

<sup>33</sup> The ACCC is currently reviewing reporting requirements and has issued its Draft Reporting Guideline available at <http://www.accc.gov.au/content/index.phtml/itemId/801751/fromItemId/3883>. The Reporting Guideline is planned for introduction in the 2007/8 financial year however the final guideline is not available at time of writing.

<sup>34</sup> This further separation may be discontinued under new reporting requirements.

#### 4.1.4 Results of the analysis

In its most recent monitoring report the ACCC highlighted that, overall, airports are becoming more profitable over time.<sup>35</sup> Passenger numbers, operating margin per passenger and rates of return were increasing at most locations. In particular, the ACCC noted that since deregulation of prices, aeronautical revenue per passenger increased sharply immediately following removal of price caps and to a lesser degree in subsequent periods.<sup>36</sup> Aeronautical-related revenue, which was not subject to a price cap, increased over time to a lesser degree. At the same time, the ACCC found that operating costs per passenger have remained relatively stable (with some step-ups due to one off events in the industry).

The ACCC has not to date expressed a view as to the appropriateness of margins or returns on net assets, or implied, as it has in the case of the stevedoring industry, that competition concerns exist warranting further review.<sup>37</sup>

#### 4.1.5 Problems faced

The main problem the ACCC notes in preparing monitoring reports is the lack of alignment of service classification between regulatory reporting requirements and price monitoring requirements.<sup>38</sup> While airports submit regulatory accounts in line with definitions of the *Airports Act 1996*, it appears that airports do not or cannot fully reconcile these with costs and revenues disaggregated in line with definitions outlined in Directions for price monitoring, and do not or cannot provide complete and accurate information to the ACCC in this regard.

A further difficulty is inconsistency across locations in both cost allocation methodologies and definition of services in sub-categories at the detailed level.<sup>39</sup> The ACCC also notes that there is a lack of comparable historical data on which to base trend analysis due to structural, reporting and regulatory arrangements over time.<sup>40</sup> This restricts the ACCC's ability to monitor prices effectively due to its inability to unbundle service categories consistently across locations and over time.

In 2006 the PC was asked to examine the effectiveness of the light-handed regulatory regime and to advise on any changes to the regime. In its report the PC noted that:<sup>41</sup>

---

<sup>35</sup> ACCC, *Airports price monitoring and financial reporting 2005–06*, pp. viii-x.

<sup>36</sup> The ACCC estimated that following removal of price caps average aeronautical revenue per passenger had increased between 51% (Melbourne) and 266% (Darwin). See ACCC, *Airports price monitoring and financial reporting 2005–06*, p. 15.

<sup>37</sup> Note however that this may be due to the prior scheduling of the 2006 Productivity Commission Inquiry which considered these issues.

<sup>38</sup> ACCC, *Airports price monitoring and financial reporting 2005–06*. In particular, see Methodology Section 1.2, pp. 8–12.

<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.*

<sup>41</sup> Productivity Commission, *Review of Price Regulation of Airport Services: Inquiry Report*, 14 December 2006, p. 40-41.

- § airports consider that the light-handed approach had been effective, with the qualification that lack of policy guidance around asset valuation is the single major deficiency of the framework;
- § other users, including airlines, found that the light-handed approach failed to prevent significant misuse of market power, and pointed to systemic failures of the framework, most importantly:
- the lack of clarity around asset revaluations (consistent with airports' views);
  - lack of a transparent trigger and process for the imposition of more stringent price controls;
  - absence of a clear monitoring mechanism around non-price conditions; and
  - lack of recourse to a binding dispute-resolution process except under Part IIIA.

In addition, users highlighted that the inadequate service definitions have allowed airports to impose charges on airlines which fall outside the monitored framework, which are inflated above efficient levels. However, users conceded that the light-handed framework better facilitates commercial outcomes, and it is now easier for airports to undertake investment.

Overall, the Productivity Commission was of the view that overall the light-handed approach achieved its objectives, although it recognised the problems outlined by airport users, reflected in its recommendations for changes to the approach going forward as outlined above.<sup>42</sup>

#### 4.1.6 Arrangements going forward

From 2007, the Government plans to redefine the services subject to monitoring in order to align price monitoring with reporting requirements under the *Airports Act 1996*. The monitoring framework under the various instruments is in the process of being revised into a single reporting framework by the ACCC.<sup>43</sup>

The final list of services that will be subject to monitoring is yet to be decided. Broadly, monitoring will be limited to services where airports have 'significant market power', and will occur with respect to 'aeronautical services and facilities' as defined under Part 7 of the *Airports Regulations 1997* with some particular additions or exclusions.<sup>44</sup>

---

<sup>42</sup> *Ibid*, p. 43.

<sup>43</sup> The ACCC intends to adopt certain recommendations of the PC, most importantly it will adopt the 'line-in-the-sand' approach to recognising asset valuations for the purposes of price increases.

<sup>44</sup> The exact additions and exclusions are not yet finalised. It appears at time of writing that in the main price monitoring will still be required for 'aeronautical services and facilities', encompassing the services currently subject to monitoring under the TPA. Further information can be found at the Government Response to the Productivity Commission Inquiry Report (2006), <http://www.treasurer.gov.au/tsr/content/pressreleases/2007/032.asp>

## 4.2 Container Stevedoring

The ACCC performs ongoing monitoring of prices, costs and profits of container stevedoring service providers pursuant to a Ministerial direction given in 1999, now operative under Part VIIA of the TPA.<sup>45</sup>

### 4.2.1 Background

The current monitoring regime for container stevedoring was introduced following structural reforms in the industry in the late 1990's.<sup>46</sup> As part of this reform, the Government provided funds to stevedoring companies to ensure that employees made redundant as part of the reform process received full entitlements. The funds were subsequently recovered through a per-unit levy imposed on containers unloaded. The stevedoring companies, P&O and Patrick, agreed to fully absorb the levy.<sup>47</sup>

The ACCC's role broadly at this time was envisaged as making sure that stevedoring charges were 'commercial' and that the stevedores absorbed the levy.<sup>48</sup> The stevedoring levy ceased in May 2006.

### 4.2.2 Methodology adopted

The ACCC monitors service provision at the following ports: Adelaide, Brisbane, Burnie, Fremantle, Melbourne, and Sydney. Certain ports are excluded from monitoring as a substantial proportion of revenue is not derived from container traffic. The ACCC reports annually to the Treasurer within four months of the end of financial year. Following this, the report is made public.<sup>49</sup>

The ACCC reports key findings and observations with respect to industry trends and other important developments in the industry. For example, in its 2007 monitoring report, the ACCC reported on major developments in industry approaches to capacity expansion and land-side access management. Both of these issues impact barriers to entry and are relevant for assessing whether stevedoring companies may be abusing their market power.

---

<sup>45</sup> A copy of the Direction from the Treasurer may be found at Appendix E of the most recent container stevedoring price monitoring report: ACCC, *Container Stevedoring Monitoring Report No.9*, 2007, p. 55.

<sup>46</sup> Prior to this the PSA monitored stevedoring prices and costs from March 1991 to November 1995.

<sup>47</sup> ACCC, *Container Stevedoring Monitoring Report No.3*, 2001, p. v. In agreeing to absorb the cost of the levy, the major stevedoring companies undertook to not pass on the cost of the levy to customers through higher loading and unloading fees, but absorb the cost through equivalently reduced unit margins.

<sup>48</sup> The ACCC noted:

*"The Commission's monitoring program is designed to provide information to the Government and wider community about the progress of waterfront reform at Australia's major container terminals. The monitoring program will also provide information to the community about the absorption of the stevedoring levy by the stevedores."*

ACCC, *Container Stevedoring Monitoring Report No.3*, 2001, Page v. See also 'Rural and Regional Affairs and Transport Legislative Committee: Stevedoring Levy (Collection) Amendment Bill, 1999', Hansard, 27 August 1999, pp. 42-5.

<sup>49</sup> The latest monitoring report: ACCC, *Container Stevedoring Monitoring Report No.9*, 2007, can be found at <http://www.accc.gov.au/content/index.phtml/itemId/802397/fromItemId/655508>.

For its analysis of trends, the ACCC considers the following:

- § revenue per unit (TEU containers unloaded) – this is broken down into unit revenue from stevedoring activities (ie, lifting containers onto and off ships) and revenue from ‘other’ services (ie, berth hire, storage, container re-positioning, asset sales, vehicle booking systems and ‘other’ non-defined or unidentified activities):
  - stevedoring revenue is further broken down by container type (20 foot and 40 foot containers);
  - some revenue items included as ‘other revenue’ are also identified and discussed separately.
- § costs broken down into labour, equipment, property, levy and other costs;
- § return on assets (RoA), calculated as EBIT over average total assets excluding goodwill.<sup>50</sup> The ACCC compares the RoA to the average RoA of companies comprising the ASX200, excluding financial institutions. It also includes a comparison against the RoA of other overseas port authorities (mainly in New Zealand and Singapore); and
- § industry specific productivity measures sourced from the BTRE publication, *Waterline*, including ‘crane rate’, ‘ship rate’ and ‘elapsed labour rate’.

The ACCC examines these indicators on an aggregated national basis and calculates average revenues, costs and margins for all services. The ACCC focuses heavily on examining trends in the above over time, consistent with its role in assessing the impact of reforms on the industry.

Company specific data is also included in an Appendix, notably total and stevedoring revenue per unit, total and stevedoring cost per unit, total and stevedoring margin per unit and cost indices for stevedoring costs by category. In the latest monitoring report, further information is provided on a location basis within the company specific data.<sup>51</sup>

In addition to the above indicators, the ACCC also sets out a qualitative discussion of the characteristics of the stevedoring industry. This includes a discussion of the types of services provided by stevedoring companies, structural arrangements, the size and characteristics of the market, capacity, the role of stevedoring in the overall transport logistics chain, economies of scale in the industry, potential barriers to new entry and exit, demand for stevedoring services and the elasticity of demand, the level of countervailing power, and the regulation of ports and port services. The exact content and extent of the ACCC’s discussion varies from year to year but remains focused around the structural characteristics of the industry of most concern in terms of their impact on competition (see Section 4.2.4 below).

### 4.2.3 Information requirements

The stevedoring companies (Patrick, P&O Ports and DP World Adelaide) provide quantitative information to the ACCC annually. The ACCC does not explicitly note in its

---

<sup>50</sup> Goodwill is excluded as it obscures the underlying profitability of operations.

<sup>51</sup> ACCC, *Container Stevedoring Monitoring Report No.9*, 2007, Appendix A pp. 40-43.

reports what information is requested and provided, and has not to date publicly issued guidance to this effect. However, at a minimum, it appears that the relevant companies provide, for each location:

- § total terminal revenue, comprised of stevedoring revenue<sup>52</sup> and other revenue;
- § volume throughput split into different container sizes;
- § total terminal cost disaggregated into stevedoring costs, labour, equipment (including depreciation), property, levy and other categories; and
- § details of asset accounts and movements during the year.

The ACCC does note that it does not collect data on actual prices charged to clients for stevedoring services. Rather, data is provided by the companies on an aggregate basis for each location for the total terminal activities and for the stevedoring function only. Unit measures are inferred from this aggregated data. For example, companies provide information such as total revenue and volume by container size and port, which is then used to determine per-unit revenue estimates at each location.

The ACCC supplements this information with publicly available information from submissions to other regulators, annual reports, ASX data and reports produced by the Bureau of Transport and Regional Economics. It also seeks other information from informal contacts with stevedoring companies.<sup>53</sup>

#### 4.2.4 Results of the analysis

The ACCC does identify specific competition concerns and does make conclusions on the extent to which competition appears to be effective.<sup>54</sup> However, it does not specifically state whether, in its view, prices are at efficient levels.

In its most recent monitoring report the ACCC questioned the intensity of competition in the stevedoring industry and, in particular, the incentives of the incumbent firms to compete on the basis of lower prices. In particular the ACCC expressed concern over the following:<sup>55</sup>

- § the ability of incumbent stevedores to maintain average unit revenue levels despite an overall reduction in unit costs during a period of significant capacity expansion; and
- § comparatively higher returns on assets, notwithstanding a significant expansion in the asset base for the third consecutive year.

On the basis of the above, the ACCC stated:<sup>56</sup>

---

<sup>52</sup> Defined as revenue attributable to loading and unloading of cargo, including rebates and penalties, and excluding revenue from 'break-bulk' work, provision of ancillary services.

<sup>53</sup> ACCC, *Container Stevedoring Monitoring Report No.9*, 2007, p.6.

<sup>54</sup> *Ibid*, p.38.

<sup>55</sup> *Ibid*, p.3 and 38.

<sup>56</sup> *Ibid*, p.38.

*“These results reinforce concerns expressed in previous monitoring reports that outcomes in the stevedoring industry may not be consistent with outcomes that could be expected under effective competition.”*

In addition to the above, the ACCC identified characteristics of the industry which provide evidence of barriers to entry, although it did not reach a view as to the ‘height’ of these barriers. The industry characteristics highlighted by the ACCC include:

- § existence of economies of scale, evidenced by lower per unit costs partly attributable to recent capital investments which raised productivity – although the ACCC also notes that expressions of interest by potential entrants suggest that scale economies are not insurmountable deterrents to entry;<sup>57</sup>
- § the existence of long term exclusive leases of berth space for which competitors are not generally invited to tender when they come up for renewal (that is, port managers tend to simply deal with the incumbents in renewing the leases);<sup>58</sup>
- § the possible need for a new entrant to establish a presence at several ports in order to compete with incumbents who provide a national service;<sup>59</sup> and
- § land-side access to the ports is controlled by incumbents via their respective vehicle booking systems - the ACCC notes that revenues from this service have risen significantly since 2001/02, and that this creates a potential bottleneck for any future entrant.<sup>60</sup>

It is unclear whether the ACCC has any recourse to further action other than the use of its powers under sections 45 and 46 of the TPA which deal with anti-competitive conduct. It appears that the ACCC could request that the Minister approve it holding an inquiry in relation to specified matters under section 95H(3) of the TPA. If this were to occur it is unclear whether the ACCC has the authority to recommend the instigation of price notification or some other form of price control in its inquiry report.

The reason why the ACCC has not yet instigated an inquiry to address the competition concerns raised in previous monitoring reports may be because each jurisdiction is currently reviewing the regulation of its ports and port authority and handling and storage facility operations at significant ports to ensure that where economic regulation is warranted it conforms with agreed access, planning and competition principles. These reviews are to be completed by the end of 2007. The ACCC also recently instituted legal proceedings against a number of former Patrick companies (now owned by either Asciano or Toll) and a number of former P&O companies (now owned by DP World) for alleged contraventions of section 45 of the TPA.<sup>61</sup> The ACCC is seeking a range of remedies including: injunctions, declarations,

---

<sup>57</sup> *Ibid*, p.51.

<sup>58</sup> *Ibid*, p.36.

<sup>59</sup> *Ibid*, p.52.

<sup>60</sup> *Ibid*, p.37.

<sup>61</sup> The ACCC also instituted legal proceedings against Australian Amalgamated Terminals Pty Ltd for its involvement in a number of the alleged contraventions.



pecuniary penalties and orders preventing the companies from continuing to give effect to the allegedly illegal agreements.

### 4.3 Medical Indemnity Insurance

The ACCC has monitored medical indemnity insurance (MI insurance) premiums from 1 January 2003 to assess whether they are “actuarially and commercially justified”.<sup>62</sup> The monitoring arrangements appear to fall outside the price monitoring provisions of the TPA, ie, an announcement was made by the Prime Minister in 2002 but there is no direction under the price surveillance provisions within Part VIIA of the TPA.

#### 4.3.1 Background

Prior to 1 July 2003, MI insurance was mainly offered by medical defence organisations (MDO's) on a discretionary basis.<sup>63</sup> MDO's were non-profit 'mutuals' owned and operated by members. At this time medical practitioners reported significant increases in insurance premiums. In addition, during 2002, the largest MDO in Australia, United Medical Protection, went into provisional liquidation.

In response to these events the government introduced a package of reforms around the medical insurance industry in 2002 aimed at 'ensuring a viable and ongoing medical indemnity insurance market'.<sup>64</sup> As part of these reforms, MI insurance could only be provided by licensed insurers and a price monitoring framework was implemented, with monitoring to be performed by the ACCC.

The ACCC began its monitoring activities in 2003 and was initially requested to monitor premiums for a period of three years. In 2005 the ACCC, upon Government's request, extended its role to examine the actuarial and commercial justification of premium relativities between jurisdictions.<sup>65</sup> In 2006, the ACCC's monitoring role was extended for a further three years, and broadened to include a new entrant into the market, Invivo. While not specifically stated, the extension of the ACCC's timeframe for monitoring and monitoring activities were likely due to ongoing implementation of reforms in the insurance sector, including legislative amendments, additional initiatives to reduce the cost of insurance to practitioners and a separate review of competitive neutrality in the industry.

#### 4.3.2 Methodology adopted

Six insurance providers are currently monitored. The ACCC monitors premiums on an annual basis and produces an annual report.<sup>66</sup>

---

<sup>62</sup> ACCC, *Medical Indemnity Insurance 4<sup>th</sup> monitoring report*, March 2007, p.1.

<sup>63</sup> *Ibid.*

<sup>64</sup> ACCC, *Medical Indemnity Insurance 4<sup>th</sup> monitoring report*, March 2007, p.1.

<sup>65</sup> Jurisdictions are defined by state and territory.

<sup>66</sup> The latest monitoring report, *Medical Indemnity Insurance 4<sup>th</sup> monitoring report*, March 2007, can be found at <http://www.accc.gov.au/content/index.phtml/itemId/784517/fromItemId/654313>.

The methodology and results of the ACCC's analysis in assessing commercial and actuarial justification are described in detail within each annual price monitoring report, including details of the type of information requested and provided by insurers. The ACCC conducts both qualitative and quantitative analysis, although it omits some quantitative results from the report.

#### 4.3.2.1 Trend in costs and premiums

The ACCC analyses historical trends in expenses and premiums. In particular, it examines:

- § trends in claims, including ultimate claim costs per annum, claims frequency and average size of claims;
- § trends in other expenses, namely reinsurance and 'general and underwriting' expenses; and
- § trends in premiums, including total premium revenue and average premiums, including average premium by medical specialty (ie, premium by customer type).<sup>67</sup>

The ACCC does not make an assessment of the reasonableness of expenses. The ACCC reports results on the above on a combined basis, but not an insurer-specific basis.

#### 4.3.2.2 Actuarial justification

The ACCC assesses actuarial justification at the industry level by examining common factors or issues in medical indemnity insurance pricing. The ACCC's approach.<sup>68</sup>

*“considers the process adopted by insurers in the derivation of premium rates, the approach for constructing those premiums, the level of detail used to support pricing assumptions, the rigour of the analysis and the extent to which other relevant issues (such as medical indemnity and tort reforms) have been considered in setting prices.”*

The ACCC makes an assessment as to the appropriateness of specific components which would appear more in the way of commercial decisions. Specifically, the ACCC assesses:

- § the process used to set premiums, including incorporation of actuarial advice, appropriate use of sound actuarial techniques and consistency with additional supporting information (such as external reports);
- § determination of pure risk premia, including assessment of assumptions underlying calculation of the pure risk premium, presence and appropriateness of components included in the calculation, and consistency with actuarial assessments of the same;
- § expenses, including appropriateness of the level of expenses;

---

<sup>67</sup> Including GP – Non-Procedural, General physician, GP – Procedural; Anaesthetist, General Surgeon, Gynaecology, Plastic surgeon etc.

<sup>68</sup> ACCC, *Medical Indemnity Insurance 4<sup>th</sup> monitoring report*, March 2007, p.35.

- § reinsurance, including effective use of reinsurance, alignment with actuarial recommendations (in terms of inclusion of cost in premiums), and appropriateness of expectations around recoveries;
- § surplus component contained in the premiums, including adequacy to achieve capital targets and appropriateness and purpose of surpluses;
- § premiums and premium relativities, including actual versus recommended premiums, the degree of cross-subsidisation and method of derivation of relativities across classifications; and
- § the degree to which Government initiatives (High Cost Claims Scheme and Run-Off Cover Scheme) and torts reform have impacted on premiums.

Going forward, it is likely that the ACCC will rely more on actuarial assessments of appropriateness of premiums, which is now required to be provided under the *Professional Standard on Financial Condition Reports (PS 305)* issued by the Institute of Actuaries of Australia.<sup>69</sup>

In making its assessment, the ACCC focused heavily on consistency of approach across providers, and use of and consistency with actuarial analysis and assessments. Its view as to actuarial justification appears to be primarily driven by these considerations. Overall, the ACCC takes a control-based, risk management approach to making its assessment, focusing on the processes of the insurers rather than making its own independent substantive assessment as to the points above.<sup>70</sup>

The ACCC adopted alternative approaches with respect to one new entrant, Invivo, due to lack of historical data and the slightly different nature of its business (Invivo substantially repackages QBE policies). However, it broadly assessed Invivo by comparison to the industry premium and cost standards.

#### 4.3.2.3 Commercial justification

In order to assess commercial justification at the industry level, the ACCC's methodology focuses on making a determination as to whether individual premiums charged by insurers would be viable in a commercial market on an ongoing basis. For each insurer, the ACCC examines:

- § financial projections provided to APRA in 2002-03;
- § revised financial projections prepared in subsequent financial years; and
- § actual results for each financial year as reported to APRA.

From the information above, the ACCC constructs several key ratios or indicators:

---

<sup>69</sup> *Ibid*, p.39.

<sup>70</sup> In assessing appropriateness of treatment of the HCCS initiative, the ACCC took the approach in two instances that where the HCCS was not factored into the actuarial assessment, it was still actuarially justified as both providers could (a) show business reasons why it had not been included, (b) the exclusion resulted in benefits under the scheme not being fully recognised (as opposed to over-recognised), and (c) the HCCS was considered in establishing pure risk premia. See ACCC, *Medical Indemnity Insurance 4<sup>th</sup> monitoring report*, March 2007, p.44.

- § solvency – measured by current and forecast net asset position;
- § emerging surplus – measured by current and forecast proportion of surplus-to-premium. (the ACCC then assesses whether this is sufficient to meet solvency and capital targets submitted to APRA);
- § minimum capital requirement (MCR) – actual and forecast net asset versus MCR (the ACCC examines whether capital targets will be met by reviewing forecast and actual positions as a percentage of MCR);
- § return on net assets - actual and forecast;<sup>71</sup>
- § underwriting performance – actual and forecast. Performance is assessed based on key expense-to-premium ratios specific to the insurance industry.<sup>72</sup>

Again, the ACCC reports results for the above on a combined basis, not an insurer-specific basis.

#### 4.3.2.4 Assessment of justification of premium relativities

The ACCC assessed relativities by reviewing:

- § the alignment of actual versus actuary-recommended relativities;
- § the quantum of cross subsidies as provided by providers;
- § the availability of claims data in various states;
- § extent of analysis performed; and
- § extent of consideration of tort law reforms.

#### 4.3.3 Information requirements

The ACCC requests that the six providers provide a range of qualitative and quantitative information with respect to premium setting arrangements, cost structure and impact of government reforms. The ACCC relies on this information and does not independently verify the information or actuarial advice.<sup>73</sup>

The ACCC also utilises information provided to APRA by licensed insurers in making its assessment.<sup>74</sup> The ACCC notes that it has attempted to align information requirements for price monitoring to those of APRA for prudential regulation to reduce the reporting burden on providers.<sup>75</sup> However, it notes the different roles played by APRA and the ACCC for

---

<sup>71</sup> Return on net assets defined as emerging surplus net of tax as a percentage of the total net assets held over the period.

<sup>72</sup> Specifically, loss, expense, reinsurance and combined (loss plus expense) ratios, defined respectively as claims expense to premium, other expense (excluding reinsurance and claims) to premium, reinsurance to premium and (loss plus expense) to premium.

<sup>73</sup> ACCC, *Medical Indemnity Insurance 4<sup>th</sup> monitoring report*, March 2007, p.2.

<sup>74</sup> Where possible, the ACCC now collects information directly from APRA.

<sup>75</sup> ACCC, *Medical Indemnity Insurance 4<sup>th</sup> monitoring report*, March 2007, p.84.

medical indemnity insurance has meant that the ACCC continues to seek specific information directly from insurers. It does this via a uniform information request.<sup>76</sup>

The specific additional information requested by the ACCC includes:

- § actuarial pricing reports which provide advice to the medical indemnity provider on the aggregate premium pool and specialty rates;
- § actual premium rate reports which set out the actual premiums charged for all forms of indemnity – if actual premium rates differ from what is in the report the indemnity provider is asked to detail the reasons for the difference;
- § membership, premium and claims data, including:
  - membership numbers by membership category, by jurisdiction, by income band for the previous two years;
  - recommended individual actuarial subscription rates by membership category and by jurisdiction, by income band for the previous year;
  - actual subscription rates by membership category, by jurisdiction, by income band for the previous year;
  - total gross written premium by membership category, by jurisdiction for the previous two years; and
  - the total number of claims, claims paid to date and the actuarial outstanding claims liability at the beginning of the year.
- § other information including the insurer's most recent financial condition report, copies of financial projections and updates to these projections, recent annual reports and a brief outline of any changes to the insurance policies previously offered to medical practitioners for the previous indemnity period.

#### 4.3.4 Results of the analysis

To date, the ACCC has in general found that premiums and premium relativities are actuarially and commercially justified (there have been no adverse findings leading to further investigation and so on). Where insufficient information is provided, the ACCC notes in its report that it was unable to make an assessment with respect to that provider.

In addition to its core assessment above, the ACCC provides some further review of trends in premiums and cost components in the industry, however, it does not draw any additional inferences with respect to these.

#### 4.4 Petrol

The petroleum industry has for a long time been subject to some form of price monitoring or regulation by the ACCC and preceding regulatory bodies. The current price monitoring

---

<sup>76</sup> *Id.*

arrangements have been in place since the deregulation of petrol prices in 1998. The monitoring arrangements appear to fall outside the price monitoring provisions of the TPA.<sup>77</sup>

#### 4.4.1 Background

Prior to 1998, the four major oil companies were declared under the PS Act, and were required to submit price notifications for wholesale fuel prices for approval by the ACCC. The approach by the ACCC was to approve price increases if they were below a pre-determined maximum, which was a cost-based measure.<sup>78</sup>

The maximum allowable wholesale price, as determined by the ACCC, was comprised of an import parity component (landed cost of refined petrol), an assessed local component (cost based component to allow for terminalling, marketing and distribution), and a subsidy/excise component. An additional freight component for non-refinery locations (generally non-city locations) was also allowed.<sup>79</sup>

In 1998, following recommendation by the ACCC, regulation was removed and replaced with ongoing price monitoring. The ACCC considered the regulatory regime to be ineffective as the maximum allowable price acted as a target, did not act as an effective constraint on city prices and acted as a price floor for petrol supply to country areas.<sup>80</sup> At the time, it was also felt that emerging competition would obviate the need for regulation going forward.

It is interesting to note that the Government undertook at least 18 inquiries into the petroleum industry between 1984 and 1994.<sup>81</sup>

#### 4.4.2 Methodology adopted

The ACCC currently monitors the following:

- § retail prices of petrol, diesel and automotive LPG in the capital cities and around 110 country towns;
- § international crude oil and refined prices;
- § published terminal gate prices of the refiner/ marketers and some independents; and
- § the city-country retail price differential.

The ACCC describes its role in relation to price monitoring as follows:<sup>82</sup>

---

<sup>77</sup> In addition to its price monitoring activities, the ACCC is also now responsible for administering the Oilcode, a mandatory code of conduct under the TPA.

<sup>78</sup> ACCC Submission to Senate Enquiry, p.66.

<sup>79</sup> *Ibid*, p.67.

<sup>80</sup> *Id.*

<sup>81</sup> Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report*, Report No. 14, 14 August 2001, p.13.

<sup>82</sup> ACCC Submission to Senate Enquiry, Page 63.

*“The ACCC’s price monitoring is used to provide information to consumers – through its publications and on its website – and to assist in the ACCC’s role in administering the TPA. It also assists the ACCC in preparing analysis and reports for the Australian Government and Parliament.”*

The ACCC produces a number of publications with respect to its role in informing consumers and the government.

#### 4.4.2.1 Price monitoring information and reports

The ACCC publishes an ongoing comparison of average petrol prices to the industry benchmark, the price of Singapore Mogas 95 Unleaded. The price in Singapore is used as the benchmark for Australian prices because Singapore is the closest major refining and marketing centre to Australia. It is the most likely source of imported petrol into Australia and is the biggest refiner in the Asia-Pacific region.

The ACCC shows the seven-day rolling average retail unleaded petrol prices in the five largest metropolitan cities, being Sydney, Melbourne, Brisbane, Adelaide and Perth, against the seven-day rolling average of Singapore Mogas 95 Unleaded. This is the primary measure used by the ACCC to gauge the reasonableness of petrol prices.

The ACCC has also monitored E10 petrol prices (ie, the price of unleaded petrol which includes 10 per cent ethanol) since 2006 and reports quarterly at the Treasurer’s request. The report shows the difference between the average monthly price for E10 petrol and the average monthly price for regular unleaded petrol (RULP) in capital cities and in regional towns of a quarterly basis.

#### 4.4.2.2 Information for consumers

The ACCC has a petrol price cycle website (part of the ACCC website) and produces consumer information booklets.

The petrol price cycle website was established in November 2002.<sup>83</sup> The site provides regular updates on:

- § average daily retail petrol prices over the past 30 days;
- § the days of the week on which prices were at the bottom and top of the price cycles in the previous four months; and
- § the length of the price cycles in the previous four months.

In September 2005 the ACCC publicly released a booklet on petrol pricing in Australia. The ACCC note that the booklet aims to provide an understanding of petrol prices by presenting answers to some frequently asked questions on the issue.

---

<sup>83</sup> The website was developed after the Australian Government’s response to the ACCC’s 2001 variability report, which identified consumer education as a means of reducing the variability of petrol prices. See ACCC, *Reducing Fuel Price Variability: Discussion Paper*, June 2001, p.25.

Between September 2005 and December 2005 the ACCC also produced a weekly petrol price snapshot on the ACCC website to provide additional information to consumers after both retail petrol prices and Singapore refined petrol prices increased significantly in early September 2005, principally as a result of hurricane Katrina. The snapshot contained information on petrol prices in the five largest metropolitan cities, international petrol prices and the refiner margin. It was discontinued in December 2005 after a decline in prices from their September peak.

#### 4.4.2.3 Information for Government

The ACCC has at certain times reported to the Government on specific issues such as:

- § the degree of pass through upon changes in fuel excises and the introduction of the New Tax System;
- § the feasibility of reducing variability in retail petrol prices; and
- § terminal gate pricing arrangements in Australia.

#### 4.4.3 Information requirements

The ACCC obtains survey price data from Informed Sources. Informed Sources collects price data from the majority of petrol stations around Australia, and provides daily price data to the ACCC. The ACCC obtains international crude oil and refined prices from Platts Pty Ltd.

#### 4.4.4 Results of the analysis

Coincident with its price monitoring activities, the ACCC has instituted legal action against some petrol retailers for price fixing under section 45 of the TPA and has also sought and received approval from the Treasurer for an inquiry into the price of petrol pursuant to sections 95G(3) and 95H(2) of the TPA.

##### 4.4.4.1 Legal action

The ACCC has taken action against a number of petrol retailers over the last five years:

- § on 21 May 2002 the ACCC instituted proceedings against 14 companies and individuals, alleging a long-standing price-fixing arrangement existed in the market for the supply of petrol in the Ballarat region. On 20 December 2002, the Federal Court granted the ACCC leave to join two further respondents. Nine respondents admitted the allegations prior to the trial and had penalty hearings before Justice Goldberg. On 17 December 2004, Justice Merkel found the seven contesting respondents engaged in price-fixing conduct in breach of section 45 of the TPA. On 17 March 2005 Justices Merkel and Goldberg handed down penalty judgments against all the respondents, totalling \$23.3 million;
- § on 11 November 2003 the ACCC instituted court proceedings against eight companies and 10 individuals, alleging that they fixed retail petrol prices in the Geelong area. On 29 May 2007 Justice Gray dismissed the ACCC's allegations. The court found that it could not infer a sufficient level of commitment by the parties to constitute price fixing; and
- § in May 2005 the ACCC instituted proceedings against two service stations located south of Brisbane. On June 15 the Federal Court declared on the basis of facts jointly submitted



by the parties, that the suppliers of petrol at the two petrol stations made a number of agreements to fix retail petrol prices, and one agreement to fix LPG prices, between 2002 and 2004 in breach of section 45 of the TPA. The Federal Court ordered pecuniary penalties totalling \$470,000.

While the ACCC notes that price monitoring is used to assist in the ACCC's role in administering the TPA, it is unclear whether these cases were instigated directly as a result of the ACCC's price monitoring activities.

#### 4.4.4.2 Petrol price inquiry

In early June 2007 the ACCC detected a substantial divergence between movements in domestic petrol prices and movements in the international benchmark for refined petrol used for price monitoring purposes (ie, Singapore Mogas 95 Unleaded). Towards the end of May 2007, the Singapore price benchmark declined but the average price of petrol across the major capital cities increased.<sup>84</sup>

The ACCC wrote to the Treasurer seeking approval to an inquiry into the price of petroleum pursuant to sections 95G(3) and 95H(2) of the TPA. The Treasurer agreed to this request on 15 June 2007.

Matters that will be taken into account by the ACCC for the purpose of the inquiry include:<sup>85</sup>

- § industry structure;
- § the state of competition along the value chain (the refinery, wholesale and retail levels);
- § how prices are being set at each stage; and
- § potential means of addressing any identified impediments to efficient pricing (presumably potentially including more formal price monitoring or regulation).

The inquiry is to be completed and a report submitted to the Treasurer by 15 December 2007.

## 4.5 Milk

Leviable milk products were monitored by the ACCC for six months from 8 July 2000.

### 4.5.1 Background

Prior to 1 July 2000, farmgate milk prices were regulated. Milk at the farmgate was artificially classified according to end use, as either market (drinking) or manufacturing milk. Market milk prices were set by each state government, whilst manufacturing milk prices were set in the international market at a substantially lower price (an average of 21 cents per litre in 1999-2000 compared to an average of 47 cents per litre for market milk in the same

---

<sup>84</sup> ACCC, *Inquiry into the price of unleaded petrol: Issues Paper*, June 2007, p.3.

<sup>85</sup> Matters to be taken into account by the ACCC were specified by the Treasurer. See <http://www.treasurer.gov.au/tsr/content/pressreleases/2007/050.asp>

period). State regulations prohibited interstate arbitrage through cross-border milk trade such that milk premiums were allocated to dairy farmers on a state basis.<sup>86</sup>

In an environment of ongoing deregulation in other industries within the wider implementation of national competition policy, milk pricing arrangements were considered “*increasingly difficult to justify*”.<sup>87</sup> Following the Victorian Government’s decision to remove farmgate pricing arrangements and restrictions on cross-border trade, other states also removed price support for milk, ultimately resulting in all states’ regimes ending on 1 July 2000. At the same time, the Commonwealth Government removed its manufactured milk support schemes.

It was recognised at the time that the deregulation process would have a significant structural impact on the dairy industry, and a number of assistance packages were introduced to aid transition to the deregulated environment. Certain payments to farmers under these initiatives were to be financed by a milk product levy imposed on the retail sector.

On 10 April 2000 (just before all states decided to abolish the price controls) the ACCC was directed by the Minister for Financial Services and Regulation to monitor changes in prices, costs and profits in all parts of the milk supply chain for all leviable milk products, in order to assess the effect of deregulation on consumers.<sup>88</sup> The ACCC was not asked to make any analysis around the imposition or pass-through of the levy, as it was in the case of the stevedoring industry. Monitoring was to be undertaken for a period of six months after deregulation, under a price monitoring Direction under section 27A(1)(a) of the PSA 1983.

#### 4.5.2 Methodology adopted

The ACCC used data to construct its own analysis of movements in prices and margins at the retail and processing stages of the value chain, and additionally utilised data from the Australian Bureau of Agricultural Economics (ABARE) and Australian Dairy Corporation (ADC) to examine the impact on farmers/farmgate prices at the production stage, and examine broader trends in the industry, especially the farm sector.<sup>89</sup> Data was used to examine trends over a longer time frame, partly to provide better context for events during the monitoring period, since the ACCC considered six months to be too short a period to fully assess the impact of deregulation.

The ACCC examined the average movement between each quarter of prices, unit costs, volumes, net profit margins and overall profitability. Price and demand-response results (volume changes) were reported on a disaggregated basis with respect to outlet (supermarket or convenience), state, product and geographical classification (rural, remote etc).

---

<sup>86</sup> ACCC, *Impact of Farmgate Deregulation on the Australian Milk Industry: study of prices, costs and profits*. April 2001, p.xv.

<sup>87</sup> *Ibid*, p.1.

<sup>88</sup> *Ibid*, p.xv. A copy of the Direction can be found at Appendix 1, ACCC, *Impact of Farmgate Deregulation on the Australian Milk Industry: study of prices, costs and profits*. April 2001, p.144: <http://www.accc.gov.au/content/index.phtml/itemId/306304/fromItemId/655277>.

<sup>89</sup> ACCC, *Impact of Farmgate Deregulation on the Australian Milk Industry: study of prices, costs and profits*. April 2001, p.xv.

Profitability and net profit margin results were reported on a national average basis for processors, supermarkets and convenience stores.

#### 4.5.3 Information requirements

The ACCC, using its information-gathering powers under the PS Act, issued pro-forma information requests to industry participants for the three quarters ending 30 June 2000, 30 September 2000 and 31 December 2000. These were sent to milk processors and major food retailers (supermarkets, service stations and convenience chains) requesting detailed price, volume and cost information from recipients.

In addition, the ACCC commissioned a third-party marketing firm, Inteldata e-access, to conduct surveys of milk spot prices in convenience (“corner”) stores over a spread of localities over the July-December 2000 period. Geographical spread was selected to include a balance of metropolitan, regional, rural and remote areas, as well as population size of locations.

The ACCC collected data relating to the three month period immediately prior to deregulation, in order to compare prices, costs and profits before and after deregulation became effective. The ACCC was able to obtain scanning data from supermarkets, providing a detailed breakdown of sales data by brand, size, product type and location over the full nine month monitoring period.

Where possible, the ACCC also drew upon publicly available data and analysis produced by other agencies including ABARE, the Australian Bureau of Statistics (ABS), state dairy authorities and the ADC.

#### 4.5.4 Results of analysis

Results in key indicators were as follows:<sup>90</sup>

- § farmgate drinking-milk premiums decreased;
- § variability in retail prices between states decreased;
- § retail prices for generic milk decreased on average, while specific value-added milk products (flavoured, UHT etc) increased in price on average;
- § net profit margins and overall profitability (with respect to milk) of supermarkets and convenience stores decreased; and
- § total demand for milk was relatively inelastic, however, there was a significant shift of demand from branded and value-added products toward generic milk.

During the period examined, significant dynamic changes in the retail sector occurred, notably the rollout by supermarkets of low, standardised national milk prices for their generic-brand milk. The rollout involved competitive tendering for supply by processors, coinciding with price deregulation.

---

<sup>90</sup> *Ibid*, pp.xvi-xix.

The ACCC's primary focus was the benefit to consumers from deregulation. They found that on balance consumers were better off in that (a) retail prices decreased (relative to pre-deregulation levels) while volume remained relatively stable, and (b) most Australians had access to low-priced generic brand milk via supermarket chains.

The ACCC noted that farmers' market power was substantially affected, and that farmers were significantly worse off in some states, or relatively neutral, depending on the mix of end-uses for farmgate milk in each state.

#### 4.6 Summary of Features of Monitoring Regimes

A summary of the main aspects of the above monitoring regimes are outlined below.

- § **Purpose** - with the possible exception of airports, most of the monitoring regimes administered by the ACCC are intended to be informative in nature. The ACCC reports facts and uses the information to assist in its administration of the TPA. Only in stevedoring does the ACCC make some reference to the 'competitiveness' of prices;
- § **Consequences of Monitoring** - price monitoring is not used as a direct means for introducing price controls or taking action against the firms monitored. Where competition concerns are identified as a result of monitoring activities, the ACCC either initiates a price inquiry or takes action under the TPA;
- § **Reporting** – under most regimes the ACCC reports on prices, costs and margins as directed by the Minister per the relevant provisions the TPA. Prices are generally reported on an aggregate basis and not at the firm level, with a focus generally on trends over time. Other market developments are also often discussed (eg, capacity expansions at ports and potential barriers to entry);
- § **Information Required** – the ACCC makes an effort to use information provided by the firms under other reporting requirements or obtains information from external or publicly available sources. Where it needs further information it specifies this in an information request to the relevant firms.
- § **Timeframe** – in contrast to the views of the PC, monitoring has generally continued over quite a long timeframe, even in those industries such as insurance where competition concerns were not identified (although this may simply be due to continuing industry reforms).

## 5 Monitoring of Retail Markets in Other Jurisdictions

This section considers how monitoring occurs in other jurisdictions, namely the United Kingdom and New Zealand.

### 5.1 United Kingdom

Ofgem announced the removal of retail price controls for electricity and gas in February 2002.<sup>91</sup> At that time Ofgem noted:<sup>92</sup>

*“At different stages in the development of competition differing forms of regulation will be appropriate. Assessing the effectiveness of competition, and the consequences of using the various regulatory approaches, has therefore been central to this review. The balance of benefit and regulatory risk has now shifted in favour of reliance on competition law, as a response and flexible mechanism that prohibits anti-competitive agreements or arrangements and the abuse of market power. Ofgem is committed to using these powers resolutely to safeguard the interests of customers, particularly the vulnerable.”*

With the removal of price controls Ofgem relied on its powers under competition and consumer law but notes that it would not rule out the re-introduction of price controls if warranted:<sup>93</sup>

*“Ofgem’s conclusion is that the best way of protecting customer’s interests in the future is by vigorous use of its competition and consumer law powers rather than specific supply price controls. These powers will enable Ofgem to intervene to protect customers where appropriate.”*

*“In the future, Ofgem will investigate suppliers very closely should pricing differentials between prepayment tariffs and others start to diverge significantly from the cost-to-serve differential. Ofgem would consider the most appropriate method to address this behaviour. Whilst it is expected that the Competition Act would be used to address such behaviour, using the powers described in the following section, the reintroduction of price controls is not ruled out, if such controls would more effectively target any abuse.”*

Ofgem discussed its powers under competition and consumer law and its approach to price monitoring.

#### 5.1.1 Ofgem Powers

Ofgem has powers under *The Competition Act 1998*, the *Fair Trading Act 1973* and under licence conditions.

---

<sup>91</sup> Ofgem, *Review of domestic gas and electricity competition and supply price regulation: Conclusions and final proposals*, February 2002, p.(i).

<sup>92</sup> *Id.*

<sup>93</sup> *Ibid*, p. (i) and 60.

### 5.1.1.1 Competition Act 1998

Chapter I of the Competition Act prohibits agreements between undertakings that have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom. It effectively prohibits behaviour such as price fixing and collusion between competitors and is similar in nature to section 45 of the TPA.

Chapter II of the Competition Act prohibits any conduct on the part of one or more undertakings which amounts to an abuse of dominant position in a market which may affect trade within the United Kingdom. It effectively prohibits behaviour such as excessive pricing, predatory pricing, limiting output and discrimination and is similar in nature to section 46 of the TPA.

Responsibility for enforcing the Act lies with the Director General of Fair Trading (DGFT), supported by the Office of Fair Trading (OFT). The Secretary of State made regulations setting out aspects of the co-ordination of concurrent powers between the DGFT and the sectoral regulators. These allow for the exchange of information between the DGFT and Ofgem for the purposes of determining who has jurisdiction, prevention of simultaneous exercise of powers by more than one authority, and provision for the transfer of cases. At a working level, the DGFT, Ofgem and all other regulators were parties to the Concurrence Working Party, chaired by a representative of the OFT. The Working Party aimed to ensure full co-ordination and consistency of action under the Act.

Ofgem, jointly with the OFT, published a guideline (the *Energy Guidelines*) on how it intended to apply the Act to its own sector.<sup>94</sup> This guideline set out how Ofgem may, among other things:

- § consider complaints about breach of the prohibitions;
- § impose interim measures to prevent serious and irreparable damage;
- § carry out investigations both on the regulator's own initiative and in response to complaints; and
- § require the production of documents and information and search premises.

This guideline was updated in January 2005 to reflect the modernisation of EC competition law and the development of case law.<sup>95</sup>

In December 2004 Ofgem also published an information paper for retailers in relation to supply for low income and vulnerable customer groups.<sup>96</sup> The document was developed to address concerns among retailers that considered they may hold a dominant position in a relevant market and may be at risk of breaching the Chapter II prohibitions. The key points of guidance included the following:

---

<sup>94</sup> Ofgem and OFT, *Competition Act 1998, Application in the Energy Sector*, March 2001.

<sup>95</sup> Ofgem and OFT, *Application in the energy sector, Understanding competition law*, January 2005. See [www.of.gov.uk/shared\\_of/business\\_leaflets/ca98\\_guidelines/oft428.pdf](http://www.of.gov.uk/shared_of/business_leaflets/ca98_guidelines/oft428.pdf)

<sup>96</sup> Ofgem, *Supplying low income and vulnerable customer groups*, December 2004.

- § **Relevant market** – groups of low income and vulnerable customers are in themselves unlikely to form a separate market for the purpose of competition law;
- § **Difference between dominance and abuse** – the possession of a dominant position is not prohibited, rather, it is an abuse of a dominant position which is prohibited.
- § **Price discrimination and predation** – some suppliers expressed a concern that specific tariffs for the benefit of low income and vulnerable customer groups could be considered discriminatory. Ofgem noted that there is no licence condition that prevents suppliers from offering different tariffs to different customers – a supplier may offer less profitable tariffs (ie, less profitable to the retailer) to low income and vulnerable customer groups. Ofgem’s concern is centred on behaviour that has or is likely to have an anti-competitive effect on the market.

Ofgem noted that it would be specifically concerned with tariffs that were excessive (ie, held no reasonable relation to the economic value of the product supplied) or were so low that they were predatory. It also noted that it would be concerned if a retailer were to offer tariffs that locked in customers for a long period of time without the option to terminate under reasonable terms or if the contract was automatically renewed without the need for positive action by the customer. In assessing the anti-competitive effect of such a contract, Ofgem would have regard to the number of customers affected.

#### 5.1.1.2 Fair Trading Act 1973

This Act allows for the examination of scale or complex monopolies. Under this Act Ofgem has the ability to make a reference to the Competition Commission to establish whether a monopoly situation operates, or may be expected to operate. Ofgem considers that the Fair Trading Act could be used if there were structural problems in the market.<sup>97</sup>

#### 5.1.2 Ofgem’s Approach to Monitoring the Development of Retail Markets

Ofgem recognised that a key factor in its ability to respond speedily and effectively to competition complaints was its up-to-date understanding of energy markets. Given this, Ofgem decided to continue to monitor the development of the energy retail markets, including recommencing formal data collection about trends in the industrial and commercial markets.

Ofgem publishes periodic reports on the development of the market.<sup>98</sup> At the early stage of competition, Ofgem also published an occasional paper in response to questions over why reductions in domestic electricity prices had been smaller than those in wholesale markets and whether the then pricing pattern (where switchers systematically pay less than non-switchers) reflects a competitive market.<sup>99</sup>

---

<sup>97</sup> Ofgem, *Review of domestic gas and electricity competition and supply price regulation: Conclusions and final proposals*, February 2002, pp.65-66.

<sup>98</sup> Ofgem’s latest report is available at <http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/DRMR%20March%202007doc%20v9%20-%20FINAL.pdf>

<sup>99</sup> See Ofgem, *Electricity Supply competition: An Ofgem occasional paper*, 16 December 2002 at [http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/1804\\_83occasional.pdf?wtfrom=/ofgem/whats-new/archive.jsp](http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/1804_83occasional.pdf?wtfrom=/ofgem/whats-new/archive.jsp)

### 5.1.2.1 Occasional Paper

Ofgem published an Occasional Paper in December 2002 in response to public concern over the following two issues:

1. Why reductions in domestic electricity prices had been smaller than those in wholesale markets around that time; and
2. Whether the then pricing pattern – where switchers systematically pay less than non-switchers – reflected a competitive market.

Ofgem considered three issues for the purpose of this report:

§ Retail prices – how retail prices had changed since privatisation and since the introduction of supply competition. In particular;

- average annual bills for customers of the incumbent compared to the average bill for a customer opting for the best discounts available in each supply area;

While not explicitly stated, the reported average bill for customers of the incumbent appears to be based on actual prices charged. Results were shown as an average over all supply areas such that the best discount price was an average of different suppliers over all supply areas. A separate table was included showing the average bill and best available discount by supply area;

- the average headline prices (in pounds/kWh) for industrial and commercial customers for comparative purposes;

§ Supplier's costs – changes in suppliers' cost-base over the period 1998 – 2002 and the evolution of supplier margins:

- Ofgem estimated the change in suppliers' cost-base by looking at changes in wholesale costs, portfolio purchase costs, transmission and distribution charges environmental costs and supply infrastructure; and

§ Supply competition – the extent to which competitive pressures exert a discipline upon prices:

- Ofgem considered the extent to which competitive conditions are uniform across electricity and gas and between different regions (price parallelism), gross and net switching, the price discounts required to encourage switching and changes in incumbent market shares over time.

Ofgem found that the reduction in prices of 8 – 17 per cent (incumbent/new entrant) over four years were similar to the reductions in suppliers' overall cost-base during the period. Ofgem did not comment on whether the price differential between incumbents and new entrants reflected an effectively competitive market but did note that experience of supply competition suggests that sufficient savings were available to induce many customers to change supplier.



After summarising the results of its review Ofgem noted:<sup>100</sup>

*“Ofgem will continue to monitor supply markets closely to ensure customers enjoy maximum benefit from the development of competition. Ofgem currently directs a large part of its monitoring resources to examining the supply offerings of incumbents (former Public Electricity Suppliers and British Gas) to switchers or potential switchers in “home” regions. Going forward, Ofgem will:*

- § Pay particular attention to the consequences of industry consolidation;*
- § Pay particular attention to supply offerings that appear targeted by incumbents to switchers, including potential switchers. This is not to suggest that such offerings are necessarily anti-competitive; any investigation will need to consider whether a company has market power, and the potential or actual effect of the supply offerings on competition;*
- § Continue to follow the approach set out in the Energy Guidelines in applying the Competition Act 1998; and*
- § Make an appropriate use of its investigation and enforcement powers under the Competition Act 1998 and sectoral powers (including financial penalties).*

*Meanwhile, Ofgem, in conjunction with energywatch, is also working to ensure that customers’ perception of the market gives them confidence in switching and competition. Ofgem will deal with miselling, work to reduce the frequency of transfers that do not go smoothly, and ensure that errors that arise are corrected swiftly.”*

#### 5.1.2.2 Periodic Monitoring Reports

Ofgem has published periodic updates on the state of competition for domestic gas and electricity customers since the market was open to competition. As of September 2005, Ofgem had only published these reports when it considered that it would help it meet its statutory obligations.

In its latest report dated June 2007, Ofgem noted that there had been a lot of media debate about the competitiveness of the market for domestic gas and electricity.<sup>101</sup> As was the case in 2002, concerns included the size and speed of suppliers’ price cuts in response to falling wholesale prices, customer service levels and whether the market adequately protects vulnerable and fuel poor customers.

In assessing the degree of competition in the market, Ofgem considered the following:

- §** current market shares and the split of customers by product (ie, electricity only or dual fuel) and by payment method;

---

<sup>100</sup> *Id.*

<sup>101</sup> Ofgem, *Domestic Retail Market Report – June 2007*, 4 July 2007, p. (i).

- § the relationship between wholesale and retail energy prices – including illustrations of hedging strategies;
- § price trends (based on observed tariffs), including:
  - changes in the annual bill payable under contracts for each supplier in each supply region based on standard tariffs and medium consumption levels;
  - the potential savings available to customers that have never switched supplier in each regional supply area, distinguished by payment type;
  - the potential savings available to customers that switch from the incumbent to a new entrant under different payment methods and for different contracts types (ie, electricity only, gas only or electricity and gas); and
  - the potential savings available by switching between different payment methods;
- § evidence of product innovation by reference to the offer of price guarantee tariffs, online tariffs, green tariffs and other energy services;
- § complaint data;
- § switching data;
- § market shares, including the market share of incumbents and others by region; and
- § issues relevant to customers with prepayment meters and fuel poverty, including:
  - trends in prices for prepayment customers by retailer, by supply area;
  - differences between the best prices offered to prepayment customers vs direct debit or credit customers over time;
  - price differences between prepayment bills and other payment types by supplier and by fuel type; and
  - switching rates for prepayment customers compared to direct debit and credit customers.

On the basis of this analysis Ofgem concluded that all segments of the market remain highly competitive and not just for customers that pay by direct debit or online.

The 2007 Market Report appears to be more comprehensive than earlier reports although most reports that Ofgem has published cover the following:

- § annual bills (as described in more detail above);
- § switching data – monthly transfers for electricity and gas, broken down further by incumbent gains, incumbent losses and transfers between entrants;
- § market shares – national market shares of each supplier for electricity and gas every six months for the last four years, aggregate market share of new entrants over time and current market share of incumbents and new entrants in each supply area; and
- § other issues of relevance in the reporting period.

## 5.2 New Zealand

New Zealand's Ministry of Economic Development (Ministry) monitors the performance of the electricity market, including competition issues and electricity prices.<sup>102</sup>

In this role, the Ministry undertakes a quarterly survey of domestic electricity prices (QSDEP), accompanied by an analysis of discounts and distributions made by lines companies. The QSDEP monitors movements in line and retail charges for an average domestic consumer consuming 8,000 kWh of electricity per year. The Ministry also undertakes an annual survey of domestic and commercial electricity prices and from time to time, publishes reports on electricity prices. It is unclear what power the Ministry has to recommend or take action if it identifies concerns in relation to the pricing practices of retailers.

The results of the Ministry's quarterly survey are published in a schedule on its website. The schedule shows the average charge payable by an average customer under tariffs offered to new customers by each retailer in various geographic areas. The average charge combines both the fixed and variable charge into a single figure. It includes GST and prompt payment discounts but not direct debit discounts or other rebates. The Ministry publishes the results over time and also calculates the percentage change in the average charge over time.

The Ministry's annual survey data is also published. It is updated in August each year and contains price information back to 1984. The figures presented are the average retail charge paid by the consumer to the incumbent retailer in each geographic area, by line owner, and the component of that charge which can be attributed to the lines company and transmission charges. Average retail charges are calculated for six model consumers, three of which are domestic, namely: small consumers (500 kWh per month), medium consumers (1,000 kWh per month) and large consumers (1,500 kWh per month). The tariff used to derive the average charge is the optimal tariff at a given level of consumption, when comparing low user fixed charge options to standard tariffs. Weighted averages are used where different rates apply to summer and winter loads. As is the case for the quarterly survey data, prompt payment discounts and loyalty rebates are taken into account but discounts for paying by direct debit are not.

The last report published by the Ministry in relation to electricity prices and retail competition was in January 2004.<sup>103</sup> This report appears to have been published in response to significant increases in retail prices that occurred over the two years from 2002 to 2004. At this time the Ministry assessed:

- § the movement in average retail charges for small, medium and large domestic customers from 1990 to 2003;
- § the average retail tariff/charge offered by the incumbent compared to the dearest and cheapest charge for an average customer for the period from 1999 to 2003;

---

<sup>102</sup> See [http://www.med.govt.nz/templates/StandardSummary\\_42.aspx](http://www.med.govt.nz/templates/StandardSummary_42.aspx)

<sup>103</sup> See Ministry for Economic Development, *Electricity and Retail Competition*, 27 January 2004 at [http://www.med.govt.nz/templates/MultipageDocumentTOC\\_7255.aspx](http://www.med.govt.nz/templates/MultipageDocumentTOC_7255.aspx)

- § movements in national average line charges;
- § movements in wholesale electricity prices and future drivers of wholesale prices; and
- § movements in estimated retail margins.

The Ministry concluded that there was no clear evidence of a step change in the profit margins of retailers.<sup>104</sup> The increases in retail prices observed in the market could be related to increases in the cost of new generation. This involved a shift in generation type as inexpensive gas supplies ran down and relatively more expensive sources of power, including hydro, wind and geothermal options, were anticipated.

---

<sup>104</sup> Ministry of Economic Development, Media Release: *Electricity Pricing reports Released – 27 January 2004*.

## 6 Application of Price Monitoring to Energy Retail in Victoria

This section considers the current monitoring regime in relation to energy retailing in Victoria and the issues that would need to be considered for the development of more formal price monitoring.

### 6.1 Current Monitoring Regime

The ESC currently monitors the performance of energy retailers and publishes an annual report outlining the results of its monitoring activities. In this report the ESC comments on the level of competitive activity by reference to switching data and comparisons of market offers relative to the standing offer. In particular, the ESC publishes:

- § gross switching for electricity and gas over time for Victoria as a whole (ie, not by distribution region);
- § average annual energy bills for customers in each distribution area over time and compared with the annual bill for small businesses and dairy farms (the ESC notes that the analysis is based on consumption bands and specified tariffs, although it is unclear what tariffs are used to calculate the average bill – ie, the standing offer or an average of retailers offers at each point in time); and
- § the results of mystery shopping research showing the annual bill under the offers made by each retailer in three distribution areas compared with the standing offer in that area and, where applicable, the annual cost of the offer to a customer taking account of monetary and non-monetary inducements.

Other issues are also considered in the report including:

- § affordability indicators such as expenditure on concessions and the proportion of customers subsidised under the Utility Relief Grant scheme;
- § access indicators including rates of connection and disconnection; and
- § customer service and complaint data.

### 6.2 Issues for Consideration

When transitioning from standing offer price regulation to a less intrusive price monitoring regime it will be relevant to consider the following:

- § What is the objective of price monitoring?
- § Who should conduct price monitoring?
- § Over what period should price monitoring occur?
- § What should be monitored and reported and how should it be reported?
- § What information should be collected and how should it be collected?

### 6.2.1 What is the objective for price monitoring?

As noted in section three, monitoring may be used either as an instrument of regulation and compliance by the regulator or as a means of observing and understanding the performance of a firm, industry or market.

Most of the monitoring regimes put in place by the ACCC appear to fall under the latter category, with the aim of providing information to both consumers and policy makers about the state or development of competition in the relevant market. The ACCC does not attempt to encourage the firms it monitors to price in a specific manner or below a specified threshold and in most cases does not comment on the extent to which prices are 'competitive'. Rather, it uses monitoring to identify competition concerns where they arise and relies on its powers to request a price inquiry or take action under sections 45 and 46 of the TPA.

Similarly, Ofgem in the UK views monitoring as primarily informative and relies on its powers under the Competition Act where it identifies potential breaches. At the time that price controls were removed Ofgem also noted that it would not rule out the re-introduction of price control. While not specifically stated, the re-introduction of price controls would not be a direct consequence of Ofgem's monitoring activities and reports. Rather, Ofgem would closely investigate issues where they arise before re-introducing such controls.

In the current context it would seem appropriate that monitoring not be used as the basis for a formal threat for re-regulation in and of itself. Rather, it should be used to help identify competition concerns. If concerns are raised, an inquiry should be held, with specific terms of reference, and a decision made with respect to the re-imposition of some form of price control.

### 6.2.2 Who should conduct price monitoring?

Monitoring may be conducted by the ACCC under the provisions of the TPA or by another party outside of these provisions. Given that the ESC currently monitors the performance of retail businesses, including some form of price monitoring, it may be appropriate for its current responsibility to be maintained or developed. Alternatively, if the monitoring functions of the ESC will be passed to the AER at some point in the near future, the AEMC may wish to consider recommending or implementing a more formal arrangement under the TPA provisions.

### 6.2.3 Over what period should price monitoring occur?

In its review of the PS Act, the Productivity Commission recommended that price monitoring should generally be for three years or less, possibly five years in exceptional circumstances.<sup>105</sup> After that period a decision should be made as to whether there is merit in continuing the monitoring regime.

---

<sup>105</sup> Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report*, Report No. 14, 14 August 2001, p.98-99.

#### **6.2.4 What should be monitored and reported?**

With the exception of airports, under most of the monitoring regimes administered by the ACCC prices are reported on an aggregate basis rather than being identified for specific firms or customer types. It may be that reporting on a firm specific basis is unnecessary or could lead to unintended consequences. For example, it could provide monitored firms with information about their competitors and assist participants in co-ordinating their pricing. Published prices could also potentially create a focal point for pricing in a similar way to the standing offer.

Under its current monitoring program the ESC published relatively detailed data with respect to the pricing of individual retailers by distribution area. However, we note that such information is public and could be gathered by retailers themselves under their own mystery shopping activities. In the UK, Ofgem also reports average bill data at quite a disaggregated level, by retailer by supply area.

Under section 95ZE and/or ZF, the ACCC is generally directed to monitor prices, costs and profits. This is because price changes in isolation do not reveal much about the nature of competition in a market. An assessment of changes in prices by reference to costs and margins reveals more about the state and development of competition. Given the difficulty in estimating retailers' costs, particularly given the prevalence of hedging arrangements, it will be necessary to consider how best to monitor changes in retailers costs over time. The discussion of the relationship between wholesale and retail prices contained in Ofgem's latest monitoring report could be useful in this respect.

We note that in the UK, Ofgem's monitoring regime is not limited to an assessment of prices, costs and margins. Ofgem takes a more holistic approach in assessing the development of competition and includes other indicators, such as market share and switching data. These indicators are already reported to a limited extent by the ESC.

#### **6.2.5 How should it be reported?**

The ACCC generally produces specific monitoring reports on an annual basis. In the UK, Ofgem began reporting on an annual basis but now only produces reports when it considers that these would help it meet its statutory obligations (generally when there are concerns that retail prices have not fallen rapidly in response to falling wholesale prices).

If the ESC was to be given responsibility for price monitoring this could be published as part of its current comparative performance report or as a separate report on the development or progress of competition. If a separate report were published there may be merit in publishing both switching and market share data in this separate report as opposed to the comparative performance report.

#### **6.2.6 How and what information should be collected?**

The price monitoring regime should not be overly onerous on retailers in terms of the information required to be provided.

A significant amount of information is already collected from retailers by the ESC under current reporting requirements, including information in relation to tariffs and associated

terms and conditions (ie, Product Disclosure Statements). Where possible, the body responsible for price monitoring should make use of this information before requesting further information from retailers. This is consistent with the ACCC's current approach to co-ordinating reporting regimes for airports.



## Appendix A. Price Inquiries

As noted by the PC in its inquiry report:<sup>106</sup>

*“A public inquiry provides a systematic process for gathering, assessing and disseminating information about particular pricing issues or problems. A public inquiry process can help to minimise the risk of over-regulation and encourage the use of price control only where it is best instrumented by:*

- § Informing the community and policy makers, and facilitating public debate, about the factors influencing prices in the market concerned and the significance of the pricing issue; and*
- § Providing a transparent process for evaluating policy alternatives – including alternatives to prices oversight such as pro-competitive reforms – and identifying the most appropriate way to encourage competition in a given market.*

*An inquiry could facilitate good policy making in situations where there is concern about the effectiveness of competition, strong community concerns about price levels and movements, or where governments are considering reform and deregulation of industries.”*

Public inquiries have been conducted in a number of industries.

---

<sup>106</sup> Productivity Commission, *Review of the Prices Surveillance Act 1983: Inquiry Report*, Report No. 14, 14 August 2001, p.47.

## Appendix B. Price Notification

Only airports, air services and postal services are currently subject to price notification.

### B.1. Airports

The Government undertook the privatisation of its airports via the sale of long term leases between 1997 and 2003. As part of this process, all airports in capital cities and some regional airports<sup>107</sup> were declared under the PS Act and became subject to price notifications due to the perceived potential for inefficient pricing through the misuse of market power.

Under the regulatory framework, all airports were required to submit price notifications to the ACCC which would then assess and reject or accept any proposed price changes. The Government planned to assess these arrangements after several years which it subsequently did, resulting in the Productivity Commission (PC) Report issued January 2002.

Initially, regulation occurred via a series of declarations operative under the PS Act, specifying services subject to price notification. The sequence was as follows:

- § Perth, Brisbane and Melbourne Airports declared in 1998 (Declaration 83) until 2002;
- § Adelaide, Alice Springs, Canberra, Coolangatta, Darwin, Hobart, Launceston and Townsville declared in 1998 (Declaration 84) until 2003, and
- § Sydney Airport declared in 1998 (Declaration 85) until 2003 - in mid 2002, Sydney Airport was again Declared (Declaration 90) until 1 July 2007 and in 2007 was again declared (Declaration 91) with respect to provision of aeronautical services to regional air services.<sup>108</sup>

Under these declarations, the notified services consisted of the provision of aeronautical services, being (a) aircraft movement facilities and activities, and (b) passenger processing facilities and activities. Each service is broken down further into specific activities that are excluded and included for each location.

The details of price notification were set out within Directions operative under the PS Act. Direction 13 regulated price changes for all notified services for all airports except Sydney under a CPI-X scheme. This scheme was accompanied by special provisions for ‘necessary

---

<sup>107</sup> In addition to Perth, Darwin, Brisbane, Sydney, Melbourne, Hobart, Adelaide and Canberra, regional airports at Alice Springs, Launceston, Coolangatta and Townsville were also subject to regulation.

<sup>108</sup> Regional air services is defined in the Declaration as regular public transport air services operating wholly within the state of NSW.

As of 1 July 2007, Sydney Airport Corporation is also subject to a separate Direction (Direction 30) under the Act specifying the nature of allowable price increases. Specifically, the Direction requires that the total revenue-weighted percentage change in prices over three years (beginning 1 July 2007) cannot exceed the percentage increase in the CPI over the same period.

Sydney Airport Corporation domestic airside service is also declared under the Part IIIA national access regime (effective December 2005 to 2010). The effect of this is to allow access seekers (airlines) to seek arbitration with respect to disputes over terms and conditions or pricing of access where they cannot reach an agreement with Sydney Airport.

new investment' (as assessed by the ACCC). Further directions set out values of the X-factor for each location, operative dates and required considerations of the ACCC in assessing price notifications for increases above the cap. Sydney Airport was also required to submit notifications, but was not subject to a particular price cap regime.

Sydney Airport Corporation Limited (SACL) last submitted a price notification in September 2002 with respect to services provided to regional air services.<sup>109</sup> It has not increased charges to regional air services since this time. The 2002 proposal related primarily to the structure rather than overall level of prices.

## **B.2. Air Services**

Airservices Australia (AA) is a declared person under the Act (Declaration 66), the relevant notified services being terminal navigation, aviation rescue and fire fighting, en route navigation facilities and safety regulatory activities. It is therefore subject to price notification.

AA submits a price notification approximately every twelve months for approval by the ACCC, not always relating to the same issue. Since 2002, the ACCC has made one objection in 2003 to price notifications submitted by AA.

In assessing notifications by AA, the ACCC considers in detail the questions of the impact that proposed pricing structures will have on productive efficiency and allocative efficiency, and on intermodal competition and competition for provision of notified services (creation of barriers to entry). To this end it assesses whether pricing structures provide efficient signals to market by reference to either incremental or marginal costs, and the existence of cross-subsidies between services. These considerations are weighed against practical concerns with altering market and service delivery structures.

In the case of AA price setting, the process is very similar to price setting processes in regulated industries, particularly electricity. Detail of the methodology of AA and ACCC are contained in published proposals and decisions.

In its most recent assessment the ACCC accepted a long term pricing proposal by AA which incorporated a five year price path, rather than discrete, independently assessed price changes, implying there is flexibility in the ACCC's approach to assessing price notifications.

Aviation services are somewhat unique in that there is significant safety and aviation regulation in place around the provision of services, which impacts the potential for competition and approach to the provision of such services. Services are also closely linked to those provided by airports, so some interdependency is recognised by stakeholders.

---

<sup>109</sup> ACCC Price Notifications Register. The register contains copies of the proposal, and the ACCC's statement of reasons. At the time, the ACCC did not object to the proposed price increase.

### **B.3. Postal Services**

The Australian Postal Corporation is a declared person under Part VIIA of the Act, and letter services and carriage of registered publications in Australia are ‘notified’ services under the Act.

Under Section 95Z, a declared person must notify the ACCC if it intends to increase the price of notified services above the maximum charged in the preceding twelve months. The ACCC has the power to accept or reject the proposed price change. Similarly, a declared person must notify its intent to introduce a new product that may fall within the definition of notified services and proposed pricing structure. The ACCC has the power to accept or reject the proposed structure if it deems the new service to fall within the notified definition.

The ACCC has three key responsibilities in the regulation of postal services:<sup>110</sup>

- § assessing price notifications as outlined above for Australia Post’s notified services;
- § inquiring into disputes about the terms and conditions on which Australia Post provides bulk mail services (no disputes have ever been lodged with the ACCC);
- § monitoring for cross-subsidy between notified and non-notified services.

Australia Post is subject to record keeping requirements (RKR) issued by the ACCC, under the authority of the Australian Postal Corporation Act 1989. Under the only RKR issued by the ACCC, Australia Post is required to prepare and provide independently audited regulatory accounts in accordance with the RAPM (regulatory accounts procedures manual). The accounts utilise standard financial and management reporting accounting cost and revenue information rather than additional “economic cost” information.

The regulatory accounts must disaggregate costs into 19 service areas, and categorise costs as either direct, attributable (common pooled costs where a cause-effect relationship exists with respect to particular groups of services) and non-attributable (no direct causal relationship exists). Australia Post must also provide detail of how costs are attributed and its cost-attribution methodology.

#### **B.3.1.1. Assessment of notifications:**

Price notifications for postal services are infrequent (perhaps one per year relating to a single service each time). In assessing price notifications, the ACCC broadly takes an approach similar to that taken in setting prices for regulated services; parties submit a pricing proposal, the ACCC conducts a public investigation including taking submissions, and issues a final decision either accepting or rejecting the proposed price change, or imposing some other (lower) price change.

The ACCC’s approach is guided by stated principles and certain statutory requirements with respect to notified services. Detailed information regarding methodology and analysis is contained within the various preliminary views and final decisions issued by the ACCC.

---

<sup>110</sup> ACCC website 29/10/07.

The ACCC does not necessarily conduct a full cost and revenue analysis for every notification, and exercises discretion in terms of the degree of analysis required with consideration to the cost and benefit of conducting a full pricing analysis. For example, the introduction of a new service in 2004, Impact Mail, was not subject to a full analysis due to generally positive submissions from stakeholders with respect to pricing, and the similar pricing of Impact Mail relative to existing services deemed to be close substitutes by the ACCC.

In line with general price monitoring principles issued in a Draft Statement by the ACCC, price monitoring begins by reference to a building block approach to assessing reasonableness of prices. Broadly, the ACCC assesses whether prices are efficient in that they represent (a) an efficient cost base, and (b) a reasonable return on capital.

The ACCC is more concerned with overall rates of return rather than price relativities<sup>111</sup>, however it has not made a price assessment since the issue of its RKR in 2005.

The ACCC's approach to price notifications may change following the introduction of the regulatory accounting framework.

The ACCC does not publish any product cost or margin information within its decision or published versions of submissions, however, it does disclose prices and price scales, and volume information.

### **B.3.1.2. Monitoring of cross-subsidisation**

The ACCC reviews and reports on cross-subsidisation of non-notified services on an annual basis, which began following concerns raised by competitors supplying non-notified services.

In assessing cross subsidisation, the ACCC's approach is to assess (a) whether the revenue from notified services is greater than the stand-alone cost of providing that service, and (b) whether the incremental cost of providing non-notified services is greater than the revenue generated by that service. The ACCC also reviews the above results against the fully-distributed cost test.

The ACCC performs its analysis based on accounting information provided by Australia Post. Confidential information (as deemed by Australia Post) is not disclosed as part of the cross subsidisation reporting process, however, it may be potentially separately disclosed as part of its price notification assessment process, where the ACCC feels it is in the public interest to disclose the information, or where the claim to confidentiality is not justified. In particular in its 2007 report, the ACCC only disclosed total revenue by service and total revenue, fully-distributed cost and net surplus by aggregated service groupings. No service specific costs or margins were disclosed due to confidentiality.

---

<sup>111</sup> ACCC, *Final Decision on Reply-Paid Mail Price Notification*, 2003.

# NERA

Economic Consulting

NERA Economic Consulting  
Darling Park Tower 3  
201 Sussex Street  
Sydney NSW 2000  
Tel: +61 2 8864 6500  
Fax: +61 2 8864 6549  
[www.nera.com](http://www.nera.com)