Submission to Australian Government Infrastructure Taskforce

National Competition Council

April 2005

Introduction

The National Competition Council plays a central role in the regulation of infrastructure in Australia. Under the *Trade Practices Act 1974* (TPA), the Council advises the designated government Minister on whether a particular infrastructure service should be "declared" for access. If declared, access to that infrastructure is then governed by Part IIIA of the TPA.

The Council plays a similar coverage advisory role under the *Gas Pipelines Access Law* in providing advice on whether access to particular gas pipelines should be regulated by the provisions of the National Third Party Access Code for Natural Gas Pipeline Systems (Gas Code).

In addition to its role as a coverage advisory body, the Council advises whether to certify a State or Territory access regime as an "effective" regime for access to infrastructure services. If a State or Territory regime is certified it is given primacy as the means of regulating relevant infrastructure.

It is the Council's view that the Part IIIA and Gas Code arrangements for access to essential infrastructure promote economic efficiency and an appropriate balance between the interests of infrastructure owners, users and consumers. There are, however, some specific issues that adversely effect the operation of those arrangements, as outlined in this submission.

Access

The 1993 Hilmer Review found that competition reform in Australia required the development of effective regulatory arrangements for access to bottleneck infrastructure. The rationale for access regulation is that the owners of major infrastructure facilities often have substantial market power that they can exploit, either through monopoly pricing or, in some circumstances, a denial of access to third parties. An access regime provides a means of restraining prices, maintaining output, and avoiding inefficient duplication in these situations. It was viewed as a more efficient form of intervention that reliance

on general trade practices law, and in particular litigation under s 46 of the TPA or protracted commercial disputation.

In 1995, the Hilmer recommendations were implemented through Part IIIA of the TPA, which establishes a legal regime for third parties to negotiate the use of certain infrastructure services owned by another party. In addition, State and Territory Governments have developed a number of industry-specific access regimes. While Part IIIA includes a substantial focus on testing whether a particular service should be regulated, the State or Territory regimes tend to focus more closely on the specific regulatory arrangements for covered services. Part IIIA includes an effectiveness test to determine whether a State or Territory regime has primacy over Part IIIA.

Bottleneck issues

Access regulation creates a means for parties to negotiate access to the services of natural monopoly infrastructure such as rail tracks, ports, electricity networks, gas pipelines and airports.

Part IIIA provides three pathways by which a party can seek access:

- an application to "declare" a service for access. If a service is declared, parties are entitled to negotiate access with the facility owner, with recourse to dispute resolution by the ACCC
- negotiation of access via a voluntary access undertaking that has been made by the facility owner to the ACCC
- negotiation of access via the provisions of a State or Territory access regime.

The declaration route does not provide immediate access. The Council's work in declaration is to determine whether an infrastructure service falls within the ambit of Part IIIA. This tends to involve a period of investigation, followed by a recommendation and Ministerial decision. If the Minister's

decision is appealed, a final decision will take further time. Access for a particular business is not guaranteed and may be granted only after commercial negotiation and ultimately dispute resolution.

Voluntary access undertakings and State and Territory access regimes can provide more timely avenues for access. Under these frameworks, the "coverage" process is already complete and access seekers may confine their efforts to the negotiation of terms and conditions for the services they require.

Access regulation, when applied appropriately, can promote the efficient use of Australia's infrastructure and may delay or avoid wasteful duplication of facilities. In this sense, the purpose of access regulation is to "unlock" infrastructure bottlenecks. For example, the Council is currently considering an application to declare access to certain rail services in the Pilbara region of Western Australia. The applicant argued that access to the service would avoid the costs of constructing a parallel line and was necessary to promote competition in mineral and freight markets.

Part IIIA does not distinguish between facilities that service export markets and those servicing domestic markets, although the characteristics of relevant markets are considered under the coverage criteria. The Council considers it proper that the TPA does not make such a distinction. First, it would be difficult to separate and identify infrastructure that is exclusively dedicated to export markets. Second, exporters that depend on essential infrastructure face similar risks of denial of access and monopoly pricing as their domestic market counterparts. It is therefore appropriate that exporters can rely on effective access regulation. For example, a removal of access regulation for port and other transport services would enable facility owners to exert market power and raise prices to at least the levels of an alternative facility. Higher infrastructure charges would ultimately damage the competitiveness of Australia's exports.

Infrastructure owners argue that regulation creates a level of risk and imposes costs that can have the effect of deterring efficient investment, exacerbating the bottlenecks it is intended to remove. In recognition of these

issues, the scope of Part IIIA is confined to a narrow range of nationally significant infrastructure with natural monopoly characteristics, and where access is necessary to promote competition in at least one dependant market.

Part IIIA incorporates additional features to limit unnecessary costs. In particular, it:

- recognises the primacy of existing contractual rights;
- ensures that regulatory and dispute resolution processes take account of the interests of infrastructure owners; and
- requires consideration of whether regulated access is in the public interest.

The Council works from the presumption that access regulation is intrusive, and should not be imposed unless it promotes net economic benefits. As part of its consideration of access applications, the Council assesses the potential costs of imposing regulation, including direct regulatory costs and any systematic distortion of incentives for investment.

A majority of the Council's recommendations under the Gas Code have been to remove or not impose access regulation and in relation to Part IIIA the Council's recommendations have included both positive and negative recommendations.

In general, the Council considers that Part IIIA provides a balanced framework. There are however amendments to both the Gas Code and Part IIIA under consideration which will further improve the operation of these schemes. In particular a clearer specification that economic efficiency is the overarching objective of both schemes will reinforce the Council's position that efficiency considerations are to be given primary consideration in applying the coverage criteria.

The Council also supports the notion of greater flexibility in regulatory options for some infrastructure, depending on the costs and benefits of implementation. For example, prices monitoring, supported by enforceable

dispute resolution could provide a light handed alternative to regulation via access arrangements with reference tariffs.

At the same time, the Council would caution against exemptions from Part IIIA, either for export infrastructure or by way of fixed exemption periods ("access holidays") for greenfields projects. While the Council accepts the need for regulatory certainty for new infrastructure, there are more efficient mechanisms than to grant blanket exemptions from the Act. The risk of exemptions is that they may allow infrastructure with significant market power to adversely affect competition for very long periods. To reduce regulatory risk for greenfields investors, the Council supports proposals to introduce a binding "no coverage" ruling for any facility unlikely to have market power. The ruling could be made available to coincide with timelines for approval, planning and licensing processes.

In addition to changes to Part IIIA currently under consideration, the Council considers there would be value in further refining access regulation by:

- amending the arrangements for appeals against coverage decisions
- considering the appropriateness of the involvement of political decision makers.

In addition, the Council provides comments on:

- the importance of administrative separation between "coverage" and "regulation" issues
- the desirability of maintaining a regime for access regulation with broad application
- issues arising from State and Territory access regimes.

The Council's views on these matters are set out in the following sections.

Appeal arrangements

Part IIIA and the Gas Code provide for a three step decision making process in determining whether to declare an infrastructure service for access, certify a State or Territory access regime as effective, or cover a gas pipeline under the Gas Code.

1. The Council considers the application against the statutory criteria and formulates a recommendation.

2. The designated Minister considers the application against the same criteria as those observed by the Council and publishes a decision.

3. The parties may apply for a review of the Minister's decision to the Australian Competition Tribunal (Tribunal).

The current arrangements make available a full merit (*de novo*) review by the Tribunal. This constitutes a full reconsideration of the matter.

The Council considers that the current appeal/review provisions significantly increase the time and cost of finalising a declaration application, without a corresponding improvement in outcomes. Further the current provisions create incentives that can undermine earlier stages of the process. In particular, parties have scope to reserve their position and not fully participate in the Council's processes, in the knowledge they can provide material to the Tribunal that is not available to the Council or Minister. New lines of argument, additional factual and opinion evidence and, on occasions, new parties are all permitted in what are termed 'appeal' proceedings. In considering fresh material, the Tribunal is hampered by having fewer resources than those available to the primary decision maker.

The adversarial nature of Tribunal proceeding also needs to be contrasted with the Council's investigative approach, which permits a wide range of information to be considered. By comparison, the Tribunal is limited to information put before it, and may not have the benefit of submissions from two similarly resourced parties.

Rather than establishing an appeal against a first instance decision, the current "appeal" process in essence provides for "another roll of the dice" – arguably by a less well resourced and specialised adjudicator. In practice, rather than operating as a means of reviewing first instance decisions, most coverage decisions are appealed by a party in the hope of a different outcome. The Council considers that the current review framework creates uncertainty, allows parties to impede the primary decision making process and can impose significant delays on stakeholders seeking access to bottleneck infrastructure.

These concerns could be addressed by focusing the Tribunal's jurisdiction on detecting errors of principle and limiting the basis of such a review to material that was available to the Council and the Minister, as well as any updating material that was not available at the time of those considerations.

The Council considers that these refinements to the review arrangements would improve the quality of material available in the primary decision making process and reduce the scope for gaming behaviour. This would improve the timeliness of decision making, provide greater certainty for the parties, and ultimately, reduce delays in the provision of access to infrastructure – where it is warranted. It would also allow the Tribunal to focus on improving the regime's operation by addressing significant issues of principle.

While appropriate appeal/review rights are an important element of the access regimes under Part IIIA and the Gas Code, it is the Council's view that review and appeal proceedings should focus on issues of principle. It is not appropriate for the Tribunal to substitute an alternative judgement unless the first instance decision is shown to be wrong in principle.[1]

[1] While the Council has confined its comments to appeal/review of the coverage decisions it is involved in, there is also likely to be merit in reviewing the scope of appeal/review arrangements for regulatory determinations on terms and conditions of access.

Role of the Ministers

Part IIIA requires a Minister to decide an application for declaration or certification following a recommendation from the Council. Similarly, the Gas Code requires a Minister to make a decision on coverage of a gas pipeline following a recommendation from the Council.

The Minister must be satisfied of the criteria set out in Part IIIA and the Gas Code respectively in precisely the same manner as the Council is required to be satisfied of those matters. There has been a considerable divergence of approach adopted by different Ministers, particularly in certification and Gas Code matters.[2] For example, some Ministers appear to be content to accept the Council's recommendations provided the Council has followed proper processes and considered all submissions before it. Other Ministers prefer to consider the issues themselves, sometimes in great detail, in order to be satisfied. Some Ministers appear to accept submissions and material that was not before the Council, while other Ministers appear only to consider the information before the Council at the time it made its recommendation.

This lack of uniformity means that parties often have little or no understanding of how the Minister will approach the issue. This may result in considerable uncertainty among interested parties and, in some cases, significant delay. At the time of this submission, for example, the designated Minister has not made a decision on the Council's recommendation on certification of the Queensland Gas Access Regime. The Council forwarded its recommendation in November 2002.

Aside from the question of uniformity, the Council questions the benefit of requiring a Minister to duplicate a process that has already been undertaken – particularly in light of the delays that can arise. The Council considers that the Minister should be removed from the decision making process. Rather,

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2 Part IIIA limits the Minister to a 60 day decision making period for declaration applications. The Minister is not constrained to a timeframe in considering certification and Gas Code matters.

the Council's final recommendation should become the decision, with parties free to seek a review by the Tribunal (with some amendments to that process as outlined above).

Separation of coverage and regulation

Part IIIA and the Gas Code provide for a separation of responsibilities for coverage and regulation matters. The Council is the coverage advisory body on Part IIIA and Gas Code matters, while the ACCC and state bodies undertake the relevant regulatory functions.

It is sometimes argued that this separation is administratively inefficient and that the responsibilities should be rationalised into a single body. The Council considers that this would compromise the integrity of the regulatory framework.

There is a clear distinction between "coverage" and "regulation" issues. Coverage decisions are concerned with broad policy issues such as identifying natural monopoly infrastructure and analysing current and prospective competitive conditions in relevant markets. Conversely, arbitration and regulation focus specifically on the regulated infrastructure. They involve analysis of specific access prices and underlying costs, asset valuations, depreciation, rates of return and prices, as well as a range of requirements for the actual provision of third party access.

The Council believes there are considerable benefits in maintaining the institutional separation. In particular, this separation recognises that regulation imposes significant costs as well as benefits. It is therefore important that a decision to regulate infrastructure be undertaken through a rigorous and transparent coverage test.

Independent and distinct processes are essential to the effective operation of the coverage test. There is a danger that if the regulator also makes the coverage decision, participants – especially infrastructure owners – may feel

constrained in their ability to contest the applications for fear of alienating the potential future regulator and arbitrator.

Further, there is a danger that a regulator may be perceived as having a particular mind-set that inevitably leads to regulation, or as being disinclined to appropriate testing for continued coverage. Such perceptions are plausible because of the essential conflict between the roles of coverage and regulation of terms and conditions post-coverage.

Broad application

Part IIIA has potential application to all infrastructure that meets the appropriate criteria. While the Gas Code provides a more specific regime for gas pipeline infrastructure, the tests, processes and institutional arrangements mimic Part IIIA. Should the Gas Code be amended such that it did not provide effective access regulation, Part IIIA could be invoked.

The Council of Australian Governments Energy Market Review Report – *Towards a truly national and efficient energy market* (Parer report) considered the regulatory arrangements currently in place in the energy market. The report recommended the formation of a national energy regulator, whose responsibilities would include decision making on coverage.

As noted, the Council does not support the amalgamation of coverage and regulatory responsibilities under one body. Further, the Council notes that an effect of the above proposal would be to separate the responsibilities for coverage of energy infrastructure from coverage decisions in other industries. The Council considers that the coverage tests in Part IIIA and the Gas Code should be administered by a single body, and be disciplined by identical review mechanisms to ensure that access regulation is applied on a nationally consistent basis. It is important for all stakeholders, including infrastructure owners, to have confidence and certainty that the coverage tests will be applied consistently for all facilities, and that consistent decision making processes will be observed.

State and Territory access regimes

Aside from Part IIIA, State and Territory Governments have developed a number of industry-specific access regimes. Part IIIA includes an effectiveness test to determine whether a State or Territory regime has primacy over Part IIIA.

In gas and electricity, the State and Territory regimes have evolved through co-ordinated national processes, resulting in a high degree of national consistency. This has provided strong underpinnings to address the complex issues that may arise from cross-border access issues. This process is ongoing. The establishment of a national energy regulator facilitates scope for additional steps towards rationalisation and reduction of regulation in that sector.

In other industries, including rail, State and Territory regimes have evolved on a more piecemeal basis. This has led to multiple regulators with different regulatory processes. The Council considers this framework to be less than optimal, especially in the regulation of services that cross jurisdictional boundaries. In rail, for example, interstate movements between some jurisdictions require the negotiation of multiple access arrangements. The differences in approach for each access regime mean that negotiating interstate rail access is more onerous and complex than it need be. Learning from the experience in gas and electricity, the Council considers that a national regime for rail access would streamline the regulatory framework and bring efficiency benefits for infrastructure owners and access seekers. For industries that don't involve national network infrastructure (such as ports), consistent approaches to access regulation may be less essential, but would nonetheless benefit national users by minimising the costs of operating under multiple regimes.